The as efficient competitor test – back to facts

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1 Introduction

In the long awaited judgment in the Intel case, the ECJ clarified the case law applicable to exclusionary abuses. It first confirmed that the purpose of Article 102 TFEU is not to prohibit the exclusion of competitors that "are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation". Conversely, the target of Article 102 TFEU are practices that "have an exclusionary effect on competitors considered to be as efficient as it is itself and strengthening its dominant position by using methods other than those that are part of competition on the merits." This judgment is therefore a milestone that confirms the spirit of the 2009 Guidance Communication on Enforcement Priorities in Applying Article 102 TFEU (Guidance Paper) that raised the As Efficient Competitor (AEC) analysis as an overarching principle. In the Guidance Paper, the Commission explains that it “(…) 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”. The Intel judgment did not go as far as to reverse the previous case law of Hoffmann-La Roche which considered fidelity rebates as capable of restricting competition by their very nature. However, it clarified that the parties can submit evidence that their “conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects”. When they do so, “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; 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”.

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1 The authors are Senior Consultants at Compass Lexecon. The opinions in this article are the sole responsibility of the authors and do not necessarily represent the views of Compass Lexecon’s clients and other experts.
2 Judgment of the Court (Grand Chamber) of 6 September 2017, Intel Corp. v European Commission, Case C-413/14, paragraph 134.
3 Ibid, paragraph 136.
4 Communication from the Commission — Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 24 February 2009, 2009/C 45/02, para. 23.
5 Judgment of the Court of 13 February 1979, Hoffmann-La Roche & Co. AG v Commission of the European Communities, Case 85/76.
6 Judgment of the Court (Grand Chamber) of 6 September 2017, Intel Corp. v European Commission, Case C-413/14, paragraph 138.
7 Ibid, paragraph 139.
A debate has followed this judgment on whether the Court was stating the existence of a presumption in the assessment of unilateral conduct by dominant firms. This debate is theoretically interesting and we would argue that we do not read the judgment as setting such a presumption for rebates, as it exists, for instance, for cartels. However, the relevance of this debate is limited in practice. Firms will attempt to show that their behaviour was not capable of restricting competition. Therefore, the relevant debate is not whether there exists a presumption in theory, but how firms can in practice assess the capability to foreclose and how the Commission will assess this rebuttal and weigh the evidence submitted by the parties, as well as, most importantly, with what legal standard.\(^8\)

This article is intended to be a practical user guide to help assess their rebates’ capability to foreclose. It first discusses how firms can assess whether their practices are capable of restricting competition. It then reviews the most important issues that are open as to the way the Commission will review such evidence.

2 The AEC test as a foundation to a theory of harm

Since the publication of the Guidance Paper and the Intel decision, most of the debate has focused on the relevance of a comparison of lost rebates with margins. In the Intel decision, the Commission specifies that “[i]n order to assess whether the rebate system is capable of hindering the expansion or entry of as efficient competitors (…), it is necessary to determine, in view of the level of the rebate, what is the effective price for the buyer over a relevant range of its purchases, if this amount were to allow the buyer to benefit from the rebate”.\(^9\) In practice this requires comparing the effective price to a relevant measure of cost. This comparison is often referred to as the AEC test. Since the start, this has been a harmful misconception.

The AEC test in the context of the Guidance Paper had never been thought of as a new form-based rule based solely on price-cost comparisons. Conversely, the AEC test has always been thought of, and presented, as an overarching principle, or a thought experiment, to explain how and when certain practices could lead to the anticompetitive foreclosure of efficient rivals. This has been perfectly expressed by the Court in the previously quoted paragraph 134 of the Intel judgment.

The most common mechanism of anticompetitive foreclosure is that some non-linear pricing leads to total or partial lock-in of a large share of customers or, alternatively, of a certain number of customers of strategic importance. Limited access to these customers would then hamper the ability of the incumbent’s competitor(s) to act as an efficient competitive constraint on the incumbent. These two

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\(^8\) The judgment also clarified in paragraph 140 that the analysis of the capability to foreclose is relevant to assess the existence of either objective justifications or efficiencies. Indeed, the balancing of effects can only be made by counterbalancing likely anticompetitive effects with likely procompetitive effects and that using the same legal standards.

steps have been present since the start in the Guidance Paper, the Commission’s initial *Intel* decision\(^\text{10}\), as well as in the General Court’s judgment in *Intel*.\(^\text{11}\)

Already in its 2014 judgment in *Intel*, the General Court extensively discusses the “strategic importance” of the OEMs and of the retailer covered by the exclusivity agreement.\(^\text{12}\) This strategic importance is also the most crucial part of the theory of harm described by the Commission in its decision.\(^\text{13}\) The same reference to Apple’s strategic importance can be read in the Commission’s press release on its recent *Qualcomm* decision: “Then as today, Apple was a key customer for LTE baseband chipsets, being an important maker of smartphones and tablets with a premium brand image worldwide”.\(^\text{14}\)

Therefore, showing how lock-in leads to anticompetitive foreclosure clearly remains part of the legal test, even when the likelihood of lock-in can be assumed or superficially assessed. Antitrust enforcers need to show in each case that the lock-in of some customers can lead, with a certain degree of probability, to anticompetitive foreclosure. Conversely, parties do not fall short of possibilities to show that, despite the lock-in of a few customers, the rebate is not foreclosing a competitor. This would be the case, for instance, if the rebate only concerns a limited number of customers of no particular strategic importance or if competitors can thrive when not addressing the locked-in customers.

In addition, parties can also show that no customer was locked-in by their rebates. In its 2014 *Intel* judgment, the General Court proposed a categorization of rebates into quantity rebates, exclusivity rebates and rebates based on a mechanism that can have a fidelity-building effect, including individualised retroactive rebates.\(^\text{15}\) These categories were not helpful for assessing the risk of lock-in because what generates lock-in is the magnitude of the discount, and not its form or whether it is retroactive or not. A very large volume-based discount is more likely to lock in a customer than a small so-called retroactive rebate.

Moreover, anyone who ever 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% of the customer’s demand? Or 80%? Could the exclusivity concern a segment of demand only?

At the same time, contrary to common beliefs, these categories did not provide any legal certainty to firms. This can be best illustrated by the example of Michelin, which was fined both for its initial scheme and, some 20 years later, for a scheme that it seemed to have designed to comply with the initial

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\(^\text{10}\) Decision of the Commission, COMP/C-3 /37.990 – Intel.


\(^\text{13}\) See in particular Decision of the Commission, COMP/C-3 /37.990 - Intel, sections 4.2.4 and 4.2.5.


\(^\text{15}\) Judgment of the General Court of 12 June 2014, Case T-286/09, Intel Corp. v European Commission, para. 75-78.
In a famous decision in 1981, the Commission found that Michelin infringed European law for applying in the Netherlands a system of discounts based on individual targets. Right before the decision was taken, Michelin proposed to amend its rebates by removing any reference to individual targets. The Commission refused to make a legal assessment of this rebate scheme and simply mentions that it “reserves the right to check whether this new system is compatible with the Treaty”, merely listing very general criteria it would apply to such assessment. In May 1996, the European Commission opened an investigation about Michelin’s behaviour in France and concluded in 2002 that Michelin infringed Art. 82 of the EC Treaty by applying a complex system of non-linear pricing based on standardized conditions. The infringement allegedly lasted since 1980, even though the form of non-linear pricing applied by Michelin evolved over time. The Michelin saga, with a 20-year lag between the two decisions, does not speak in favour of the level of legal certainty provided by the European case law at the time.

In the Intel judgment, the ECJ overrules the categorization of rebates based on their form, but mentions exclusivity as a relevant factor. It does so in a very long definition of exclusivity, which, in our opinion, is prone to the same critique as the categorization of rebates proposed by the General Court before. Exclusivity is not very easy to define, otherwise the Court would not have needed 10 lines of convoluted formulas with many verbs and commas to try and define it.

Parties are likely to challenge the claim that their rebates were exclusive and everyone’s efforts would then focus on trying to assess characteristics of the scheme, which actually have limited direct relevance for assessment of the competitive effects. In fact, even exclusive (whatever that means), small rebates are still not capable of locking in a customer. It is now well established in merger control that the debate on market definition should not obfuscate the debate on the competitive assessment. The first is only an imperfect tool for the second. When a tool is too imperfect to be of any use (as for instance HHI in merger control), one should just stop using it. The same should apply to the assessment of non-linear pricing. Trying to fit various forms of non-linear pricing into boxes has been tried for decades in European law and it has proven to generate little legal certainty as well as a large amount of sterile debate. The reason for that is that the shape of the non-linear pricing is not the most important factor to assess the likelihood of anticompetitive foreclosure.

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19 Judgment of the Court (Grand Chamber) of 6 September 2017, Intel Corp. v European Commission, Case C-413/14, paragraph 137.
To an overwhelming extent, the most important factor is whether the rebate is large or not. There is an academic debate on whether small rebates can also lock in customers. Such anticompetitive foreclosure can indeed emerge due to coordination failure\textsuperscript{20}, sometimes magnified by downstream competition.\textsuperscript{21} It can be due to contract complexity\textsuperscript{22} or a more general impact of non-linear pricing.\textsuperscript{23}

In many respects, assessing the likelihood of anticompetitive foreclosure based on one of these theories of harm is much more challenging than in the case of a large rebate to strategic customers, as in the Intel case. Antitrust enforcers or complainants might be willing to build such a theory or be forced to do so by the facts of a particular case. This will be a challenging task. In practice, however, we are more likely to be concerned with large rebates. It is also conceptually easier to consider harm stemming from large and targeted rebates.

In addition, rebates are not small or large out of context. As a matter of fact, there exists no other general rule to decide whether a rebate is large or small than to compare rebates with margins (we will discuss internal documents at the end of this paper). As the Court indicated in Intel, the standard for the margin comparisons should be the one of an as efficient competitor.

Naturally, we cannot exclude a situation where foreclosure of a less efficient competitor would be anticompetitive. One, however, needs a limiting principle that strikes the right balance, taking into account the costs of type 1 (over-enforcement) errors. There are good reasons to be more concerned in general by the exclusion of an efficient rival.

There is also no reason to assume that smaller competitors are necessarily less efficient. There was, for instance, no reason in the case of Intel to assume that AMD was less efficient. To the contrary, AMD was described as a growing threat. Departing from the standard of an as efficient competitor should therefore be an exception that needs to be duly motivated. One should apply a high standard of proof when claiming that the exclusion of a less efficient competitor is anticompetitive. This can happen, as we see in Post Danmark II.\textsuperscript{24} However, as a matter of principle, it is recommended to start with the as efficient benchmark.

3 Practical application of the test to rebates

In the specific case of conditional rebates, the AEC test is implemented by estimating the effective price "a competitor would have to offer in order to compensate the customer for the loss of the conditional

\textsuperscript{24} Judgment of the Court of 6 October 2015, Post Danmark A/S v Konkurrencerådet, Case C-23/14.
rebate if the latter would switch part of its demand (‘the relevant range’) away from the dominant undertaking’.\textsuperscript{25}

The Guidance Paper notes that “the effective price that the competitor will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate the customer loses by switching, calculated over the relevant range of sales and in the relevant period of time”.\textsuperscript{26} Hence, in applying the test, it is necessary to identify:

- the average (or list) price,
- the lost rebates in the event the customer switches,
- the relevant range of sales (in the case of retroactive rebates referred to as the “contestable share”),
- the relevant period of time (over which the customer is considering to switch).

As long as the effective price remains consistently above the Long Run Average Incremental Cost (LRAIC) the AEC test is “passed” in the sense that as efficient competitors would be able to compete effectively notwithstanding the rebate (this introduces a presumption that the rebate is not capable of foreclosing anti-competitively, which constitutes a weak ‘safe harbour’). Conversely where the effective price is below the Average Avoidable Cost (AAC), then “as a general rule the rebate scheme is capable of foreclosing even equally efficient competitors”.\textsuperscript{27} In Intel’s case, the AAC was lower than its long-run average incremental cost (LRAIC) as it excluded any or most incremental R&D, as well as marketing and general administrative costs.

If the effective price is between AAC and LRAIC, the Commission would investigate whether other factors point to the conclusion that entry or expansion even by equally efficient competitors is likely to be affected.

In essence, the test as explained in the Guidance Paper allocates the dominant firm’s total discount to the contestable portion of demand and assesses whether the resulting price of those units would be below the dominant firm’s cost. If so, an equally efficient rival could not compensate customers for the forgone discounts when competing for the contestable portion of their demand.

In its decision in the Intel case, the Commission applied a methodology that is a slight variation of the one contained in the Guidance Paper. In that decision, and in line with the Guidance Paper, the Commission considered that an equally efficient competitor would need to cover at least its average avoidable costs (AAC).

Consequently, the Commission’s AEC analysis assessed the following:

\textsuperscript{25} Guidance Paper, para. 41
\textsuperscript{26} Guidance Paper, para. 41
\textsuperscript{27} Guidance Paper, para. 44
• The total dollar amount of Intel discounts that each customer would forgo by switching part of its demand away from Intel;

• The number of microprocessors that a hypothetical competitor would need to supply at a price that would compensate customers for the forgone discounts, but would still be above cost (the ‘required share’); and

• Whether this ‘required share’ was larger than the number of microprocessors open to competition (the ‘contestable’ share). If so, an equally efficient competitor could not realistically compete for the ‘contestable’ share of a customer’s demand.

Effectively, in Intel, the Commission identified the required share and compared that with an estimate of what share of the customer’s requirements was contestable during the appropriate time horizon.

The Commission’s choice of the AAC as the relevant cost benchmark was conservative from the perspective of an enforcer. If the Commission had decided to allocate some share of the very substantial R&D and other costs to the sales to each OEM to come closer to the LRAIC, it would be easier to fail the AEC test, in the sense that the required sales would tend to fall above the contestable shares more frequently.

From the defendant’s perspective, it is more conservative to take the LRAIC approach. This is because the Commission may argue that a hypothetical as efficient competitor would need to make certain R&D investments in order to meet the customer’s unique and specific requirements for one or more product. Furthermore, since R&D investments are fixed and do not vary with the volume of sales in the short term, it seems more appropriate for defendants to use LRAIC (as opposed to AAC) as the relevant cost benchmark.

The discussion of the cost elements that should enter into the computation of the LRAIC should be deeply grounded in the facts of the case. In many situations, a large portion of the costs will not be incremental to the decision to address a particular customer. This would be the case of any costs related to fundamental research or basic infrastructure, which are necessary to be active in the market at all. Therefore, the allocation of large portions of such fixed costs will correspond to a measure of Average Total Costs that can grossly overestimate the LRAIC of an as efficient competitor.

The formula used by the Commission in its Intel decision computes the minimum required share expressed in number of units (U) which the customer would need to shift to an equally efficient chipset supplier for a given device within the appropriate time horizon, for that supplier to still make a profit from supplying that customer. In making this calculation, the formula considers that the alternative supplier charges the same average selling price (P) as the dominant firm in the absence of the rebates and incurs the same LRAIC per unit (C). Finally the formula assumes that the as efficient competitor would need to compensate the customer for the total expected loss of rebates (TL), resulting from the decision to switch to another supplier.

28 In particular, a formula similar to the one used in the case of Lenovo’s and HP’s rebates to OEMs. See Decision of the Commission, COMP/C-3 /37.990 – Intel, para. 1285 and para. 1459.
Thus, to profitably supply the customer, an equally efficient competitor would have to match the incumbent’s gross price, $P$, compensate for the total lost rebates, and sell a sufficient quantity $U$, such that the sale is profitable, i.e. $U(P-C)-TL$ is positive. Therefore, the minimum required units can be computed as follows:

$$U = \frac{TL}{(P-C)}$$

Accordingly, to compute this number of required units one needs to know the total amount of rebates that are lost, as well as the gross margin that would be expected from these sales. In practice, the total loss (TL) is obtained by adding together the lost rebates associated with different types of incentive payments offered by the dominant undertaking.

Having obtained the minimum required number of units, one then needs to compare this estimate with the number of units a competitor could realistically gain if the customer concerned were to shift part of its requirements to it (i.e. “the contestable share” - in other words, the contestable number of units). Such information should generally be readily available in the market.

Naturally, any interpretation of the test should account for measurement errors.29 If all variables are measured with error, one should not put too much emphasis on the fact that the test is “just passed” or “just failed”. Conversely, if the estimated contestable share is close to the share required to recover short-term costs, this is evidence that the rebate is capable of preventing access to a given customer. Conversely, if a competitor can sell and recover close to his long-term costs, the rebate is probably not capable of restricting access to the customer.

4 The suction effect, the (non)contestable share and the proper timeframe

Furthermore, the AEC comparison should not be based on artificial time periods, like calendar years, but should instead take into account the technical and commercial reality. One should assess the financial inducements at the time when the customer could have effectively considered switching as well as the way a competitor is likely to structure its offer and the way the incumbent is likely to react to it. The assessment of when a customer is likely to switch is exclusively an empirical assessment. There could exist industry trends, but in some industries, different customers have different strategies. In such a situation, the empirical assessment must be tailor made for each customer.

In the Intel case, the Commission assumed that Intel was an unavoidable trading partner irrespective of the rebates it offered to OEMs. Here, the suction effect came from the fact that OEMs needed to sell Intel based computers, at least for some period of time, because Intel had brand recognition with final customers. So ramping up AMD, even for DELL and HP, had to be gradual. DELL or HP could not switch all of its computers overnight to AMD, so AMD had to start small. This obligation to continue buying from Intel, for at least a significant portion of time, is an essential part of the theory of harm. However, in many industries, a switch would rather be drastic and immediate, as it might be more profitable to have only one provider. Therefore, there is no reason to assume that an incumbent,

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29 Guidance Paper, para. 41
irrespective of the magnitude of its market power, is an unavoidable trading partner for any customer in the market.

In *Post Danmark II*, even though customers could only switch a small part of their needs because of the legal monopoly, they could do so at any point in time.\(^{30}\) DELL, HP and other OEMs in *Intel* also sold at any point in time a very large portfolio of products that they were regularly renewing. At any point in time, they could also design an AMD based computer and switch part of their demand to a competitor, even though it would be a small part. The same applied largely to the customers of Michelin, Tomra,\(^{31}\) Velux\(^{32}\) and Hoffmann–La Roche.

In other cases, for technical reasons, the customer can only switch when he renews one of his flagship products. Often in these situations, the main element that restricts the customer’s ability to switch is not commercial, it is technical. For instance, it might not be economically reasonable for the customer to multi-source for a particular product in situations of significant economies of scale and situations where R&D investments are invariant to output. It could also be possible that the whole design of a product has to be tailor made to some of its key components. In this situation, once the design is made, the input cannot be switched to a competing supplier.

In such situations, it is also unlikely that any rival would make the necessary customer-specific R&D investments unless it had the expectation that those investments would lead to a reasonable return, typically that the customer would single source for at least a given model (or at least buy a minimum volume). If the input supplier’s competitor would consider that only a certain share of the customer’s requirements for a given model was contestable, it would likely not invest the same level of R&D even absent the rebate. This is because the R&D expenditures, being fixed, would only be recouped if allocated over larger sales volumes.

Consequently, the customer would normally select a particular input producer among the alternative (ex-ante) as efficient rivals and it would not have any incentive to switch a share of his sales for that product ex-post. He could even lack the ability to do so ex post. In other words, only input supply for new models would likely be contestable. By contrast, in such situations, previous sales of old models and legacy sales of the old models would typically be non-contestable to some extent (we discuss this point below).

In such an economic context, a consistent application of the AEC test requires comparing the “minimum required units” of a given input that the as efficient competitor would need to sell to cover his costs with the actual “realised sales” of the model which carries that specific input. If the estimated amount of required units is unreasonably large, then it would be unlikely that the competitor would be able to profitably induce the customer to switch (absent purchase commitments to which customers are generally extremely unlikely to commit).

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\(^{30}\) Judgment of the Court of 6 October 2015, Post Danmark A/S v Konkurrencerådet, Case C-23/14.

\(^{31}\) Judgment of the Court of 19 April 2012, Tomra Systems ASA and Others v European Commission, Case C-549/10 P.

Conversely, if experience shows that a particular customer does have the habit to dual-source or to switch providers for existing products, the analysis should be made at key moments where the customer was actually considering such a switch or, alternatively, when his past behaviour indicates that he would likely consider such a switch. Such an assessment cannot be theoretical. It can neither be based on industry averages as particular customers typically have different sourcing strategies.

This assessment also has to take into account the natural timeframe for such a switch. In complex industries, there can be a significant lag between the decision to buy from a new supplier and the effective purchase. Imagine for instance that the technical and commercial process of switching takes six months to a year. Then, if a client has agreed with the incumbent on an exclusivity rebate with a one year period, it has already taken the decision not to buy from a competitor for this given year. Assessing whether the client would switch in the middle of the year is therefore a hypothetical exercise without any link with the technical and business reality of this industry. The only relevant timeframe for the analysis is therefore at the moment when the contract was signed.

Moreover, assuming that the whole rebate would be lost if the client would not exclusively buy from the incumbent is, in many instances, not the most credible counterfactual. In many instances, the client would be able to negotiate other arrangements that would include some (even though reduced) discount. It is generally very important to know in this context whether contracts can be renegotiated, whether they can be breached or not, and under what conditions.

As a first proxy, the test should be made at the level where the rebate is granted. If the granularity of data allows it, it might be useful to compute these figures at different points in time, for instance by quarter when the rebate is paid by quarter. However, even in this situation, this period might not correspond to the technical or commercial reality, where the switch is more of a long term decision for reasons explained previously. It is then the consistency with which the required share exceeds the contestable one that is of prime relevance.33

Last, there is also no reason to believe, in general, that a competitor would be unable to offer the same contract duration as the incumbent. For example, consider a two-year contract in a context where commercially and technically the customer could switch after one year. The reimbursement that would have to be made in case the customer switches is one year worth of rebates. This is clear. But a competitor could sign a two year contract as well, or an even longer one. Then, the one year worth of lost rebates does not need to be recouped in the one remaining year. In particular, there is no reason to believe that the contestable share corresponds to the remainder of the contract. In this situation as well, the assessment has to be grounded in the technical and commercial reality of the given market.

5 A lost rebate is a lost rebate and the suction effect does not increase over time

In Post-Denmark II, the Court makes a very brief assessment of the suction effect and insists on elements, which (lack of) relevance is worth discussing here. The Court first insists on the fact that rebates were granted on the basis of an expected volume and would be corrected ex-post if necessary.

33 Guidance Paper, para. 43
As a consequence, a client whose volume would be lower than expected would have to reimburse part of the rebates.\textsuperscript{34} The fact that some advance payments have to be reimbursed is a mere consequence of the modalities of the granting of the rebate, and does not change its nature. When taking its decision, a firm is likely to treat in a similar way having to reimburse a rebate as losing the rebate it was expecting. Therefore, whether the rebate is paid at the end of the year or is granted on the basis of expected volumes and adjusted at the end of the year makes little difference.

The Court also seems to attach a particular importance to the fact that suction is likely to be larger at the end of the period.\textsuperscript{35} It is correct that the temptation of a customer could be high not to risk losing one year worth of certain rebates on the last order of the year. However, it is not established that this temptation has any foreclosure effect at all. A competitor could simply compete in equal terms during a period that immediately follows. As a matter of economics, it is actually very unclear whether the suction effect is increasing over time.\textsuperscript{36}

However, this consideration is likely to be of a very minimal relevance. The core of the concern is whether within a period of time that makes business and technical sense, a large portion of the demand for a significant number of customers is likely to be unchallengeable by competitors. Whether this effect is stronger in February or in November is really at best of secondary relevance. Establishing commercial relationship is never done over-night. Having to wait a few months to address customers can hardly be considered a significant barrier. Therefore, the concern is not whether one would have to wait for the end of the contract to compete effectively, but whether one can expect the rebate to remain in place year after year (or quarter after quarter), such that it is never possible to address the locked-in demand and expand on the merits. As explained earlier, this assessment has to be based on the realistic options that real customers have at the moment they consider switching and not on theoretical (and wrong) assumptions on the way a representative customer makes decision.

6 Future rebates on contestable sales are not switching costs

Moreover, one needs to exert caution not to double count in the analysis future rebates, i.e. rebates on future sales of existing or new products. It is clear that future rebates on new products are potential rebates on sales that would not occur if the customer started sourcing from another provider. These cannot constitute a switching cost. The fact that the dominant firm proposes competitive prices for inputs for entirely new products cannot be tantamount to financial retroactive inducements for loyalty.

By choosing a different provider for the future, the customer loses the benefit of the dominant firm’s low price in return for a potentially even lower price from a competitor. This is genuine price competition on

\textsuperscript{34} Judgment of the Court of 6 October 2015, Post Danmark A/S v Konkurrencerådet, Case C-23/14, paragraph 32
\textsuperscript{35} Ibid, paragraph 34.
\textsuperscript{36} At the end of the period, one knows with certainty the effects of a particular order on the total rebate. However, even the first order of the year will have an effect on the final level of the rebate. The consequences of this order are normally anticipated by the client. If the customer’s business is entirely certain, time does not make any difference and suction is constant over time. If the business is uncertain and the client is risk averse, suction could actually reduce over time rather than increase, contrary to the Court’s statement.
the merits. The level of the list price, or the size of the rebates and discounts, is irrelevant in this comparison. Only the final expected price matters. For instance, whether the customer offers a list price of 15 with a rebate of 2 or a list price of 20 and a rebate of 7 should make no difference. Therefore, the rebates on future sales of new models should be excluded when estimating the size of the switching cost.

Nevertheless, even those future foregone fixed rebates need to form part of the AEC analysis because the as efficient competitor would need to match them as part of the normal competitive process. What is important is that they do not enter the analysis twice – i.e. through the switching costs and the price of the rival.

Strictly speaking, one could also consider that future rebates on existing models (the legacy sales) should be excluded from the switching costs as well. Indeed, if following a switch the customer would continue producing part of his existing models containing the dominant firm’s input, he would likely incur large costs. It would then be more profitable to simply discontinue these products and replace them with products based on the competitor’s inputs, acquired at a competitive price.

7 What is a strategic customer?

As already mentioned, and in line with the Guidance Paper (para. 27) and the Intel decision, the AEC test as an overarching principle stands on two legs. In practice, it has been widely confused with the first leg only.

The first leg intends to assess the magnitude of the rebate only and there is no other way to do so. It is a measure of the capacity to foreclose an as efficient competitor from access to the customers concerned by a rebate scheme (the lock-in test as described above). The second leg involves the analysis of the impact of such foreclosure on the market, i.e. the assessment of whether it is anticompetitive.

In practice, both legs of the AEC test can be used to demonstrate the absence of capability to foreclose: parties can show that the rebate is small or that it does not concern an important customer.

The two parts of the test are explained in para. 27 of the Guidance Paper:

“If the data clearly suggest that an equally efficient competitor can compete effectively with the pricing conduct of the dominant undertaking, the Commission will, in principle, infer that the dominant undertaking's pricing conduct is not likely to have an adverse impact on effective competition, and thus on consumers, and will therefore be unlikely to intervene. If, on the contrary, the data suggest that the price charged by the dominant undertaking has the potential to foreclose equally efficient competitors, then the Commission will integrate this in the general assessment of anti-competitive foreclosure (see Section B above), taking into account other relevant quantitative and/or qualitative evidence.”

The nature of such evidence is discussed in para. 20 if the Guidance Paper:

“The Commission will normally intervene under Article 82 where, on the basis of cogent and convincing evidence, 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
position of the customers or input suppliers: this may include consideration of the possible selectivity of the conduct in question. The dominant undertaking may apply the practice only to selected customers or input suppliers who may be of particular importance for the entry or expansion of competitors, thereby enhancing the likelihood of anti-competitive foreclosure."

Overall, the first leg of the test shows that the rebate makes access to some customers significantly more difficult. The second leg depends on the theory of harm and assesses whether the nature of the rebate’s coverage is such that foreclosure is actually anticompetitive. With large selective rebates à la Intel, foreclosure is anticompetitive if it covers strategic customers. If rebates play on the mis-coordination or on the non-linear pricing pattern, then the rebate scheme has to cover a significant share of total demand.

8 What about internal documents?

In its recent press release on the Qualcomm decision, the Commission extensively mentions internal documents as a relevant basis to assess the lock-in of Apple: "In fact, internal documents show that Apple gave serious consideration to switching part of its baseband chipset requirements to Intel. Qualcomm’s exclusivity condition was a material factor why Apple decided against doing so, until the agreement came to an end."37

Internal documents, both from the parties to antitrust proceedings and from their clients, are generally very valuable sources of information. For example, in the Intel decision (para. 956-957), the Commission mentions that HP was offered 1 million chips for free by AMD and that it only accepted 160,000 as this was the limit HP could accept without losing Intel’s rebates. To the extent that 1 million chips is not a small quantity for either HP or AMD, this type of evidence clearly indicates that the rebates did induce some material lock-in. This type of evidence, however, is not without limitations. Internal documents might come from parties who have an interest in the outcome of antitrust proceedings. In addition, they always raise questions of interpretation.

For instance, short of the example of AMD’s offer to HP mentioned before, it can be particularly difficult to judge how competitive a rival’s offer was. In the example mentioned by the Commission in Qualcomm, it would therefore be necessary to establish that Intel’s failure to provide chips to Apple was not the consequence of a commercial decision not to match the rebate, even though it would have been feasible for Intel to do so.

Different types of evidence have relative weaknesses and strengths. This is the case of margins and rebates comparisons as well as of internal documents. However, the idea that economic evidence is necessarily less robust than qualitative assessment and the internal documents’ review is a myth. Because every type of evidence has weaknesses, it is dangerous to use only one. Whenever possible, one should confront different types of evidence. When qualitative and quantitative evidence tell

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inconsistent stories, an appropriate answer is not to insist on the weaknesses of quantitative assessment, while neglecting the downsides of the qualitative one. An appropriate answer is to try to understand the reasons behind the discrepancies. In any event, the existence of internal documents should not be seen as a reason not to use other available and complementary quantitative tools.

9 The big interrogation mark: how (and when) will the Commission assess such evidence?

Since the much celebrated Court judgment in Intel was published in early September 2017, many conferences, opinion pieces and academic papers have expressed opinions on the consequences of the judgment on the Commission’s approach to assessing the capability of rebates to foreclose as efficient competitors. The Commission’s own voice has however been much scarcer. The Commission’s most definite answer to the ECJ’s Intel judgment will probably be its recent decision in Qualcomm. The decision is, however, not yet published and a mere press release is probably not worth to comment on. To date, the most articulate public statement is a speech by Director General (DG) Johannes Laitenberger.38

Contrary to the views held by many, DG Johannes Laitenberger stated in this speech that the Intel judgment will have “a limited impact on the Commission’s investigations because […] the Commission’s Article 102 cases over the last ten to fifteen years always showed anti-competitive capabilities”.

We would have expected DG Laitenberger to back these 15 years of efforts of his staff in promoting a more economic approach and to endorse unambiguously the analytical approach in the 2009 Guidance Paper by referring to the “as-efficient competitor” framework. But he did not do so.

DG Laitenberger considers that “[p]lacing the burden of rebuttal on the dominant firm encourages it to put forward its best evidence early in the process. Indeed that is in the firm’s interest if it has a good case”. However, this will only be the case if the defendant has a clear understanding of the concrete evidence that DG Competition will consider probative and of the standard of proof that DG Competition will apply in its review. Requiring the dominant firm to implement an AEC framework, in particular in self-assessment, would have made sense both as a matter of economics and legal certainty.

In addition, DG Competition has so far not been willing to set out the standard of proof under which it will assess the evidence presented in rebuttal. DG Laitenberger says that “[u]ltimately, it is not the type of evidence that is decisive. It is the solidity of the evidence that counts”. This is not a statement we disagree with in principle. However, not all evidence should have the same value and DG Laitenberger adds no word about what evidence counts as solid.

Instead of referring to the AEC test, DG Laitenberger stated that “the Commission will apply the most suitable tools to assess the specific case – including, where appropriate, analyzing the ‘as efficient competitor test’ when the dominant company provides the necessary information during the

administrative procedure”. As he did not explain when the test is inappropriate, this leaves a very wide margin of discretion to the Commission, who then runs the risk of being accused of being awfully discretionary.

Firms may try to argue that their behavior is not capable of excluding an as-efficient competitor, but one concern when reading DG Laitenberger’s statement is that DG Competition may not consider “appropriate” the obvious way to do so, which is to test whether the rebate is large or not, i.e. whether an as-efficient competitor can profitably replicate the discount scheme under scrutiny. DG Competition may ignore the results of their test and focus the assessment of capability to foreclose on the following criteria:

- the extent of the undertaking’s dominant position on the relevant market;
- the share of the market covered by the challenged practice;
- the conditions and arrangements for granting the rebates in question;
- the duration and amount of the rebates; and
- the possible existence of a strategy aiming to exclude as efficient competitors.

Each of these elements is relevant. However, they are not of equal relevance. A very small rebate, even applied for a very long period of time on a large portion of the market, is normally not capable of foreclosing an as efficient competitor. This is the reason why the Commission has in the first place put forward in its Guidance Paper a tool intended to assess the magnitude of a rebate, taking into account margins and the possible existence of a non-contestable portion of demand.

Our concern is the following: A rebuttable presumption must specify clear-cut, objective, structured and unambiguous rebuttal criteria. This is what happens with other tests in the Commission’s arsenal, like the AKZO\(^{39}\) test in predation cases or the Bronner\(^{40}\) test in refusals to deal or the margin squeeze test used in telecom cases. Simply putting forward a list of relevant factors without structure or hierarchy does not meet the standard. The only structured and consistent approach put forward to date by the Commission in the area of Article 102 TFEU enforcement remains its 2009 Guidance Paper, as applied, inter alia, in the Commission’s decisions in Intel and Velux.

Clarification on the likely Commission’s assessment of the evidence submitted by the parties in these types of proceedings would therefore be very welcome.

10 Back to presumptions

\(^{39}\) Judgment of the Court of 3 July 1991, AKZO Chemie BV v Commission of the European Communities, Case C-62/86.

\(^{40}\) Judgment of the Court of 26 November 1998, Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG, Case C-7/97.
We do not read the *Intel* judgment as categorising exclusivity rebates as the equivalent of “object-type” restrictions under Article 101 TFEU. What we read is the Court responding to the question whether the EC should have looked at the evidence submitted by Intel with respect to the rebate’s size, coverage, duration, etc. We do not believe that the Court is saying that the Commission does not need to assess these conditions in the first place. To the contrary, and independently of the fact that the Commission is still bound by its Communication, we believe that there would be good reasons for the Commission to assess the magnitude of lock-in on its own initiative when deciding whether to bring forward a case.

In the previously quoted speech, DG Laitenberger considers that the *Intel* judgment simply endorses DG Competition’s use of presumptions in the assessment of unilateral conduct by dominant firms. He justified the use of (rebuttable) presumptions as a way to “reconcile accuracy and administrability”. Formalistic per se rules are easy to administrate but are not accurate, since they typically give rise to both type 1 (over-enforcement) errors and type 2 (under-enforcement) errors. These errors can be mitigated at a minimal cost in terms of administrability by allowing the defendant (for per se illegality rules) or the plaintiff or DG Comp (for per se legality rules) to rebut those presumptions by showing that the conduct under scrutiny did not have (for per se illegality rules) or did have (for per se legality rules) “anti-competitive capabilities”. Thus the use of rebuttable presumptions should increase accuracy without compromising administrability.

We do not disagree in principle. While there is no economic justification for the use of formalistic rules in abuse of dominance cases because they are not accurate, this is less the case for rebuttable presumptions. They can minimize the expected cost of error and can be easier to administer than a full-fledged, unstructured ‘rule of reason’ type of analysis. Presumptions of legality, like the so-called “exceptional circumstances” test used to assess refusal to deal allegations under EU law,


DG Laitenberger mentions that “*almost all presumptions are rebuttable*”. This statement is correct. But it does not help us to answer the fundamental questions in connection with the use of rebuttable presumptions: What type of conduct should be presumed illegal or legal? Is that determination exclusively based on the form or should the legal and economic context also be taken into account and when so? Should presumptions be conditional on the results of certain economic tests, such as the price-cost test in predation cases? What evidence should be adduced in order to rebut a given presumption?

Of course, a good presumption must get it right most of the time. We may take comfort in the idea that if the presumption is rebuttable the right decision will ultimately be taken. We should nonetheless be concerned about the many inefficiencies stemming from a presumption that is systematically attacked.
A presumption that gets it wrong most of the time will get rebutted once and again and this will lead to all parties, including DG Competition, wasting a lot of time and money.

As a matter of economics, we do not believe that such a presumption is justified for exclusivity or loyalty-enhancing rebates. It is not a good presumption, according to the criterion laid out above. Most importantly, these discount schemes are unlikely to have anti-competitive capabilities unless they cannot be profitably replicated by an as efficient competitor. In addition, many of them have clear-cut pro-competitive rationales.

We expect that in antitrust proceedings the parties will come forward with evidence on the absence of capability and on the presence of efficiencies. If we are right, 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. This would avoid the considerable waste of time and resources due to cases dropped after SOs are issued or continued after supplementary SOs (“SSOs”).

11 Conclusion

There is still considerable uncertainty over the way evidence on capability to foreclose and efficiencies will be assessed. This uncertainty is largely due to the scarce guidance given, to date, on this question by the Commission. Nevertheless, it is already clear that the Commission has to assess evidence put forward by the parties on the capability to foreclose and the objective rationale or the efficiency defence for the rebate. As the Court reminded in UPS/TNT\(^{42}\), economic evidence is as important as any other type of evidence and the Commission will have to adequately assess this evidence.

We therefore argue that dominant companies should use the AEC framework during antitrust proceedings. More importantly, they should use this framework to self-assess rebate schemes. Self-assessment is clearly more credible than evidence collected during administrative proceedings. Results of such assessment are treated as in tempore non suspecto documents and can thus be most influential when submitted at early stages of administrative proceedings.