Intel and the more economic approach to exclusionary conduct

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Abstract

Since 1999 the European Commission aims at a more economic approach to competition law. This approach may conflict with a legal line of reasoning. This is especially visible in discussions regarding exclusionary practices. The Intel case particularly illustrates this tension.

This paper addresses two questions. 1. How do the decisions in the Intel case by the European Commission, the General Court and the Court of Justice relate to the more economic approach to exclusionary practices? 2. What consequences can be expected to arise from the judgement by the Court of Justice?

The Commission Decision (2009) used both form based and effect based arguments. The judgement of the General Court (2014) seemed the end of the more economic approach to exclusionary practices. The judgement of the Court of Justice (2017) appears to be the “rebirth” of the more economic approach. Loyalty rebates used by a dominant firm are no longer considered to be abusive per se. Hence, the judgement of the Court of Justice implies that a less strict norm applies to loyalty rebates used by dominant firms.

It is to be expected that this has an influence on the enforcement strategy of competition authorities and on the behaviour of dominant firms. The latter will more often be inclined to offer loyalty rebates. Furthermore, a reduction in the probability of false positives and an increase in the probability of false negatives can be expected. Overall, there are both positive and negative welfare implications.
I. Introduction

“Competition works and competition policy makes it work better. That is what it is all about – making markets work better for consumers”, according to a well-known statement by Neelie Kroes.¹

For economists it seems evident that competition policy should be directed at increasing welfare. There is some room for discussion about whether this should be consumer welfare or social welfare.² Nevertheless, originally increasing welfare was not the goal of European competition policy. The formulation of the Treaty of Rome (1957) appears to be strongly influenced by Ordoliberal thinkers.³ For Ordoliberals protecting competition is an end in itself. Article 3f of the treaty mentions “the institution of a system ensuring that competition in the common market is not distorted”.

Between 1999 and 2004 Mario Monti aimed at bringing competition policy in line with modern economic thinking. At the end of his mandate as European commissioner for competition policy he argued that “competition policy is now clearly grounded in sound micro-economics”.⁴ We may observe, in other words, a transition towards a more economic approach to competition law. This transition is established using “soft law”, especially guidelines used by the Commission in applying competition law. Roughly, competition law itself did not change, but what changed is the way in which the Commission enforces competition law. This gave rise to tensions between the more economic approach used by the Commission and the more formal approach applied by the General Court and the Court of Justice.⁵

The most controversial part of competition policy regards the approach to abuse of dominance, especially the approach to exclusionary practices. Exclusionary practices are “actions taken by dominant firms to deter new competitors from entering an industry, to oblige rivals to exit, to confine them to market niches, or to prevent them from expanding”.⁶ Since exclusionary practices may lead to harm to consumers, fighting exclusionary practices may lead to an increase in consumer welfare.

On 6 September 2017, the Court of Justice of the European Union published its judgement on the Intel case. This is a widely discussed case regarding exclusionary practices. Previously, in 2009, the European Commission published its decision in the case. And the General Court published its decision in 2014. In the discussion on the Intel case, the role of the more economic approach is a prominent theme.

This paper addresses two questions.

- How do the decisions in the Intel case by the European Commission, the General Court and the Court of Justice relate to the more economic approach to exclusionary practices?

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² Simon Bishop and Mike Walker (2010), The Economics of EC Competition Law, Sweet & Maxwell, p. 29-32.
⁵ Cf. Anne C. Witt (2016), The more economic approach to EU antitrust law, Bloomsbury.
• What consequences can be expected to arise from the judgement by the Court of Justice? More specifically, what are the welfare implications?

This paper starts with a short presentation of the essential facts in the Intel case. After that, the decision by the European Commission, the judgement by the General Court, and the Court of Justice will be discussed. In this, the question of how these decisions and judgements relate to the more economic approach will be discussed. Next, the paper investigates the welfare implications. The basic idea is that the Court ruling implies a less strict norm, implying that rebate schemes will less frequently be considered to be abusive. Based on this, the paper discusses implication for behaviour and welfare.

II. The case

A. Essential facts

Intel was the leading dominant firm producing central processor units (CPUs) of the so-called X86 architecture. These processors run both Windows and Linux. The only serious competitor is AMD. The relevant geographic market is worldwide. Intel offered conditional rebates to four major original equipment manufacturers (OEMs): HP, Dell, NEC and Lenovo. Furthermore, Intel used “naked restrictions”: Intel paid OEMs in return for cancelling or delaying the launch of computers based on AMD processors. AMD filed an official complaint in 2000. This was the start of an extensive sequence of events.

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>18 October 2000</td>
<td>Complaint AMD</td>
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<tr>
<td>13 May 2009</td>
<td>Decision European Commission</td>
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<tr>
<td>22 July 2009</td>
<td>Appeal Intel</td>
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<td>12 June 2014</td>
<td>Judgement General Court</td>
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<td>24 Augustus 2014</td>
<td>Appeal Intel</td>
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<tr>
<td>20 October 2016</td>
<td>Conclusion AG Wahl</td>
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<td>6 September 2017</td>
<td>Judgement Court of Justice</td>
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B. The decision of the European Commission

On 13 May 2009, the European Commission adopted a decision finding that Intel had abused its dominant position. The Commission first of all concludes that the conditional rebates granted by Intel constitute fidelity rebates which fulfil the conditions of the Hoffmann-La Roche case law. On top of that the Decision also conducts an economic analysis of the capability of the rebates to foreclose a competitor which would be as efficient as Intel, albeit not dominant. (Summary of decision, par. 25 and 28). The Commission concludes that Intel’s behaviour resulted in a reduction of consumer choice and in lower incentives to innovate. The Commission, in other words, used both form based and effect based arguments.

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C. The Judgement by the General Court

Intel brought an action for the annulment of the decision. On 12 June 2014, the General Court upheld the Commission Decision. The General Court held that the rebates granted to Dell, HP, NEC and Lenovo were exclusivity rebates. The General Court explained that the question of whether such a rebate can be categorised as abusive does not depend on an analysis of the circumstances of the cases aimed at establishing the capability of the rebate to restrict competition. Hence, the General Court did not see any reason for investigating arguments regarding the effects of the rebates.

The General Court, in other words, followed a form based type of argumentation. The judgement can be qualified as hostile towards an effect based analysis. “Unfortunately, at least for now the gap between the Court’s form based standard and an effects-based policy remains wide. This dichotomy will continue to make compliance work a challenging task, at least for dominant firms that are intent on competing intensely for every sale they can win in the market.”

The judgement is “unduly formalistic” and fails to “incorporate the teachings of economics”. “The outcome in the Intel case represents a setback in the transition process towards a More Economic Approach”.

“There is no doubt that this is a very formalistic judgement, which – if confirmed by the Court of Justice – will likely turn back the clock of European policy towards abusive conduct”.

D. The Judgement by the Court of Justice

Intel brought an appeal against the judgment of the General Court before the Court of Justice. In this case, Intel claimed that the General Court erred in law by failing to examine the rebates at issue in the light of all the relevant circumstances.

Advocate general Wahl proposed to set aside the judgement of the General Court and to refer the case back to the General Court. According the AG Wahl, based on existing case law it is impossible to make a sharp distinction between types of rebates that are prohibited per se and types of rebates that are only prohibited if anti-competitive effects can be shown. An assessment of “all the relevant circumstances” takes place in all the cases.

The Judgement of the Court of Justice was published on 6 September 2017. The judgement is in line with AG Wahl’s opinion. The most crucial element in the judgement of the Court of Justice is that the General Court was required to investigate all of Intel’s arguments regarding the AEC test. More specifically: “the judgment of the General Court must be set aside, since, in its analysis of whether the rebates at issue were capable of restricting competition, the General Court wrongly failed to take into consideration Intel’s arguments seeking to expose alleged errors committed by the Commission in the AEC test (par. 147). Therefore, the Court of Justice referred the case back to the General Court.

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14 Opinion of advocate general Wahl, delivered on 20 October 2016 in Case C-413/14 P Intel Corporation Inc. v European Commission.
Now, apparently effect based arguments are relevant. A system of rebates may be objectively justified. The exclusionary effect “may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer.” (par. 140).

E. Interpretation of the development
Investigating the decisions of the European Commission, the General Court and the Court of Justice in the Intel case, we may observe a development in the role of form based and effect based types of arguments. The Commission Decision was a first attempt to not only use form based but also effect based arguments. According to the General Court, it is only form based arguments that count. The 2014 judgement of the General Court seemed to indicate the end of the more economic approach to exclusionary practices. The judgement of the Court of Justice appears to be the “rebirth” of the more economic approach. The Court did not follow the “hostile approach” where, in line with Hoffmann-La Roche, the use of loyalty rebates by dominant firms is considered to be abusive. The Court of Justice decided that effect based arguments are relevant. Loyalty rebates used by a dominant firm are no longer considered to be abusive per se. As Ibáñez Colomo puts it: “the presumption underlying the prima facie prohibition of exclusive dealing and loyalty rebates can be rebutted by a dominant firm”. In other words: the judgment of the Court of Justice implies that a less strict norm applies to loyalty rebates used by dominant firms.

III. Welfare implications

A. Potential outcomes
This leads to the question of what consequences can be expected to arise from the judgement of the Court of Justice.

A competition authority or a court has to decide whether behaviour of a dominant firm is abusive or not. Assume that the goal of competition law, in line with the more economic approach, is to promote welfare. Ideally, inefficient behaviour will be considered abusive and efficient behaviour will be considered not abusive. All decision making based in imperfect information may give rise to false positives and false negatives.

Table 1. False positives and false negatives

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<tr>
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<tr>
<td>Abusive</td>
<td>True positive</td>
<td>False positive</td>
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<tr>
<td>Not abusive</td>
<td>False negative</td>
<td>True negative</td>
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Clearly, a form based approach will lead to a relatively large number of false positives. The reason being, that the competition authority or the court does not have to investigate whether the behaviour of the dominant firm inflicts harm on consumers.

A less strict norm can be expected to lead to a reduction in false positives. Figure 1 is helpful in systematically tracing potential consequences.

Figure 1. Potential outcomes

A dominant firm may decide not to apply a rebate scheme (lower part of figure 1). Such a choice may be induced by a strict enforcement of competition law. Public enforcement is often analysed using Becker’s economic approach to crime and punishment. Public enforcement of competition law leads to an expected sanction for firms abusing a dominant position. If the probability of detection and the fine lead to an expected sanction that exceeds the profits generated by abuse of dominance, this behaviour will be deterred. This outcome may or may not be efficient (i.e. welfare enhancing).

A dominant firm may also decide to apply a rebate scheme (upper part of figure 1). This can be efficient or inefficient. A rebate scheme may be efficient if this helps in realizing economies of scale or if it helps in avoiding a double marginalization problem. A competition authority or a court may decide whether or not to use of the rebate scheme is abusive. In case the competition authority or the court decides that the use of the rebate scheme is abusive, this may be a true positive of a false positive. In case of a negative decision, this may be a true negative or a false negative.

From an efficiency point of view it would be preferable if the use of efficient rebate schemes leads to the decision that the rebate scheme is not abusive, whereas the use of inefficient rebates schemes leads to the decision that the rebate scheme is abusive. This requires, in the terminology of Kirstein and Schmidtchen, that competition authorities and courts have a perfect “judicial detection skill”. In practice, the judicial detection skill tends to be imperfect. If a rebate scheme is inefficient, the conditional probability that the rebate scheme is considered to be abuse is $r$. In case a rebate scheme is efficient, the conditional probability that the rebate scheme is considered to be abuse is $w$.

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Table 2. Judicial detection skill

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<tbody>
<tr>
<td>Abusive</td>
<td>r</td>
<td>w</td>
</tr>
<tr>
<td>Not abusive</td>
<td>1 − r</td>
<td>1 − w</td>
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</table>

In case of a perfect judicial detection skill it is certain that the use of inefficient rebates will be considered abusive, hence \( r = 1 \). Furthermore, the use of efficient rebates will never be considered abusive, hence \( w = 0 \). Consequently, in case of a perfect judicial detection skill we have \((r - w) = 1\). If a competition authority or a court is unable to distinguish efficient and inefficient rebate schemes we have \( r = w \), consequently \((r - w) = 0\). If \((r - w) < 0\) the competition authority or the court has a negative detection skill. In general, \(-1 \leq (r - w) \leq 1\) where a higher value indicates a better detection skill.

The Court ruling tends to influence how often the potential outcomes will be realized in practice. The judgement leads to a less stringent norm, implying that rebates schemes will less frequently be considered to be abusive. Part of the “false positives” will shift to “true negatives” \((w\) will decrease). And part of the “true positives” will shift to the “false negatives” \((r\) will decrease). Changing the norm implies a change in the trade-off between false positives and false negatives: the price of obtaining a reduction in the probability of false positives is an increase in the probability of false negatives.

B. Reduction in the probability of false-positives

In line with Hoffmann-La Roche the use of loyalty rebates by dominant firms was considered to be abusive. Loyalty rebates, however, by definition lead to lower prices for consumers. Hence, consumers tend to be better off. That is the case as long as the rebates do not lead to the foreclosure of as efficient competitors. The Hoffmann-La Roche approach clearly leads to false positives, in the sense that behaviour that does not harm competition and consumers will be forbidden. Leaving this, in the words of Bishop and Walker, “hostile approach” will lead to a reduction in the probability of false positives.\(^{20}\) That is, in terms of table 2, \( w \) will be reduced. From the perspective of consumer welfare this is to be applauded.

C. Enforcement focussed on evident cases

It can be expected that the judgement of the Court will influence the enforcement strategy of competition authorities. Competition authorities can be expected to focus on cases where it can easily be shown that loyalty rebates will lead to foreclosure of as efficient competitors. That is, competition authorities will most likely not focus on cases that, on balance, will result in an increase in (consumer) welfare. In this way, the means allocated to the enforcement of competition law tend

to be used in an efficient way. Accomplishing such a focus was, in fact, one of the aims of the guidelines.  

D. Increase in the probability of false-negatives
A larger part of the cases where loyalty rebates actually lead to the foreclosure of as efficient competitors will, as a consequence of the focus on evident cases, not be investigated by the competition authority. If the Commission focuses on evident cases, the less evident cases will not come into the picture. This may include cases where dominant firms effectively foreclose as efficient competitors or where dominant firms discourage investments by competitors. In terms of table 2, \( r \) will be reduced. Consequently, \( 1 - r \), the probability of false negatives, will increase. From the perspective of consumer welfare, this is an undesirable implication.

E. Increase in the use of loyalty rebates
If the use of loyalty rebates is no longer quasi-forbidden, it is to be expected that dominant firms will more often offer these rebates. Firms offering efficient loyalty rebates will be faced with a lower probability of false positives. Hence, offering these rebates becomes more attractive. By the same token, firms offering inefficient rebates will be faced with an increased probability of false negatives. Hence, offering these rebates becomes more attractive.

The probability of false positives may lead to “over deterrence”, that is deter socially desirable behaviour. Consequently, a decrease in the probability of false positives tends to be welfare enhancing. The probability of false negatives may lead to “under deterrence”. Consequently, an increase in the probability of false negatives tends to have negative welfare implications. This shows a trade-off between the deterrence of undesirable behaviour and the chilling of desirable behaviour.  

F. Increase in enforcement costs
There is a category of actors that clearly benefits from the transition to a more economic approach. These are actors that are professionally involved in competition cases: competition lawyers and consultant providing arguments that can be used in competition cases. From a societal point of view, the time spent on competition cases is, of course, an opportunity costs. The costs increase caused by the transition to a more economic approach appears to be substantial.

Witt presents illustrative data. Between 1971 and 1998 the average length of article 102 infringement decisions was 19.2 pages. Since 2005 the average length is 214.5 pages. Obviously, the production of these decisions not only generates costs. As far as these analyses contribute to the effectiveness of competition policy, especially the prevention of false positives, they may help in preventing welfare losses.

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21 Luc Peeperkorn and Katka Viertio (2009), Implementing an effects-based approach to Article 82, Competition Policy Newsletter, 2009-1.
23 Anne C. Witt (2016), The more economic approach to EU antitrust law, Bloomsbury, p. 315-316.
G. Interpretation

The Intel ruling has both positive and negative welfare implications. These are summarized in Table 3. A priori, it is unclear whether the Intel ruling on balance is welfare enhancing. There are, however, reasons to be optimistic. The main problem was the high probability of false positives and, consequently, the incentive for not using loyalty rebates, even though this could be welfare enhancing. So, the Intel ruling helps in preventing these welfare losses. This is, however, not a free lunch. The probability of false negatives will increase, since law enforcement will be more focused on cases that can be expected to harm competition and consumers. Hence, an increasing number of cases will stay under the radar. And this may induce dominant firms to take the risk of using inefficient rebate schemes.

Table 3. Welfare implications

<table>
<thead>
<tr>
<th>Positive</th>
<th>Negative</th>
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<tbody>
<tr>
<td>• Reduction in the probability of false positives</td>
<td>• Increase in the probability of false negatives</td>
</tr>
<tr>
<td>• Enforcement more focussed on evident cases</td>
<td>• Increase in enforcement costs</td>
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<tr>
<td>• Increased use efficient loyalty rebate schemes</td>
<td>• Increased use inefficient loyalty rebate schemes</td>
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IV. Conclusions

Since 1999 the European Commission aims at a more economic approach to competition law. This not only regards to goal (welfare) but also the line of argumentation (micro economic analysis of market failures and potential solutions). Applied to exclusionary practices, the more economic approach effectively amounts to a shift from a form based approach toward an effects based approach. Central to the effects based approach is the question of whether exclusionary practices lead to harm to competition and consumers. In the terminology of economics: do these practices have negative welfare implications?

Relative to a form based approach an effect based approach implies a less strict norm. This change implies a reduction in the probability of false positives and an increase in the probability of false negatives. The probability of false positives tends to discourage the use of efficient rebate schemes. Hence, reducing the probability of false positives tends to be welfare enhancing. The probability of false negatives tends to encourage the use of inefficient rebate schemes. Hence, increasing the probability of false negatives tends to be welfare reducing. So, a priori the welfare implications are unclear. However, since the main problem of a form based approach can be considered the excessive probability of false positives and the associated deterrence of efficient behaviour, there are reasons to be optimistic.

Some caveats are in order. First, a transition to an effect based approach will lead to an increase in enforcement costs. Second, “the Intel sage” continues, now the case is referred back to the General Court. Nevertheless, the Court judgement is a milestone in the discussion and consequently leads to some reduction in uncertainty. The Court takes some distance from the form
based approach and makes some room for the effect based approach. “The Court recognizes that exclusivity rebates must be presumed to be anticompetitive but, at the same time, clarified that a dominant company can rebut such presumption by showing that the conduct was not capable of resulting in foreclosure”. 24 Given the far from linear development in judgments by the Commission and the Court, it remains to be seen what the future will bring. 25
