Intel rewrites rebates rules: ECJ requires economic assessment

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In its ruling on the European Commission's 500-page *Intel* decision, the European Court of Justice (ECJ), in a few short paragraphs, revisited 40 years of jurisprudence as to when a dominant company's rebate scheme may be abusive.

At a glance

As-efficient-competitor benchmark endorsed

The ECJ reversed *Post Danmark II* (Paragraphs 55 to 57) to bring rebates case law in line with pure pricing abuses (eg, predatory pricing and margin squeeze). What matters is whether the rebate scheme would exclude competitors as efficient as the dominant company. If a scheme causes an inefficient competitor to exit, that is part of the competitive process (Paragraphs 133 to 134).

Full analysis must be undertaken if defendant raises 'no exclusion' defence

Established case law holds that tying customers to a dominant company by exclusive dealing or pricing schemes with a similar effect is abusive (Paragraph137). But the ECJ finds that this case law "must be further clarified" if the defendant puts forward reasons why its scheme has no exclusionary effects. If that is the case, a full market analysis is required, and an assessment of a strategy aiming to exclude as-efficient competitors (Paragraphs 138 to 140).

No* per se *illegal category of loyalty rebates

The lower court had not reviewed the adequacy of the commission's foreclosure analysis, since it found that there was no need to do so. On the face of it, the rebate schemes were exclusionary. For this legal error, the ECJ reversed and remitted to the lower court for further review. The ECJ therefore reversed the lower court decision in its most contentious finding that certain types of rebate could be illegal *per se*, because they are conditioned on exclusivity or near exclusivity. Where a defendant raises a no-exclusion defence (likely to be the case in practice), then a merits analysis must be undertaken. There is no *per se* (or 'by object') short cut.

De minimis *revived, Article 102 priorities guidance reprieved*

A review of the scheme must involve:

- an assessment of market power;
- market coverage of the scheme;
- the scheme mechanics; and
- its potential to exclude as-efficient competitors.

Therefore, by implication, *Post Danmark II*'s denial of *de minimis* (lack of impact) defences in rebates cases is overruled. The ECJ also implicitly endorses the as-efficient-competitor approach of the

Article 102 enforcement priorities guidance – the continued applicability of which was in doubt after the lower court's judgment.

What next?

The Intel saga is far from over, but this judgment means that companies have greater scope for crafting compliant rebate schemes without the difficulty generated by the lower court's *per se* abusive rebate category. They can take comfort that properly devised schemes can be defended if they show no potential for exclusion.

Background

Intel is an allegedly dominant supplier of central processing unit chips for computers and servers. According to the commission's 2009 decision, Intel agreed with its main desktop customers that it would pay them substantial rebates in return for exclusivity or near exclusivity, amounting to between 80% and 100% of their needs. The rebates in some cases totalled hundreds of millions of dollars. Intel also paid additional sums to these customers and a PC retailer to:

- not stock competitor-chip-based PCs;
- delay the introduction of rival chips; and
- confine the competitor chips to non-strategic products.

The commission found this to be an abuse of dominant position and imposed fines of €1.06 billion. The decision was upheld by the General Court.

Decision

Rebate schemes

The lower court held that there was no economic defence to exclusivity-linked rebate schemes. For a dominant company, a rebate scheme linked to exclusivity – being the purchase of all or most of a customer's requirements – is presumed illegal, irrespective of its actual effect.

The ECJ disagreed. Exclusive dealing or pricing schemes with a similar tying effect had been held to be an abuse of dominance in the past, but the case law required further clarification as it was not the case if the defendant put forward evidence showing that the scheme did not exclude competitors.

This exercise must involve consideration of (Paragraph 139):

- "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, their duration and amount"; and
- "the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market".

The ECJ found that demonstrating likelihood of as-efficient-competitor exclusion is also required by the concept of objective justification in Article 102. Without understanding whether as-efficient competitors will be excluded, it is impossible to know whether a scheme shows countervailing benefits outweighing any restrictive effects:

> *"That balancing of the favourable and unfavourable effects of the practice in question on competition can be carried out in the Commission's decision only after an analysis of the intrinsic capacity of that practice to foreclose competitors which are at least as efficient as the dominant undertaking."* (Paragraph 140.)

This conclusion reversed the lower court's finding that some types of rebate are abusive *per se*. It also implicitly overrules *Post Danmark II* (Paragraph 74) – to which the ECJ does not refer – that rules out *de minimis* defences. The ECJ in *Intel* suggested that the scope of the alleged illegal practice's market coverage was central to a foreclosure analysis. *De minimis* scope must therefore suggest lack of exclusion.

The commission had put forward a detailed economic foreclosure model and analysed the contestable share of sales available to Intel rivals. It had modeled the impact of Intel's rebates in preventing rivals from competing for that share and found that even if they had the same cost base as Intel (an as-efficient competitor), they could not viably have competed on price. This analysis was skirted over by the lower court, despite Intel's challenges. It found no need to review the as-efficient-competitor analysis because it held that other elements of the rebate schemes demonstrated exclusion. The ECJ reversed this finding and remitted the case for further review by the lower court.

Extraterritoriality

Intel argued wider jurisdictional points, claiming that the European Union had no jurisdiction over some of the relevant agreements and periods insofar as they related to conduct, parties, sales or purchases outside the European Economic Area (EEA). The ECJ found sufficient nexus to the EEA in pricing practices aimed at Lenovo personal computers. There were sufficient indications of real, substantial and foreseeable impact on the EEA, given the likelihood of potential exports from China to Europe.

Procedural errors

In addition to the substantive elements, Intel appealed the General Court's decision, finding that the commission made no procedural errors in relation to a five-hour interview held with an employee of one of Intel's main desktop customers (Dell). Intel challenged the General Court's conclusion that it was sufficient for the commission to provide Intel with a list of topics discussed rather than a record of the interview.(1) Intel also argued that the ECJ erred by concluding that it was up to the company to provide evidence that the commission failed to record exculpatory evidence (ie, evidence that would have helped Intel's case).

The ECJ concluded that the commission was required to record these interviews. There was no such thing as informal interviews. However, as is often the case with procedural issues, it held that the error had not invalidated the final result. It was incumbent on Intel to demonstrate that the information provided would have been exculpatory in nature. Intel had not satisfied that burden – all parties agreed that the commission had not relied on the evidence in its decision. The ECJ set a high bar for legal error, since it will generally be impossible to know the nature of unrecorded evidence. The ECJ's reasoning is also fanciful in part – saying that Intel could have sought to have Dell witnesses compelled to testify before the General Court as to the exculpatory nature of any such evidence, or sought to access the Dell witnesses by other means.

Comment

Volume-linked rebate schemes are a daily occurrence. They reduce prices and can increase output. They are an efficient means of solving price or volume negotiations where the buyer and seller find it difficult to predict future volumes.

Though not a final decision, the case marks a potentially major departure from the arguably form-based (or 'ordo-liberal') approach to rebates advocated by the European Union's lower court. The ruling draws together the two lines of debate and looks to blend them but, in doing so, comes down firmly on the 'effects' based side. All that an investigated party need do is raise the argument, with supporting evidence, that there is no actual foreclosure in order for the European Commission to be required to look at the efficient competitor's arguments in detail.

The new benchmark is easily invoked and offers greater flexibility for practitioners counselling on rebate schemes. There is no *per se* indefensible rebate category. Rather, companies can defend well-crafted rebate schemes – small steps, low price increments, appropriate reference periods – based on the merits.

The case also signals a reprieve for Article 102 regarding priorities guidance, which adopts an as-efficient-competitor test in its analysis of rebate schemes. A hard line by the ECJ on rebates might have caused this to be revised.

The Intel saga is far from over, but the case brings a welcome re-injection of economic analysis into

the debate.

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Endnotes

(1) Following a complaint by Intel, the European Ombudsman concluded that the commission's failure to take a proper note or to record the agenda of the meeting in its investigation file constituted maladministration.
