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Discounts and Rebates after *Intel*

Paul Gilbert

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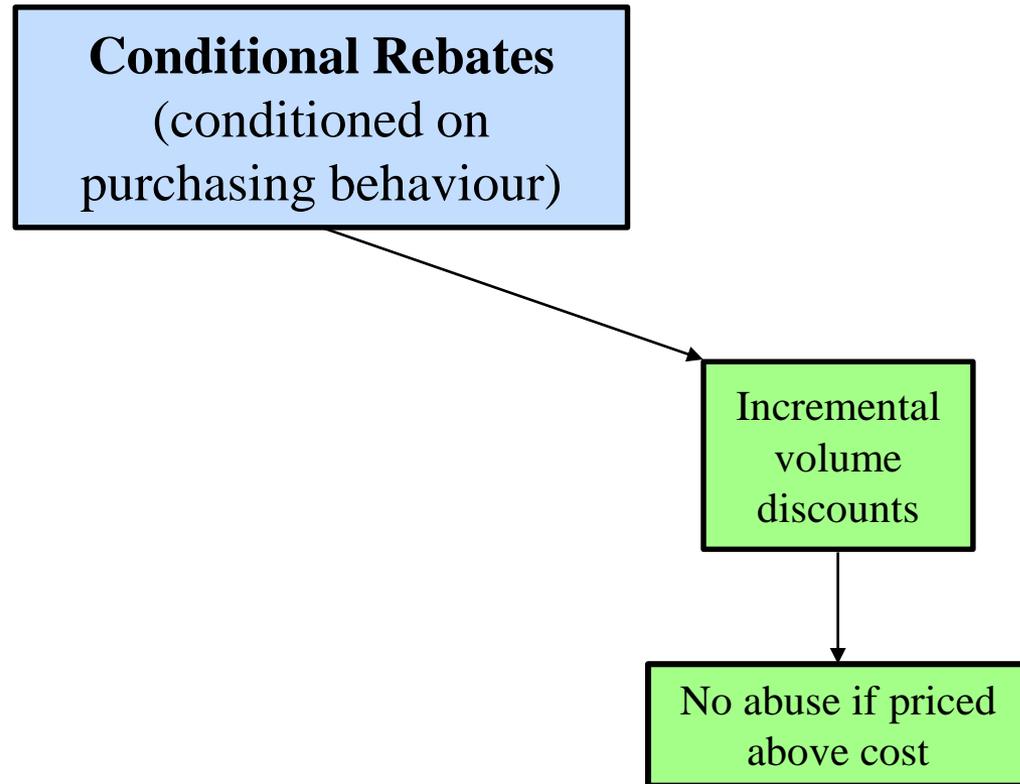


What is the Concern with Discounts and Rebates?

- A dominant firm can replicate the effects of predatory pricing without having to price below cost.
- Two possible approaches to analysis of discounts and rebates:
 - **Form-based approach.** Certain type of discounts treated as *per se* unlawful.
 - **Effects-based approach.** Practice only unlawful if it has anti-competitive effects.
- Retrospective rebates are not conceptually different from prospective discounts, but “suction effect” can increase risk of anticompetitive effects.



Are There Still Three Categories?



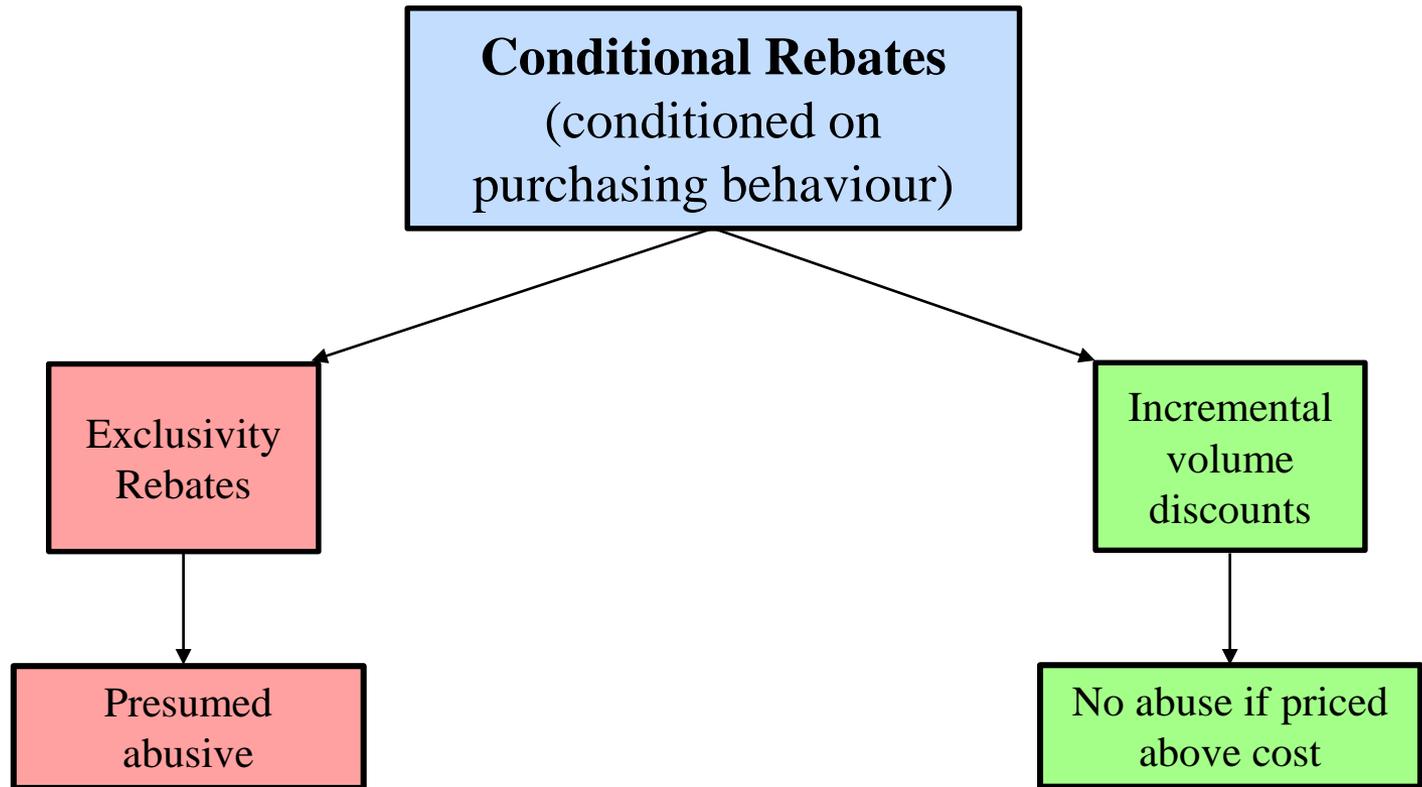
Volume-Based Rebates

“Quantity rebate systems linked solely to the volume of purchases made from an undertaking occupying a dominant position are generally considered not to have [a] foreclosure effect.”

Case T-203/01 – *Michelin*,
Judgment of 30 September 2003



Are There Still Three Categories?



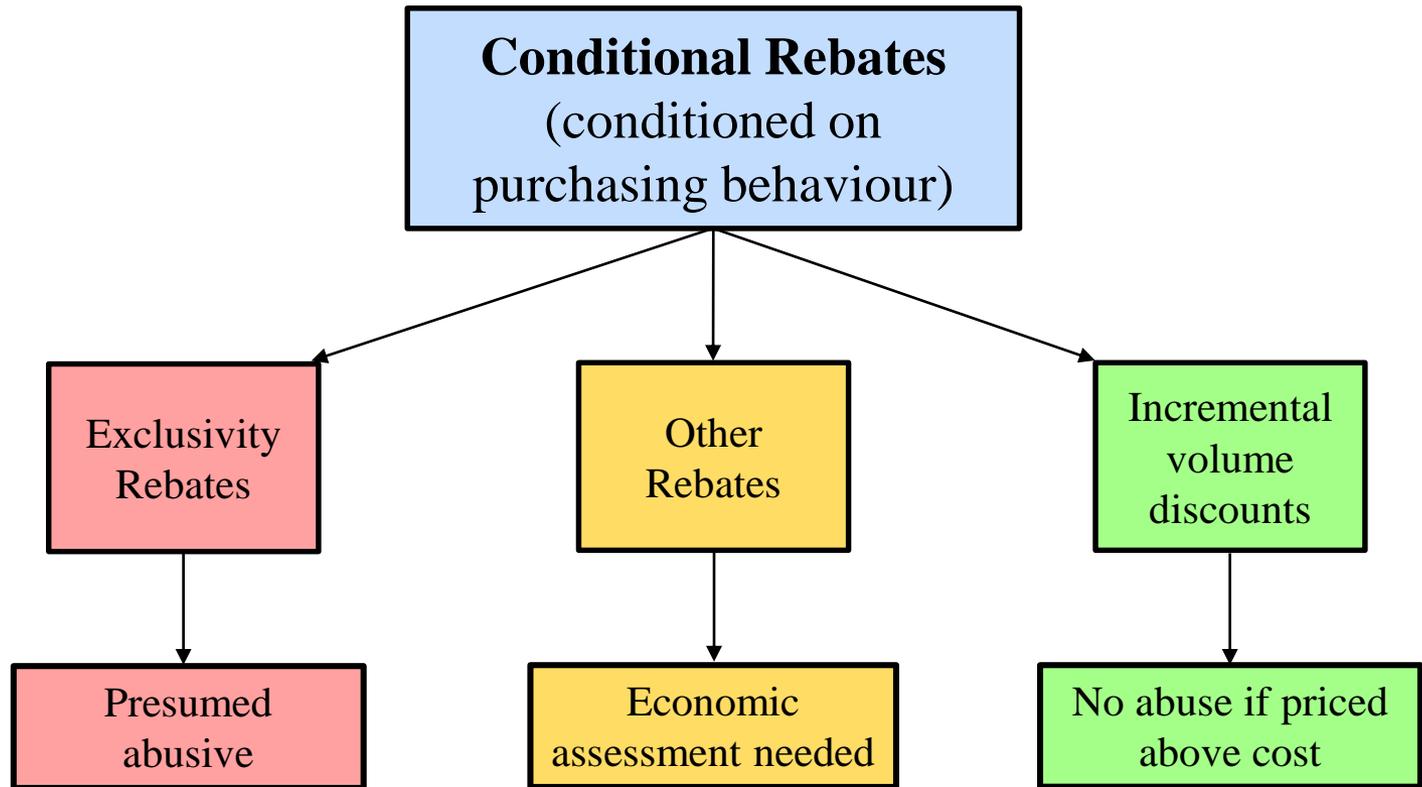
Exclusivity Rebates

“ [exclusivity] rebates — when granted by a dominant undertaking — can also have actual or potential foreclosure effects similar to exclusive purchasing obligations [...] the likelihood of anti-competitive foreclosure is higher where competitors are not able to compete on equal terms for the entire demand of each individual customer. ”

Commission Guidance Paper on enforcing abusive exclusionary conduct by dominant undertakings (2009/C 45/02)



Are There Still Three Categories?



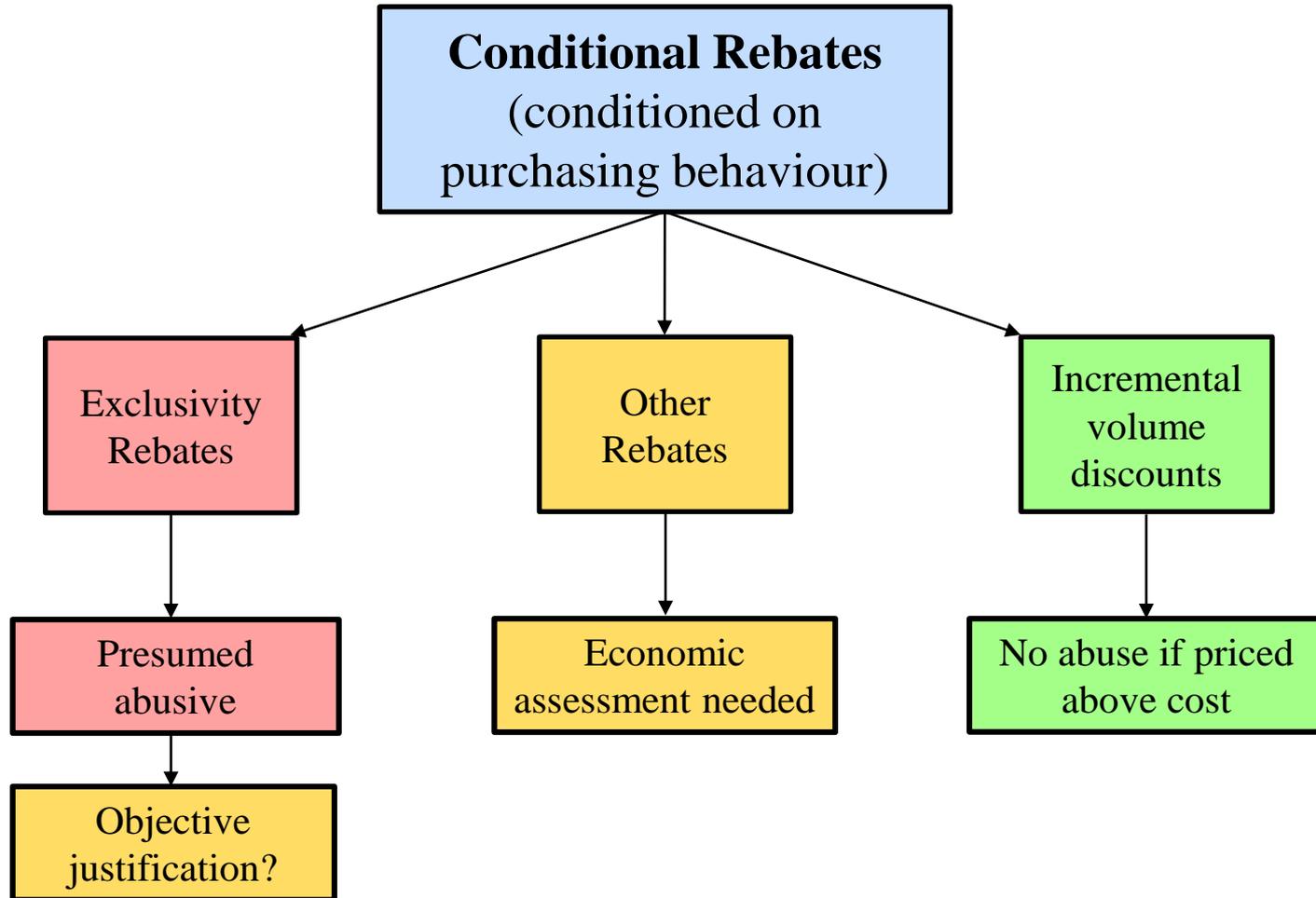
Other Loyalty-Inducing Rebates

“ What is in the Commission’s view relevant for an assessment of the loyalty enhancing effect of a rebate is [...] the foreclosing effect of the rebate system on (actual or potential) competitors of the dominant supplier. ”

Commission Guidance Paper on enforcing abusive exclusionary conduct by dominant undertakings (2009/C 45/02)

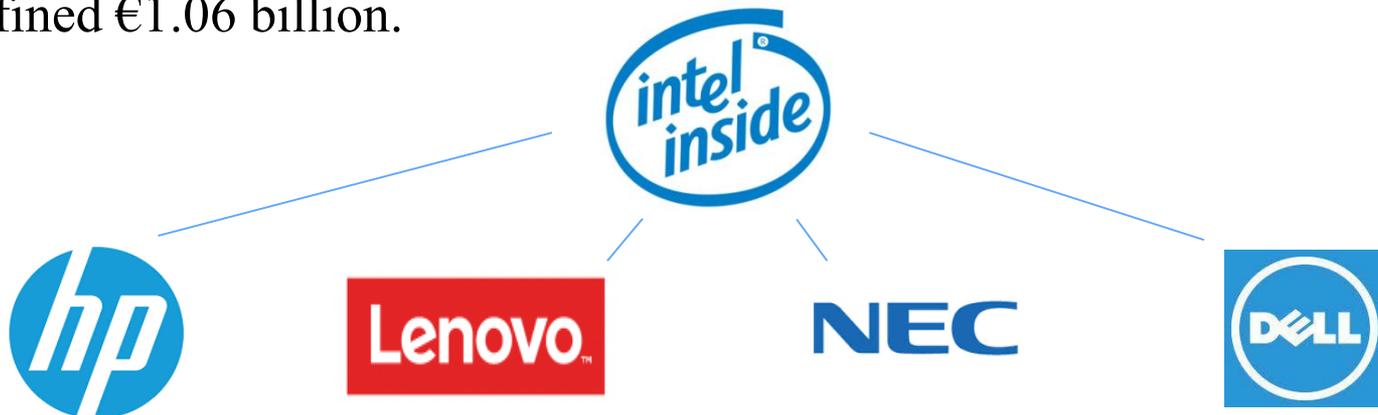


Are There Still Three Categories?



The *Intel* Case

- Intel found to be dominant in the worldwide market for CPUs with x86 architecture (70% share).
- Intel conditioned discounts to Dell, HP, NEC and Lenovo on requirement to purchase CPUs from Intel. And paid OEMs to postpone or delay launch of its major rival's CPUs.
- European Commission determined that rebates were exclusionary and were by their nature capable of restricting competition.
- Intel fined €1.06 billion.



The Court of Justice Judgment in *Intel*



- The Commission and General Court held that exclusivity discounts can be treated as “by nature” restrictive without the need for further examination.
- The Court of Justice took a more nuanced position.
 - Exclusivity discounts are presumed to be restrictive.
 - The dominant firm can rebut this presumption if supported by evidence.
 - The Commission must then prove that the conduct is capable of producing anticompetitive effects based on an examination of all relevant circumstances.



The “As Efficient Competitor” Test



- The Court of Justice held:

*“Competition on the merits may, by definition, lead to the departure from the market or the marginalisation of **competitors that are less efficient**”*

- This requires:

“an analysis of the intrinsic capacity of that practice to foreclose competitors which are at least as efficient as the dominant undertaking.”

“The General Court must examine all of the dominant undertaking’s arguments seeking to call into question the validity of the Commission’s findings concerning the foreclosure capability of the rebate concerned.”

*“the AEC test played an important role in the Commission’s assessment of whether the rebate scheme ... was **capable of having foreclosure effects on as efficient competitors.**”*

“In those circumstances, the General Court was required to examine all of the dominant undertaking’s arguments concerning that test.”

Case Study – Qualcomm

- Qualcomm dominant in LTE chipsets (90% share).
- Qualcomm paid Apple to use only Qualcomm LTE chipsets in iPhones and iPads from 2011 to 2016.
- Using other chipsets would result in the loss of future payments and “clawback” of payments already made.
- Commission found that Qualcomm’s conduct was presumptively unlawful ...
- ... but considered evidence submitted by Qualcomm that payments were incapable of foreclosing competition.



Case Study – Qualcomm

- Relevant factors in effects assessment included:
 - Extent of Qualcomm’s dominance
 - Proportion of market covered by the agreements (and by Apple as a customer of LTE chipsets)
 - Duration of the agreement and amount that Apple would have to repay if it switched
 - Contemporaneous evidence that Apple considered switching but was influenced by payments by Qualcomm in deciding not to.
- Commission ultimately rejected Qualcomm’s arguments.



“ Qualcomm's strategic behaviour prevented competition and innovation in this market, and limited the choice available to consumers. ”

Margrethe Vestager
European Commissioner
July 2019



Case Study – Google Android

- Google found dominant in:
 - Licensable smart mobile OSs (excluding Apple) with 95% of worldwide market
 - App stores for Android mobile OSs as Play Store accounts for 90% of Android app downloads.
- Commission held that Google acted abusively by making payments conditional on “*exclusive*” pre-installation of Google Search.
- Revenue sharing agreements provided payments to OEMs on the condition that they:
 - Pre-installed Google Search
 - Did not pre-install another search app (although user could download others).



Case Study – Google Android

- Google argued that equally efficient competitor could offset revenue-share payments.
- Relevant factors in effects assessment included:
 - Proportion of market covered by the agreements
 - Effect on OEMs’ incentives to pre-install rivals
 - Whether rivals could profitably overcome any reduced incentives by compensating OEMs
 - Whether rivals could overcome any reduced incentives through user downloads
 - Any other efficiency or objective justification for “exclusivity”.
- Commission accepted need to consider Google’s evidence on AEC but ultimately rejected its arguments.

“ Google has used Android as a vehicle to cement the dominance of its search engine. *These practices have denied rivals the chance to innovate and compete on the merits.* ”

Margrethe Vestager
European Commissioner
July 2018



The Concern with Exclusionary Rebates

- A dominant firm leverages a **non-contestable portion of demand** to foreclose smaller, equally efficient competition from the **contestable portion of demand**.
- Exclusionary mechanism:
 - Discounts offered on conditions that link purchases of non-contestable and contestable portions of demand.
 - If the customer switches the contestable portion of its demand, it also loses discounts on purchases that it cannot switch.
 - The rival therefore needs to compensate the customer for the lost discount on the portion of demand **that is not switched** as well as matching the price on the contestable share.
 - This can make it impossible for a smaller competitor to offer a competitive price because even an equally efficient supplier would have to sell below cost.

Example of Retroactive Rebate

- Retroactive discounts paid on all units if customer hits target.
 - List price of product is £10.
 - 6% retroactive discount if customer purchases 100 units or more in one year.
 - Customer pays £990 for 99 units but only £940 for 100 units.
 - Customer pays less for 100 units than for 99 units. Price of last unit is -£60.
- Similar issues can arise with a prospective discount system if it “penalizes” customers for missing target with discount reduction on future sales.



But Competitive Effects Depend on Economic Factors

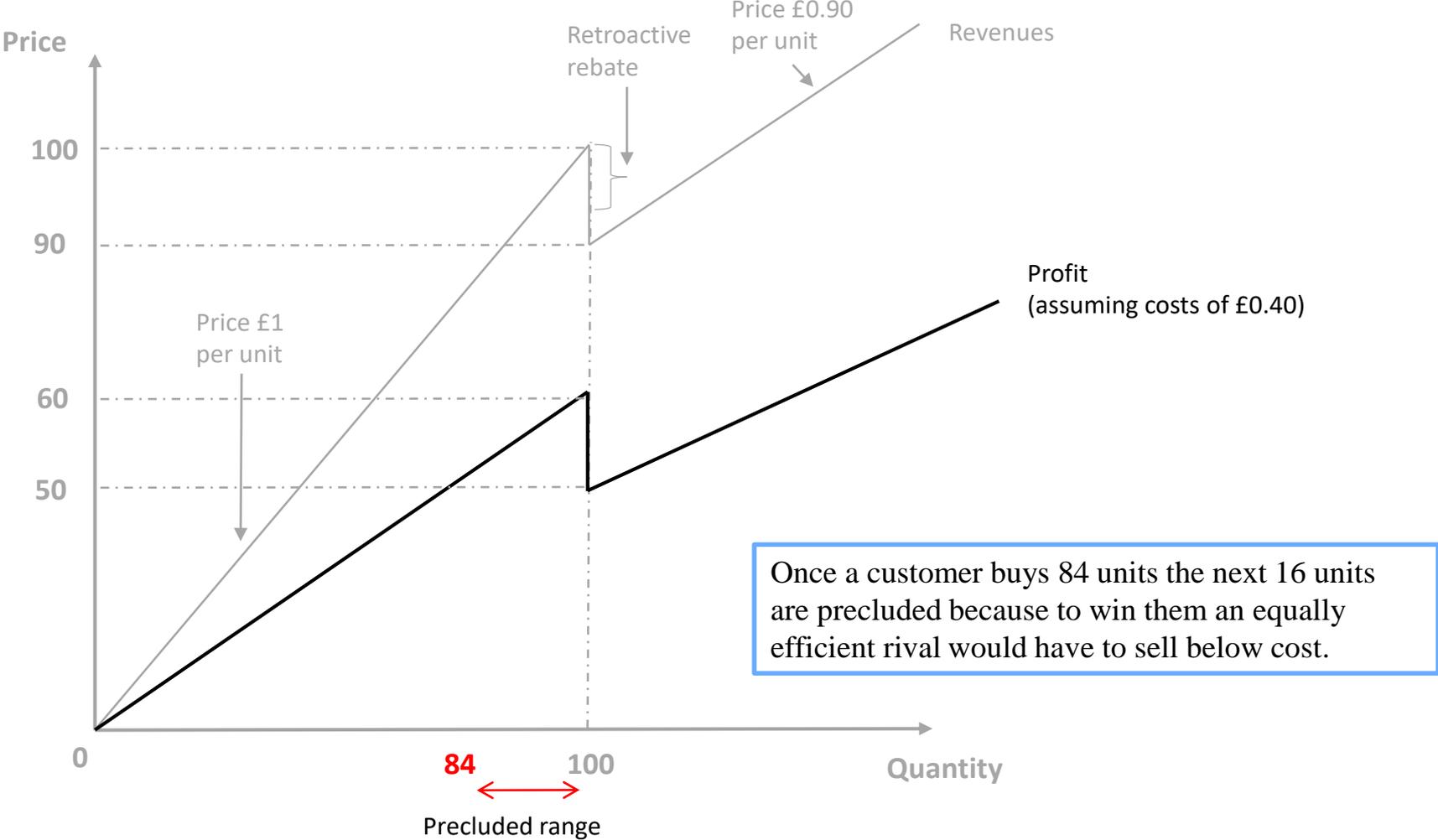
- Whether equally efficient rivals will likely be foreclosed depends on:
 - **The size of the contestable portion of demand.** The larger the contestable portion of demand, the less likely a discount will foreclose rivals.
 - **The level of the discount.** The smaller the discount, the less likely restrictions will arise.
 - **Cost structure.** The relevant costs for the analysis are the costs of the dominant firm. “Long run average incremental costs” or “average total costs”?
- “As efficient competitor” test examines these factors to determine whether discount is likely to foreclose equally efficient rivals.
 - What is the **effective price** that a rival needs to offer to match the discount and win the contestable portion of demand?
 - Does the effective price exceed the dominant firm’s costs?

Example of AEC Test

- Retroactive rebate scheme.
 - Non-contestable demand: 75% (assume 75 units).
 - Price: £10 per unit.
 - Discount of 10% on all units if customer buys 100 units.
 - Total discount: $£1 \times 100 = £100$.
- Apply total discount to contestable share.
 - $(25 \times £10) - £100 = £150$.
 - Effective price of contestable units: $£150/25 = £6$.
 - Is dominant firm's costs $>£6$ per unit?
- Assume discount is 20%:
 - Effective price becomes £2.



Example of Retroactive Rebate



The CMA's No-Abuse Finding in *Remicade*

- MSD UK proposed a volume based discount matrix for Remicade when biosimilars entered.
 - Matrix was based on forward-looking reviews
 - If purchases met volume threshold, a higher discount applied in the next period.
 - CMA alleged that if threshold was not met, discount would be lowered.
- The CMA argued that the matrix was designed to exclude biosimilars by leveraging a base of existing patients.

The CMA was concerned that MSD's Discount Scheme created a financial disincentive for the NHS to switch to Biosimilars, even though Biosimilars were significantly cheaper (per vial) than Remicade.



The CMA's No-Abuse Finding in *Remicade*

- MSD submitted AEC calculations showing no exclusionary effect.
- CMA did not place weight on AEC analysis but agreed that matrix was unlikely to produce an exclusionary effect.
 - Matrix was forward-looking, so no “suction effect.”
 - Switching of existing patients was higher than anticipated.
- Counterfactual analysis showed no effect in practice.



The Role of Intent

- An authority does not need to prove anticompetitive intent, but anticompetitive intent may be taken into account as an aggravating factor.
- In *Remicade*, the CMA alleged that MSD UK had anticompetitive intent but concluded that was not sufficient alone to find an abuse.
- If there is good evidence of anticompetitive intent (e.g. from internal documents), it will likely colour an investigation.

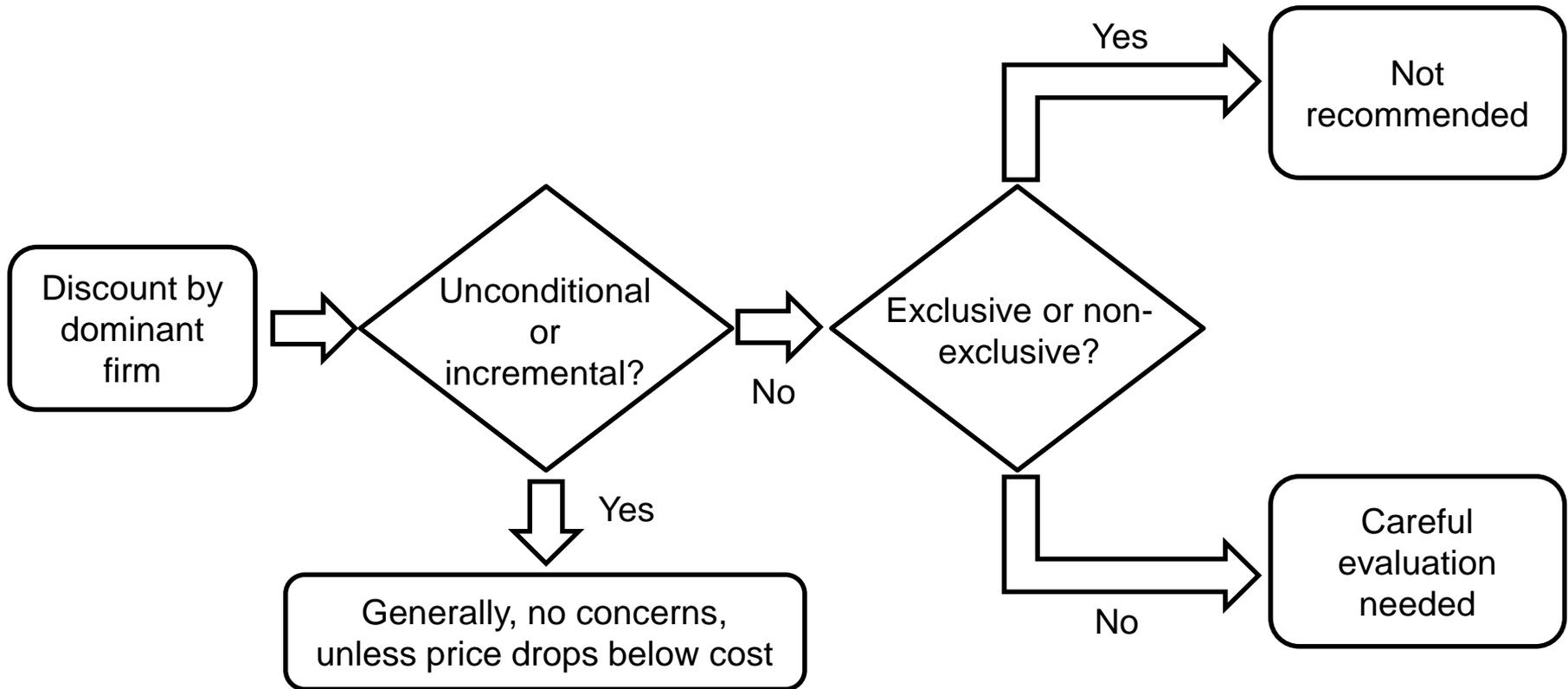
Although anti-competitive intent is neither a prerequisite nor sufficient in itself to establish an abuse, it is one of the factors that may be taken into account when determining whether a dominant position has been abused.



Conclusions

- Three categories of rebates still exist.
- Always possible to argue no anticompetitive effect, but caution required with exclusivity rebates.
- Authority will look to all available evidence – not just economic models.
- Questions remain over whether dominant entity’s own costs are the correct measure, given economies of scale.
- Authority likely to place weight on rationale, internal documents and other evidence of intention.
- Can exclusivity rebates ever be “objectively justified” in practice?

Discounts: Risk Assessment





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