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ECJ on Intel: Half-way there!

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The Intel case: the problematic conducts

- Intel offered rebates of up to 16% to 4 major PC manufacturers, conditional on 80% purchases' exclusivity

- Intel paid PC manufacturer to delay introduction of AMD products

- Intel paid major retailer not to stock AMD PCs

- 2014: General Court upholds European Commission decision

- 2017: Court of Justice sets aside General Court judgment and returns to GC

➢ Economists around the world rejoice!!

ECJ on Intel

- Re-affirms the focus on foreclosing as-efficient competitors

- Confirms that a presumption of illegality applies to exclusivity rebates by a dominant company

- However, clarifies that in case of substantiated submission by the dominant company, an analysis of potential effects has to be carried out

➢ ALMOST there!!!!

    ➢ Procedural vs Substantive issue?

ECJ on Intel

- List of factors to be considered:

    - the extent of the undertaking's dominant position on the relevant market

    - market share covered by the challenged practice

    - conditions and arrangements for granting the rebates in question

    - their duration and their amount;

    - assess the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market

ECJ on Intel

- Use of AEC test:
    - Limited to objective justification and efficiency defence? [paragraph 140]
    - Emphasizes that if Commission has conducted an AEC test and the dominant company has questioned its validity, the GC has to review the applicants' views
    - Not obligatory for EC to conduct AEC but if it does, then GC needs to assess comments on it
        - Falls short from introducing an AEC test as a requirement
    - Gives the Commission discretion not to run AEC test. This is unfortunate!
        - What happens if a competition authority does not run AEC, parties do? And outcome differs? Will the authority argue its not necessary as there is a clear cut case?

EC Guidance on retroactive rebates

- Priorities Guidance sets out how the AEC analysis may be conducted:
  - Assess the contestable share: How much of a customer's purchase requirements can realistically be switched from the dominant company to another supplier?
  - Calculate the effective price spread over the contestable share which must be offered by a competitor to match the value of the dominant company's rebate.
  - Identify the relevant costs. Check whether the effective price is below the relevant costs

- Are as-efficient competitors able to offer similar rebate schemes profitably?
  - If Yes, then there is no distortion of the competitive process;
  - If No, can they compete effectively by reducing their prices profitably?
  - Assess whether the effective price is below cost. If so, there is a risk of illegal foreclosure

Analysis of Rebates

Assessment of rebates must take into account:

- the extent of the undertaking's dominance

- the extent of the market covered by the rebate

- the structure and duration

- is it part of a strategy to exclude as efficient competitors?

As Efficient Competitor Test

- Estimate what price a rival would have to offer in order to compensate the customer for the loss of the conditional rebate if the latter would switch "part of its demand" away from the dominant undertaking:

  - For incremental rebates, "part of its demand" is normally the incremental purchases that are being considered.

  - For retroactive rebates, it will generally be relevant to assess in the specific market context how much of a customer's purchase requirements can realistically be switched to a rival (the 'contestable share')

- The effective price that the rival will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate it loses by switching, calculated over the relevant range of sales and in the relevant period of time.

➤ This is not as straightforward as it sounds

As Efficient Competitor Test: Who is the Competitor?

- Is it the complainant? Not necessarily
- Identifying the "As-Efficient Competitor", requires an assessment of:

  - The markets directly and indirectly affected by the unilateral conduct under scrutiny [**somewhat straightforward**]
  - Relevant asymmetries between the allegedly dominant firm and the As-Efficient Competitor [**not easy when defending a conduct**]
  - The discount offered by the dominant firm **[not straightforward]**
  - Actual demand under the contract **[straightforward]**
  - The quantity targets in the contract **[straightforward]**

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Considerations in conducting AEC test: Contestable Share

- Market share / share of dominant company sales which a non-dominant competitor can compete / share of the market that the entrant can supply

- Smaller than the share of the market allegedly foreclosed by the conduct under scrutiny –the foreclosure share

- The relevant contestable share may be greater than the share of the market the entrant can currently supply if, for instance, the entrant is about to expand its product line or increase its capacity

- **Challenge** for dominant firm is to estimate an contestable share "**acceptable**" to the competition authority

First Phase of AEC: Contestable Share

- Estimate contestable market share
  - Market intelligence/business plans (projected penetration under different scenarios)
  - Determine the contestable market share using actual market shares.
  - Determine the contestable market share based on consumer preferences
- For an existing competitor: data related to the fluctuations of sales over time
- For a potential competitor: evaluation of the scale of sales that a new entrant would reasonably be able to reach (or if impractical the past trend of new entrants in the same or similar markets.
- An anti-competitive foreclosure: only if an equally or even more efficient competitor is unable to compete **not for the entire size** of the customer's demand, but **just for the portion of demand** which is not monopolized by the dominant firm.

First Phase of AEC: Contestable Share

- CS: contestable share

- CD: contractual demand threshold

- D: conditional discount –awarded if quantity demanded from incumbent equals CD > 1–CS

- P_U: undiscounted price

- P_E: entrant price

First Phase of AEC: Contestable Share

- Entrant will be able to compete for the contestable share only if

  - $P_E CS + P_U (1-CS) \leq (P_U - D) CD + P (1 - CD)$ or

  - $P_E \leq P_U - DCD/CS$

- Conditional discount can be replicated profitably so no abusive conduct if

  - $(P_E - DCD/CS)CS > COST$

- Threshold for Contestable share in short run$= (DCD + COST)/P_U$

Considerations in conducting AEC test: Cost measures

- Average Avoidable Costs (AAC): specific to each unit of production and includes raw materials, production, packaging, direct labor

- Long Run Average Incremental Cost (LRAIC): specific to each production line includes also indirect labor, production facilities, logistics, marketing, distribution

- Excludes part of costs "common" to other product lines, e.g. back office functions (legal, finance), factory / warehouse covering multiple products

- Average Total Costs (ATC): AAC, LRAIC, plus apportionment of common cost

- **Challenge:** Allocating marketing, logistics, distribution [**not straightforward in multi product markets**]

Second Phase of AEC: Effective Price and Discount

- Average price that a competitor would need to propose to the customer to compensate the loss of the discount offered by the dominant firm

- Competitor can refund the customer of the rebate lost from the dominant undertaking only relying on the contestable demand.

- Effective price competitor must offer to match the dominant firm's discounted price would certainly be lower than the latter.

- Effective price increases with the sales made by the competitor and thus the size of the contestable demand, because the competitor is progressively in a better position to recoup the discount lost by the customer over a higher number of units.

Second Phase of AEC: Effective Price and Discount

$$P^E = P^L [X - r (X + Y)] / X$$
$$D = X + Y = 1$$
$$P^E = P^L [1 - (r / X)]$$

P^E = effective price

P^L = list price

r = discount rate

D = total demand

X = share of demand contestable

Y = share of demand non-contestable

Difference the discount range can make

- Shall the total discount be taken into account or only the incremental one?
  - The answer to this question can lead to totally different conclusions

Discount level for the AEC test	Total Discount	Incremental Discount
Average Weighted price dominant company	2.490	2.490
Average Weighted cost dominant company	2.000	2.000
Dominant company market share	0.924	0.924
Competitor market share	0.066	0.066
Contestable market share	0.050	0.050
Discount	0.003	0.090
Effective price of competitor	**2.341**	**-1.992**
	NO FORECLOSURE	FORECLOSURE

Conclusion on the AEC Test

- If the effective price *associated to the contestable demand* is below AAC of the dominant firm, then the retroactive rebate is considered capable of foreclosing an equally or even more efficient competitor, **so abusive**;

- if the effective price is between AAC and LRAIC the retroactive rebate, an equally or even more efficient competitor would be able to compete despite the presence of the dominant firm's retroactive rebate, **so not abusive**.

- Challenges with identifying contestable demand and amount of discount

Thank you

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