

# Loyalty Rebates – the approach of the EU in Intel and the future

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# The Decision: Headline Messages



1. Intel was dominant in the supply of x86 CPU chips to OEMs
  - readily established on the facts
  - 70+% market share regardless of precise market definition
2. Infringement of Article 102 TFEU – abuse of a dominant position
  - exclusionary conduct by, Intel, the dominant supplier of x86 CPUs, towards AMD
  - exclusionary conduct comprising loyalty rebates and so-called “naked restrictions”
3. Remedy imposed by the European Commission
  - first significant decision since Guidance Paper on enforcement of dominance
  - €1.06 billion fine – highest European Commission fine levied on a single company
  - order to “cease and desist” practice
4. Intel appealed the decision in July 2009
  - long process anticipated – no indication of hearing date for the General Court



# Commission Findings: Loyalty Rebates and “Naked Restrictions”



1. Loyalty rebates offered to OEMs over five year period, 2002-2007
  - roll-back rebates conditioned on purchasing all or nearly all CPU needs from Intel
    - Dell: exclusive purchasing of CPU needs
    - HP: no less than 95% of CPU needs for business desktops/notebooks
    - NEC: no less than 90% of CPU needs
    - Lenovo: exclusive purchasing for notebooks
  - MSH: payments to sell Intel-based PCs exclusively
  - Commission concluded that rebates were de facto conditional on exclusive/near exclusive purchasing arrangements
  - Loyalty element strengthened because implication of not meeting purchasing thresholds was not clear to contracting OEMs.



## Commission Findings: Loyalty Rebates and “Naked Restrictions” (contd.)

2. Intel was also found to implement so-called “naked restrictions” on OEMs
  - payments to postpone and/or cancel the launch of AMD-based products (HP, Acer, Lenovo)
  - payments to restrict distribution of AMD-based products (HP)
  - Commission found direct harm to competition which required no economic analysis of anticompetitive foreclosure (no objective justification or efficiency)



# Commission's approach to loyalty rebates in Intel

1. Considered that exclusionary loyalty rebates always constitute an infringement of Article 102 TFEU
2. No legal requirement to perform effects-based economic analysis to demonstrate anticompetitive foreclosure and no need to demonstrate actual foreclosure
  - *“for the purposes of establishing an infringement of Article 102 EC, it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned.”*  
Case T-219/99 *British Airways*, paragraph 293
3. But Commission went on to carry out effects-based analysis as well



# Loyalty rebates – EC approach to effects-based economic analysis

$$R = \frac{\sum_{i=1}^n (x_i - \bar{x})(y_i - \bar{y})}{\left[ \sum_{i=1}^n (x_i - \bar{x})^2 \sum_{i=1}^n (y_i - \bar{y})^2 \right]^{1/2}}$$

## 1. Commission's Guidance Paper on A102 TFEU enforcement priorities

- effects-based economic analysis as a filter for enforcement priorities
- uses the “as efficient competitor” (AEC) test
- Guidance Paper post dates Intel – but approach incorporated into Decision

2. AEC test: the Commission calculates the price of DomCo's competitor in order to match DomCo's normal price less the loyalty rebate that it is offering. This is the Effective Price for the competitor and is compared with DomCo's Average avoidable cost (AAC) and Long-run average incremental cost (LRAIC) to see whether it is higher or lower.



## Loyalty rebates – EC approach to effects-based economic analysis (con'td)

### 3. AEC test based on three parameters

- Contestable share: proportion of customer demand that can be competed for
- Pricing benchmarks: Average Avoidable Cost (AAC) and Long-run average incremental cost (LRAIC) of DomCo versus Effective Price of Competition
- Time horizon: time over which infringement occurred



# Issues with AEC Test

## 1. Contestable share difficult to assess

- Highly subjective
- In Intel, Commission concluded contestable share very low for AMD due to Intel's brand dominance ("must have")
- amount of total rebate is applied to contestable share – implications:
  - highly leveraged if contestable share is small
  - need high degree of clarity on rebate operation/amount to calculate
  - critical to analysis for DomCo

## 2. AAC v LRAIC

- pricing above LRAIC indicates rebate is not normally abusive
- pricing below AAC generally indicates rebate has an exclusionary effect
- pricing between LRAIC and AAC requires "other factors" to be considered
- difficult to calculate

## 3. Time horizon – subjective and open to dispute



# Hypothetical example of the AEC Test in CPU market

## Intel exclusive:

OEM purchases 100% of its needs  
(1000 CPUs) from Intel

Price: \$100

Rebate:

- 15% if purchase 100% of requirements;
- 7.5% if less than 100%

Total price for CPU needs:

$$(100-15) \times 1000$$

$$= \$85,000$$

Intel AAC = \$20

10% of the market would consider AMD CPUs – rest of demand not “contestable” due to Intel’s strength

AMD (as efficient as Intel) to offer CPUs at Intel’s AAC of \$20

## Intel + AMD:

1. OEM purchases 900 CPUs from Intel

Price: \$92.50 (\$100-\$7.50)

2. OEM purchases 100 CPUs from AMD

What is AMD’s Effective Price (EP) to match Intel exclusive price?

Total price for CPU needs:

$$(EP \times 100) + ((100 - 7.5) \times 900)$$

$$= \$85,000$$

Therefore, EP= \$17.50

Effective Price for contestable share = \$17.50 – i.e. below Intel’s AAC



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# AEC Test – issues for future application

1. Guidance Paper states that AEC will be the filter for Commission decision to investigate
  - unclear how effective the test will be as a filter
    - complex calculation with subjective parameters
    - resource intensive for the Commission to deploy
    - question ability of parties to lodge complaints based on AEC
    - what happens if price is above LRAIC in loyalty rebate structure?
  - European case law treats loyalty rebates in effect as *per se* infringements



## AEC Test – issues for future application (contd.)

### 2. Issues for self-assessment

- how does DomCo assess the contestable share of its customers?
- can DomCo assess the economic effects of its rebate structure?

### 3. Issues for a potential complainant

- competitors will not be able accurately to assess DomCo's AAC or customers' contestable share



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# Intel's defence



## 1. Commission dismissed Intel's "meeting-competition" defence

- exclusivity rebate conditions were not necessary to meet AMD pricing
- rebates were retroactive across all Intel purchases
- contradiction with Intel's arguments that AMD was capacity constrained/ did not offer competitive products
- **but** notable that Commission was willing to consider a meet-competition defence and did not dismiss it outright

## 2. Commission dismissed Intel's efficiency arguments

