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ROUNDTABLE DISCUSSION ON THE ECJ RULING IN INTEL

AUTUMN 2017

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On 6 September 2017, the European Court of Justice ("ECJ") issued a landmark judgment where it set aside the judgment of the General Court ("GC") in the highly debated Intel matter. This judgment is of particular significance because it provides guidance on the treatment of exclusivity rebates under Article 102. While the GC proposed a more formalistic approach, the ECJ judgment reinforces the need to assess the context and the size of the rebates. In this discussion piece, Compass Lexecon experts Jorge Padilla, Damien Neven and Xavier Boutin provide their views on the implications of this judgment.

Q1. Do you think this judgment is a positive development for European competition policy and the European economy?

JORGE PADILLA

I believe so. Most importantly, the ruling makes it clear that exclusivity rebates, like other loyalty-inducing rebates, are not *per se* illegal. While as an economist I disagree with the ECJ's conclusion that these rebates are presumptively anticompetitive / illegal, I take comfort in that such a presumption can be rebutted by the defendant. Ultimately, I believe the Commission, either on its own initiative or in response to the defendant's arguments and evidence, will have to analyse the relevant economic context to determine whether these rebates are indeed capable of foreclosing competition. In my opinion, once the defendant presents evidence questioning the capability to foreclose of its rebates, the Commission will have to do much more than simply allege that such evidence is insufficiently precise, not entirely convincing, or potentially subject to errors, to effectively discharge its burden of proof. The GC has the duty to ensure that this is the case, as otherwise the ECJ's rebuttable presumption of illegality will be rendered vacuous.

Furthermore, the ruling clarifies that protecting competition means ensuring that as-efficient competitors can compete on a level playing field. While economists know that in some circumstances social welfare is improved by allowing inefficient competitors in the market, the downside of protecting inefficient competitors is chilling aggressive competition from more efficient rivals. Therefore, in my opinion, the risk of over-enforcement is optimally minimised by limiting intervention to cases in which as-efficient competitors are foreclosed, as the ECJ has done.

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This is a step in the direction of imposing on the Commission a discipline with respect to the evaluation of effects. The formulation is relatively general so that one can anticipate that it will apply beyond exclusivity rebates.

The depth of the analysis of effects that this discipline entails, however, depends on the articulation (and strength) of presumptions. With respect to exclusivity rebates, the ECJ has confirmed the presumption that they are anti-competitive (unlawful under 102). The ECJ has also failed to clarify how the Commission should deal with conduct for which there is such a presumption. AG Wahl has suggested that faced with conduct for which there is a presumption of illegality, the Commission should undertake an analysis of the circumstances to determine whether the presumption was confirmed in the case at hand and in the negative, open a full-fledged investigation. This ECJ judgment has made no reference to this.

As a consequence, the scope and depth of the analysis of effects that the Commission will have to undertake, in response to the evidence from the parties are still unclear.

At the same time, one can expect that the courts will impose a discipline on the Commission with respect to the way in which it deals with the evidence submitted by the parties. The courts might impose an unreasonably high standard in this respect (leading to excessive analysis of effects) but the risk of type I errors by the courts would seem to be a least as large.

XAVIER BOUTIN

More than a decade ago, the European Commission started a process of reforms for a more effects-based approach in all its policy instruments. The inspiration and goals of this exercise have not been described better than by Lars-Hendrik Roeller and Oliver Stehmann in their 2006 paper, still accessible on DG Competition's website.[1] This process had very important consequences, including leading to Regulation 1/2003, to the new merger regulation, and to the non-horizontal merger guidelines.

With respect to single abuses, the process faced an unprecedented level of controversy. The core of the debate hinged on whether case law allowed for such an effects-based analysis. I have always been firmly opposed to literalistic readings of key writings, the Bible included. It is true that the case law is scarce. However, read in the context of the legal and economic debate at that time, I believe that the Commission's decision in *Hoffman LaRoche* is very much an effects analysis. I therefore never believed that case law was a good argument to refuse the evolution of enforcement towards a more effects-based approach.

The ECJ has put an end to this debate and sanctioned this process of reforms for single abuses, as it did before for each and every area of Antitrust. The Commission's Communication was not, to take the established formula, a statement of the law. The ECJ's judgment, which copies in its paragraph 139 the exact wording of the European Commission's guidance on the Commission's enforcement priorities in Article 102 ("Guidance Paper") paragraph 20, *is* a statement of the law of the most definitive form. It is not only binding on the Commission, but also on any Member State that applies community law.

This is not only very satisfactory for anyone who has been involved in this process. It is also very good news for the European customers, businesses and, widely, for economic growth and prosperity in the EEA. A more effects-based approach provides more real legal certainty; it allows a better and more focused assessment, deterring and punishing bad behaviors, while fostering economic progress that benefits customers.

DAMIEN NEVEN

I am not sure that one can take too much comfort that from the fact that paragraph 139 of the ECJ's judgment (7 lines) has some common language with paragraph 20 of the Guidance Paper (almost a full page). It would be a source of concern if it would not.

In my view, the nature, scope and depth of the analysis of effects mandated by the ECJ is still not as clear as the Guidance Paper laid down.

[1] http://ec.europa.eu/dgs/competition/economist/competition2005.pdf

Q2. Specifically on rebates, what are the implications for future cases?

JORGE PADILLA

Many. First, the ruling seems to put an end to any distinction between exclusivity rebates and other loyalty-inducing rebates.

Second, it sets a clear legal test for the assessment of these types of rebates. They are presumptively illegal but that presumption can be overcome by showing that, given the legal and economic context, they are not capable of foreclosing as-efficient competitors or, if that is not the case, by demonstrating that either they are objectively justified or result in efficiencies that offset their potential anticompetitive effects. Because defendants will always attempt to rebut a claim that their rebates are capable of foreclosing competition, the Commission will be forced to assess capability.

The ECJ does not mandate a particular methodology for the assessment of capability. It merely lists a series of factors that need to be considered: magnitude, duration, market coverage, etc. Those conditions are in my opinion not alternative but cumulative. Assessing market coverage is meaningless unless the rebates are sufficiently large to limit the contestability of that portion of the market that is covered by them. Likewise, a rebate scheme that is demonstrably capable of foreclosing some customers will not foreclose competition unless it affects a significant portion of demand.

Finally, while the ECJ does not state that the AEC test is necessary or sufficient to establish capability and does not mandate the test, in my opinion, the ruling implies that in any case concerning exclusivity or loyalty-inducing rebates, the Commission will have to assess any AEC test submitted by the defendant, in order to ensure that the rights of defence of the defendant are respected. Note that the AEC test provides a tool to assess whether the rebate's magnitude is sufficient to distort competition on the merits.

DAMIEN NEVEN

The judgment has effectively removed the distinction introduced by the GC between rebates contingent on exclusivity and retroactive rebates contingent on reaching particular thresholds (fidelity rebates). This is clearly welcome as these rebates can be calibrated in such a way that they have equivalent effects.

The ECJ has maintained a presumption of illegality but has indicated the type of analysis that should be undertaken to assess the rebates, which includes the magnitude of the rebates (through the AEC test), the share of the market covered and the duration of the contract. This is a sensible framework which might allow the Commission to conclude - for instance - that rebates which fail the AEC test are still not unlawful because they cover such a small share of the market that competitors are not foreclosed.

Still, one can be concerned about the significance that the ECJ seems to attach to the AEC test. First, there are clearly some theories of harm for which the AEC test is not useful. For instance, in the absence of non-contestable sales, for a theory of harm that emphasizes the ability to offer rebates that are not exclusive when the customers face competition from downstream competitors. Second, the ECJ seems to suggest that if rebates pass the test, they should be considered lawful. This seems to exclude a theory of harm such that competitors that are not yet as efficient as the dominant firm are foreclosed. Excluding such a theory entirely may not be desirable, even if there might need to be limits on its application.

XAVIER BOUTIN

I think that it is pretty clear the Intel judgment put an end to the categorization of rebates. The categories were wrong because what generates lock-in is the magnitude of the discount, and not its form or whether it is retroactive or not. A massive volume-based discount is more likely to exclude than a small so-called retroactive rebate. Moreover, anyone who tried to categorize a particular rebate or discount knows that these categories were also not very useful in practice. They were not very useful for enforcers as there was always a debate on whether a rebate was exclusive or not. Was it 95%? Or 80%? Could the exclusivity concern a segment of demand only? After all, an order of a certain number of units is a contractual clause of exclusivity for these units, so what was the limiting principle here? They were also not useful as they provided no legal certainty for firms, as shown by the example of Michelin, which was fined both for its initial scheme and, some 20 years later, for the one that it seemed to have designed to comply with the initial judgment.

It appears now that rebates are to be assessed as any other potentially excluding practices, without any presumption. The surrealistic claims that rebates are not low pricing practices, or even are not pricing practices at all, is now behind us too. The wording used by the

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DAMIEN NEVEN

ECJ is incredibly general. As pointed out by, amongst others, Nicolas Petit, the French version does not even refer to 'pricing practices' but to 'practices'. All these practices are to be analysed according to paragraph 20 of the Guidance Paper and paragraph 139 of the ECJ's judgment, which are identical in substance.

The 'clarification' of the ECJ is particularly welcome. This is as much as one can hope from an ECJ judgment. More clarity will come from the GC's judicial review in Intel and after, in particular, with respect to the articulation of the criteria in paragraph 139 and to the appropriate assessment of evidence submitted by parties. I believe that the UPS-TNT judgment already provide some insight.

DAMIEN NEVEN

I am not convinced that the distinction between the incremental rebates and other types of rebates has been set aside by the ECJ. This distinction (unlike the distinction between rebates contingent on exclusivity and other fidelity rebates introduced by the GC in Intel) has been made repeatedly by the ECJ (for instance in Michelin). The ECJ has also presumed that such rebates were not anti-competitive because they could be justified by scale economies (without considering the issue in any detail).

More importantly, I cannot convince myself that the ECJ has lifted the presumption that rebates contingent on exclusivity are anti-competitive. It is true of course that the ECJ is not saying that the Commission does not need to assess the relevant circumstances when faced with rebates contingent on exclusivity. But this *is* the way in which the ECJ jurisprudence was interpreted so far (including by the Commission) and paragraph 137 of the judgment tends to confirm that presumption, unless one reads *Hoffman La Roche* as involving an analysis of effects. This is the reading that AG Wahl had suggested and it has not been endorsed explicitly by the ECJ. Hence, I am afraid that it may be premature to conclude that the presumption has been lifted.

XAVIER BOUTIN

I do not think that the ECJ has maintained a presumption of illegality, at least given the way I understand what a useful and operative presumption is.

The ECJ has left the categorization of rebates within the 'sound of silence' of the old concepts it does not mention. Therefore, it seems to me that the ECJ has put all practices (pricing and rebates) at the same level.

The ECJ has clearly set the standard for enforcement in *Post Danmark II* (paragraph 67): "*Only dominant undertakings whose conduct is likely to have an anticompetitive effect on the market fall within the scope of Article 82 EC*". I believe that AG Wahl sent a similar message.

Therefore, when the ECJ uses the term 'capable' in the context of the Intel decision, it must mean 'likely', and not 'remotely capable'. The word capable is more confusing than the word likely, but I believe they have been used interchangeably by the ECJ over the years.

Therefore, what matters are the effects of a particular practice. There exist presumptions for Article 101, for instance for cartels. These presumptions are useful when they are clearly stated and easy to administer. This is the case for cartels: cartels are necessarily bad; they are also relatively easy to define.

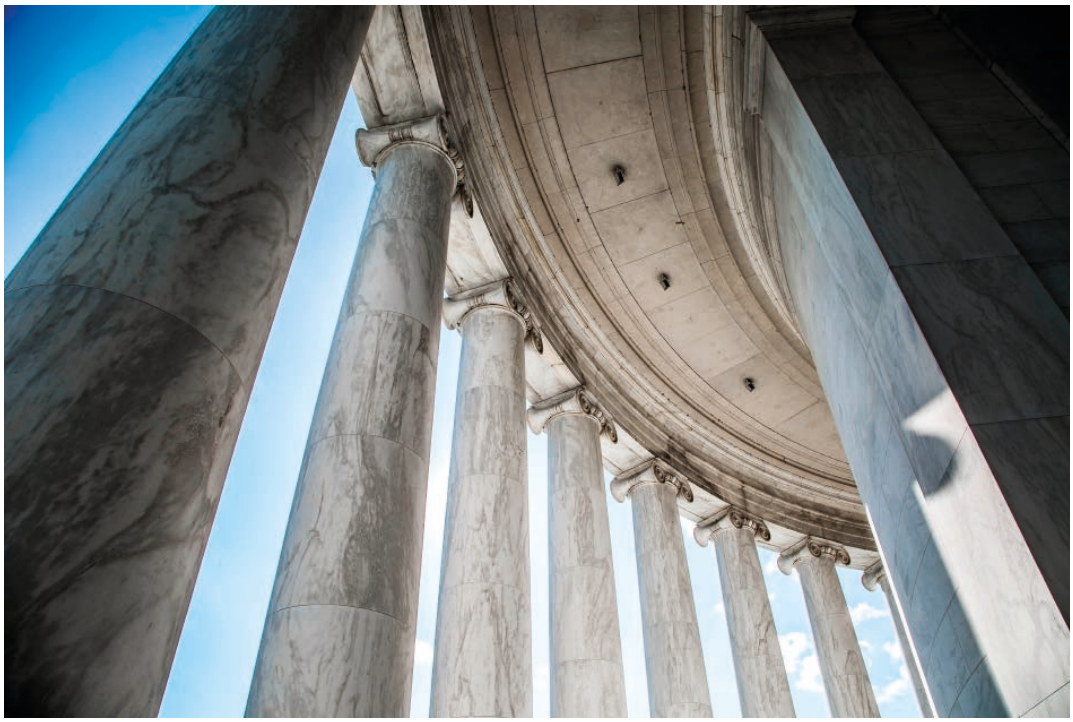
Loyalty enhancing rebates (or exclusivity rebates) are hard to define. I like this quotation from the French poet Boileau: *"Ce qui se conçoit bien s'énonce clairement, et les mots pour le dire arrivent aisément"*.[2] If one needs convoluted formulas, 10 lines, 15 verbs and 20 commas to define a particular form of object restriction, then the definition is probably not so clear-cut. It will be subject to interpretation and is therefore not useful in practice. Moreover, if one needs 200 pages to show that a restriction is an object restriction, one should think of using the same 200 pages to demonstrate likely effects and call this restriction an effect restriction instead.

Rebates are truly not necessarily bad, contrary to cartels. It is in practice not unlikely that many firms will argue that their pricing is not capable of foreclosing, that it is objectively necessary or that it generates efficiencies. In any of these situations, there will necessarily be a debate on the effects of a particular rebate, in its legal and economic context. There is no other way. As rightly pointed out by AG Wahl: when facing a presumption, it is not possible to enter into a debate about effects or balance efficiencies. The ECJ says the exact same thing in paragraph 138.

Therefore, the only thing that matters in practice is that the ECJ has clearly explained, consistent with paragraph 27 of the Guidance Paper, that one will have to assess the level of foreclosure and also (not instead) the existence of a strategy to foreclose. The term 'strategy' does not refer to intent but to a real strategy targeting particular clients, in the sense of paragraph 29 of *Post Danmark* quoted by the ECJ in Intel or Section 4.2.4 of the Commission Intel decision.

The wording of the ECJ decision might suggest that competition authorities could just wait for the parties to shoot first. If parties do not come with evidence, this

approach will save time, as it does for cartels. However, if parties do come forward with evidence, and I expect many will, this will generate a considerable waste of time and resources in the form of cases dropped after SOs or continued after supplementary SOs ("SSOs"). It would then be preferable if competition agencies test the merits of their cases in the first place, as the Commission has committed to do in its Guidance Paper.



Q3. More generally, for companies under investigation under Article 102, what should they be doing to prepare and respond to Commission concerns, in light of this judgment?

JORGE PADILLA

This one is simple in my opinion. First, they should assess whether their discounts could foreclose as-efficient competitors by analysing all the factors listed by the ECJ in its ruling and, therefore, they should assess their rebates using an AEC test since, as stated above, I see no other meaningful way of determining whether the magnitude of the rebates is problematic. Second, they should also be prepared to explain the rationale for their discounts, i.e. the efficiencies that result from their use. That requires more than a narrative. It requires hard data.

XAVIER BOUTIN

I believe that this not only a question of what they should do but also *when* they should do it. It is always easier to write down the rationale for one's actions and the decision-making process contemporaneously, rather than *ex-post*. Evidence produced in this way is also more convincing. Due to inevitable institutional inertia, it is also easier to stop an investigation earlier rather than later. For this reason, firms have a strong interest to self-assess their dominance *ex ante,* as well as assessing the potential anti and pro-competitive behaviours. This will provide them with compelling evidence that can be submitted at the most efficient moment.

Even though the judgment certainly opens the door for companies to grant rebates, large inducements are still not necessarily viewed as unproblematic by antitrust authorities, and for good reasons. Dominant firms should therefore only embark on such practices when they have a good reason to do so. These reasons should be better than 'others do it as well', as these others are unlikely to be dominant. They should also be more specific than 'customers asked for it', as strategic customers' interests are not necessarily aligned with those of consumers. It would be particularly useful to document *in tempore non suspecto*, i.e.

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XAVIER BOUTIN

[2] What is conceived well is expressed clearly, and the words to say it come easily

contemporaneously, and in a comprehensive manner the issue that the firms are facing, and why a particular form of non-linear tariff is appropriate to solve the issue. In addition, self-assessment of the capability to foreclose would be particularly useful. One of the virtues of a focus on an as-efficient competitor is that it allows for this self-assessment. This self-assessment should compute the viable scale under various scenarios of costs (average avoidable costs ("AAC") and long run average incremental costs ("LRAIC")) and possibly with some robustness, in case it can be expected that competitors are temporarily possibly less efficient (due to scale, learning by doing, etc.).

DAMIEN NEVEN

Even if one can dispute the wisdom of the emphasis that is given to the AEC test (see above), the status that it is given by the ECJ is useful for dominant companies. As the investigation showed, Intel was effectively using the logic of the AEC test in calibrating its rebates. In particular, it was trying to assess the contestable share, which is the more difficult parameter to assess and the more decisive to the outcome of the test. Dominant companies should at least have some comfort that if they pass the test, the Commission will have an uphill battle.

Indeed, if the AEC test had not been given the status of a quasi-safe harbour, dominant firms would have had to calibrate their rebates to maintain 'some profitability' for their competitors. And there is no limiting principle for what this level of profitability should be. (This is the uncomfortable situation in which Tetra Pak finds itself after the decision by State administration for Industry and Commerce ("SAIC") in China with respect to its rebate policy.)

XAVIER BOUTIN

Formalistic rules often give rise to large type 1 and type 2 errors. They unduly constrain firms that mean no harm and can still be manipulated by those who have anticompetitive plans. A more effects-based approach limits both type 1 and 2 errors. This is good news for all firms, except those who intend to anti-competitively foreclose their competitors.

It might be difficult to infer the effects of a practice or the purpose of a strategy from the outside. But firms normally know why they behave the way they do. Therefore, if firms are trying to anti-competitively foreclose their competitors, the only advice to give them is: 'don't do it, this is bad for society'. Moreover, there will be no way to hide behind formalistic rules and you will get caught. If firms are trying to solve a fundamental issue, the advice is: 'document your problems when you face them and make sure you do not cause collateral damage'. And come forward with this evidence when asked because you will have no second opportunity to make a first good impression.

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>
> JORGE PADILLA

Q4. Does the judgment imply that the Commission will be looking for more quantitative evidence, for example on the scale of any possible efficiencies?

JORGE PADILLA

I really do not know. The ruling disrupts the *status quo* under which the Commission has operated for years. I guess the initial reaction of the Commission may be to downplay the implications of the change. The Commission may indeed be in that phase at the moment, given the messages that some of its members are delivering in public forums. The Commission is likely to reconsider its practices and will fully embrace the ultimate implications of the ruling in the medium to long-term, when those who have lost in court calm down and those who are in a hurry to finalise cases which only make sense under the old *per se* paradigm realise that they may hurt the institution if they go on ignoring the deep implications of the ruling. They will then realise that they have no option but to spend more time considering the effects of the practices under scrutiny and to consider with a more open mind the procompetitive stories defendants may present.

DAMIEN NEVEN

Intel has never put forward any efficiency claims. Efficiencies put forward in terms of solving problems of moral hazard or solving problems of double marginalization in rebate schemes may also not find much echo among business people. They tend to argue that retroactive rebates are preferred by customers because they provide greater visibility of the net prices that they will pay over the horizon of the contract. This Commission is, however, likely to remain unconvinced. The best argument in favour of rebates is probably still that, in the circumstances of the case at hand, they are not anti-competitive in the first place.

XAVIER BOUTIN

The judgment does not directly deal with efficiencies, as Intel did not articulate a procompetitive rationale for its scheme. It did not help the quality of the debate on rebates that while economists were emphasizing the many benefits of non-linear tariffs, the main firm under scrutiny did not explain the benefits of its large payments to a selected number of large OEMs.

The Commission has courageously initiated the process towards a more effects-based approach of exclusionary practices. This judgment will give the Commission the opportunity to close the circle. One cannot expect that the Commission will do the same with respect to the pro-competitive rationale for non-linear tariffs. It takes two to tango, and this second step has to come from the business and the private practice community.

Firms and their advisors are often reluctant to proactively engage in a discussion on the business rationale for their non-linear tariffs, under the perception that an efficiency defence is already an acknowledgement of harm. This is not the case.

Irrespective of whether firms substantiate the pro-competitive rationale of their behaviour or not, the assessment of harm entirely falls on the Commission. If the parties do submit an efficiency defence, the balancing still falls on the Commission. Articulating the benefits of a non-linear tariff and how these benefits are passed on to consumers, for instance through better quality products, is by no mean an acknowledgement of harm. To the contrary, firms can substantiate efficiencies and challenge the presence of harm at the same time.

More importantly, the issue of the pro-competitive rationale of a practice goes beyond an efficiency defence and this is made clear by paragraphs 139 and 140 of the judgment. Firstly, paragraph 140 in the corrected version in English (and from the beginning in the French version), makes a clear distinction between objective justifications and efficiencies. Secondly, paragraph 139 clarifies that once the Commission has looked at dominance, coverage, the 'conditions and arrangements for granting the rebate', their duration and their amount, the Commission also must *"assess the possible existence of a strategy aiming to exclude competitors that are at least as efficient"*. Evidence not only that the non-linear tariff does not correspond to a strategy to exclude, but is actually meant to solve a fundamental issue like lock-in or free riding is certainly part of this assessment. Such problems could threaten key investments which benefit customers, and in some situations are necessary for the product to exist in the first place.

DAMIEN NEVEN

The Guidance Paper had introduced a clear distinction (at paragraph 28) between objective necessity and efficiencies (in line with the approach used in the Article 101). This distinction has not so far been validated by the ECJ (or the Commission for that matter in actual cases). The *French* version of paragraph 140 (and the correction of the English version) are indeed intriguing. It is actually remarkable that it was not the French version that was corrected (one can suspect that, given the poor French in which parts of the judgment was written, it was originally written in English). If this distinction is confirmed, it is indeed very welcome.

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