SYMPOSIUM: AEC TEST POST-INTEL

The as-efficient competitor test: some practical considerations following the ECJ Intel judgment

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1. Introduction

The ECJ Intel judgment provides a strong endorsement for both an effects-based analysis and the as-efficient competitor principle for the application of article 102 TFEU. It is particularly remarkable that the Court made very broad statements in this regard, making it clear that article 102 TFEU is not meant to protect less efficient competitors. As explained in the judgment, competition on the merits may, by definition, lead to the departure of less efficient competitors from the market, and article 102 TFEU’s purpose is not “to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market”. Intel is by all means a far-reaching judgment on important principles.

Nevertheless the Commission has so far been rather ambivalent on how to interpret and practically implement the ECJ Intel judgment. While DG Competition cannot ignore the very clear principles set forth in the judgment, for the time being, it does not appear to embrace them either (to say the least). For instance, in his much anticipated speech at the CRA conference that took place two months after the ECJ Intel judgment, Director General Laitenberger minimised the importance of the as-efficient competitor test, which the Commission will use “where suitable”, and totally ignores the strong endorsement by the ECJ of the as-efficient competitor principle.

Communication on this topic by other DG Competition officials has so far been unusually limited, supposedly to avoid expressing dissenting internal views. Given that the ECJ Intel judgment gave a remarkably strong endorsement of the Commission’s Guidance Paper on exclusionary abuses, the Commission’s ambivalence is in my view a missed opportunity for the Commission to unambiguously reaffirm the relevance and importance of the Guidance Paper for its enforcement of article 102 TFEU.

1 Judgment of the Court (Grand Chamber) of 6 September 2017, Intel Corp. v European Commission, Case C-413/14 P (hereafter “ECJ Intel judgment”).
2 In this article, I make a distinction between the “as-efficient competitor principle” and the “as-efficient competitor test”. The principle is meant to designate the general consideration that article 102 TFEU is not meant to protect competitors that are less efficient as the dominant company. The as-efficient competitor test is a narrower test aimed at establishing whether an as-efficient competitor can effectively match the offer made by the dominant company. In the case of loyalty rebates, the as-efficient competitor test can be performed by checking whether a company that has the same cost structure as the dominant company is able to profitably match the offer made by the dominant company. In case of loyalty rebates, the as-efficient competitor test is narrowed still further to establish whether a company that has the same cost structure as the dominant company is able to profitably match the offer made by the dominant company, when all rebates that the customer would lose in case it switched supplier, are applied to the contestable share of the customer’s demand.
3 ECJ Intel judgment, para. 133 and 134.
4 As explained in Assimakis Komninos’s paper in this symposium, “Intel: The ECI Finally Speaks – Time to Listen”, Intel should be seen as a programmatic or framework judgment, which pronounces fundamental principles, and leaves the Commission with the opportunity and flexibility to use the appropriate tools to apply these principles in the context of an effects-based analysis.
Moreover, in the recent Qualcomm case, in which the Commission found that Qualcomm infringed article 102 TFEU by offering exclusivity rebates to Apple for LTE baseband chipsets, the Commission did not implement an as-efficient competitor test (hereafter, “AEC test”). The Commission deemed sufficient to reject the AEC test submitted by Qualcomm, and to rely instead on internal documents from Apple, without conducting its own AEC test. It thus seems that according to the Commission, the finding of an abuse was clear enough without any need for checking whether the conduct would pass the as-efficient competitor test. Remarkably, the Commission appears to believe that this approach is fully in line with the ECJ Intel judgment. In particular, the Commission gave significant weight to internal documents from Apple, without conducting its own AEC test. It thus seems that according to the Commission, the finding of an abuse was clear enough without any need for checking whether the conduct would pass the as-efficient competitor test. Remarkably, the Commission appears to believe that this approach is fully in line with the ECJ Intel judgment. In other words, what is the standard under which the excluded competitor would be considered “as efficient”? Based on the limited public information currently available, the implicit standard that the Commission applied in Qualcomm does not appear to be very high, since the Commission seems to consider that it is entirely in its discretion whether to conduct an as-efficient competitor test, and that it may instead rely on other evidence that may not directly address this question.

In light of these developments and recent learnings from the economic literature, I first briefly discuss below the role of the AEC test in exclusivity rebate cases. I then highlight a few practical implications for how the AEC test should be conducted when assessing whether exclusivity rebates are anticompetitive.

2. The Role of the As Efficient Competitor Test

2.1 The AEC Test is one useful element of a broader theory of harm

As clearly set out in the Commission’s Guidance Paper, the as-efficient competitor test is an input which fits within a wider theory of harm. Showing an infringement requires establishing anticompetitive foreclosure, i.e. foreclosure of competitors that would result in consumer harm. Showing, on the basis of an as-efficient competitor test, that a competitor that is as efficient as the dominant company cannot match the dominant company’s offer is thus just one step in testing the theory of harm. Showing that this foreclosure would harm customers also requires establishing that the conduct is of such magnitude, and market conditions are such, that it would effectively foreclose an as-efficient competitor from the market to the detriment of consumers. In practice, such a finding of consumer harm will thus depend on a variety of factors, such as the share of the market covered by the practices, the power of the incentives provided by the rebates and the size of the non-contestable share of demand, the importance of economies of scale and the intensity of downstream competition.

While the as-efficient competitor principle has been strongly endorsed by the ECJ Intel judgment, recent developments in the economic literature may seem to call into question the relevance of the as-efficient competitor test in the context of exclusivity rebates. Indeed, economic models have identified specific situations where exclusion of an as-efficient competitor can take place without the dominant company pricing below cost. In such situations, an asymmetry between the incumbent and the new entrant may prevent an as-efficient competitor from effectively countering the dominant company’s offer, even if the dominant

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9 In particular, the Commission gave significant weight to internal documents from Apple (see European Commission’s press release of 24 January 2018).
12 This asymmetry may for instance result from a first-mover advantage of the dominant company (that has already sunk the fixed cost of entry) and coordination failure among buyers, or from the financial constraints that the new entrant may face.
company prices above cost. Furthermore, a less efficient competitor may still exert a competitive constraint on the dominant company, so that the exclusion of such a competitor could also lead to higher prices for customers.

The as-efficient competitor test provides a strong disciplining mechanism for the Commission.

This has led some leading scholars and economists to advocate against the use of price-cost tests in the context of conditional rebates, given that such test may lead to both type 1 (over-enforcement) and type 2 (under-enforcement) errors. Notably, my esteemed colleague Steve Salop has proposed an alternative approach based on a raising rivals’ cost framework. In this framework, exclusivity may lead to both type 1 (over-enforcement) and type 2 (under-enforcement) errors. Notably, my esteemed colleague Steve Salop has proposed an alternative approach based on a raising rivals’ cost framework. In this framework, exclusivity makes it harder for potential entrants and existing competitors to compete effectively, thereby reducing the competitive pressure on the dominant company, which may result in higher prices even if the foreclosed competitor is less efficient than the dominant company. The focus under a raising rivals cost framework is on the magnitude of the foreclosure and possible consumer harm. On this basis, Professor Salop argues that “[t]raditional rule of reason and antitrust injury analyses capture anticompetitive, consumer harm from [Conditional Pricing Practices] better and more consistently than a price-cost test.”

Interestingly, the use of the AEC test within a wider theory of harm, as mandated in the Guidance Paper, also ensures that a proper focus is placed on foreclosure and consumer harm before finding an infringement, just as it is with a raising rivals’ cost framework. A difference however is that under an as-efficient competitor principle, exclusion of a less efficient competitors should not in principle be considered as constituting an infringement.

When choosing a rule aimed at providing guidance to firms from an ex-ante perspective, there is a good reason to depart from an approach aimed at considering as anticompetitive any conduct that could harm welfare. While it is true that anticompetitive effects can take place in a variety of situations, even in some instances when the AEC test is passed, this does not mean that a rule that ignores the AEC test is superior to a rule that provides a safe harbour based on the as-efficient competitor test. Indeed, a pure case-by-case analysis without clear rules provides little guidance to firms, and hence risks discouraging pro-competitive behaviour. Competition for exclusivity enhances rivalry, and hence having safe-harbours that firms can implement ensures that such competition takes place when exclusivity is usually not anticompetitive.

Furthermore, the as-efficient competitor test provides a strong disciplining mechanism for the Commission. Indeed, one would want to avoid the Commission having to conduct a full-blown investigation every time a complaining competitor is excluded from the market. Exclusion is a normal outcome of competition on the merits - less efficient competitor often simply get driven out of the market as a result of competition. Risks of type 1 error are thus high given the difficulty of determining whether the exclusion was the result of anticompetitive conduct, or just the result of such competition on the merits. Furthermore, while it is correct that the exclusion of a less efficient competitor may in some instances release a constraint on the most efficient competitor, artificially maintaining less efficient competitors in place may also crowd out more efficient entry. It

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13 The AEC test, defined narrowly, is passed when the effective price is above the cost of the dominant company. In the case of rebates, the effective price is defined as the list price offered by the dominant company, minus the rebate that the customer loses by switching (where the rebate is applied over the contestable share of sales).


thus seems natural to focus enforcement resources on the more harmful conduct, which consists in the exclusion of as-efficient competitors. The AEC test allows to identify such exclusion, and provides clear guidance to dominant firms (in contrast, a rule that says that rebates can also be considered anticompetitive if they lead to the exclusion of less efficient competitors does not provide clear guidance to companies determining their pricing policies).

Finally, it is often said that exclusivity rebates are different from pure pricing practices because the intent is to exclude, and hence pricing tests are less relevant in the context of exclusivity rebates. However, the same exclusionary mechanisms are at play for exclusivity rebates as for pricing practices such as predation, and a strong conceptual difference in the treatment of both types of practices is thus not justified from an economic point of view. In other words, there is no sound basis for ignoring the AEC test in exclusivity rebates, while relying on it for other exclusionary practices such as predation.

2.2 When to use the AEC Test

Of course, this does not mean that an AEC test needs to be carried out in every case. In particular, taking into account all circumstances of the case, the finding of an infringement can safely be rejected if it is clear that the practice could not lead to consumer harm, without it being necessary to formally conduct the AEC test. This could be the case for instance when the exclusivity rebate has a very small market coverage, or when the rebate itself is relatively limited.

Whether the converse - i.e., that the exclusivity rebate would be so clearly abusive that there is no need to conduct an AEC test to establish infringement – would be true is in my view doubtful. Maybe the rebate is so high and the contestable share so low that one can be very quickly be satisfied that the dominant company would not pass the test, but this is still carrying out the test. Furthermore, having a large part of the market covered would not be sufficient to establish concerns if the suction effect of the rebate is small.

Can the Commission then find an infringement without relying on the as-efficient competitor test? Here, I think it is useful to distinguish two situations.

First, if the Commission is considering a theory of harm based on the exclusion of an as-efficient competitor, running such a theory without relying on an as-efficient competitor test appears particularly risky for the Commission, as it could easily be challenged (in particular, if the dominant company submits its own AEC test, as per para. 138-139 of the ECJ Intel judgment).

Of course, the results of the test must be seen in light of the strength of the evidence, and other evidence also has to be taken into account, but the AEC test cannot in my view simply be ignored in such a situation. Indeed, if the ECJ’s Intel judgment has to have any meaning, it is necessary for the Commission to establish a coherent theory of harm showing that the practice excludes an as-efficient competitor. Conducting an AEC test is a critical element to test such a theory of harm.

Second, the Commission may be considering a theory of harm that does not rely on the exclusion of an as-efficient competitor. Although the AEC test is not determinant for such a theory of harm, it still provides useful information for assessing the investigated practice. For example, if the dominant company prices above cost, one would need to establish why the rival cannot counter the dominant company’s offer. Furthermore, one can wonder whether the Commission should run such theories of harm, especially given the strong as-efficient competitor principle set forth in the ECJ Intel judgment. At the very least, the standard of proof that the Commission would need to meet to establish such a theory of harm should be very high.
3. Some Practical Implications for the AEC Test

3.1 The importance of contemporaneous evidence

Dominant companies would be well-advised to conduct an as-efficient competitor test at the time they are considering offering an exclusivity rebate, rather than only later on in the context of an investigation. This is for two main reasons.

First, conducting an AEC test as part of a systematic compliance exercise allows dominant companies to get a good view of the competitive impact of their rebates before implementing them. For example, a rebate that does not pass the AEC test should be seen as risky from a competitive angle (unless other circumstances of the case indicate that exclusion of an as-efficient competitor is unlikely, e.g. due to the coverage of the rebate), while a rebate that comfortably passes the AEC test is much safer (subject to the considerations below). The test therefore provides useful actionable information for dominant companies.

Second, the Commission is likely to give more weight to an AEC test conducted in tempore non suspecto than to a test conducted solely as part of the dominant company’s defence during an investigation.

The Commission is likely to give more weight to an AEC test conducted in tempore non suspecto.

For instance, the Commission rejected the AEC test conducted by Qualcomm during the investigation and relied instead on Apple’s internal documents suggesting that Apple gave serious consideration to switching part of its supplies to Intel, and that Qualcomm’s exclusivity condition was a material factor why Apple had ultimately decided not to do so.21 If Qualcomm had performed an AEC test before granting the rebate, it might have been more difficult for the Commission to discard such contemporaneous evidence – at least Qualcomm would then have been able to bring contemporary evidence placing Apple’s documents in context.

Of course, what should ultimately matter is not when an analysis was conducted, but whether it is sound. Furthermore, one should note that internal documents from a customer suggesting that it is not using a competitor because the cost of losing an exclusivity rebate is too high, does not provide evidence that the exclusivity rebate excludes an as-efficient competitor. A customer’s internal documents would provide relevant information regarding the exclusion of as-efficient competitors only if i) the offer by the competitor is at cost, ii) the competitor has the same costs or lower costs than the dominant firm, and iii) the offer is for the contestable share of the demand.

However, given the Commission’s apparent reluctance of fully applying the learning from Intel, any practical possibility of reinforcing the credibility of the AEC test is useful. Conducting the test early means that it is used as a decision tool rather than as a justification during the proceedings, which makes it more difficult for the Commission to ignore.

3.2 The non-contestable share of demand

Leveraging a non-contestable share of a customer’s demand to exclude a competitor on the contestable share is a key mechanism through which exclusionary abuse can take place. In the presence of a non-contestable part of the customer’s demand, the competitor can only bid for part of the customer’s business.22 By making the effective price on this contestable share too low for a competitor to enter, the incumbent can exclude an as-efficient competitor. Such a strategy would be particularly interesting for a dominant company if the competitor could later develop and challenge the dominant company also on the non-contestable share of its demand.

22 Conversely, in the absence of a non-contestable part of the customer’s demand, an entrant could compete for the entire customer business, and hence the dominant company’s exclusivity rebate would have no anticompetitive effect.
Thus, knowing how big the contestable share is, is critical for assessing the impact of an exclusivity rebate. Yet, there is quite some uncertainty as to what the contestable share of a customer demand is, and different stakeholders may reasonably take divergent views on this difficult question. As detailed in the Guidance Paper, the Commission should therefore take into account the margin of error that is inherent to this type of exercise.23

From a practical point of view, it is thus essential to conduct a thorough sensitivity analysis with respect to the non-contestable share of the market, essentially calculating the AEC test under several plausible non-contestable share hypotheses.

As a potential guide to conservatively determine a plausible contestable share as part of a compliance exercise, one may for instance want to consider the share that the competitor was able to obtain with other customers. In case of a new entrant, one may want to consider the shares that (similarly placed) competitors are able to obtain with similar customers. These should be seen as conservative approaches (everything being equal), since observed shares are by definition smaller or equal to the shares that could potentially be obtained.

### 3.3 Key Customers

In its Intel judgment, the ECJ indicates that one of the factors that the Commission should analyse is the share of the market covered by the challenged practice.24 While it is clear that a rebate that would only cover a tiny part of the market would not be sufficient to lead to anticompetitive effects, what should in practice be the threshold for potential anticompetitive effects to materialise?

The guiding principle should be to consider whether the market coverage is large enough for deterring entry by an as-efficient competitor (or for preventing the development of an existing as-efficient competitor). Hence, the response is definitely case-specific, as it will depend on the profitability of entry on the part of the market not covered by the practices, which in turn depends on the size of the market and the margins that can be achieved with the remaining customers. These must be sufficient for the entrant to cover its fixed cost of entry. In addition, market coverage has to be seen in light of the strength of economies of scale, to determine whether a competitor can attain a size that allows efficient production on the part of market not covered by the practice.

It is thus in principle not necessary for the practices to cover the near entirety of the market for anticompetitive effects to materialise. In some markets, access to key customers may be necessary for allowing entry by as efficient competitors, and a strategy targeting such customers may be sufficient to deter such entry. The dominant company could thus apply a “divide and conquer” strategy, consisting in pricing below cost for some critical customers to deter entry, and recouping these losses by charging higher prices to remaining customers (which would not be sufficient to trigger entry by themselves).25

Of course, in some markets, key customers may be large enough in themselves to justify entry – in such a case, the new as-efficient entrant should in principle be able to compete for this customer and replicate the dominant firm’s offer, except possibly in specific circumstances (e.g. when part of this customer’s demand is non-contestable).

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23 Guidance Paper, para 41.
24 ECJ Intel judgment, para. 139.
25 Another reason why the dominant undertaking may compete aggressively for key customers is if such customers would have the ability to self-supply.
takes credit for its decision ensuring Intel is able to compete for Apple’s supplies, at the same time observing Intel being able to supply around half of Apple’s poses question on the relevance of the Commission's theory of harm. 29

So while the guiding principle with respect to the length of the exclusivity should be whether the competitor can still effectively compete in the next contract renewal, a cautious dominant firm may want to limit the exclusivity duration as much as possible. 30 However, the length of the exclusivity should not be viewed in abstracto, but very much depends on the specifics of the case and the rationale for exclusivity. For example, the exclusivity rebate may have been agreed because of the specific investments that the supplier had to undertake to supply the customer. A longer exclusivity period may be fully justified if necessary to recoup the cost of such investments.

3.5 Entrants that are not yet as efficient

The Guidance Paper foresees that the AEC test should be applied in a dynamic sense. 31 That is, if an entrant is just less efficient at first given its limited scale, but would otherwise be considered as as-efficient when it reaches a larger scale, the AEC test should not be applied in a narrow sense, but one should consider whether such a dynamically as-efficient competitor would be excluded from the market. This does make a lot of sense, as one should not allow a dominant company to take advantage of its economies of scale to kill competitors that would provide a strong source of competition down the line.

One possible temptation however for the Commission would be to consider that it can

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27 This point is also echoed in the FTC complaint against Qualcomm (Federal Trade Commission's Complaint for Equitable Relief, January 17, 2017, para. 129), which considers both potential static and dynamic effects of being an Apple supplier. Specifically, the FTC complaint highlights the following points. First, Apple sells large volumes of premium handsets that require premium processors with high margins, which helps a new entrant "achieve a scale of business that confers research-and-development flexibility." Second, a new entrant would learn "from engagement with Apple's engineering teams," achieves technical validation by demonstrating its ability to meet Apple's demanding technical requirements," and "can field-test its processor through global launches." Finally, the FTC considers that "[a] nascent supplier obtains a reputational halo effect from selling to Apple. This reputational boost may help a supplier win sales at other OEMs."

28 Commissioner Vestager’s speech of 25 January 2018 mentions the

29 At least from a dynamic point of view, Intel not supplying Apple with LTE baseband chipsets during the infringement period has not prevented Intel from developing into an effective competitor able to supply a very significant share of Apple’s requirements. And would an as-efficient competitor able to supply around half of the customers’ demand not have been able to match Qualcomm's offer/compensate Apple for the loss of Qualcomm's rebate if Apple switched part of its supplies to Intel?

30 This is of course a different issue from the question of the period that should be taken into account to calculate the as-efficient competitor test. This question is discussed in the article by Aleksandra and Xavier Boutin included in this symposium.

quickly discharge its burden of proof with regard to the as-efficient nature of the competitor, e.g. by pointing to internal customer documents highlighting the switching costs that exclusivity rebates create, but without directly assessing whether the rebates had an exclusionary effect on as-efficient competitors.

Such a loose interpretation of what constitutes an as-efficient competitor would be misguided. It is important to be very restrictive about what one considers as an as-efficient competitor. As-efficient competitors should include competitors that are likely to become as efficient when they gain more scale, and such a prospect must not be merely hypothetical. Clear evidence on the as-efficient nature of the excluded competitor, rather than loose considerations, needs to be relied upon to establish an infringement. Otherwise, the ECJ judgment’s strong and sound principles would be devoid of any meaning.

4 Conclusions

While the ECJ has made it clear in its Intel judgment that article 102 TFEU is not meant to protect less efficient competitors, DG Competition so far appears to not fully embrace this view and to take a somewhat ambivalent position towards the AEC test. While applying the AEC test consistently, as also set forth in the Commission’s Guidance Paper, would be an important disciplining mechanism for the Commission, it is currently unclear when exactly the Commission considers it necessary to use such a test.

Practically, and even in light of these uncertainties, the AEC test has a lot of value for dominant companies. Since the ECJ considers that it is necessary for the Commission to essentially conduct an effects analysis if the dominant company shows that its conduct is not capable of foreclosing an as-efficient competitor, one should expect that dominant companies will typically run such a test as part of their defence (and that the Commission, anticipating this would also be well-advised to do so). But even more fundamentally, I would recommend that dominant companies apply the AEC test as part of their compliance process before granting exclusivity rebates, which also make it easier to defend in light of other contemporaneous evidence reviewed by the Commission during its investigations.

Conducting the AEC test is an exercise that economic experts routinely apply when advising dominant companies. Of course, while the assessment may be more complex in some markets, and identification of the relevant costs and contestable shares require careful economic consideration and judgment, the test itself relies on a relatively limited amount of data and information from the dominant company, and hence can generally be carried out within a relatively short timeframe, as part of the test for a broader anticompetitive foreclosure theory of harm.

Indeed, the AEC test should be seen as one input within a coherent exclusionary theory of harm taking into account all circumstances of the case. In some instances (e.g. when the market coverage is limited and does not concern critical customers), a careful assessment of the facts of the case may thus be sufficient to dismiss the possibility of anticompetitive effects, without it being necessary to conduct a formal AEC test. This is true not only for exclusivity rebates, but also for a wide variety of discounts and payments that lead to some form of price discrimination across customers, which are widespread and often enhance rivalry among suppliers.