The *Intel* EU-saga:
A progress report

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*) The views expressed in this presentation are those of the author and do not necessarily reflect the views or opinions of the European Commission.

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Introduction

This presentation gives an **overview** of the *Intel-saga* and provides an outlook on the assessment of exclusionary conduct by dominant firms

- *Intel* is a key case for assessing **loyalty rebates** under EU law
- More generally, *Intel* concerns the principles of evaluating potentially **exclusionary conduct** under Article 102 TFEU
- **Form-based vs effects-based** assessment of foreclosure

Timeline (so far)

- 2009 **Commission** decision employs effects-based approach
- 2014 **General Court** confirms the decision on appeal, but deems price/cost test redundant
- 2017 **ECJ** sends the case back to General Court to assess price/cost test and alleged lack of effects

Introduction

This presentation will address the following topics

- The **older case law** (form-based approach)
- The **economics** of loyalty rebates
- Modernization and the **Guidance Paper** (effects-based approach)
- The **Commission’**s *Intel* decision (2009)
- The **General Court**’s *Intel* judgment (2014)
- The **ECJ**’s *Intel* judgment (2017)
- **Discussion**: Assessing the competitive effects of loyalty rebates in practice

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The older EU case law

The older EU case law on loyalty rebates takes a **form-based approach** that considers almost all forms of loyalty-inducement as inconsistent with the competitive process

According to the courts, **loyalty rebates**

- "*[constitute] recourse to methods different from those governing normal competition*" (*Hoffmann-La Roche*)
- "*[do not] constitute a mode of exercise of the normal operation of competition*" (*BA/Virgin*)

Main concern: loyalty rebates make it **more difficult for rivals to win sales** as they induce loyalty to the dominant incumbent

The older EU case law

Presumptively unlawful

- Retroactive rebates (e.g., *Michelin I/II*, *BA/Virgin*, *Tomra*)
- Individualized rebates (e.g., *Michelin I*, *Hoffmann-La Roche*)
- Market share contracts (e.g., *Coca-Cola*, *Intel*)
- Exclusive dealing (e.g., *Hoffmann-La Roche*, *Coca-Cola*)
- Bundled discounts (by analogy, *Hoffmann-La Roche*)

Presumptively lawful

- Incremental, standardized, single-product volume rebates (if cost-based) (*Michelin II*)

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The economics of loyalty rebates

The per se-approach of the older case law has been **criticized** by several observers as too interventionist

Indeed, making it “more difficult for rivals to win sales” is a **debatable legal standard** for assessing exclusionary conduct, since pro-competitive conduct also makes it more difficult for rivals to win sales

Economically, loyalty rebates induce **lower prices for marginal units**, which may be a natural competitive reaction since competition is most intense at the margin

As a result, targeted price cuts via rebates **may intensify overall competition** (and lower average prices) as price pressure is most intense at the margin, where firms compete for contestable sales

The economics of loyalty rebates

Competition in loyalty rebates, therefore, may not lead to foreclosure, but to a **more competitive** market outcome (even absent any cost efficiencies)

But this is not necessarily so when loyalty rebates are employed by a **dominant firm** rather than multiple competing suppliers

Because the most effective tool to compete is often also the **most effective tool to exclude** rivals!

Concern: dominant companies might **leverage market power** over non-contestable units into contestable units via loyalty rebates

Hence, an effects-based approach will prohibit loyalty rebates **if and only if** they leverage market power against smaller rivals

The economics of loyalty rebates

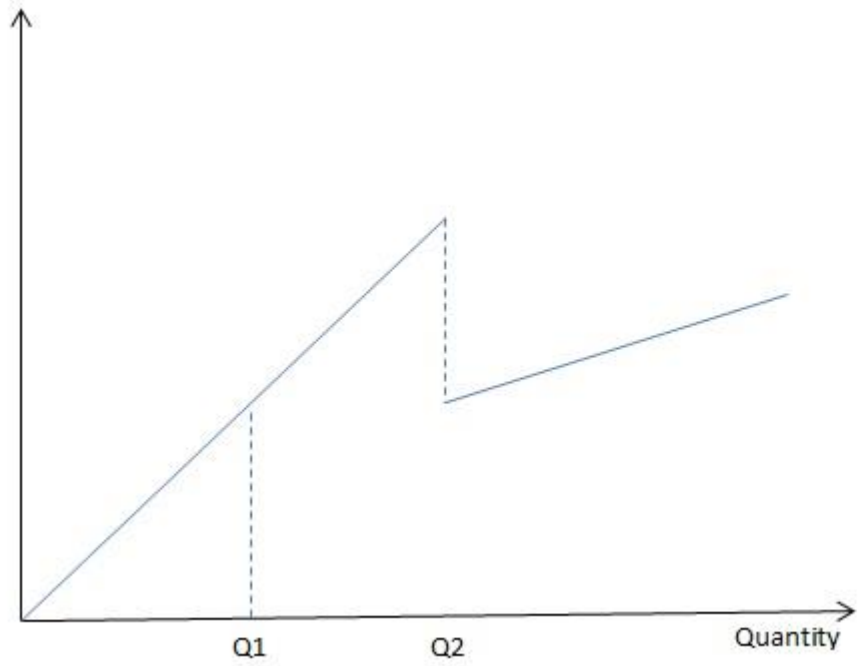

Figure 1: Exclusionary effect of retroactive rebate

The economics of loyalty rebates

Contrary to incremental rebates, **retroactive rebates** provide a discount on *all* units that a customer has purchased, not only on those that exceed the applicable quantity target

This characteristic leads to a significant **drop in expenditure** at the quantity target from which on the retroactive rebate is granted

As a result, **effective prices** for parts of demand in the vicinity of the threshold become very low or even negative

A dominant firm might therefore abuse retroactive rebates by effectively imposing **below cost prices** on contestable units to harm competitors

This is particularly of concern when such conduct **deprives rivals of efficient scale**, to harm their current or future ability to compete (e.g., by undermining their ability to invest in R&D)

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The Guidance Paper

In light of the ambiguous competitive effects of unilateral conduct, the Commission in 2009 **revised its prioritization** with respect to loyalty rebates cases (and exclusionary conduct more generally)

- Acknowledgment that loyalty rebates **can be pro-competitive**
- Prohibition of loyalty rebates **if anti-competitive foreclosure** can be shown (effects-based approach)
- Publication of the **Guidance Paper**

Two-step approach towards retroactive rebates in the Guidance Paper

- As-efficient-competitor test (is there **foreclosure**?)
- Effect on competition (is there **competitive harm**?)

The Guidance Paper

In the first step, the AEC test compares the **effective price** that rivals have to compete with (for contestable units) with the dominant firm's incremental cost

According to the test, effective prices for contested units can only be lowered so much that hypothetical, equally-efficient rivals can still **compete on the merits** (but effective prices cannot be lowered more)

In the second step (if the AEC test was failed), a concrete **theory of harm is formulated and tested**

Example: **show a high foreclosure share** and significant economies of scale to argue that the conduct will lead to marginalization of rivals

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The Commission's *Intel* decision

The 2009 *Intel* decision applied the **Guidance Paper approach** but also noted that the conduct is prohibited according to the old case law in any event

Intel had granted conditional rebates for quasi-exclusivity (**market share contracts**) to a number of key OEMs such as Dell

A relatively small proportion of OEMs' demand was contestable by AMD, while Intel CPUs were considered a **"must have" product**

AMD effectively had to compete with below-cost prices over the contestable range of customers' demand (i.e., the **AEC test failed**)

The Commission's *Intel* decision

Example: as AMD could not offer HP a compensating rebate, it offered **one million x86 CPUs for free**, but HP had to refuse (and took only a small part)!

Evidence on **competitive effects**

- **Significant proportion** of addressable market affected
- CPUs make up significant proportion of **OEMs' costs**
- CPU **scale economies** are crucial for R&D and manufacturing
    - Credible theory of marginalization (**raising rivals' cost**)
- Off-equilibrium **threats** to play competing OEMs off against each other (picking winners), as OEMs care about *relative* prices
- Use of additional exclusionary tools such as **retail exclusivity** and "**bribes**" for not introducing competitor innovations

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The General Court's *Intel* judgment

In its 2014 *Intel* judgment, the General Court found that a dominant firm that **ties purchases via rebates** generally acts abusively (thereby confirming the old case law)

According to the court, it is **not necessary to consider the specific circumstances** of a particular rebate scheme if the rebates induce quasi-exclusivity (pure form-based prohibition)

"*The Commission is not therefore required to demonstrate the foreclosure capability of exclusivity rebates on a case-by-case basis*"

Accordingly, "*it is not essential to carry out an AEC test*"

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The ECJ's *Intel* judgment

In a recent judgment, however, the **ECJ overturned the General Court judgment** and referred the case back to the lower court

The decision points out that not only the form of a loyalty rebate matters, but **also its likely effect**:

“*[The] case-law must be further clarified in the case where the undertaking concerned submits […] on the basis of supporting evidence, that its conduct was not capable of restricting competition*”

“*In that case, the Commission is […] required to analyse […] the share of the market covered by the alleged practice, as well as the conditions and arrangements for granting the rebates in question, their duration and their amount; it is also required to assess the possible existence of a strategy aiming to exclude competitors that are at least as efficient*”

The ECJ's *Intel* judgment

“*The analysis of the capacity to foreclose is also relevant in assessing whether a system of rebates […] may be objectively justified*”

“*If, in a decision finding a rebate scheme abusive, the Commission carries out such an analysis, the General Court must examine all of the applicant’s arguments seeking to call into question the validity of the Commission’s findings*”

Therefore, the *Intel* case will now be referred back to the General Court, which will have to **assess Intel’s arguments alleging lack of competitive effects** (in particular, with respect to the AEC test)

In short, the **saga will continue** (though informed by the ECJ’s guidance)

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Discussion

So **what does all of this imply** for the assessment of loyalty rebates and exclusionary conduct more generally?

From the Court's decision, it seems clear that not only the form of unilateral conduct matters for the assessment, **but also its likely effect**

Arguably, this involves formulating and assessing a **theory of competitive harm** (as in other areas of competition law) and assessing defendants' arguments that there is no competition concern

The precise degree of evidence required to bring an exclusionary case will of course also depend on the **type of the conduct** in question

E.g., if a company with 80% share starts covering the entire market with fully exclusive contracts, then this is clearly **more likely to be harmful** than if a 45% company uses occasional rebates at the margin

Discussion

Generally speaking, **contracts that reference rivals** (such as market share contracts and exclusive dealing) are more likely to cause competition problems than purely output-based rebates.

Since different types of loyalty contracts differ in the way they affect competition, it is also sensible to consider **potentially different tools** to analyse their impact on the market

E.g., while price/cost tests are particularly well-suited to identify **predatory types** of exclusionary conduct, alternative tools may be useful to identify foreclosure effects from contracts referencing rivals

This is **not to say** that analysing the ability of as-efficient-competitors to compete against such contracts is irrelevant

Discussion

But rather that competition assessment is not a **one-trick pony** that should only rely on one type of evidence.

E.g., in the recent ***Qualcomm*** decision, the Commission assessed (and dismissed) an AECT by the defendants, but did not invoke an own AECT to find harm.

Given the **many iterations** of the *Intel*-saga, it seems likely that the last word on the topic is not yet spoken.

However, there is now **significant new guidance** by the Court that should facilitate applying a pragmatic and effective approach

The details of the policy for specific loyalty abuses will have to be **shaped by case practice** going forward, so there will no doubt remain interesting topics to debate!

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