

E.CA Economics

Is economic analysis in 102 cases still relevant post Intel?

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A critical review of the Intel judgement

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Introduction

- On June 12, the European General Court (“EGC”) confirmed a decision by the EU Commission which had found that **Intel had engaged in abusive rebate practices** to foreclose its competitor AMD
 - This was one of the first Commission decisions which applied **an effects-based analysis** on rebates
- While the case relates to **exclusivity rebates**, it also addresses some important “**horizontal**” **issues regarding potentially exclusionary conduct**
 - The relevance of the “**as efficient competitor**” (**AEC**) **test**, which is the leading assessment tool for potential price abuses under the current EC Guidance paper
 - A weighting of the components of the **ability, incentive and effect trilogy** for the assessment of a potential abuse
 - The role of **business justifications*** in Article 102 TFEU cases
- It is therefore a **key judgement on the “refined-economic-approach”** reform in relation to Article 102 TFEU cases
- And it is rather clear in its ruling....

* Note: throughout the presentation I use the terminology “**business justification**” to address both “objective justifications” and “efficiencies” in its legal sense

The remains of an economic assessment in exclusivity rebates cases – deconstruction of a holistic economic assessment or persistence in classical principles of competition law?



Torso from Miletus, Paris, Louvre

- The **AEC test is not required to prove nor sufficient to disprove an abuse** as it produces **false negatives** under the Court's standard of "no detrimental effect on competitor"
- From the ability, incentive and effect trilogy **only the (cap)ability component** is relevant
 - Neither incentives nor likely or actual effects play a role
 - **Appreciability is presumed** if the form is met; any *de minimis* provision is rejected
- **Price related business justifications are ruled out**; only cost related efficiencies may play a role
- The judgement stands in **strong contrast to the EC Guidance paper** (a conflict which the EGC tries to resolve, see para 157, by reverting to the non-applicability of the Guidance paper for the Intel judgement, but...)
- The judgement, hence, **puts into question the current reform agenda of the EU Commission** regarding Article 102 cases and supports a **non-harmonized assessment of 102 cases** throughout Europe

A critical review of the Intel judgement

The Intel case at a glance*

The EGC judgement, in particular its horizontal part

Major shortcomings of the EGC judgement from an economic perspective

The remaining fragments of an economic analysis

* Disclaimer: The author has not been involved in the Commission's investigation and, hence, can not judge and does not want to comment on the merits of the Commission's case against Intel. The presentation is commenting on the general approach taken by the EGC only.

Intel's conduct

- Intel agreed with several PC manufacturers on
 - **conditional rebates**, offering rebates that are conditioned on the PC manufacturers purchasing all or almost all of their supply needs from Intel
 - **naked restrictions**, offering payments to delay or scrap the launch of products containing AMD chips
- Intel also offered a large retailer a payment in return for its commitment to exclusively sell products containing Intel chips (considered equivalent in its effect to the conditional rebates to PC manufacturers)
- Intel's market share **exceeded 70 percent**

The EU Commission's assessment

- **Theory of harm/ likely effect on consumers**
 - Reduction of consumers' choice between different products
 - Lower incentives to innovate
- With regard to **conditional rebates** the Commission applies the **AEC analysis** (on 150 pages!)
 - Given the contestable share, does an as efficient competitor have to offer its products below a viable measure of Intel's cost to compensate a PC manufacturer for the loss of the Intel rebate?
 - Conclusion that Intel *effectively* imposed below-cost prices on contestable units
- With regard to **naked restrictions**, the Commission concludes that these directly harmed competition
- **Business justifications are considered to be flawed** as “they relate more generally to conduct to which the Commission did not object (i.e. discounting/provision of rebates), and not to conduct to which the Commission did object (i.e. conditions associated with the discounts/rebates” (Summary of Commission Decision, para. 35)



Commission condemns Intel to a record fine of 1.06 billion EUR and prohibits it to make use of exclusive deals



One of the first EU Commission decisions which applies an effects-based analysis related to rebates

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The EGC's assessment – a form-based categorization of conduct*

- **Distinction between three types of rebates**
 - **Quantity discounts:** Rebates linked solely to the volume of purchases. Presumption of legality due to potential cost savings (para. 74)
 - **Exclusivity rebates:** rebates which are conditional on exclusive or close to exclusive purchases (para. 76)
 - “they are designed to remove or restrict the purchaser’s freedom to choose his source of supply and to deny other producers access to the market” (para.77)
 - “are, by their very nature, capable of restricting competition” (para. 87)
 - the grant of an exclusivity rebate by an unavoidable trading partner makes it structurally more difficult for a competitor to submit an offer at an attractive price and thus gain access to the market* (para. 93)
 - Case law establishes a presumption of illegality, irrespective of the specifics of the case (e.g. the size of the rebate or the contestable share)
 - the question whether an exclusivity rebate can be categorised as abusive does not depend on an analysis of the circumstances of the case aimed at establishing a potential foreclosure effect* (para. 80)
 - **Rebates that do not induce exclusivity (third category):** they may also have a fidelity-building effect and may comprise rebates with individual sales targets
 - The circumstances of the case have to be taken into account
 - However, case law establishes a presumption of illegality also for some rebate types within that category (e.g. retroactive/ market share based rebates)
- **Naked restrictions** would “amount to an abuse of a dominant position” (press release No 82/14, p3), i.e. be deliberately anticompetitive

*If not mentioned otherwise the references are to the EGC's judgement

The AEC test is considered neither necessary nor sufficient

- AEC analysis is the **leading assessment tool for potential price abuses** under the current EC Guidance paper
- EU Commission conducted an AEC test in the Intel case (on many, many pages...)
 - Given the contestable share, does an as efficient competitor have to offer its products below a viable measure of Intel's cost to compensate a PC manufacturer for the loss of the Intel rebate?
- EGC argues that AEC analysis is **not a necessary condition** to find foreclosure:
 - *it is not essential to carry out an AEC test* (para. 144)
- **Nor is it sufficient for ruling out an abuse (no safe harbour provision anymore!)**
 - *Even a positive AEC test result would not be capable of ruling out the potential foreclosure effect which is inherent in the mechanism described in paragraph 93 above.* (para. 151)
- In fact, the AEC analysis could lead **to false negatives!**
 - *“even if the competitor were still able to cover its costs in spite of the rebates granted, that would not mean that the foreclosure effect did not exist* (para. 150 and press release No 82/14, p2)”
- The AEC test is also **not required for rebates of the third category** (para. 153)
 - *It follows that, even if an assessment of the circumstances of the case were necessary to demonstrate the potential anti-competitive effects of the exclusivity rebates, it would still not be necessary to demonstrate those effects by means of an AEC test.* (para.146)

From the ability, incentive and effect trilogy only the (cap)ability component survived the court's scrutiny...

- Neither **incentives** nor **likely** or **actual effects** play a role
 - *The Court would point out that, contrary to the applicant's claim, the question whether an exclusivity rebate can be categorised as abusive does not depend on an analysis of the circumstances of the case aimed at establishing a potential foreclosure effect. (para 80)*
- **Conceptual economic reasoning** seems also to be rejected in the case of naked restrictions
 - *...it is necessary to reject the applicant's argument that the Commission is required to demonstrate the capability of restricting competition 'in economic terms'. (para 209)*
- In fact, the **anticompetitive object equals an anticompetitive effect**, at least in the case of naked restrictions
 - *Next, it should be pointed out that, for the purposes of applying Article 82 EC, showing an anti-competitive object and an anti-competitive effect may, in some cases, be one and the same thing. (para 203)*
- **Appreciability** is presumed if the form is met; any **de minimis provision** is rejected
 - *In addition, the possible smallness of the parts of the market which are concerned by the practices at issue is not a relevant argument...The Court of Justice has therefore rejected the application of an 'appreciable effect' criterion or a de minimis threshold for the purposes of applying Article 82 EC... (para. 116)*



Dominance plus form of conduct (i.e. exclusivity rebates and naked restrictions) equals abuse

From the ability, incentive and effect trilogy only the (cap)ability component survived the court's scrutiny...(continued)

- The Court is willing to accept some tension/ differentiation to Article 101 TFEU
 - *Whilst it is true that, in the context of Article 81 EC, the Court of Justice has held that, in a normal situation on a competitive market, it is necessary to assess the exclusive relationships between a supplier and a retailer in their specific context, which has implied in particular an analysis of the cumulative effect of a network of such relationships, it is however clear that those considerations cannot be accepted in the context of the implementation of Article 82 EC, which relates to markets in which, precisely because of the dominant position of one of the economic operators, competition is already restricted (see paragraph 89 above). (para. 170)*



Dominance assessment the only part where the 'economic context' is taken into account for behaviour which otherwise is not presumed illegal

Business justifications – Intel’s arguments

- By using a rebate, **Intel only responded to price competition** from AMD and thus met competition
- The rebate system was necessary to achieve **important efficiencies** (Commission Summary Decision para. 34)
 - Lower prices
 - Scale economies
 - Other cost savings and production efficiencies
 - Risk sharing and marketing efficiencies
- 86 percent of the market was contestable (EGC judgement, para. 194)
- The impact of the exclusive deals on competition was minor since **AMD grew during the investigation period**
 - *First, the applicant attempts to demonstrate that its practices were not capable of restricting competition by arguing that, during the relevant period, AMD reaped the greatest commercial success in its history, reported uniquely rapid growth rates with the very OEMs deemed to be the target of abusive behaviour, faced manufacturing capacity constraints that hampered its ability to satisfy demand for its CPUs and grew its investments in research and development. Moreover, the quality-adjusted price of CPUs fell 36.1% annually over the period covered by the contested decision. (para.185)*

Business justifications – The EGC’s view

- Dominant firms may not argue that an exclusivity inducing conduct did not restrict competition in the first place by providing **evidence of actual intense competition**
 - *The fact that, over the period covered by the contested decision, AMD reaped great commercial success and, consequently, faced capacity constraints could at most show that the applicant’s practices did not produce actual effects. However, that could not suffice to demonstrate that the practices implemented by the applicant were not capable of restricting competition. (para. 186)*
- Nor by reference to **conceptual arguments**
 - *Although exclusivity conditions may, in principle, have beneficial effects for competition, so that in a normal situation on a competitive market, it is necessary to assess their effects on the market in their specific context [...], those considerations cannot be accepted in the case of a market where, precisely because of the dominant position of one of the economic operators, competition is already restricted. (para. 89)*



Price related justifications are ruled out by the EGC

Business justifications – The EGC’s view (continued)

- In principle the **EGC accepts an efficiency defence**
 - *Lastly, it should be noted that it is open to the dominant undertaking to justify the use of an exclusivity rebate system, in particular by showing that its conduct is objectively necessary or that the potential foreclosure effect that it brings about may be counterbalanced, outweighed even, by advantages in terms of efficiency that also benefit consumers (see, to that effect, Hoffmann-La Roche, paragraph 71 above, paragraph 90; Case C-95/04 P British Airways, paragraph 74 above, paragraphs 85 and 86; and Case C-209/10 Post Danmark [2012] ECR (“Post Danmark”), paragraphs 40 and 41 and the case-law cited). However, in the case in point, the applicant has put forward no argument in that regard. (para. 94)*
- In fact, the EGC considers volume rebates as procompetitive based on a presumption of underlying cost efficiencies (para. 74)
- For the case at hand it is unclear why cost related efficiencies are not taken into account/ discussed by the EGC
 - Most likely because the parties did not “formally” trigger an efficiency defence as they were contesting the conditional character of the rebate



Some leeway to argue for cost related efficiencies is still left...

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Three major shortcomings of the judgement – (1)

- The test standard applied by the Court of “no detrimental effect on competitors” seems over inclusive – it excludes any form of rivalry between a dominant firm and its competitors
 - It would equally apply to other fidelity increasing rebates or volume effects
 - And protect inefficient competitor to the same extent as efficient
- It seems wrong in particular in **innovative industries where “efficiency leapfrogging” is feasible**
- More in general such an approach makes firms’ **recoupment of fixed costs/ investment** more difficult
- And has the potential to incentivizes a **dominant firm conduct** as mode of competition in industries with asymmetric market structures
 - E.g. forms of price leadership models



The court applies an over inclusive test standard

Three major shortcomings of the judgement – (2)

- It has been argued that a sound economic approach would require an integrated analysis of likely (or actual) pro- and anticompetitive effects specifically for price related business justifications
- This reasoning is based on economic literature identifying procompetitive effects of exclusivity
 - Exclusivity can intensify competition among remaining options
 - Accordingly, competition for exclusivity can be more intensive than standard competition (see e.g. Mathewson and Winter (1987) and Bernheim and Whinston (1998))
- And builds on accepted legal practice in other areas of competition law
 - **Aftermarkets:** Exclusivity of repair and maintenance services may trigger intensive competition for system market/ primary market
 - **Bundling:** Rebates are provided conditional on buying a bundled package which may intensify competition for the bundle
 - **State Aid:** Competitive tenders are considered free of state aid as competition for the market (i.e. temporary exclusivity) assures competitive pricing
- Note: this is **not to argue for exclusivity contracts being procompetitive**, it is simply meant to stress that procompetitive effects cannot be excluded *per se*



The court excludes price related business justifications

Three major shortcomings of the judgement – (3)

- AEC test was **THE WORKHORSE** for the assessment of exclusionary price abuses by the EU Commission
- It offers a **unifying test** for all prices abuses
 - This also includes fidelity rebates/ retroactive rebates
 - A distinction between price abuse and exclusivity seems rather artificial
 - EGC argues that “Different treatment of exclusivity rebates and pricing practices is justified by the fact that, unlike an exclusive supply incentive, the level of a price cannot be regarded as unlawful in itself.” (para. 99)
 - The marginal price of a retroactive (exclusivity inducing) rebate can be calculated, though, and depends on the amount of rebate, non-contestable purchases, purchases share trigger, etc.
- The AEC test is **rather simple** as it allows to rely on the incumbents cost data
- And it **incorporates efficiency considerations** to some extent
 - Allows to some extent an integrated analysis of pro- and anticompetitive effects
 - And thereby allows to distinguish between acceptable and non-acceptable level of rivalry



AEC test post Intel is left with significant damage

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Remaining fragments of an economic analysis, while waiting for the next major attempt to reform current practice...

- **Dominance assessment** becomes (again) more important
 - Dominance assessment the only screen to bring in the economic context for behaviour which otherwise is not presumed illegal
- Economic analysis to assess whether a rebate falls **into the second or third category**
 - Assess the level of induced loyalty
 - Replicate loyalty rebate with less-controversial rebate forms
- **Conceptual analysis** for exclusivity rebates which just fall into the third category
 - Economic analysis to assess the “capability to harm competition”
- Economic analysis of **cost based efficiencies**

Thank you!

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Legal background on efficiencies*

- In Europe firms which are considered to be **dominant** have to behave *with a special responsibility* in the market
 - Dominance has been defined under Community law as a position of economic strength enjoyed by an undertaking, which enables it *to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers*
 - Similar to Section 2 Sherman Act - **monopolization**
- For instance a dominant firm **may not grant conditional rebates or price below costs** while a non-dominant firm may do so without violating antitrust law
- Within the 2009 Guidance paper the EU Commission commits to an **efficiency defence**
 - Efficiencies are realised or are likely to be realised **as a result of the conduct**;
 - The conduct is **indispensable** to realise these efficiencies;
 - The likely efficiencies **outweigh** any likely negative effects on competition and consumer welfare;
 - The conduct does **not eliminate effective competition** by removing all or most existing sources of actual or potential competition.
- **Burden of proof** is with the dominant firm

***the following slides are based on Friederiszick/ Gratz (2013):**

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2324133

Recent enforcement priorities (based on Friederiszick/ Gratz 2013)

Opened investigations (#15) and final EU commission decisions (#15), 2009 – 2013

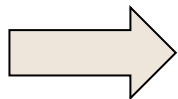
	Regulated network industries			Manufacturing		Services		Pharma
	Energy	Transport	Telecoms	General	IT Hardware	IT Software	Financial Services	
Exclusive dealing	EDF (2007; 2010)				Intel (2007; 2009)			
Tying/ bundling				Reel/ Alcan (2008; 2013)		Microsoft (2008; 2009/ 2012; 2013) Google (2010/ 2010/ 2010)	Reuters (2009; 2012)	
Refusal to supply/ margin squeeze	ENI (2007; 2010) RWE Gas (2007; 2009) GDF (2008; 2009) E.ON Gas (2010; 2010) ČEZ (2011; 2013)	Deutsche Bahn (2012) ARA (2011)	TP (2008; 2010) Slovak Telekom (2009)		IBM (2010; 2011)	MathWorks (2012)	CDS (2011/ 2013)	
Predatory pricing								
Exploitative abuses				Honeywell, DuPont (2011)	Rambus (2007; 2009) Samsung (2012) Motorola (2012/ 2012)		S&P (2009; 2011)	
Others	Swedish Interc. (2009; 2010) OPCOM (2013)							Servier (2009)

Annotation: Microsoft (2012;2013) has not be counted in as it is a pure follow-on decision

Recent enforcement priorities (based on Friederiszick/ Gratz 2013)

Final EU commission decisions (#15), within objective justifications were mentioned, 2009 – 2013

	Regulated network industries			Manufacturing		Services		Pharma
	Energy	Transport	Telecoms	General	IT Hardware	IT Software	Financial Services	
Exclusive dealing					Intel (2007; 2009)			
Tying/ bundling				Reel/ Alcan (2008; 2013)		Microsoft (2008; 2009/ 2012; 2013)	Reuters (2009; 2012)	
Refusal to supply/ margin squeeze			Telekomunikacja Polska (2008; 2010)		IBM (2010; 2011)			
Predatory pricing								
Exploitative abuses							S&P (2009; 2011)	
Others								



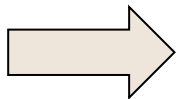
In 7 out of 15 cases efficiency defences or other objective justifications were somehow discussed; companies mostly active in the IT sector/ innovation related

Cases in which the companies brought forward objective justifications

Case/ Conduct/ Sector	Objective justifications raised by the dominant undertakings
<p>Intel (fine; under appeal); Exclusive dealing; IT</p>	<ul style="list-style-type: none"> • By using a rebate, Intel responded to price competition from its rivals • The rebate system was necessary to achieve efficiencies (lower prices, scale economies, other cost savings and production efficiencies and risk sharing and marketing efficiencies) <p>Transparent discussion (25 paragraphs); main argument by the Commission: efficiencies relate to rebates, but not to exclusivity condition; insufficient evidence and availability of less restrictive means</p>
<p>Reel/ Alcan (Commitment Decision); tying; manufacturing</p>	<p>Alcan justified tying by arguing for</p> <ul style="list-style-type: none"> • Product related efficiencies • Operational efficiencies • Reputational efficiencies <p>Transparent discussion (10 paragraphs); rebutted due to customer requests for untied product and higher prices for combined product</p>
<p>Telekomunikacja Polska (TP) (fine; under appeal); Refusal to supply; Telecommunications</p>	<p>TP claimed that it had difficulties</p> <ul style="list-style-type: none"> • to simultaneously manage several projects on many various wholesale services (“high regulative activity”) • to develop proper IT systems • to find human resources to perform certain projects <p>Despite TP did not evoke properly an efficiency defence the Commission carefully assessed objective necessity grounds</p>

Cases in which the companies brought forward objective justifications

Case/ Conduct/ Sector	Objective justifications raised by the dominant undertakings
Microsoft (Commitment Decision); Tying of Internet Explorer to Windows; ICT	In the earlier case of the tying of Windows Media Player to Windows, Microsoft argued the tying <ul style="list-style-type: none"> • lowers transaction costs for consumers • saves resources • makes it easier for third-party software producers to implement a functionality → increase in the value of the operating system package for end-users No transparent discussion in its later decision (no paragraph)
IBM (Commitment Decision); Refusal to supply (after-markets); ICT	Intellectual property rights with regard to some inputs required to provide maintenance service to IBM mainframes No transparent discussion (one paragraphs; making the point that IP alone does not justify non-supply)
Standard & Poor's (Commitment Decision); Excessive pricing; Financial Services	Intellectual property rights over US ISIN databases and on US ISIN numbers for the use of which it is entitled to claim licensing fees No transparent discussion (four paragraphs); mainly arguing that no copyrights did exist
Reuter Instrument Codes (Commitment Decision); tying; Financial Services	The Commission took the preliminary view that the conduct can not be justified on grounds of <ul style="list-style-type: none"> • of intellectual property rights • the protection of TR reputation • Or technical risks linked to RICs No transparent discussion (no paragraph)



In **only 3 of the 7 cases**, in which an efficiency defence/ objective justification was somehow mentioned, **a transparent discussion** of the reasoning was put forward (Intel, Reel/ Alcan and TP)
in not a single case the efficiency defence became decisive...