COMPASS LEXECON

Exclusionary practices post-Intel and new theories of harm

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Brussels, 07 November 2018

EC 102 ENFORCEMENT POLICY AFTER GC INTEL JUDGEMENT (MARCH 2017)

- "Exclusivity rebates are **presumed to be anticompetitive**"
- "This also means that **the commission is not obliged to demonstrate the anticompetitive effects** of such rebates"
- "We are nevertheless **obliged to assess any efficiency claims** brought by the dominant company."
- "But **given the authority's limited resources**, we carry out an in-depth assessment **only if** the dominant company comes forward with **efficiency** arguments."
- 102 Guidance paper is "dead (or moribund) letter"

PRACTICAL IMPLICATIONS

- No requirement for the EC to:
  - articulate the economic mechanism through which the exclusivity rebate results in a restriction of competition or harm to consumers (i.e. no need to articulate a theory of harm)
  - assess the **incentives for the dominant** firm to offer exclusivity rebates.
  - assess the **incentives for customers** to accept exclusivity rebates

- Dominant firm can advance an efficiency rationale but standards of proof are asymmetric. EC can presume a restriction of competition. The dominant firm has to prove efficiencies (including indispensability which requires articulating counterfactuals that cannot be observed)

- how can efficiency benefits outweigh an undefined quantity?

- **The GC Intel judgement de facto put exclusivity rebates in the "per se" box**
- **(equivalent to a cartel infringement).**
  - This alone defeats common and economic sense: theory indicates (and empirical evidence confirms) that cartels increase prices and generate no efficiencies. Exclusionary rebates reduce prices and can generate multiple efficiencies.

"THAT WHICH IS SEEN, AND THAT WHICH IS NOT SEEN"
FRÉDÉRIC BASTIAT

…a law, gives birth not only to an effect, but to a series of effects. Of these effects, the first only is immediate; it manifests itself simultaneously with its cause — it is seen. The others unfold in succession — they are not seen

Between a good and a bad economist this constitutes the whole difference — the one takes account of the visible effect; the other takes account both of the effects which are seen, and also of those which it is necessary to foresee.

Now this difference is enormous, for it almost always happens that when the immediate consequence is favourable, the ultimate consequences are fatal, and the converse.

"THE UNSEEN"

- Minimal cost for less efficient competitors to bring complaints: meritless complaints crowd out legitimate complaints (moral hazard and adverse selection in the presence of information asymmetry).

- Dominant firms are induced to settle eliminating the risk of error or judicial scrutiny:
  - Incentives to dedicate scarce resources to bring "easy" cases away from potentially more harmful practices with significant and actual negative effects.
  - commitment decisions replace non-infringement or infringement decisions. This increases legal uncertainty.

- A dominant firm will take care not to offer rebates that would induce a customer to buy exclusively from it. But why should a customer source partially from a less efficient firm. How can competition for a buyer's *partial* requirements be systematically better than competition for all its requirements?

- …Increased incidence of false positives:
  - Customer may pay higher prices.
  - Dominant firms may invest less in R&C.
  - Less efficient competitors can compete distorting the optimal allocation of resources.

ECJ INTEL JUDGEMENT: REBUTTABLE PRESUMPTION OF ABUSE

- The ECJ Intel judgment restores common and economic sense and is fully in line with the case law:

- Exclusivity rebates are to be assessed in the same way as fidelity rebates:
  - Conditional rebates (including exclusivity rebates) are presumptively abusive.
  - **But this presumption is rebuttable**

> *137 In that regard, **the Court has already held** that an undertaking which is in a dominant position on a market and ties purchasers — even if it does so at their request — by an obligation or promise on their part to obtain **all or most of their requirements exclusively** from that undertaking **abuses its dominant position** within the meaning of Article 102 TFEU.*

ECJ INTEL JUDGEMENT: HOW TO REBUT

- The ECJ "clarifies" that to rebut the presumption the defendant must show that the exclusivity rebate :
  - is not capable of restricting competition, in particular, by foreclosing an as efficient competitor.

- This echoes the 102 Commission Guidance:
- Par 23: *vigorous price competition is generally beneficial to consumers. With a view to preventing anti-competitive foreclosure, the Commission will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking*

*138. However, that case-law must be further clarified in the case where the **undertaking concerned submits**, during the administrative procedure, on the basis of **supporting evidence**, **that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects.***

*133 In that respect, it must be borne in mind that it is in no way the purpose of Article 102 TFEU to prevent an undertaking from acquiring, on its own merits, the dominant position on a market. **Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market***

140 [The Commission's foreclosure analysis must assess the] *'intrinsic capacity … to foreclose competitors which are **at least as efficient** as the dominant undertaking'*

PROBATIO DIABOLICA?

- Recently Commissioner Verstager argued that ""*in the last few months, we've looked very closely at how this judgment affects what we do. And in practical terms, our main conclusion is that you won't see fundamental change*."
- At first sight it appears the Commissioner is right. After all the defendant has an almost impossible task: while substantial evidence may prove the devil's existence (capability to foreclose), there is no evidence that denies the devil's existence (no capability to foreclose); therefore, one cannot deny the devil's existence.
- Hence, if the ECJ had stopped at par 137-138 one could hardly disagree with the Commissioner.
- But where a legal system would appear to require an impossible proof, the remedy is to reverse the burden of proof or give additional rights to the party facing the probatio diabolica.
- This is what the ECJ does in paragraph 139:

138… where the undertaking concerned **submits**, during the administrative procedure, **on the basis of supporting evidence**, that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects.

139 In that case, **the Commission is** not only **required to analyse**:

- first, the **extent of the undertaking's dominant position** on the relevant market and,
- secondly, the **share of the market covered** by the challenged practice,
- as well as the **conditions and arrangements** for granting the rebates in question,
- their **duration** and
- their **amount**;

"**Capability to foreclose" assessment**

- TOH matching the facts of the case
- (Qualitative) analysis of all relevant circumstances (e.g. CMA decision in Unilever)

AEC TEST

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

ANTICOMPETITIVE FORECLOSURE

No need to show actual effects!
No need to show likely effects!

102 COMMISSION GUIDANCE VS. GC INTEL JUDGEMENT

- *The Commission will normally intervene [IF] the allegedly abusive conduct is likely to lead to anti-competitive foreclosure.*
- *The Commission considers the following factors to be generally relevant to such an assessment:*
  - ***the extent of the allegedly abusive conduct**: in general, the higher the percentage of total sales in the relevant market affected by the conduct, the longer its duration, and the more regularly it has been applied, the greater is the likely foreclosure effect*
  - ***the position of the dominant undertaking** / the conditions on the relevant market / the position of the dominant undertaking's competitors.*

Rebates contingent on exclusivity offered by a dominant firm **are deemed unlawful irrespective of**:

- the level of the rebate (§ 108)
- the duration of the contract (§ 110)
- the share of the market affected by the rebate (§ 116),

or

- the significance of the segment in the market that is affected (§ 128).

“All models are wrong, but some are useful”

- EC advances a theory harm articulating the economic mechanism that relates the practice to the anticompetitive foreclosure. Example in Intel:

1. Intel offers some payment (lump sum or conditional retroactive rebates) in exchange for exclusivity and sells the input at the monopoly price.
2. AMD could offer to sell its input to OEMs at a much lower price.
3. Each OEM realizes that if it accepts the low price and entry occurs, then the incumbent will lower its price to the other firms who remain exclusive.
4. The resulting downstream competition will compete away the profits from the low price.
5. Thus, no OEM can gain by accepting the low price from the entrant (AMD) since the benefits from the entrant's lower input price would be competed away.
6. Each OEM would therefore prefer to accept the incumbent's offer and obtain the fixed rebate rather than to purchase from the entrant.
7. Thus, Intel's strategy enables it to maintain supra-competitive prices in the downstream input market while excluding the entrant.
8. Consequently, final consumers face higher final goods prices and are deprived of the option of purchasing goods with the entrant's input.

- The defendant can show that the underlying assumptions and the mechanism of harm is not consistent with the facts of the case, example:
  - Competitors are able to (profitably) replicate the same discount offering or by other means
  - the proportion of the market that is foreclosed is small relative to the minimum efficient scale of those competitors

- If the assumptions match the facts ***and*** the ToH is internally consistent the defendant can seek to demonstrate that only less efficient rivals will be foreclosed with an AEC test:
  - It does not require data or information on competitors and
  - Relies on own data and assumptions that can be objectively verified or assessed (e.g. non-contestable share)

AEC TEST

i. is administrable under a self-assessment regime
ii. facilitates judicial scrutiny
iii. enhances legal certainty

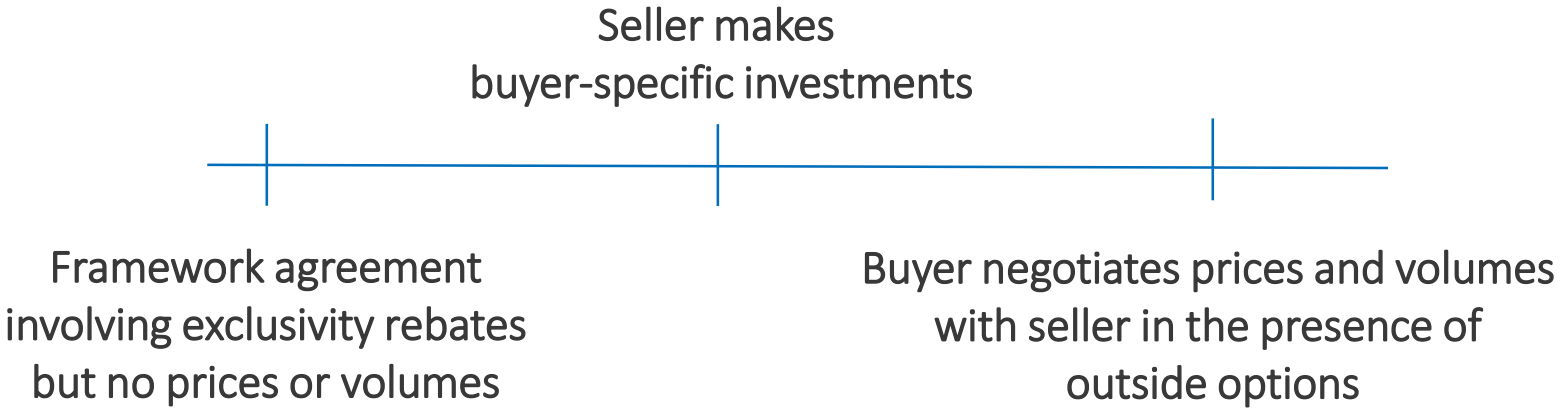
THE 102(PAR 3) DEFENSE: OBJECTIVE JUSTIFICATION, EFFICIENCIES AND BALANCING

- *ECJ Intel judgement:*
  - *134: The analysis of the capacity to foreclose is also relevant in assessing whether a system of rebates which, in principle, falls within the scope of the prohibition laid down in Article 102 TFEU, **may be objectively justified.***
  - *In addition, the exclusionary effect arising from such a system, which is disadvantageous for competition, **may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer** (judgment of 15 March 2007, British Airways v Commission, C-95/04 P, EU:C:2007:166, paragraph 86).*
  - ***That balancing** of the favourable and unfavourable effects of the practice in question on competition **can be carried out in the Commission's decision only after** an analysis of the intrinsic capacity of that practice to foreclose competitors which are at least as efficient as the dominant undertaking.*

- Guidance paper par 28:
  - *A dominant undertaking may do so either by demonstrating that its conduct is objectively necessary or by demonstrating that its conduct produces substantial efficiencies which outweigh any anti-competitive effects on consumers. In this context, the Commission will assess whether the conduct in question is indispensable and proportionate to the goal allegedly pursued by the dominant undertaking.*

CAN EXCLUSIVITY REBATES PRODUCE OFFSETTING EFFICIENCIES?

- As a matter of economics and business practice this is often the main (or even only) rationale for offering or requiring exclusivity:
  - Align incentives (law firms and clients)
  - Optimise fixed cost recovery in the presence of economies of scale and scope
  - Mitigate double marginalisation
  - Avoid free-riding
  - Avoid Ex-post opportunism (hold-up)
  - …



THE SILENT (SLOW) REVOLUTION

- It may not be apparent yet, but the “duty to review the defendant’s attempt to rebut the presumption” will trigger a slow but silent revolution in EU 102 enforcement.

- The duty to review will result in an assessment that will form an integral part of the decision; it does not suffice that the analysis of capability to foreclose, whether relying on an AEC test or not, is used merely to prioritise cases.

- In some circumstances, allegedly dominant firms can self-assess ex ante by running an AEC test . In others they can document the efficiency justification for introducing certain rebate schemes

- Spurious complaints will be reduced releasing scarce resources to investigate ex-officio.

- More importantly, the ECJ judgment has wider enforcement implications beyond pricing conduct:
- By explicitly rejecting a de facto “per se” approach under 102 the ECJ signals that it is willing to review complex cases, even those resulting in partially offsetting effects (and thus it encourages the EC to bring such cases:
    - Is big data a source of market power? Can the processing and combination of personal data foreclose AECs? What is the effect taking into account the benefits to consumers from improving services based on big data?
    - Is planned obsolescence capable to foreclose AEC in aftermarkets? Can it nevertheless lead to consumer benefits?
    - Is self-preferencing by a multi-sided platform that enjoys network effects anticompetitive?