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The Intel Judgment: an economic perspective on compliance

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Introduction

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What “supporting evidence” might a dominant firm (Domco) advance to show its scheme is not capable of foreclosure?

- As efficient competitor test (AEC Test)
- Bigger picture evidence on the likelihood of efficient competitors being foreclosed (see, e.g. Commission’s 2009 Guidance Paper)
- Efficiency arguments

What is the AEC test? (I)

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- A price-cost test
- Compare a measure of price against *Domco's* costs (assists self-assessment)
- What price?
    - **Incremental rebates:** is the discounted price above cost?
    - **Retroactive or lump sum rebates:** if we allocate the value of the rebate (evaluated at the target) to "contestable units" is the implied price below cost?
    - What is the size of each buyer's contestable units measured over what time period?
- What cost?
  - In Intel, *Commission* adopted AAC benchmark, measured over one year
  - Guidance Paper on Enforcement Priorities indicates pricing above LRAIC would not be likely to foreclose as efficient competitors

What is the AEC test? (II)

Example: Incremental rebate scheme.

- List price is £10 and applies for first 99 units.
- Discounted price is £9 and applies for 100th unit and thereafter.
- If discounted price (£9) is above the cost benchmark, the AEC test is passed.

What is the AEC test? (III)

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Example: Retroactive rebate scheme / lump sum rebates.

- List price is £10 and applies for first 99 units.
- Discounted price is £9 and applies for <u>all units</u> when 100 or more units are purchased.
- At the target, it is *as if* a lump sum rebate of £100 is awarded.
- Suppose that Domco would have sold 60 units at the list price because the buyer is locked-in to purchasing such units – these 60 units are “captive”.
- Therefore 40 units (of the 100 covered by the target) are contestable.
- We allocate the £100 lump sum to those 40 units (i.e. £2.50 per unit).
- The discounted price is £7.50. If this exceeds the cost benchmark, the AEC test is passed.

What is the AEC test? (IV)

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Important notes

- There is no “economically correct” measure of cost.
- The cost benchmark is a choice as regards an authority’s intervention threshold (or a firm’s desire to take risk).
  - Using a long run (i.e. higher) measure of cost is safest from a compliance perspective.
- The price-cost test (whilst frequently useful) is not determinative in an assessment of competitive harm arising from alleged pricing abuses…

Why is the AEC test not determinative?

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Domco may fail the test in relation to units that cover only a small part of the market

- There may be sufficient volumes of
    - contestable units priced above cost or
    - units unaffected by the rebate scheme
- ..for which rivals can compete and secure an efficient scale.

Domco may pass the test but an authority may take the view that competition from ‘less efficient competitors’ is important in the specific circumstances of the case

- But what circumstances?
- Former state-owned monopoly (did not gain dominance on its own merits) as in Post Danmark II?

Bigger picture evidence on the capability of foreclosure (e.g. Guidance Paper, 20)

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Dominant Supplier

Rival supplier

1: dominance

Greater degree of dominance seen as aggravating factor

Buyers subject to scheme

Other buyers

2: alternative routes to market to become a viable competitor?

What share of the market is covered by the scheme?

Are affected buyers the gateway to the market?

Is forward integration viable? Is direct supply viable?

How great are scale economies denied to rivals? Is there room for viable rivals?

3: how does discount scheme affect incentives of (representative) buyers?

Conditional on meeting a target?

Conditional on near exclusivity?

Individualised targets?

Type of rebate – incremental, lump sum, retroactive?

As efficient competitor test – adapted to the type of scheme.

Final consumers

4: is there a coherent fact-based theory of LIKELY harm to competition?

Evidence of actual harm?

Are the foreclosed rivals key to constraining the dominant firm?

Possible Objective justifications (I)

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- CJEU indicates that prior to considering objective justifications, the Commission must conduct "*an analysis of the intrinsic capacity of that practice to foreclose competitors which are at least as efficient as the dominant undertaking*" (140).
- Nonetheless, if Domco is considering a rebate scheme that might be deemed to be fidelity inducing or an exclusivity rebate then it makes sense to ask:
  - What does Domco want to achieve with the scheme?
  - Can this be achieved just as well with a scheme less likely to aggravate a competition authority?!
- So what objective justifications might be advanced…?

Possible Objective justifications (II)

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Incentivising promotional efforts of downstream firms, when their effort is hard to monitor

- Target is required to induce extra effort (e.g. distributor has to promote Domco's goods effectively to reach target, too costly to monitor that promotional effort directly)
- Demand volatile, so share of needs target 'controls' for demand shocks (form of risk sharing or efficient way to deal with incomplete information)

Combining appropriate incentives to invest with a buyer's desire to stock a second supplier

- Establish setting for Domco's investment in distributors, by preventing distributors using that investment to benefit a rival supplier (too costly for Domco to monitor this directly)
- Buyer may value second supplier (differentiation, second source of supply, resilience)
- Share of needs target allows Domco confidence that its investment is not used to sell too much of its rival's product (and so makes its initial investment worthwhile)

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