Intel and the future of Article 102*

A test-case for the effects-based approach

In a long-awaited ruling, last week's General Court judgment[1] has confirmed the Commission's 2009 *Intel* decision.[2] The Commission's decision had found the chip producer to infringe competition rules by granting anti-competitive rebates to computer manufacturers ("OEMs") in an attempt to exclude its rival AMD from the market. The Commission had handed down a fine of over a billion euros against Intel, the largest penalty ever imposed on a single firm at the time.

The *Intel* decision had been the first investigation in which the Commission had explicitly used an *effects-based approach* to assess the competitive consequences of loyalty rebates under Article 102 TFEU. Specifically, it had applied a so-called "as-efficient-competitor test" ("AECT") and found that even an equally efficient competitor would have been unable to compete against Intel's offerings for sales volumes that could realistically be contested by a rival (the so-called "contestable share of demand"). The Commission therefore argued that Intel had leveraged market power from "non-contestable" sales (those portions of OEM's chip requirements for which Intel was deemed an "unavoidable trading partner") into "contestable" sales (those that rivals could in principle compete for) – thereby forcing AMD to compete for marginal volumes with below-cost prices.

The *Intel* case has been considered a "test case" for the Commission's effects-based approach toward single-firm conduct, which it had set out in its 2009 Guidance Paper.[3] The prior case law had largely been form-based and operated with strong legal presumptions, leaving little room for an analysis of the competitive nature of potentially exclusionary conduct.

The General Court judgment

The General Court's *Intel* judgment holds that the Commission rightly found the chip producer to breach competition rules. Critically, however, the judgment also notes that the Commission's effects-based analysis was ultimately redundant given the particular form of Intel's rebates. Specifically, the Court considers Intel's rebates to constitute *exclusivity-inducements* in the sense of *Hoffmann-La Roche* (the first major exclusionary conduct case under EU competition law from the 1970s).[4] While the Court does review (and upholds) the Commission's conclusion that Intel's conduct was capable of restricting competition, it also points to settled case law establishing that Intel's conduct could be presumed illegal in any event.

From a policy perspective, the Court therefore re-asserts the form-based standard and finds that effects-based analysis is largely unnecessary for these types of rebates. Perhaps most notably, the Court argues that exclusivity-inducing rebates impair competition even in cases where an equally efficient rival could compete against the rebates in question. According to the Court, exclusivity inducements generally make it more difficult for rivals to compete in the market – *even* in instances where the size of the rebates is marginal, or where the affected part of the market is minor. The judgment therefore concludes that conducting an AECT was unnecessary to demonstrate the anti-competitive nature of Intel's conduct.

The general standard toward exclusionary conduct

The Court's main argument for its presumption against exclusivity inducements is that such conduct makes it harder for rivals to compete. From a substantive point of view, this is a worrying standard for assessing unilateral conduct. After all, competition on the merits also makes it harder for rivals to compete (e.g., lower prices or higher quality). Hence, such an open-ended test does not tell us something useful about the conduct's competitive merits (or lack thereof). Indeed, the Commission had previously endorsed the AECT precisely because it is useful to discriminate between struggles of rivals that are due to competitive pressures, and struggles that are in fact due to exclusionary behaviour.

Of course, if applied on its own, a purely quantitative standard would leave much to be desired, since effective prices below cost are not synonymous with anti-competitive effects. Even so, the AECT is a useful screen to weed out unmeritorious allegations, and is based on robust economic logic. Together with complementary evidence that supports and substantiates a concrete theory of harm, the AECT can therefore be instrumental to identifying the competition implications of complex rebate schedules.[5]

The trouble with the standard of review that the Court seems to endorse in *Intel* is that it appears to take us back to the equation "harm to competitors = harm to competition" – a notion that the

* The views expressed in this memo are those of the author's, and do not reflect the opinions of other CRA experts, or CRA's clients.

1 Case T-286/09 Intel Corp. v. Commission, Judgment of 12 June 2014 (General Court).

2 Case COMP/37.990 Intel (Commission decision of 13 May 2009). CRA experts supported Intel before the Commission and in the appeal of the Commission's decision. The author of this memo was not involved in that work.

3 European Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009 (C45) 07.

4 Case 85/76 Hoffmann-La Roche & Co AG v. Commission, 1979 E.C.R. 461 (European Court of Justice).

5 The basic idea here is similar as in predation cases: a price-cost test alone does not tell the whole story about "low" prices, but is a useful first step to screen out conduct that is generally unlikely to harm competition.

Commission had all but abandoned during the modernisation of Article 102 enforcement. But, admittedly, the two-pronged approach of the Commission's own decision may have played its part here, since the decision had explicitly relied on the form-based precedent in addition to its effects-based analysis.

Categories of abuse

The Court finely distinguishes between three types of rebates:

1. Pure quantity discounts
2. Exclusive dealing (including rebates that induce quasi-exclusivity)
3. Other rebates (including individualised rebates, retroactive rebates and other discounts, as long as they stop short of quasi-exclusivity)

The judgment reiterates that rebates in the first category (pure quantity discounts) are presumed to be lawful. This is consistent with the case law, whereby such rebates are deemed to reflect cost savings in making larger deliveries. Of course, in reality, profit-maximising firms have manifold incentives to offer quantity rebates and discounts even where there are no cost savings to speak of. Perhaps most notably, rebates are regularly granted to price differentiate between different units in order to compete for incremental volumes. This is done by offering lower prices for marginal sales, which are more heavily contested by rivals and hence exhibit a higher elasticity of demand. Since pure volume discounts are almost always pro-competitive in nature, the Court's presumption of legality thus has substantive merit – albeit for somewhat different reasons than an economist would advance.

The Court goes on to hold that rebates in the second category (quasi-exclusivity, the *Intel* case) are presumed illegal in the absence of an "objective justification". The major concern with this rebuttable presumption is that objective justifications are likely to be very hard to advance in practice. Essentially, the Court applies the same standard here as in "by object" cases under Article 101(1). Thus, while in theory the presumption does not entail a *per se* prohibition, everyone who has tried to argue an efficiency defence in an object case knows what this standard implies. In fact, the Court explicitly notes that competition authorities are not required to consider the circumstances of the case in exclusivity investigations (e.g., the size of the rebate or the position of competitors). This standard therefore leaves firms rather limited room for defending the wide variety of uses of exclusive dealing and exclusivity-inducing discounts that enhance competition.

Finally, the Court finds that for rebates in the third category ("all other rebates"), the specific circumstances of the case have to be taken into account by a competition authority. On a somewhat more upbeat note, the Court therefore leaves an opening to distinguish such rebates from the much harsher treatment that is afforded to rebates of the *Intel* kind. Whether this will eventually result in a more balanced analysis of such discounts remains to be seen. No doubt private practitioners will point to the distinction, which seems to provide a basis for effects-based pleadings. Yet, in the face of a largely form-based case law ranging from *Michelin II*[6] to *Tomra*,[7] it seems far from clear that the Court would treat such rebates any more lightly today than was previously the case.

The specific legal standard toward exclusivity

One of the main tenets of the *Intel* judgement is that exclusivity inducements should be considered as particularly harmful, because in effect they restrict the choice of purchasers. The judgment relies on language from the old case law here, which the Commission had also maintained in its decision as a form-based complement to its effects-based analysis.

Unfortunately, a standard based around "choice" of purchasers without further qualification would not allow a meaningful distinction to be made between pro- and anti-competitive conduct. There are many industries in which companies have been found dominant even though customers' demand is in principle fully contestable (think of Michelin's tyre sales, for instance). In such industries, it is often normal to "compete for the customer" rather than to "compete for the individual sale". Competition for such exclusive contracts can be extremely intense (think of Coca Cola and Pepsi competing to be exclusive suppliers to restaurants chains or concert venues). Moreover, even when there is some non-contestable share of demand, exclusivity rebates do not generally impair rivals' ability to compete. In fact, empirical studies of exclusivity-inducing contracts suggest that such conduct is regularly motivated by efficiency considerations and benefits consumers in a wide range of circumstances (though this must certainly not always be the case).[8]

An unqualified standard of choice is therefore not one that allows a meaningful distinction between pro- and anti-competitive conduct. After all, every successful sale of a good "forecloses" a certain portion of the market to rivals: the portion that is made up by this individual sale. The relevant question is not whether a purchase commits customers to the seller for some amount of goods, but whether rivals were able to compete in the market. We therefore need an objective criterion (such as the AECT) to determine whether choice was curtailed in a way that could stifle competition.

Finally, the judgment also holds that the share of the market that has been foreclosed through exclusivity clauses is irrelevant for a finding of an infringement. From a substantive perspective, this is regrettable: if such a small portion of demand is affected by aggressive conduct that rivals can happily compete for the vast majority of the market, competition is likely to benefit from loyalty-inducing conduct. In such cases, rivals are not forced below their

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[6] Case T-203/01 Manufacture française des pneumatiques Michelin v. Commission, 2003 E.C.R. II-4071 (Court of First Instance).

[7] Case T-155/06 Tomra Systems and others v. Commission, 2010 E.C.R. II-297 (General Court).

[8] See e.g. Lafontaine &. Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy* (2008) ("*when manufacturers choose to impose restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision*").

minimum efficient scale, and customers that are affected by exclusivity have to be rewarded through significant price reductions, which compensate them for their inability to mix and match suppliers.

Implications for competition enforcement

The *Intel* judgment is undoubtedly a significant court victory for the Commission in one of the most pivotal antitrust cases of the past decade. Looking beyond the specific case and considering the more general implications for the Commission's policy toward exclusionary conduct, where we stand seems much less clear. The past years have seen significant modernisation efforts on the part of the Commission to assess unilateral conduct based on its competitive consequences (rather than focusing on form-based criteria that are often remote from substantive realities). Against this background, the *Intel* judgment appears as a forceful statement of the Court that it is intent on upholding its form-based doctrine, at least as far as exclusivity rebates are concerned. Given the widespread recognition that rebate-based competition is a key manifestation of the competitive process, the judgment is therefore likely to be seen as a major set-back by many observers.

For dominant firms, *Intel* implies that increased caution will be of utmost importance when designing rebate systems, in particular as regards elements of exclusivity. The ensuing "price umbrella" for competitors may well benefit smaller firms, as the competitive responses of their dominant rivals will be curtailed by the desire to remain compliant with the law. It is conceivable that this imbalance may also generate some spurious litigation, as less efficient competitors may seek to ensure that their more efficient rivals cannot make use of the same competitive instruments that they themselves employ.

On a more positive note, the Court has not constrained the Commission's freedom to prioritise its case work on the basis of effects-based considerations, not even with respect to exclusivity rebates. Indeed, the Court emphasises that Intel could not rely on the Guidance Paper because the Commission's investigation was initiated prior to its publication – a special circumstance that will not apply in future investigations. For as long as the Guidance Paper remains the Commission's expressed policy stance toward unilateral conduct, its ability to evaluate cases on the basis of substance therefore remains untouched, at least in principle.

Unfortunately, at least for now the gap between the Court's form-based standard and an effects-based policy remains wide. This dichotomy will continue to make compliance work a challenging task, at least for dominant firms that are intent on competing intensely for every sale they can win in the market. In actual case work, the use of economic evidence to defend pricing practices will likely shift to the very early stages of an investigation, as the policy objectives of the Guidance Paper will in effect have to be pursued through prioritisation.

The Commission will need to manage a delicate balancing act between ensuring predictability, respecting the case law and at the same time evaluating conduct on a case-by-case basis in terms of its implications for competition. As the effects-based approach towards loyalty rebates has been explicitly pursued by the Commission for nearly a decade now, it seems difficult to think this progress will be reversed. As effects-based analysis has brought widely-acknowledged improvements to competition policy – from merger control to restrictive agreements – there is no good reason for Article 102 to be the one area which does not eventually benefit from its insights about the competition implications of firms' conduct.

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