



# The *Intel* Decision: Some Economic Remarks

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# Disclaimer

- Though CRA worked for Intel throughout the European Commission's investigation, I did not work on this case myself
- The views expressed in this presentation are completely my own personal views

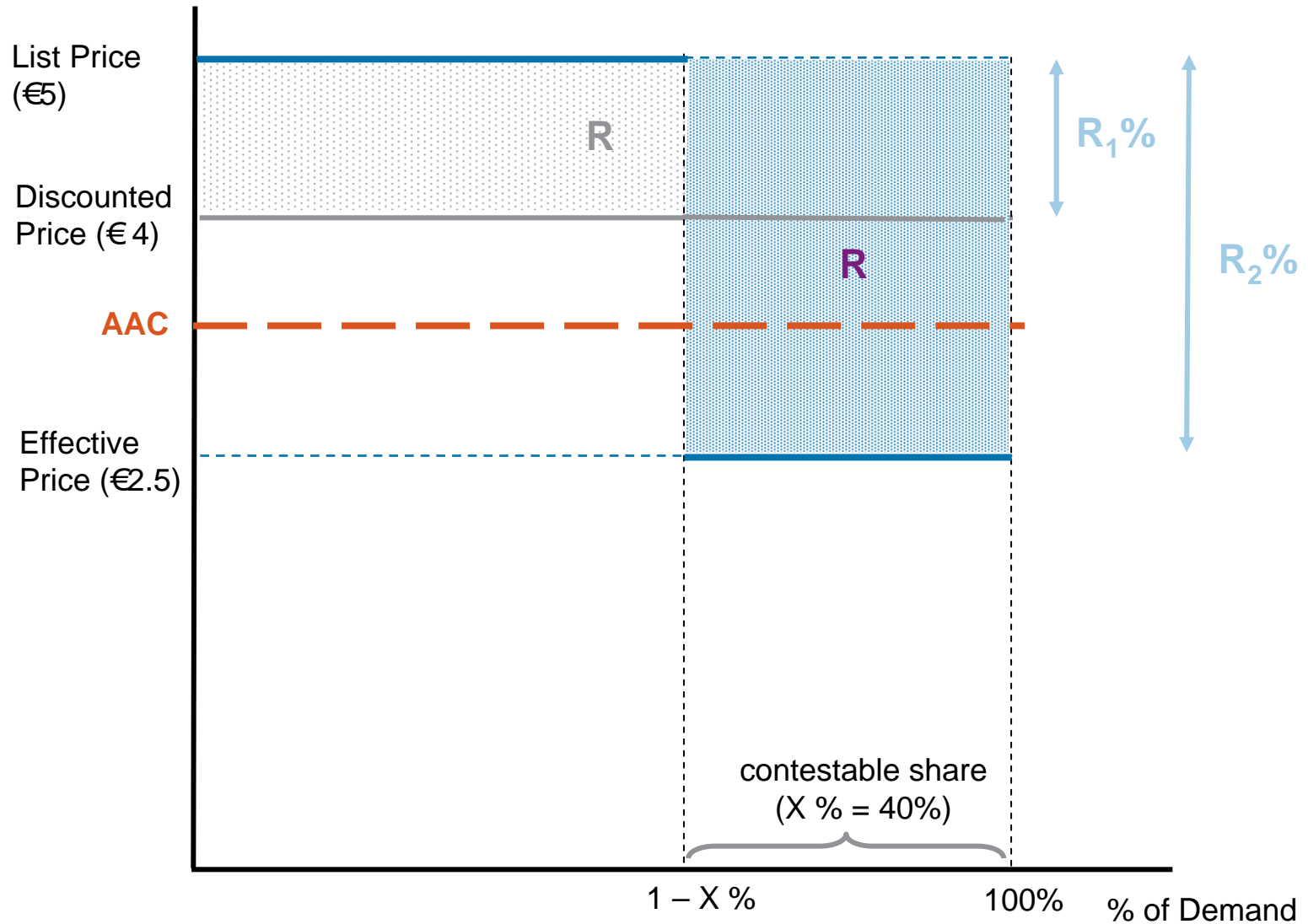
# Economic Issues Raised by the *Intel* Decision

1. The treatment of loyalty rebates in *Intel*, and the AEC Test
2. Are rebates simply a form of targeted predation, and if so does the predatory theory of harm makes sense?
3. Do loyalty rebates actually ‘leverage’ a firm’s dominant position?
4. If rebates go beyond predation, is there any additional evidence to support such a theory of harm?
5. What (additional) evidence on competitors is required to support an effects-based analysis?
6. Can consumer harm simply flow from a loss of ‘choice’ in the short-run?
7. Some practical issues in implementing the AEC Test

# 1. Assessment of Loyalty Rebates in *Intel*

- The move away from the purely form-based approach to rebates applied by the Commission as recently as in *Tomra* (2006) is a welcome and significant step
- In *Intel* the Commission implements the empirical ‘As-Efficient Competitor’ (AEC) test for rebates put forward in the 2009 Guidance document
- However the Commission also reiterates some of the traditional form-based ‘analysis’ (¶¶920-925)
  - Intel’s fidelity-discounts restricted the OEM’s ‘freedom to choose’ and were thus anti-competitive (¶933)
  - No evidence of actual foreclosure is therefore required
  - AEC analysis is not indispensable for a finding of infringement

# 1. The AEC Test



## 2. Are Loyalty Rebates simply “Predation in Disguise”?

- The AEC test applies a quasi-predatory framework to loyalty rebates
  - Effectively interprets rebates as ‘disguised’ predation: predatory incremental prices are ‘hidden’ by non-predatory prices on non-contestable units
  - Contrary to the *Intel* decision (and the Guidance paper too), this interpretation is consistent with the dominant firm engaging in profit sacrifice on incremental units
- As in any coherent theory of predation, it is necessary to discuss and assess the scope for asymmetric future recoupment possibilities between the predator and the prey (as the Guidance paper recognises)
  - Deep pockets (possibly from the revenues on non-contestable units?)
  - Reputational effects
  - Asymmetric information on costs
- These issues however are not discussed in *Intel* decision (which seems to assume that recoupment is *not* actually required for the theory of harm to make sense)

### 3. Are Rebates a Form of Leverage?

- “The point of departure for an as efficient competitor analysis in this case is that Intel is an unavoidable trading partner. The rebate therefore enables Intel to use the inelastic or ‘non-contestable’ share of demand of each customer, that is to say the amount that would anyhow be purchased by the customer from the dominant undertaking, as *leverage to decrease the price for the elastic or ‘contestable’ share of demand*, that is to say the amount for which the customer may prefer and be able to find substitutes.” (¶1005)
- “[...] not all rebates genuinely benefit consumers. As regards conditional rebates by a dominant company, *the fact that a “rebate” can be leveraged by the dominant company from its non-contestable share into the contestable share* may allow that company to foreclose as efficient, or even more efficient rivals, even if its overall average price is higher than that of its rivals. This is therefore to the detriment of consumers and competition both in the short and in the long term, in terms of price, choice and innovation.” (¶1612)

(emphasis added)

### 3. Are Rebates a Form of Leverage?

- It is true (simply as a matter of arithmetic) that if Intel is an unavoidable trading partner with respect to certain sales, then if Intel offers a R% discount on all units as part of a competition for N additional (contestable) units, AMD would have to offer a discount for these contestable units that is greater than R%.
- But
  - The asymmetry in the % level of the rebates does *not* mean that Intel has an advantage in competing for the contestable units: its effective price for the incremental units is the *same* as the one that AMD needs to offer to remain competitive
  - If contestable units are equally valuable for both firms, then both should be willing/able to offer the same price
  - Intel's ability to express the discount as a % of total sales (rather than just incremental sales) is not a source of economic leverage *per se*

## 4. Non-Predatory Theories of Loyalty Rebates

Economic theory offers non-predatory (and potentially anti-competitive) interpretations of loyalty rebates, but these require even *more* sophisticated economic analysis

### Naked Exclusion

- A dominant firm can engage in cost-less exclusion if buyers are fragmented and an entrant needs to reach critical mass
- Sequential and/or discriminatory pricing might achieve such an outcome
- In this case, the rebate might be 'cosmetic' (i.e. the actual prices paid are at monopoly levels, on all units)
- For this theory to work, need sufficiently fragmented buyers (with limited competition between them) and exit of the rival (eventually)
- Also need buyers to continue purchasing at monopoly prices even if the rival has not exited yet

### Exclusionary bundling

- Non-contestable and contestable units may be viewed as separate products
- If so, bundling the two through a rebate can allow a firm to extract additional surplus from the 'monopoly' market
- This may actually *benefit* consumers (with no exclusionary intent)
- For consumers to be harmed, need a (credible) threat to charge above monopoly price for the monopoly product (or monopolisation of the contestable market followed by recoupment)
- This intuition can be applied to single-product setting, where lump-sum rebates can implement efficient pricing (but also exclude a smaller rival)

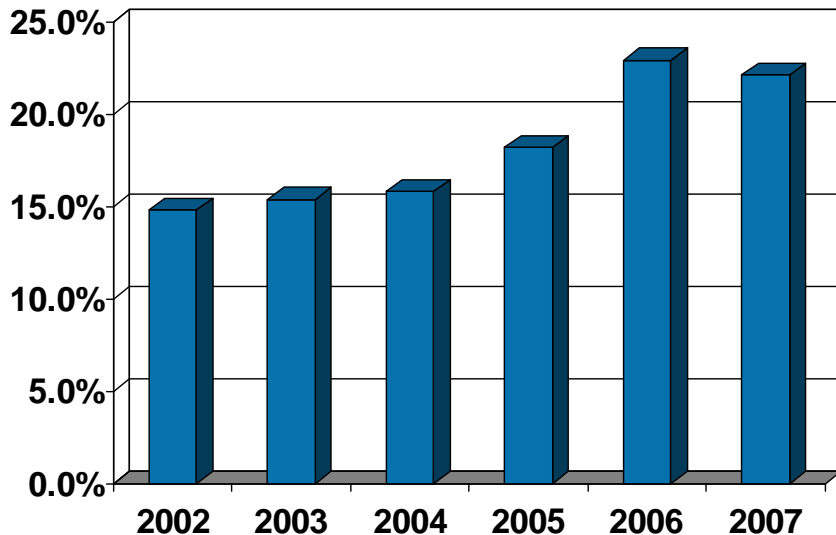
## 5. The Commission's Analysis of Effects on Competitors

- An effects-based analysis should not stop at an AEC test, especially in a case which is looking at conduct that took place over a number of years (2002 – 2007, with a Decision taken in 2009)
- The AEC test should be primarily seen as a *screen* to identify rebate structure which are potentially of concern, due to:
  - Low contestability (i.e. ineffective 'competition for the market')
  - Significant (and individualised) rebates
- But evidence of actual effects on competitors (*not* necessarily consumers) should still be required before making a finding
- Commission does not analyse effects on AMD in detail
  - Intel's anti-competitive conduct allegedly reduced AMD's investment/R&D incentives (this is simply asserted though)
  - Actual evidence on AMD's performance is dismissed on the grounds that AMD could have done better but for the conduct

## 5. Did Intel's Conduct in fact Marginalize AMD?

- AMD increased its market share

AMD Microprocessor Share



- Expanded manufacturing capacity
  - More than doubled capacity from 2004 to 2007
  - Announced \$2.6 billion Capacity Expansion in 2006

- Launched successful new products
  - Opteron 2003
  - Dual Core 2005
- Expanded R&D capabilities
  - R&D expenditures increased every year, 2001 to 2006
  - Added new R&D and design facilities in 2006, 2007 & 2008
- Accessed capital markets
  - Raised close to USD 10 billion between 2001 and 2007
- The Commission itself accepts that AMD became a more credible competitor over the period of the conduct (see paragraphs ¶¶ 1243, 1258, 1693)

## 6. The Commission's Analysis of Likely Consumer Harm

- The Commission claims that Intel's rebates harmed consumers by depriving them of product choice:
  - “Through a variety of rebates which were tailored for each OEM, Intel was able to use the tool of conditional rebates that were capable of inducing loyalty and thereby limiting consumer choice and foreclosing the access of competitors to the market” (¶1598)
  - Alleged ‘leverage’ effects harmed consumers also in the short-run
- Rebates to end-consumers should be treated as presumptively beneficial in the *short-run* since the loss of choice accepted by consumers is *compensated for* by the discount
  - Injury to consumers typically only follows in a dynamic setting, through the marginalisation/exit of rivals and recoupment (as in a standard predatory theory of harm)

## 6. The Commission's Analysis of Likely Consumer Harm

- The Commission does not explain why we should depart from a basic 'predatory' framework to understand consumer harm in the case of loyalty rebates
- Is it because rebates actually leverage pre-existing monopoly power?
  - If so, the precise leveraging mechanism must be set out and empirically tested
- Or is it because rebates are paid to intermediate customers, who may not adequately represent the interest of consumers?
  - If so, one needs to explain why competition between OEMs does not lead to a full/significant pass-through of rebates to final consumers, or does not allow OEMs that carry AMD to gain share at the expense of Intel 'loyalists'
  - The implicit assumption that intermediate customers simply 'pocketed' Intel's discounts with no benefit to final consumers is likely to be the exception in exclusionary pricing cases (cf. *British Airways*), and not the rule

## 7. Some Practical Issues in Implementing the AEC Test

- Two of the three key variables required to implement the test (the loss of rebate if loyalty is breached, and the contestable share) are particularly hard to measure
  - In Intel the Commission used the internal estimates of the OEMs
  - The effective price schedules are very sensitive to both assumptions (more than to costs)
  - Risk of ‘false convictions’ higher than in simple predatory cases
- Measuring contestable share over a short (one-year) horizon is unduly conservative, if a rival faces incentives to ‘invest’ in market legitimisation by key OEMs and is able to recoup such investments over a short period of time (2-3 years)
- Excluding volumes not subject to exclusivity from the computation of contestable share can lead to perverse results (cf. HP vs. Dell)
- Using AAC for the AEC test creates a sensible precedent

# Conclusion – Where to From Here?

- Elements of a form-based approach to loyalty discounts remain in place
  - Evident from the Commission's fairly cursory assessment of effects on competitors and consumers
- The AEC test may still provide some useful structure to dominant firms for competition compliance purposes
  - Key parameters can be documented internally to show that discounts can be matched by smaller rivals
  - Alternatively, incremental above-cost discounts remain the safer option!
- The tensions with the Article 82 Guidance paper will ideally will be resolved in future cases which fall more clearly within the period covered by the guidelines

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