



INTERNATIONAL COMPETITION NETWORK

**Report on the Analysis of Loyalty Discounts and
Rebates Under Unilateral Conduct Laws**

Prepared by

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Executive Summary

This paper was prepared by the ICN Unilateral Conduct Working Group (UCWG) for the 8th Annual Conference of the ICN in June 2009. This year, the Working Group continued its work on the analysis of unilateral conduct by examining tying and bundled discounting, and single-product loyalty discounts and rebates. For each practice, the group gathered information through a questionnaire.¹ This paper on loyalty discounts and rebates is based on the responses of competition agencies and non-governmental advisors (NGAs) covering thirty-four jurisdictions.²

Most responding agencies stated that their competition laws do not specifically define loyalty discounts and rebates. The agencies define loyalty discounts and rebates much like the questionnaire did – discounts or rebates on units purchased of a single product, conditioned on the level or share of purchases. Some agencies highlighted that loyalty discounts and rebates condition discounts on loyal purchasing behavior; in other words, customers receive the discount only if their purchases exceed a certain threshold. A few agencies define the term to cover only discounts or rebates that apply to *all* units of the customer's purchases of the product.

Many agencies indicated that single-product loyalty discounts and rebates are considered a legitimate form of price competition and are generally procompetitive. While loyalty discounts and rebates can create efficiencies and can benefit consumers through lower prices, there is also general agreement that when exercised by dominant firms or firms with substantial market power, they have the potential to cause anticompetitive harm in certain circumstances. Given the potential benefits to consumers from loyalty discounts and rebates, several responses expressed a cautious approach to enforcement.

Many responses acknowledged a lack of experience in evaluating single-product loyalty discounts and rebates. During the past ten years, responding agencies brought approximately 45 cases in which a violation was established. Thus, while the responses and discussion of some agencies that contributed to this report are based on the experience and rulings in cases, a number of agencies' responses were based largely on their policy views and how they likely would assess such conduct. A summary of the key findings drawn from the responses is set out below.

¹The questionnaire and responses are available at <http://www.internationalcompetitionnetwork.org/index.php/en/working-groups/unilateral-conduct/questionnaire>.

² Responses were received from agencies in thirty-four jurisdictions: Belgium, Brazil, Bulgaria, Canada, Chile, Colombia, Croatia, Czech Republic, Denmark, European Union, France, Germany, Hungary, Ireland, Israel, Italy, Jamaica, Japan, Jersey, Korea, Lithuania, Mexico, Netherlands, Poland, Romania, Russia, Serbia, Singapore, South Africa, Switzerland, Taiwan, Turkey, United Kingdom, and United States (The references to US DOJ throughout this report are based on its November 2008 questionnaire response and do not necessarily reflect DOJ's current views.). Eight responses were received from NGAs. Barbosa, Müssnich & Aragão Advogados (Brazil), Damien Geradin (EC), Gianni, Origoni, Grippo & Partners (Italy), Paul Lugard and Martin Jongmans (Netherlands), Stoica & Associates (Romania), Hoffet, Meinhardt, Venturi (Switzerland), ABA Section of Antitrust Law's Unilateral Conduct Committee (United States).

The Role of Price-Cost Tests

Many agencies indicated that they would use price-cost tests to evaluate the legality of loyalty discounts and rebates. Among the agencies that use price-cost tests, some use a predatory pricing analysis to assess loyalty discounts and rebates, while others use price-cost test to assess whether the loyalty discount arrangement forecloses competitors by limiting their opportunities to compete for sales. Several of these latter jurisdictions stated that price-cost comparisons are one factor, among others, in their assessment of whether loyalty discounts and rebates have an anticompetitive effect.

The Role of Foreclosure Analysis

Agencies stated that loyalty discounts and rebates can be anticompetitive in certain circumstances. Several agencies stated that the discounts can be anticompetitive if they effectively foreclose a large share of the relevant market such that they exclude rivals or act as a substantial impediment to entry and/or expansion.

Presumptions and Safe Harbors

Given the importance of price cutting to vigorous competition, almost all agencies stated that there are no circumstances under which a firm's use of loyalty discounts and rebates is presumed illegal. Rather, agencies analyze the impact of the conduct on competition. No agency reported having a safe harbor from a finding of liability. However, a few agencies explained that they would be less likely to take enforcement action if the price is above their relevant cost benchmark.

Intent

The majority of responses indicated that anticompetitive intent is not required, but is often considered a relevant factor, particularly in assessing competitive effects. Agencies in a few jurisdictions may consider intent when establishing fines.

Justifications and Defenses

Many jurisdictions accept as a justification that single-product loyalty discounts and rebates may lead to efficiencies. Some agencies take the position that the actual efficiencies may depend on the type of single-product rebate (e.g., rebate schemes with individualized volume targets may be less likely to achieve the same efficiencies as those achieved with standardized volume targets). Some agencies accept a meeting competition defense under certain strict conditions.

Some agencies stressed that justifications and defenses must have an objective basis. Benefits that are purely speculative or that would arise only in the distant future are disregarded. Most agencies agree that, while it is up to the agency to show anticompetitive effects, the firm has the burden of proving efficiencies.

I. Introduction

A. Definition of Loyalty Discounts and Rebates

Most responding agencies stated that their competition law does not specifically define loyalty discounts and rebates. In practice, agencies define them as discounts or rebates on units purchased of a single product, conditioned upon the level or share of purchases.³

According to the European Commission, what characterizes single product loyalty discounts and rebates is their conditionality — they are conditional on the customers' engaging in loyal purchasing behavior. Customers are given a discount or rebate if their purchases over a defined reference period exceed a certain threshold. Discounts or rebates may be granted on all purchases (retroactive rebates) or only on those made in excess of those required to achieve the threshold (incremental rebates).

Agencies in seven jurisdictions provided further details of the definition of loyalty discounts and rebates used in their jurisdictions.⁴ For example, the U.S. antitrust agencies use a narrower definition, referring only to offering discounts or rebates on *all* units of the customer's purchases (e.g., purchasing 100 or more units results in a 10 percent rebate on all units purchased) rather than also including in the definition those discounts or rebates that apply *only* to units beyond the threshold (e.g., purchasing 100 units results in a 10 percent discount on all additional units). Israel's definition includes a discount conditioned on the customer's purchasing all or a defined portion of its requirements from the monopolist and a target discount whereby the customer agrees to purchase a certain quantity during the following year.

A few agencies did not provide a definition of loyalty discounts and rebates.⁵ For example, the Brazilian agency explained that the concept of loyalty discounts and rebates is not defined in their legislation, nor has the agency dealt with any such cases.

³ Those of Belgium, Bulgaria, Canada, Chile, Colombia, Croatia, Czech Republic, Denmark, European Union, France, Germany, Hungary, Ireland, Italy, Jamaica, Jersey, Lithuania, Netherlands, Poland, Romania, Russia, Serbia, South Africa, and United Kingdom.

⁴ Those of Israel, Mexico (the statutory definition in Mexico refers to granting discounts offered as incentive for suppliers or distributors to engage in exclusive contracts under the condition of not using, acquiring, selling, commercializing or supplying the products or services produced, distributed or commercialized by a third party), Singapore (guidelines include reference to fidelity discounts defined as schemes where discounts are conditioned on buyers making all or a large portion of their purchases from the dominant firm), Switzerland, Taiwan (defined with respect to the telecommunications industry as discounts offered to customers that are accompanied by provisions prohibiting the customers from switching trading counterparts, or the offer of large discounts to customers who are more likely to switch trading counterparts to prevent such switches), Turkey (offering discounts on the condition that the customer obtains all purchases or at least an important part of its purchases from the dominant seller and it does not buy from the seller's rivals), and United States.

⁵ Those of Brazil, Japan, and Korea (no statutory definition).

B. Policy Considerations

Many responding agencies indicated that single-product loyalty discounts and rebates are common in their jurisdictions.⁶ For example, the response from the Taiwan Fair Trade Commission states: “Loyalty discounting is a common strategy that a number of enterprises employ to compete with their rivals.” The Hungarian authority states: “Loyalty discounts and rebates are common business practices in Hungary.”

Likewise, many responses noted that loyalty discounts and rebates are considered a legitimate form of price competition and generally procompetitive.⁷ The Canadian Competition Bureau’s response states that, “in general, practices that lower prices to consumers are pro-competitive. Firms are encouraged to compete on price, in addition to quality, choice, etc. . . . Low prices are generally a hallmark of competition and a benefit to consumers.” According to the U.S. ABA Antitrust Section’s Unilateral Conduct Committee, loyalty discounts and rebates are very common in the United States and can benefit consumers by reducing prices and increasing output, leading to more efficient resource allocation even when offered by a dominant firm. The response from the competition agency in Colombia suggests that loyalty discounts and rebates are generally procompetitive commercial strategies used by economic agents – with or without a dominant position – as incentives to increase their volume of sales of a specific product, promoting efficiency and benefiting consumers.⁸ The French Competition Authority states that the assessment of loyalty discounts and rebates must recognize that practices contributing to vigorous price competition are very positive for consumers.

While loyalty discounts and rebates can create efficiencies and benefit consumers, there is also general agreement that when exercised by dominant firms or firms with substantial market power, they can cause anticompetitive harm in certain circumstances. The Canadian Competition Bureau’s response explains that loyalty discounts and rebates “should not be discouraged, but for when they lower prices to predatory levels or have an exclusionary or disciplinary effect, the firm offering the rebates was dominant (where dominance might result from the anticompetitive act) and competition was substantially lessened or prevented as a result of the offering of the loyalty rebate scheme.” In the Russian Federal Antimonopoly Service response, loyalty discounts are generally considered to be procompetitive; however, they may have anticompetitive effects if used “for predatory pricing (restrictive practice) or price discrimination (exploitative practice) purposes.”

The German Bundeskartellamt stated that single-product loyalty discounts and rebates should be analyzed by focusing on whether they are capable of producing a loyalty enhancing “suction effect,” which may lead to negative effects on competition (e.g.,

⁶ Those of Colombia, Chile, Croatia, Germany, Hungary, Italy, Poland, Singapore, Taiwan, and United States. But see agency responses from Bulgaria and Belgium.

⁷ See agency responses from Canada, Chile, Colombia, France, Hungary, Italy, Mexico, Poland, Russia, Romania, Singapore, United Kingdom, and United States. However, some jurisdictions contend that such discounts by a dominant firm are generally anticompetitive and may result in distortion of competition and exclusion of competitors. See agency responses from Belgium and Bulgaria.

⁸ See also agency response from Brazil (volume discounts that increase depending on the quantity purchased have an economic rationale).

foreclosure, by maintaining or raising barriers to entry).⁹ The Bundeskartellamt adds that, consequently, the analysis should not be limited to examining whether the discount amounts to predatory pricing because that approach may risk missing loyalty discounts that lead to prices that are not predatory but may nevertheless harm competition. The Chilean competition agency had concerns that loyalty discounts and rebates could be an effective way to preclude potential competitors from entering the market. A few responding agencies have not yet developed criteria for evaluating the legality of loyalty discounts and rebates.¹⁰

There can be a large degree of similarity between the policy that a competition authority applies in relation to single-product loyalty discounts and rebates, and tying and bundled discounting.¹¹ For example, the U.K. response “advocates a unified approach to tying, bundling and loyalty discounts, viewing them all as forms of conditional discounting.”

As detailed in Section II.C., many responses acknowledged a lack of experience in evaluating single-product loyalty discounts and rebates.¹² Thus, while the responses and discussion of some agencies that contributed to this report are based on their experience and rulings in cases, other agencies’ responses were based largely on their policy views and how they likely would assess such conduct. Several responses also expressed openness to further development in this area. For example, the French Competition Authority noted: “To date, the French Competition Authority has had a relatively limited number of occasions to enforce this general policy in cases dealing with loyalty rebates granted by dominant firms. Thus, it is foreseeable that the decisional practice, which has already clarified a number of issues, will further develop in the coming years.” Similarly, the Turkish Competition Authority stated: “The Competition Board tries to analyse the discount issue on a case by case basis, there is still room for improvement to have an economic approach regarding discounts, loyalty discounts and single product loyalty discounts.”

In view of the potential for single-product loyalty discounts and rebates to benefit consumers and the relative lack of significant enforcement experience, several responses expressed a cautious approach to enforcement. The Canadian Competition Bureau response explains that “the Bureau has taken a careful stance in its enforcement of loyalty rebates in an attempt to avoid chilling legitimate price competition. Low prices are generally a hallmark of competition and a benefit to consumers.” The U.S. Department of Justice commented: “U.S. law has tended to tread very cautiously in the areas of bundled discounting and single-product loyalty discounts. The concern is that the cost of uncertainty in these areas may harm

⁹ I.e., the discount arrangement provides a strong economic incentive to concentrate purchases on the dominant firm so that entry of potential competitors is made difficult, or market exit of actual competitors is probable or likely in a way that it can be reasonably expected (cf. European Court of First Instance (CFI), Case T-219/99, *British Airways v. Commission* [2003] ECR II-5917, paragraph 271 *et seq.*; CFI, Case T-203/01, *Michelin v. Commission* [2003] ECR II-4071, paragraph 75 *et seq.*).

¹⁰ See, e.g., agency responses from Belgium (in the absence of case law, it is difficult to predict what exactly will make loyalty discounts and rebates abusive), Brazil (would apply a rule of reason approach), Jersey (likely would apply approach consistent with EC precedent), Ireland, and Lithuania.

¹¹ This is, for instance, the case in Canada with respect to bundled and single-product loyalty discounts and rebates.

¹² See, e.g., agency responses from Chile, Jamaica, Jersey, Lithuania, Serbia, Slovak Republic, Switzerland, and Taiwan.

consumers by deterring firms from engaging in beneficial price cutting, which is antithetical to what the antitrust laws aim to do.” The Irish Competition Authority explained that it “employs an effects-based approach to the analysis of . . . single-product loyalty discounts and rebates. This decision is influenced considerably by recognition of the danger that a form based/presumptions approach could discourage pro-competitive and pro-consumer conduct by firms. The Authority believes that a competition analysis focused on preventing consumer harm can minimise the risks and the costs of misdiagnosis.” The European Commission expressed a similar concern, noting that, while discounts and rebates are often instruments of healthy and legitimate price competition, the difficulty for the competition authority is, “as with so many alleged abuses of market power, to distinguish genuinely pro-competitive behaviour from anti-competitive or exploitative conduct.”

II. Legal Basis and Enforcement Experience

A. General v. Specific Provisions

All the responding agencies, with one exception, address single-product loyalty discounts and rebates under unilateral conduct provisions that do not explicitly refer to discounts and rebates.¹³ Consequently, single-product loyalty discounts and rebates are covered under their general unilateral conduct provision.¹⁴

Most antitrust provisions that cover single-product loyalty discounts and rebates apply only to dominant firms. However, competition agencies from Japan, Germany, and Taiwan have provisions addressing unilateral conduct by non-dominant firms.¹⁵

B. Civil v. Criminal Laws

The questionnaire asked members whether single-product loyalty discounts and rebates are a civil or criminal violation in their jurisdiction. Twenty-seven responding authorities indicated that single-product loyalty discounts and rebates are subject only to civil law.¹⁶ In seven jurisdictions, single-product loyalty discounts and rebates can be both civil and criminal offenses.¹⁷ However, no responding agency reported bringing any criminal cases.

¹³ In Mexico’s law, the statute mentions the “granting of discounts or incentives” as a possible anticompetitive conduct.

¹⁴ Note that, in addition to their own laws, which are generally similar to the EC’s Article 82, competition agencies from EU member states apply Article 82 when the practices at issue may affect trade among them. Some other jurisdictions have modeled their unilateral conduct law after Article 82, *e.g.* Israel and Jersey.

¹⁵ For example, Sections 20 (2) and (3) of the German Act against Restraints of Competition address single firm conduct by undertakings that do not have a dominant position but have relative market power. The Japan Fair Trade Commission also may prohibit single-product loyalty discounts and rebates under its unfair trade practice regulation, which does not apply only to dominant firms or firms having significant market power.

¹⁶ Those of Belgium, Brazil, Bulgaria, Canada, Chile, Colombia, Croatia, Czech Republic, European Union, Germany, Hungary, Italy, Jamaica, Jersey, Lithuania, Mexico, Netherlands, Poland, Romania, Russia, Serbia, Singapore, South Africa, Switzerland, Taiwan, Turkey, United Kingdom, and United States.

¹⁷ See agency responses from Denmark, France (in practice, no criminal conviction on abuse of dominant position has ever been rendered in 20 years), Ireland (criminal prosecutions are not envisaged

C. Agency Enforcement

The responses indicate that agencies have investigated few single-product loyalty discounts and rebates cases beyond a preliminary stage during the last ten years. Eleven agencies did not conduct any in-depth investigation regarding loyalty discounts and rebates.¹⁸ Seventeen agencies answered that they had conducted in-depth investigations, but either have never brought any cases or found a violation in only one or two instances during the past ten years.¹⁹ Only six agencies reported finding violations in four or more cases.²⁰

Most investigations of loyalty discounts and rebates were prompted by competitor complaints. The agencies in Denmark, France, Hungary, Taiwan, and the United States as well as the European Commission (according to the response by NGA Damien Geradin) self-initiated some of their investigations. Israel conducted one in-depth investigation, which was conducted in the framework of a sector inquiry. In France, some cases were prompted by competitor complaints and others were either self-initiated or forwarded by the French Ministry for Economy or by the Authority for the Regulation of Electronic and Postal Communications.

D. Private Enforcement

According to the responses, with one exception, all agencies and NGAs answered that private parties in their jurisdictions can challenge single-product loyalty discounts and rebates in court.²¹ However, in Mexico and Singapore a private challenge may be brought only after the agency has acted and an appeal has been addressed by the court.²² In a few jurisdictions, either private parties must petition the agency first or

in practice), Israel (subject to proof of specific intent; no criminal case has been brought); Japan (no criminal prosecution has been brought), and Korea (subject to fines).

¹⁸ Those of Belgium, Colombia, Czech Republic, Ireland, Jamaica, Jersey, Mexico, Romania, Serbia, Singapore, and Slovak Republic. Not all agencies provided the number of investigations.

¹⁹ Those of Brazil, Bulgaria (1 violation), Canada, Croatia (1 violation), Germany (2 violations), Hungary (1 violation), Israel (1 violation), Italy (2 violations), Japan (1 violation), Korea (1 violation), Netherlands (1 violation), Switzerland (2 violations), South Africa (1 violation), Taiwan (1 violation), Turkey, United Kingdom, and United States. Data from Chile was not available.

²⁰ Those of Denmark, the European Union, France, Lithuania, Poland, and Russia. During the previous ten years, responding agencies brought approximately 45 cases in which a violation was established. Lithuania challenged loyalty discounts and rebates in four cases. The Danish Competition Authority and the Polish Office of Competition and Consumer Protection (from 2004 to 2008) each challenged five cases. The French Competition Authority (since 2004) and the European Commission each brought eight cases. The Russian FAS is not included in this count; it estimates that conducts between 20 and 30 in-depth investigations per year, most of which are resolved with a formal decision, with about ten percent resolved informally.

²¹ There is no private right of action available to challenge loyalty discounts and rebates in Canada. Private rights of action are available in: Belgium, Brazil, Bulgaria, Chile, Colombia, Croatia (damages claims), Czech Republic (no known cases), Denmark, European Union, France, (no cases), Germany, Hungary (no known cases), Ireland, Israel (no known cases), Italy (the Gianni, Origoni, Grippo & Partners, NGA response suggests that the number of private antitrust actions in Italy has been increasing significantly in the last few years), Jamaica (no known cases), Japan, Jersey (no known cases), Korea (no known cases), Lithuania, Mexico, Netherlands, Poland (no cases), Romania (no known cases), Russia (no cases), Serbia, Singapore, South Africa, Switzerland (no known cases), Taiwan (no cases), Turkey, United Kingdom (no known cases), and United States.

²² See also agency responses from Poland (due to practical difficulties, no private lawsuits have been filed; if private challenges are brought in the future, the agency contends they will almost certainly be follow-on lawsuits).

the court may seek the agency's opinion. For example, in Switzerland, private parties are allowed to challenge loyalty discounts and rebates in court, but the case is referred to the Competition Commission for an opinion.²³ In South Africa, complainants must lodge a complaint with Competition Commission prior to referring a case to the Competition Tribunal.²⁴ In Colombia, the parties may challenge loyalty discounts and rebates before the agency or through a "popular legal action" similar to a class action, but without the possibility of a claim for private damages.

In most jurisdictions private challenges are rare — in some, no cases have been brought.

Agencies in only six jurisdictions reported any private actions.²⁵ In general, the responses describe instances of private parties who claim harm as a result of alleged anticompetitive discounts, seeking an end to such discounts and damages in court.²⁶ The Bundeskartellamt reports that, following its November 2007 decision in the *Share deals* case,²⁷ plaintiffs lodged a private case with the Düsseldorf Regional Court in late 2008. The plaintiffs sought information about the profits earned by the firms operating the rebate schemes that the Bundeskartellamt found to violate EC antitrust rules, and then claimed damages in the range of hundreds of millions of Euros.

III. Analysis of an Abuse of Dominance/Monopolization Based on Single Product Loyalty Discounts and Rebates

A. Presumptions and Safe Harbors

Almost all agencies stated that there are no circumstances under which a firm's use of loyalty discounts and rebates is presumed illegal. Rather, agencies look to the impact of the conduct on competition. The UK Office of Fair Trading stressed that it uses "due caution before intervening against loyalty discounts and rebates and eschews any per se approach in this respect," given the many policy considerations that suggest that loyalty rebates and discounts can be procompetitive.

Only agencies in the Czech Republic and Israel reported a presumption of illegality, which applies only in exceptional cases. The presumption is rebuttable in the Czech Republic if there are objectively justifiable reasons for the conduct. In Israel, however, the presumption cannot be rebutted.

²³ See response from the Swiss agency and response by the Swiss NGAs (Hoffet, Meinhardt, Venturi) indicating no known private cases.

²⁴ Further, according to the agency response from South Africa, complainants can refer a case directly to the Competition Tribunal as an interim relief application (prior to the Competition Commission completing its investigation) or as a contested referral (after the Competition Commission has completed its investigation, but found that the conduct does not raise competition concerns).

²⁵ Those of Chile, European Union, Ireland, Japan, South Africa, and United States.

²⁶ According to the European Commission response, in practice, victims of antitrust infringements may face difficulties seeking reparation of the harm suffered. Consequently, in 2008, the Commission recommended a number of minimum rules that would guarantee an effective system of antitrust damages actions for breach of EC antitrust rules across the European Union.

²⁷ See English press release at http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2007/2007_11_30.php. Note that the case was not investigated under abuse of dominance provisions.

None of the responding agencies reported having a safe harbor from a finding of liability. However, a few responding agencies explained that they would be less likely to take enforcement action if the price is above the relevant cost benchmark.²⁸ Some responses mentioned that loyalty discounts or rebates are not illegal when engaged in by a firm lacking dominance or substantial market power, or the prospect thereof.²⁹

A few agencies stated that they have not yet addressed the issue of presumptions or safe harbors in this context.³⁰

B. The Role of Price-Cost Tests

Many responding agencies indicated that they use price-cost tests to evaluate the legality of loyalty discounts and rebates.³¹ Only a few agencies responded that price-cost tests do not play a role in the analysis.³² Several others responded that their use has not yet been addressed in this context.³³

Of the agencies that use price-cost tests, several indicated that they consider loyalty discounts and rebates equivalent to offering a price discount on a single product and assess them using a price-cost test drawn from predatory pricing analysis.³⁴ For

²⁸ See responses from the European Commission (there is a “soft” safe harbor if the effective price is above the relevant cost benchmark), Hungary (pricing below relevant cost benchmark test is a prerequisite to prove illegality), United Kingdom, and U.S. DOJ. The responses from the U.S. DOJ and FTC note that the lack of a Supreme Court decision makes it difficult to state whether there is a safe harbor based on the conduct, such as for above-cost pricing.

²⁹ See agency responses from Canada (in its Guidelines, the Bureau states that a market share below 35 per cent will generally not give rise to concerns of market power or dominance under section 79, and this can be considered a safe harbor in this context), Japan (not yet addressed safe harbors for discounts under its private monopolization provision; however, in its unfair trade practices guidelines, discounts offered by a firm ranked at most fourth in the market and with less than a 10% share are not illegal), and United States. See also Section II.A, above.

³⁰ See agency responses from Belgium (in the absence of case law and an explicit legal provision, it is difficult to state that loyalty discounts and rebates can be presumed illegal), Jersey (presumptions and safe harbors not yet addressed; however, the agency likely would interpret Jersey’s competition law consistent, so far as possible, with EC competition law).

³¹ See notes 34 and 36, below.

³² They do not play a role in the agency’s analysis in Czech Republic, Chile, and Poland.

³³ The use of price-cost comparisons have not yet been addressed in this context by the agencies in Ireland (no formalized policy), Japan, Jersey (the agency noted it likely would follow EC practice), Korea (pending court decision on the use of price-cost tests in this context); Lithuania, and Turkey (no price-cost analysis undertaken although costs are evaluated in general terms). Price-cost tests were not referenced in the agency responses from Brazil, Bulgaria, Israel, Jamaica, Mexico (the discounted price does not need to reach a predatory level to make the strategy real or potentially harmful), Serbia, South Africa, and Switzerland (the Swiss NGA response (Hoffet, Meinhardt, & Venturi) suggested that “the authorities may need to examine whether the practice is replicable by competitors and, as a result, whether matching the pricing strategy of the dominant firm would lead competitors to price below some measure of costs”).

³⁴ See, e.g., Canada, Colombia (applies a predatory pricing test using average variable cost), Romania (loyalty discounts are considered to be a legal practice unless they can be reduced to predatory pricing or price discrimination by a dominant firm), Russia (same), and United States (most judicial decisions involving loyalty discounts and rebates have applied some type of price-cost test). See also agency responses from Belgium (foreclosure is likely to be an important factor; loyalty discounts may imply that the pricing is also predatory; in that case, the price-cost comparison will be an important element), France (the French authority used a price cost test in *La Poste* to determine whether a rebate scheme

example, according to the Canadian Competition Bureau, loyalty discounts and rebates can be anticompetitive when they bring the total price on all units sold to a customer below the supplier's average avoidable cost ("AAC") for the product and recoupment is likely or has occurred, such that competition has been or will be substantially lessened or prevented. Other agencies may use different cost measures.³⁵

Other agencies that employ price-cost tests use them to evaluate whether loyalty discounts and rebates are capable of having a foreclosure effect.³⁶ Several of these agencies stated that price-cost comparisons are just one factor, among others, in the assessment of whether loyalty discounts and rebates have an anticompetitive effect, as explained in the next subsection.³⁷

C. Role of Foreclosure Analysis

Many agencies stated that loyalty discounts and rebates can be anticompetitive if they foreclose a large share of the relevant market such that they exclude rivals or act as a substantial impediment to entry and/or expansion.³⁸ Several of these agencies use price-cost tests in their analysis of foreclosure.³⁹

might create a risk of predation), Hungary (market foreclosure must be likely; probably some sort of predation test could also be used), and Taiwan (costs and the extent to which costs can be recouped are considered in the telecommunication industry.).

³⁵ For further information regarding agencies' practices with respect to predatory pricing, including the use and definition of cost measures, see the ICN Predatory Pricing Report presented at the 7th Annual Conference of the ICN in Kyoto, Japan (April 2008), available at: http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/FINALPredatoryPricingPDF.pdf.

³⁶ Those of Croatia, Denmark (applied a cost-based test as part of the assessment in two cases; however it was not conclusive), European Union, France (price-cost comparisons may play a role, among other elements, in the assessment of whether single-product loyalty discounts and rebates may have a foreclosure effect), Germany (in general, the Bundeskartellamt analyzes whether a discount scheme is likely to lead to foreclosure effects. Price-cost comparisons have not played a role in the analysis, but if price-cost data were readily available, it might be used in an investigation), Italy, Netherlands (likely will use a price-cost test in future cases), Singapore (price-cost tests are relevant in so far as they have a causal effect of foreclosure on competition arising from the fidelity discounts), and United Kingdom.

³⁷ See, e.g., agency responses from European Commission (the price cost test is integrated in the general assessment of anticompetitive foreclosure) and France (price-cost comparison may play a role, among other elements).

³⁸ See, e.g., agency responses from Bulgaria (competitive concerns are distortion of competition and exclusion of competitors), Canada (if the loyalty rebate has the effect of exclusive dealing in that it, for example, forecloses a competitor from an important conduit to the market such as distributors, the loyalty rebate may be examined as an exclusionary practice), Chile (looks to whether the conduct produces artificial barriers to entry or market foreclosure effects), Croatia, Denmark (looks to whether access to market is hampered or blocked), France, Germany, Hungary, Japan, Jamaica, Jersey (according to relevant agency guidelines, looks to whether conduct removes or limits competition from existing or new competitors), Mexico (concerns arise when the dominant firm succeeds in preventing entry of other low cost producers), Netherlands (threatened exclusion of rivals must be shown), Poland (must have an exclusionary effect), Singapore, South Africa, Switzerland, Taiwan, and Turkey. In the Czech Republic, harm to competition or consumers may be found when loyalty discounts and rebates hinder the operations of other undertakings in the relevant market.

³⁹ See note 36 above.

1. Assessing Foreclosure

The European Commission response explains that it analyzes whether a loyalty discount or rebate is likely to lead to anticompetitive foreclosure, i.e., whether it is likely to produce an adverse impact on consumer welfare, explaining that the identification of consumer harm will rely on qualitative as well as, where possible and appropriate, quantitative evidence.⁴⁰ If the effective price in a rebate scheme for the relevant range of a customer's demand is below AAC, as a general rule the arrangement is deemed capable of foreclosing equally efficient competitors from that part of the demand.⁴¹ Because effective prices above long run average incremental cost ("LRAIC") would normally allow an equally efficient competitor to compete profitably, notwithstanding the rebate, the European Commission would normally not intervene if that were shown by the price-cost test. When the effective price is between AAC and LRAIC, the Commission will investigate whether other factors indicate that entry or expansion by equally efficient competitors is likely to be affected.

The French Competition Authority assesses whether or not the behavior of the dominant firm, considered in its context, is likely to reduce consumer welfare, by having the actual or potential object or effect of excluding equally efficient competitors from the marketplace.

The German Bundeskartellamt defines market foreclosure as a "situation where actual or potential competitors of the dominant firm are completely or partially denied profitable access to a market and where the maintenance of the degree of competition still existing or the growth of competition in the market is thereby hindered." In the assessment of foreclosure, the Bundeskartellamt analyses whether the discount provides a "strong economic incentive to concentrate purchases . . . on a dominant firm," which will likely either hinder entry or make actual competitors exit the market. The economic incentives are considered in light of such attributes as the percentage discount and the sales (turnover) on which the discount is based.

The response of the UK Office of Fair Trading indicated that the test for foreclosure should be whether the loyalty discounts risk foreclosing an equally efficient competitor.⁴² In describing its foreclosure analysis, the OFT noted that "the impact should be sustained or durable and not merely transitory . . . in order to mitigate the risk that competition law intervention is deployed in order to protect less efficient rivals or where there will be new entrants within a relatively short period. Furthermore, this is important in relation to considering whether there is a likely substantial impact on effective competition."

⁴⁰ The European Commission considers that the assessment of conditional rebates differs from that of predation in that, according to the Commission, it can have foreclosure effects without necessarily entailing a sacrifice for the dominant undertaking.

⁴¹ See also agency responses from Italy and United Kingdom.

⁴² Though consumer harm may not be a necessary condition of a finding of actual infringement in the United Kingdom, the OFT will bear in mind potential consumer benefits and efficiencies that can be attributed to loyalty discounts and rebates when considering whether to investigate.

In the assessment of foreclosure, a few responses mentioned looking at the time period for the offered discount or rebate and whether it was retroactive.⁴³ For example, the Danish Competition Authority is unlikely to investigate discount schemes with a discount of no more than approximately five percent, a short reference period, e.g., no longer than three months, and an incremental rather than retroactive structure.⁴⁴ France considers the time period as well, and explained that a reference period of a year or less is less likely to raise competitive concerns than a longer reference period. Germany also considers the period over which the discount is calculated.

The European Commission considers the likelihood of anticompetitive foreclosure to be higher when competitors are not able to compete on equal terms for the entire demand of each customer. Its response explains in general terms, that “retroactive rebates may foreclose the market significantly, as they may make it less attractive for customers to switch small amounts of demand to an alternative supplier, if this would lead to loss of the retroactive rebates. The higher the rebate as a percentage of the total price and the higher the threshold, the greater the inducement below the threshold and, therefore, the stronger the likely foreclosure.”

Similarly, the Italian authority adds that above cost sales may cause foreclosure when customers are unable or unwilling to switch their entire demand away from the dominant supplier (e.g., because its products are a “must-stock item”) and other undertakings can compete only for smaller chunks of the total market demand. The Bundeskartellamt mentioned that the importance of the dominant firm as a trading partner and the importance of its products (e.g., as “must-stock items”), as well as potential losses that switching to other suppliers would bring about are relevant to the assessment.

Several responses noted that they consider whether the discounts are “personalized” or “individualized.”⁴⁵ The European Commission stated that an individualized threshold may allow the dominant firm to set the threshold at a level where switching suppliers may be very expensive for the customer. By comparison, a general discount available to all is less likely to have a “loyalty enhancing effect.”

2. Degree of Proof

Jurisdictions have different standards of proof with regard to anticompetitive effects: some require proof of actual anticompetitive effects (e.g., South Africa), while others require varying degrees of lesser proof, from a showing of potential anticompetitive effects⁴⁶ to a showing of likely⁴⁷ or probable⁴⁸ anticompetitive effects. According to the German Bundeskartellamt, neither the competition agency nor, in civil litigation, the plaintiff is required to show that competitors were actually forced to exit the market as a consequence of the loyalty discount or rebate. Rather, it suffices to show

⁴³ Those of the European Union, Denmark, France, Germany, Korea, Turkey (limited time periods are among the justifications), and United Kingdom.

⁴⁴ The Danish Competition Authority notes that it will follow the EC Guidance paper on Article 82.

⁴⁵ See response of European Union, France, and Germany.

⁴⁶ See, e.g., agency responses from Bulgaria, France, Lithuania, and Turkey.

⁴⁷ See, e.g., agency responses from European Union, Hungary, Italy, Jersey, Mexico, Netherlands, and Singapore.

⁴⁸ See agency responses from United States.

that the conduct is capable of producing an exclusionary effect, i.e., that the discount scheme provides for a strong economic incentive to concentrate purchases with the dominant firm so that the entry of potential competitors is made difficult or the market exit of actual competitors is probable or likely in a way that can reasonably be expected.

IV. Intent

The questionnaire asked whether a firm's intent is relevant in examining single-product loyalty discounts and rebate cases. The majority of responses indicated that intent is not required, but in 17 jurisdictions it is often considered a relevant factor, particularly in assessing the effects of the practice.⁴⁹ Ten agencies said intent was not relevant to their assessment.⁵⁰ Three agencies replied that intent is required.⁵¹

Although it is a necessary element under the Competition Act in Croatia, intent does not have to be proven separately from other relevant factors of the offense. This approach contrasts with that in Canada, where an intended negative effect on a competitor is required for a loyalty discount or rebate scheme to be considered anticompetitive, but this alone is insufficient to conclude that an abuse has occurred.⁵²

Similar to the responses received pertaining to tying and bundled discounts, several responses indicated that although intent was not a requirement in establishing an offense, it is one factor considered during an investigation.⁵³ Some jurisdictions said that intent may be relevant in assessing competitive effects.⁵⁴ Authorities may look to both direct and indirect evidence in the form of the business strategies and other internal documents to find "evidence of the willingness to exclude competitors from the market through the implementation of the rebate scheme."⁵⁵ The South African response stated that while intent is not required, it is necessary that the dominant firm be enhancing its market power. The Competition Commission suggested that this is

⁴⁹ See notes 52 – 54, below. This issue has not been addressed by the agencies in Ireland (no formal policy) and Jersey (indicated that the issue had not yet been addressed, however it would be expected that any future discussion of intent would be consistent with the view taken in by the European Commission). Serbia and Switzerland did not respond to this question.

⁵⁰ Brazil, Bulgaria, Czech Republic, Denmark, Hungary, Jamaica, Lithuania, Netherlands, Russia, and Singapore.

⁵¹ Canada, Croatia, and Mexico.

⁵² In Canada, intent may be inferred. In the words of the Federal Court of Appeal in *Canada Pipe*: "Proof of the intended nature of the negative effect on a competitor can thus be established directly through evidence of subjective intent, or indirectly by reference to the reasonably foreseeable consequences of the acts themselves and the circumstances surrounding their commission, or both."

⁵³ Intent *may* be considered a relevant factor in Belgium, Colombia, France, Israel, Korea, Romania, Singapore, South Africa, Taiwan, and Turkey. In Poland, proof of intent is used as supplemental evidence. See also notes 52 and 54, below.

⁵⁴ See agency responses from European Union, Japan (important factor for judging the probability of exclusion), Germany, Romania, United Kingdom (intent is not generally a factor, however, in exceptional cases where effects are difficult to prove, it may be taken into account), and United States (noting that intent to increase sales by taking competitors' customers, for example, is not relevant, but evidence of the business purpose behind the conduct is relevant in assessing competitive effects), and NGA response from Lugard indicating that evidence of intent may play a role in the assessment of the likely effects in the Netherlands.

⁵⁵ See the French Competition Authority response. Similar statements are made in the responses of the European Union, Italy, and Romania.

linked to intent in the sense that the dominant firm must have an exclusionary strategy in mind with respect to its rivals.

In a few jurisdictions, intent may be considered when establishing fines.⁵⁶ In Chile, the fine may be lessened if lack of intent is proved. The Belgium Competition Authority response indicates that, while intent is not required, it may be an “aggravating circumstance.”

V. Justifications and Defenses

A. The Use of Justifications and Defenses

It follows from the responses to the questionnaire that competition authorities are generally open to justifications and defenses for the use of single-product loyalty discounts and rebates.⁵⁷ Differences exist, however, in the type of justifications and defenses that they consider acceptable, as well as the conditions that need to be fulfilled.

It appears from the responses that most jurisdictions do not have specific legal provisions establishing concrete justifications and defenses for single-product loyalty discounts and rebates, as is the case, in some jurisdictions, with respect to tying. Acceptable justifications and defenses are based primarily on policy documents and case law.

Certain competition agencies provide some guidance by stating that it should concern “valid business justifications” (Canada), “relevant business justifications” (Hungary), or “efficiency justifications” (U.S. FTC).

One generally accepted justification is that single-product loyalty discounts and rebates may lead to benefits for suppliers and consumers.⁵⁸ The U.S. antitrust agencies noted that loyalty discounts and rebates are often procompetitive and result in lower prices to consumers. A manufacturer may use them, for example, to compete for the most desirable customers or to induce services from distributors or retailers.

Some competition agencies take the position that the actual cost efficiencies may depend on the type of discount or rebate. The European Commission argues that rebate schemes with individualized volume targets are generally less likely to achieve the same efficiencies as those achieved with standardized volume targets. It recognizes, however, that “conditional rebates, by allowing the dominant undertaking to secure that the customer purchases at least a certain minimum amount over a sufficiently long period, may provide incentives for the dominant undertaking to make certain relationship-specific investments in order to be able to supply a particular

⁵⁶ Intent may also be relevant in establishing fines in Chile, Germany, Italy and Poland. See also NGA response from Hoffet, Meinhardt & Venturi indicating that in Switzerland, intent may be an aggravating factor in the assessment of a fine.

⁵⁷ The Colombian agency indicated that there is no need for justifications or defenses under its competition regime, as single-product rebates are not considered anticompetitive as such.

⁵⁸ This justification is mentioned in the responses from agencies in Croatia, Denmark, European Union, Italy, Poland, and United States.

customer.” The South African Competition Commission refers to court rulings in which it was held that volume-driven rebate schemes are more likely to be efficient than loyalty-driven ones.

The Singapore Competition Commission identified several specific pro-competitive effects of loyalty discounts and rebates. For instance, “loyalty discounts and rebates may reflect efficiency savings from supplying particular buyers, or provide an appropriate reward for the efforts of downstream undertakings to promote the dominant undertaking’s products.”

Some competition agencies accept a meeting competition defense.⁵⁹ However, strict conditions have to be met. The Danish Competition Authority considers that “a loyalty rebate which is not cost based can under circumstances be justified if the dominant company uses the rebate system to meet competition from rivals. The meeting competition defense can only be accepted if the dominant company is using the rebate system to maintain its own customers — whereas it would not be accepted if the dominant company uses the system to take over rivals’ customers.” Similarly, the Israel Antitrust Authority asserts that “this defense is meant to allow monopolists to take competitive measures that meet its rival’s competitive actions. . . . This defense is however, not meant to legitimize the tactic of ‘beating competition.’”⁶⁰ The Mexican Competition Commission adds that “if discounts are applied only to those segments of the market where there is a high probability of entry of new competitors, the purpose of the dominant firm would be to prevent the entrance of new competitors, and thus the discounts would be anti-competitive.”

Some competition agencies accept the defense that a loyalty discount or rebate cannot be prohibited if its effect on competition is non-substantial.⁶¹ The Turkish Competition Authority provided examples of cases in which this defense was accepted where the rebates were applied for a limited period of time and in a small geographic area.

A number of agencies stressed that justifications and defenses must have an objective basis.⁶² Benefits that are purely speculative, or would arise only at some time in the distant future are disregarded. Other agencies indicate that it has to be demonstrated that there is a causal link between the alleged efficiency and the loyalty discount or rebate.⁶³ The United Kingdom takes the position that, in addition, it would have to be demonstrated that the same beneficial effect would not have occurred without the loyalty discount or rebates.⁶⁴ Some agencies indicated that a justification and defense can be accepted only if there is no less anti-competitive alternative for the conduct at issue.⁶⁵

⁵⁹ The agencies of Denmark, Czech Republic, Germany, Ireland, and Israel.

⁶⁰ The Israel Antitrust Authority refers to the Court ruling in the Yedioth Ahronoth case.

⁶¹ This point is put forward by the agencies of Turkey and United Kingdom.

⁶² This requirement is mentioned by the agencies from Denmark, Switzerland, Jersey, and South Africa.

⁶³ This condition is, for instance, referred to by the European Commission.

⁶⁴ This condition is also applied by the Russian agency.

⁶⁵ Those of the European Union, Russia, and Singapore (dominant firm must show conduct is proportionate to the benefits produced).

Several responses indicate that the agencies' assessment of justifications and defenses includes the evaluation of the pro- and anti-competitive effects.⁶⁶ The U.S. FTC looks to whether the anticompetitive harm "outweighs" the procompetitive effects. Similarly, the Italian Competition Authority must establish whether any foreclosure effects are outweighed by any advantages that may be passed on to the final consumer.

Another important condition, according to some competition agencies, is the requirement that efficiencies and cost savings that result from the discount must benefit consumers.⁶⁷ The Mexican Competition Commission adds that such efficiency benefits must be transferred to consumers "on a permanent and significant basis."

Finally, several competition agencies consider a justification or defense only if it does not eliminate competition, by removing all or most of existing resources of actual or potential competition.⁶⁸ The European Commission asserts that where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweigh possible procompetitive efficiency gains.

B. Burden of Proof

Most competition agencies agree that, whereas it is up to the agency to show the anticompetitive effects, the firm has the burden of proving efficiencies.⁶⁹

⁶⁶ In these jurisdictions, a justification or defense can be accepted only if its benefits "outweigh" the anticompetitive effects. See in particular the agency responses from Belgium, European Union, Germany, Korea, Mexico, and United Kingdom.

⁶⁷ This is the case for the European Union, Germany, Ireland, and Russia. See also agency response from Jamaica (Act specifies that consumers must receive a fair share of the resulting benefit).

⁶⁸ See agency responses from the European Union, Ireland, and Russia.

⁶⁹ This is, for instance, the case for Croatia, Czech Republic, Denmark, European Union, France, Germany, Korea, Netherlands, Singapore, Turkey, and United States. But see agency response from Italy (where the Authority could not disregard any available evidence of pro-competitive efficiencies, even if they are not directly relied upon by the undertakings concerned).