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Anti-competitive exclusionary conduct in EU antitrust practice

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Outline

1. Exclusionary conduct
   - ➢ Revision of EC Guidelines (Art. 102)
2. Forms of abuse & few recent cases
3. Exclusive dealing
   - ➢ Theoretical insights
   - ➢ Case studies
     - ✓ Velux (rebates)
     - ✓ Intel

1. Exclusionary conduct

Revision of EC Guidelines (Art. 102) - 2009

Effects base approach

- Investigate the *effect of a practice* compared to an appropriate counterfactual, rather than look at the *form of conduct* only
- Proof of anticompetitive foreclosure starts with developing a theory of harm (not only noting foreclosure, but assessing *incentive*, *ability* and *consumer harm*)

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1. Exclusionary conduct

Effects base approach – main elements

- Enhance consumer welfare by protecting competition (anti-competitive foreclosure)
- Ensure consistency between 102 and 101
- Same standard of actual or likely effects (anti-competitive foreclosure) for different forms of conduct
- The use of “as efficient competitor test” to pricing abuses
- Efficiency defence: opens the possibility of the 101 type of defence for dominant firms

1. Exclusionary conduct

Effects base approach - example

‘Post Danmark’ (2012)– selective price cutting

(not a review of a Commission decision but a preliminary ruling of a question referred by a national court)

- Price discrimination in favour of competitor’s customers
- The role of the 'as efficient competitor test'
- Pricing below cost? AIC<Price<ATC
- No concerns

A big step towards the consistent application of an effects-based approach to exclusionary pricing practices of dominant undertaking

2. Specific forms of abuse

- ❑ EXCLUSIVE DEALING
- ❑ TYING AND BUNDLING (*Microsoft*)
- ❑ PREDATION (*Akzo*)
- ❑ REFUSAL TO SUPPLY & MARGIN SQUEEZE

2. Specific forms of abuse

MARGIN SQUEEZE

Cases

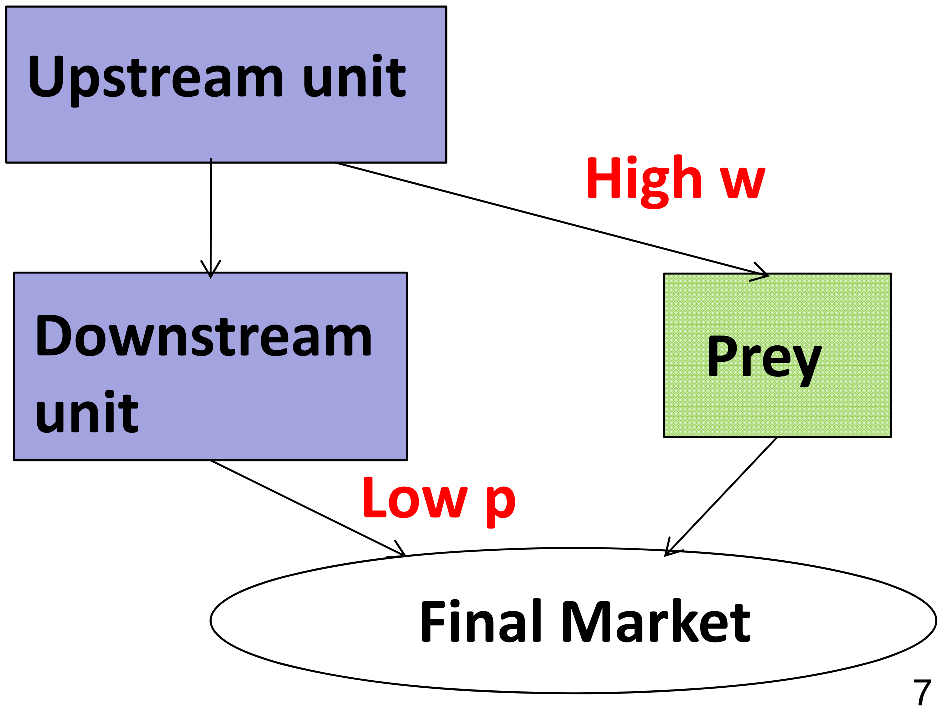
- Deutsche Telecom

(check the spread: w-p)

- Telefonica
- Telia Sonera

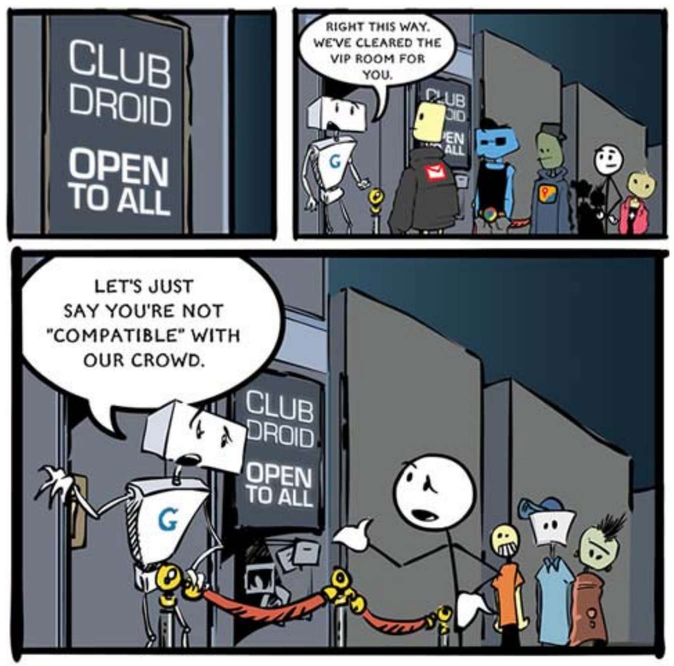
(no need for indispensability)

- Slovak Telekom



2. Specific forms of abuse

EXCLUSIVE DEALING



3. Exclusive dealing

May a dominant firm use exclusive contracts to damage actual and potential competitors?

Controversial history in anti-trust context

3. Exclusive dealing

Chicago school ('50s): efficiency effects of contracts

The buyer would only sign a contract that brings a benefit. She would not sign if a more efficient competitor is willing to enter the industry

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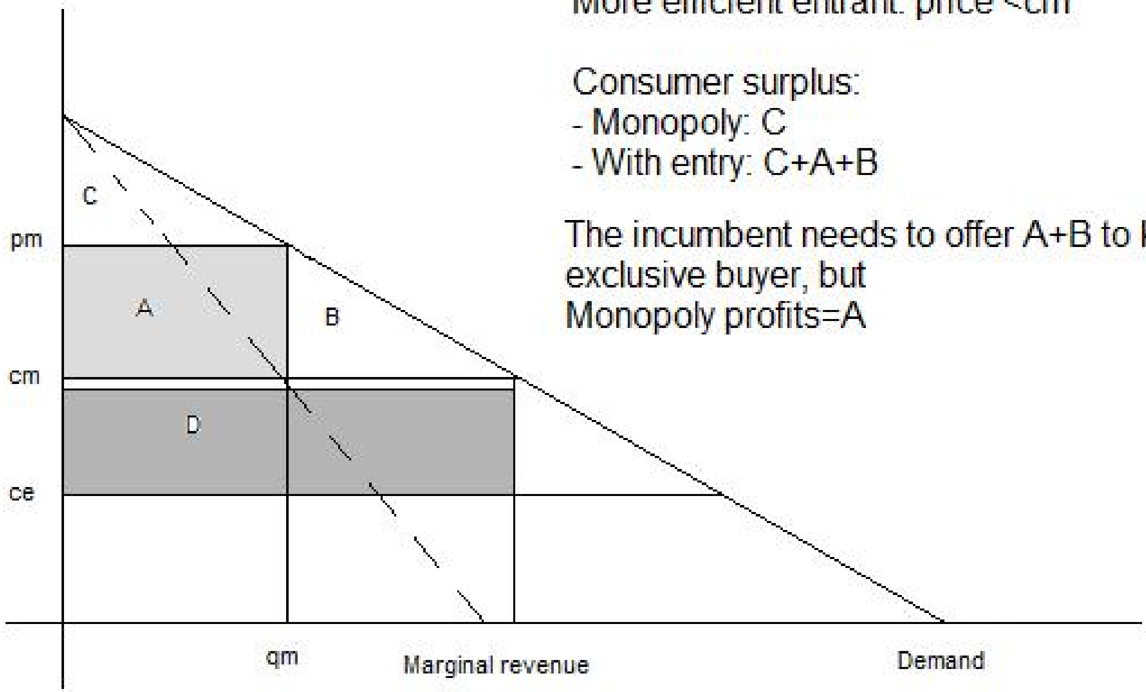
"Chicago" argument



More efficient entrant: price <cm

Consumer surplus:
- Monopoly: C
- With entry: C+A+B

The incumbent needs to offer A+B to keep the exclusive buyer, but
Monopoly profits=A

If exclusive contracts are signed they must entail some efficiency gains

"Post-Chicago" Models

There are circumstances when the incumbent is able to make an offer high enough to compensate the buyer

- Rasmusen et al. (1991) and Segal and Whinston (2000): externality among many uncoordinated buyers
  - One buyer alone is not able to trigger entry
  - If they could coordinate they would all buy from the entrant =>argument for central purchasing agencies
  - But if they can not coordinate, the incumbent might exploit this externality in order to deter entry

Guidance paper on exclusive dealing

Par. 32: “*A dominant undertaking may try to foreclose its competitors by hindering them from selling to customers through…*”:

-Exclusive purchasing obligations – UnavoidableTradingPartner

-Rebates

Tomra Judgement (2010):

Commission decision upheld by General Court

No AECT but Court was receptive to analysis of effects

Guidance paper on exclusive purchasing

Art 34:

- *In order to convince customers to accept exclusive purchasing, the dominant undertaking may have to compensate them, in whole or in part, for the loss of competition resulting from the exclusivity*
- *Where such compensation is given, it may be in the individual interest of a customer to enter an exclusive purchasing obligation with the dominant undertaking*
- *But it would be wrong to conclude automatically from this that all the exclusivity obligations are overall beneficial for the customers, including those currently not purchasing from the dominant undertaking, and the final consumers*
- *The Commission will focus its attention on those cases where it is likely that consumers as a whole will not benefit. This would in particular be the case if there are many buyers and the exclusive purchasing obligations of the dominant undertaking, taken together, have the effect of preventing entry or expansion of rival firms.*

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Velux
(Case COMP/39.451)

VELUX

FT, 6 July 2008

"The Polish window manufacturer, Fakro, which claims to be the world´s second largest producer of roof windows, aleges it has been squeezed out of certain European markets by Danish rival Velux. The Polish group claims its Danish rival uses rebates and other commercial tactics to stop retailers sticking its products. It maintains that it has been unable to build a viable distribution system in some of the main European markets as a result – including the likes of France, Germany, the UK and the Netherlands.

EC ex-officio case (Fakro did not formally complained)

Velux

Company: Velux (DK)

- Velux Group has a wide portofolio but Velux roof windows brand is a must-have and became a generic name
- Direct customers: distributors, architects, and less often final consumers
  - Low elasticity of demand: distributors and final consumers care more about the brand than the price
  - Price is a very small percentage in the price of a house

Velux

Product market

- Roof windows and accessories (blinds, shutters, decoration)
- Vertical windows are not substitutes

Geographic market - national

- Different demand conditions across European countries due to weather, density of housing, construction regulations
- Different position of competitors in different countries
- National distribution with specific rebate systems and promotion campaigns

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Velux – investigated practices

1. Rebates and other individualized benefits

- Could Velux rebates give disincentives to distributors to switch?
  - ➢ Velux uses numerous discounts and bonuses that very from country to country (similar principles)
  - ➢ Analysis of the documents provided by Velux and its distributors
  - ➢ Inspections (down raids)

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Velux – investigated practices

2. Fighting brands – predation

- RoofLITE – lower quality brand of Velux
  - ➢ Concerns that this brand was launched in order to exclude competitors (so-called fighting brands)
  - ➢ Theory of harm: Velux might have incurred losses in the sales of RoofLITE beyond what is normal for a newly launched product (predation tool)
  - ➢ Internal Velux documents and inspections
    - searching for the strategy behind the launch of the secondary brands and data concerning their profitability.

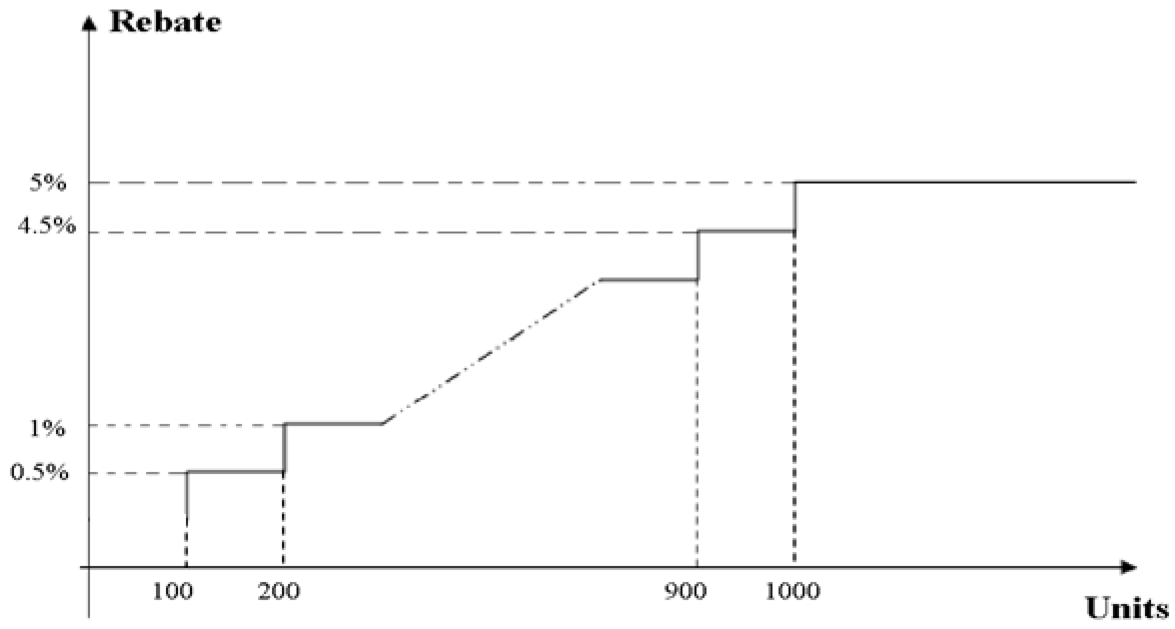
Velux

Guidance Paper on Rebates (par. 37)

- "*Conditional rebates are rebates granted to customers to reward them for a particular form of purchasing behaviour*"
    - *Granted either on all purchases (retroactive rebates) or only on those made in excess of purchases required to achieve the threshold (incremental rebates)*
    - ***They may stimulate demand and benefit consumers***
    - *However, such rebates – when granted by a dominant undertaking – can also have actual or potential foreclosure effects similar to exclusive purchasing obligations*.

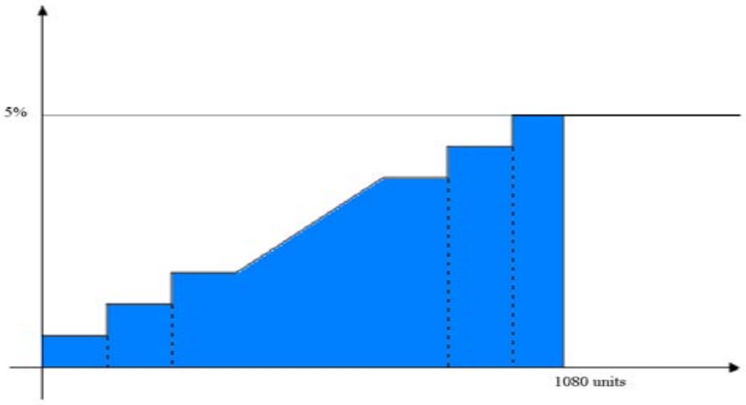
Velux

Conditional rebates



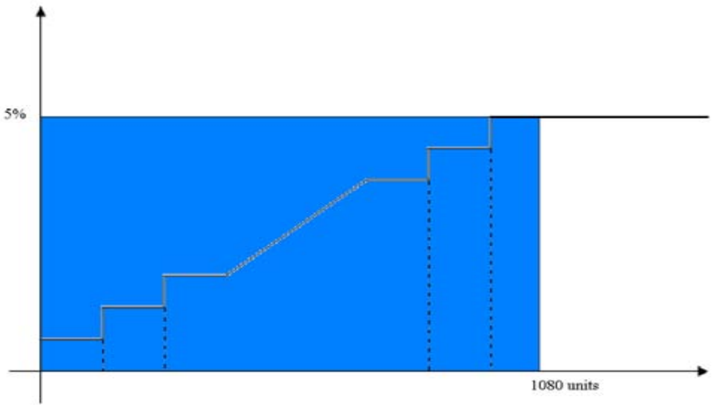
Velux

Incremental rebates



If the turnover is above the threshold of a given step, the discount increases marginally and the higher discount is applied only to the part of turnover exceeding the previous step

Retroactive rebates



The discount is applied to all units

Velux

Guidance Paper on Rebates

- Par. 40: *"in general terms, retroactive rebates may foreclose the market significantly, as they may make it less attractive for customers to switch small amounts of demand to an alternative supplier"*
    - o Strongest on the last purchased unit of the product before the threshold is exceeded - example
        - ✓ 10% rebate on total purchases if > 100 units
        - ✓ 100 units 0% rebate
        - ✓ Unit 101 is not likely to be switched to a competitor

Velux

Guidance Paper on Rebates

- Par. 39
  - ✓ Non-contestable/contestable share of demand
- Par. 41-44
  - ✓ Estimate the effective price a competitor would have to offer in order to compensate the customer for the loss of the conditional rebate
  - ✓ Relevant range (incremental purchases/contestable portion)
  - ✓ Effective price > LRAIC (<AAC)?
- Par. 45
  - ✓ Individualized / standardized

Velux

Facts of the case

- Rebates are incremental
  - o described in the general trade conditions (per country) – not individualized
  - o applied to total turnover over a period of time, normally 6 months
  - o many steps in the discount function
  - o the increments are small: 0.2-0.5%
  - o maximum rebate: 5%

Incremental rebates – example I

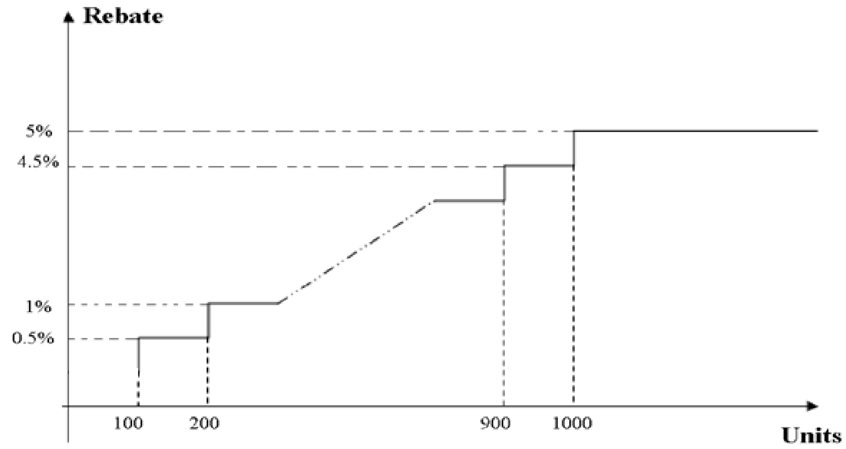
10 steps x 0.5%

No rebate for less than 99 units

Max rebate = 5% for more than 1000 units

List price = EUR 100

The lowest unit effective price = EUR 95 (for units > 1000) seems likely to cover Velux' incremental costs if the "headline price" of 100 does so



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Incremental rebates – example I

The Guidance states that "*the Commission will normally only intervene where the conducts concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking*.“ (par.23)

An equally efficient competitor competing on the margin for the last 100 windows sold would likely be able to match the discounted price of EUR 95

Conclusion: it seems unlikely that such a rebate scheme would be exclusionary

NO anti-competitive foreclosure

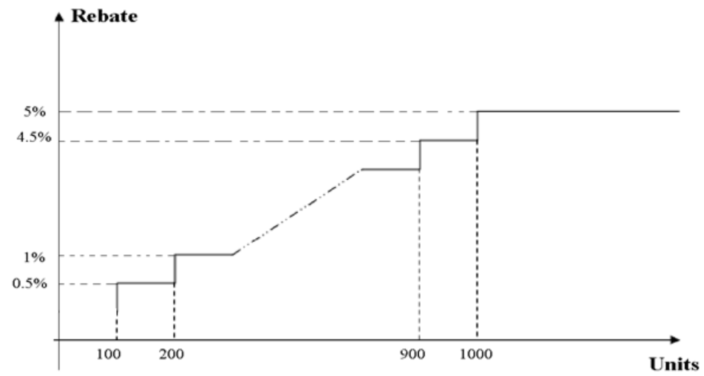
Retroactive rebates – example II

Price without rebate = EUR 100

Price for 99 windows = EUR 9900

Price for 100 windows = EUR 9950 (discount of 0.5% on all 100 windows)

- The average price of the first 100 windows is EUR 99.50
- The marginal price for window number 100 only is EUR 50
- The marginal price may even become negative



Competition

Retroactive rebates – example II

NOT the marginal price, as alternative producers typically try to sell more than one unit to a distributor

BUT the 'relevant range' alternative producers will try to compete for (contestable share)

- E.g. One 'step' (100 units) or the market share of competitors
- if a distributor buys 1000 windows instead of 900, what is the effective average price that the distributor pays?
  - Price for 900 windows (4.5% discount) = EU 85 950
  - Price for 1000 windows (5% discount) would be EUR 95 000
  - The effective average price for the 100 windows 95 000-85 950)/100 = **90.5**
  - Seems sufficiently high to cover incremental costs. Most manufacturers probably have a margin higher than 10%, although this may not be true for all industries.

Conclusion: NO anti-competitive foreclosure

Rebates - Conclusion

Par 43, 44 Guidance:

- *"as long as the effective price remains consistently above the LRAIC of the dominant undertaking, this would normally allow an equally efficient competitor to compete profitably notwithstanding the rebate. In those circumstances the rebate is normally not capable of foreclosing in an anti-competitive way*"

- *"where the effective price is below the AAC (average avoidable cost) as a general rule, the rebate scheme would be capable of foreclosing even equally efficient competitors"*

Velux Rebates - Conclusion

Commission's investigation showed that Velux had designed a conditional rebate system without anticompetitive foreclosure effects that is, competitors were not foreclosed in a way that could cause likely harm to consumers

- Rebates are not individualized
- Rebates were incremental
- Many steps in the rebate scheme
- The maximum rebate is relatively small
- P (relevant range) > LRAIC

Velux alleged predation - Conclusion

No evidence of a strategy to exclude competitors

No likely sacrifice

- Bidding markets for low cost roof windows

No likely consumer harm

- In fact, the introduction of RoofLITE in the low-cost segment of the market was a natural response to increased competition from private labels and generic goods from China
- Likely downward pressure on prices

Velux - Conclusion

Theories of harm were not confirmed

- Velux rebate system had no anticompetitive foreclosure effects
- Rooflite pricing unlikely to be predatory

Case was closed

(*Albaek&Claici 2009, CPN*)

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Intel

Intel and the Guidance Paper

The Guidance cannot apply to the decision

- Administrative proceedings already initiated
- Guidance published after Intel made its view

The Commission takes the view nevertheless that this Decision is in line with the orientation set out in the Guidance Paper

Background

- Intel's product
  - CPUs = integrated circuits that serve as a brain of a computer
- Intel's market share > 70% ('97-'07)
- Intel's customers
  - OEMs: Dell, HP, IBM ... They compete among themselves to make computer sales to final customers
- Intel's competitor
  - AMD – outperformed some of Intel's products and became the first major threat to Intel's dominant position in CPUs
- Intel's response
  - Procompetitive: improve products
  - Anticompetitive: exclusive deals

Theory for analysing exclusivity

(DeGraba & Simpson, 2010)

- Intense competition downstream
- Incumbent offers a lump-sum payment in exchange of exclusivity and sells at monopoly price
- Entrant could offer a much lower price
- If any buyer accepts lower price, the incumbent will alsio lower the price for exclusive firms
- Competition downstream drives profits to zero
- Then each buyer prefers the lump-sum
  - In many cases where downstream competition is intense, an offer of a small fixed payment from the incumbent can dominate an offer of marginal cost pricing by entrant

Infringements I

Conditional rebates

- Intel awarded major OEMs rebates conditioned on these OEMs purchasing all or almost all of their supply needs
  - DELL, HP, NEC, Lenovo
- Intel awarded payments to Media Saturn Holding (MSH), Europe´s largest PC retailer, conditioned on MSH selling exclusively Intel-based

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Analysis

- A large share of OEM's purchases could only be supplied by Intel as many final consumers would only purchase computers with Intel CPUs = NON-CONTESTABLE SALES
- What is the quantity of additional Intel units that were purchased by OEMs as a result of the exclusive arrangements? = CONTESTABLE SHARE
- Theory of harm
  - Rival exits
  - Rival's profits not sufficient to carry R&D

Qualitative evidence

Inspections (companies statements)

- Should Dell switch part of its CPU supplies from Intel to AMD, Intel retaliation could be severe and prolonged (Dell internal presentation)
- Intel granted the credits subject to the following unwritten requirements: a) that the HP should purchase at least 95% of its business desktop systems from Intel…
- It was clear to MSH that the sale of AMD-equipped computers would result at least in a reduction of the amount of Intel´s contribution payments per Intel CPU under the contribution agreement (and thus in a reduction of the total payments received from Intel, even if the total volume of Intel-CPUs sold by MSH would have remained the same as in previous periods)

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And not only qualitative...

- Conditions of the case-law for finding an abuse are fulfilled
  - Hoffmann-La Roche case (1979)
    - Tying the purchasers by a formal obligation to full or partial exclusivity
    - Fidelity rebates
- BUT, "the Commission will in addition demonstrate that on top of fulfilling the conditions of the case law, the conditional rebates that Intel granted to ... were capable of causing or likely to cause anticompetitive foreclosure (which is likely to result in consumer harm)"

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As efficient competitor test

- Capability of the rebates to foreclose a competitor which would be as efficient as Intel, albeit not dominant

- At what price a competitor which is as efficient as Intel would have to offer CPUs in order to compensate an OEM for the loss of any Intel rebate
    - Contestable share
    - Time horizon
    - Measure of relevant cost (AAC)

- Test: If Intel´s rebate scheme means that given the contestable share, in order to compensate an OEM for the loss of the Intel rebate, an as efficient competitor has to offer its products below a viable measure of Intel´s cost, then the rebate was capable of foreclosing the as efficient competitor

As efficient competitor test

- Intel's rebate scheme failed the test
  - AMD could not offer HP a compensating rebate
    - Certain OEMs are a gateway to the market
      - High market share
      - Full coverage of all market segments
      - Ability to legitimize a new x86 CPU
  - AMD offered 1 million x86 CPUs for free instead
  - HP took only a small part in order not to lose Intel's conditional rebate
      - HP requested AMD to establish a fund of $25M which HP can draw from as compensation for potential retaliatory acts from Intel

Effects

What are the effects of reducing AMD's competitive pressure?

Harm to competition and consumers

- Likely short-run consequences
  - ✓ Higher prices upstream and consequently downstream
  - ✓ Reduction of consumer choice
- Likely long-run consequences
  - ✓ Lower incentives to innovate

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Potential efficiencies

- Conditional rebates may:
  - ✓ Lower prices
  - ✓ Scale economies
  - ✓ Other cost savings and production efficiencies
  - ✓ Risk sharing and marketing efficiencies
- Lack of objective justification
  - ✓ Intel has not shown that such alledged efficiencies could not be achieved by pricing systems that would have less adverse effect on competition, such as volume rebates

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Infringements II

Naked restrictions

- Payments awarded by Intel to major OEMs conditioned on these OEMs postponing or cancelling the launch of AMD-based products and/or putting restrictions on the distribution of AMD-based products
- Harm to competition
  - Reduced choice for consumers
  - No objective justification or efficiency

Conclusion

- Credible theory of harm
- Consistent set of circumstantial factors suggesting anticompetitive foreclosure
- AECT failed
- Lack of objective justification

Intel’s behaviour was found to be an abuse of dominant position

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Decision

Fine EUR 1.060 million

- Intel WW turnover in 2007 = EUR 27.972 million
- Duration of the infringement: > 5years
- Basis: Intel´s sales in EEA

Stop the conduct

Decision appealed in Court

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Thank you!