

Rebates – Tomra, Intel

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**Views expressed are personal and do not necessarily reflect those of OFT*

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Summary

- **What do we mean by effects analysis?**
 - Likely effects or actual effects
- **Issues with the Tomra judgment?**
 - Is the General Court setting the wrong threshold?
 - Is the General Court avoiding economic analysis?
- **How does this fit with Intel?**
 - Is Intel the right benchmark for effects analysis of rebates?



The Tomra case

- **Tomra sells reverse vending machines**
- **Supermarkets are a key customer**
- **Use of exclusive agreements, individualised quantity commitments and retroactive rebates by Tomra to tie up a significant proportion of the market**
- **Complaint by a small rival Prokent, which became insolvent in 2003**
- **Commission decision March 2006 - fine of €24m**
- **General Court decision September 2010 – appeal dismissed in its entirety, upholding Commission’s decision**

3 key arguments from Tomra

1. Inadequate evidence of actual effects

2. Inadequate analysis of the rebates

- no examination of Tomra's costs to determine whether rebates capable of foreclosing competition

3. Insufficient coverage of total demand

- 61% of the market open to competitors so alternative routes to market available

Actual or likely effects

- Hoffmann La Roche considers whether the conduct ‘has *the effect* of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition’
- “The ‘effect’ referred to in [Hoffmann la Roche] does not necessarily relate to the actual effect of the abusive conduct complained of. For the purposes of establishing an infringement of Article 82 EC, it is sufficient to show that the abusive conduct of the undertaking in a dominant position tends to restrict competition or, in other words, that the conduct is capable of having that effect.” Michelin II para 239 cited by General Court in Tomra at para 289.
- EC article 82 Prioritisation guidance talks throughout about ‘likely’ or ‘potential’ effects

'likely' effects is the correct standard

- **Can never observe the counterfactual ⇒ pure 'actual' effects analysis impossible**
 - Tomra's argument that exit of competitors is not evidence of effects of conduct but is due to alternative reasons indicates the difficulty of actual effects analysis
- **Philosophically 'likely effects' captures the objectives of article 82**
 - Ability to prevent harm before actual effects occur
 - Deterrence requires that unsuccessful attempts to harm competition should be caught
- **Judgment confirms (para 219) that examination of actual effects is not necessary**
- **Paras 287-9 imply that demonstration of likely effects is not necessary but instead only that conduct is 'capable of' having that effect**

Key question is the level of evidence required to meet the 'likely' or 'capable of' threshold

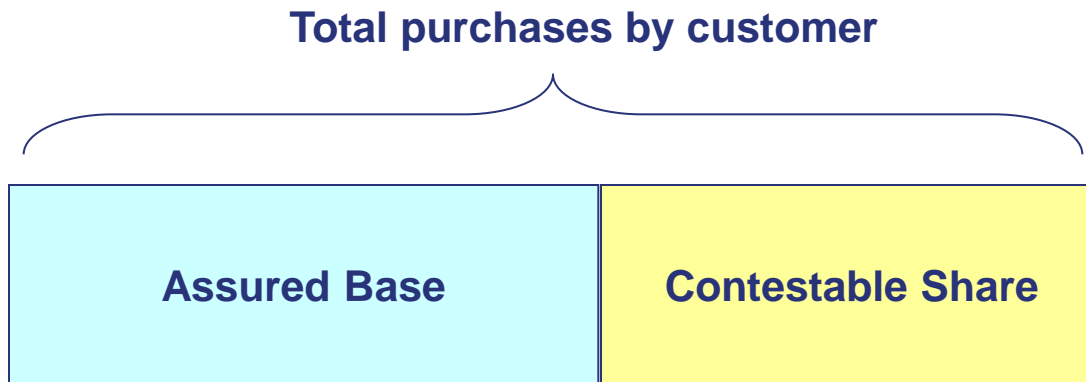
Rebates: A per se abuse?

General Court cites Hoffmann La Roche (at paras 208-9) and Michelin II (at paras 210-11) that de facto exclusivity is an abuse of dominant position

Para 216 poses question did the commission provide 'adequate statement of reasons'?

Paras 217-219 no real discussion of the adequacy of the analysis conducted

De facto exclusivity with rebates



If effective price over contestable share is lower than cost, an as-efficient competitor will not be able to make profitable sales to the customer.

Example: Cost is £8,000 per unit, Price is £10,000 per unit

Expected customer purchases is 100 units

A 5% discount if a customer buys 100 units

Effective price over last five units is zero (i.e. same price to buy 100 or 95 units)

Effective price over last 25 units is £8,000 (once customer has bought 75, next 25 units cost £200,000)

If assured base exceeds 75 units an as-efficient competitor cannot expect to make profitable sales

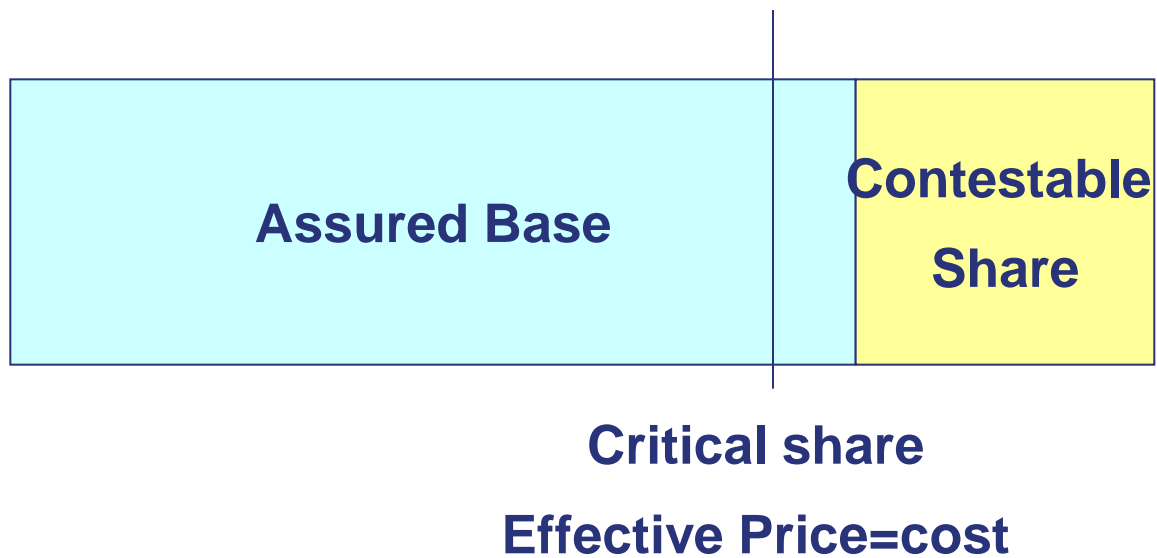
Effect of changes in costs

Costs per unit	Assured base sufficient for exclusivity
£8,000	75
£6,000	88
£5,000	90
£4,000	92
£2,000	94

Without looking at costs and assured base it is impossible to tell whether a 5% discount is sufficient to lead to de facto customer exclusivity or not

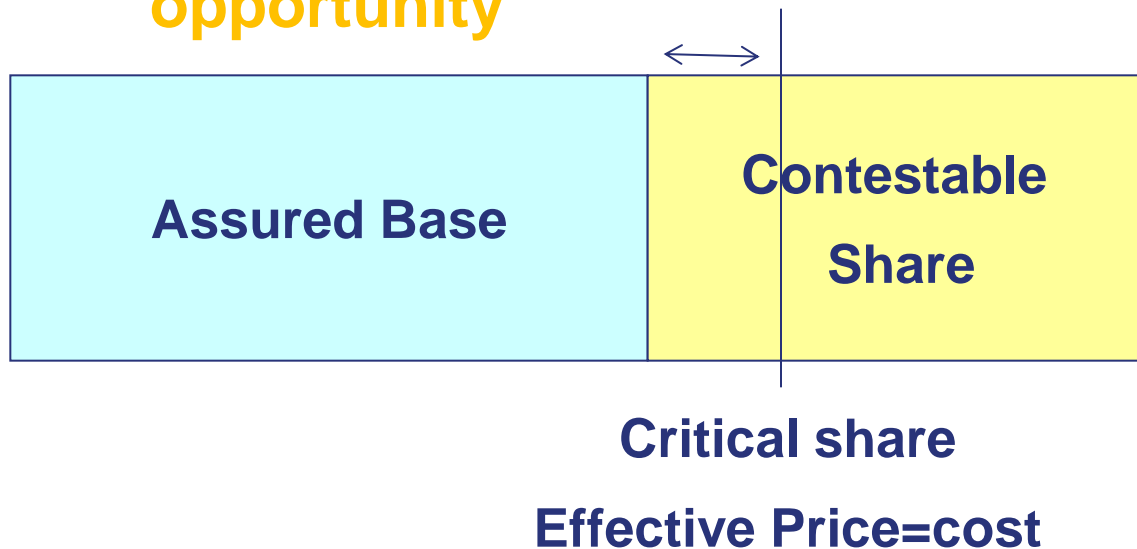
Window of opportunity

No window of opportunity

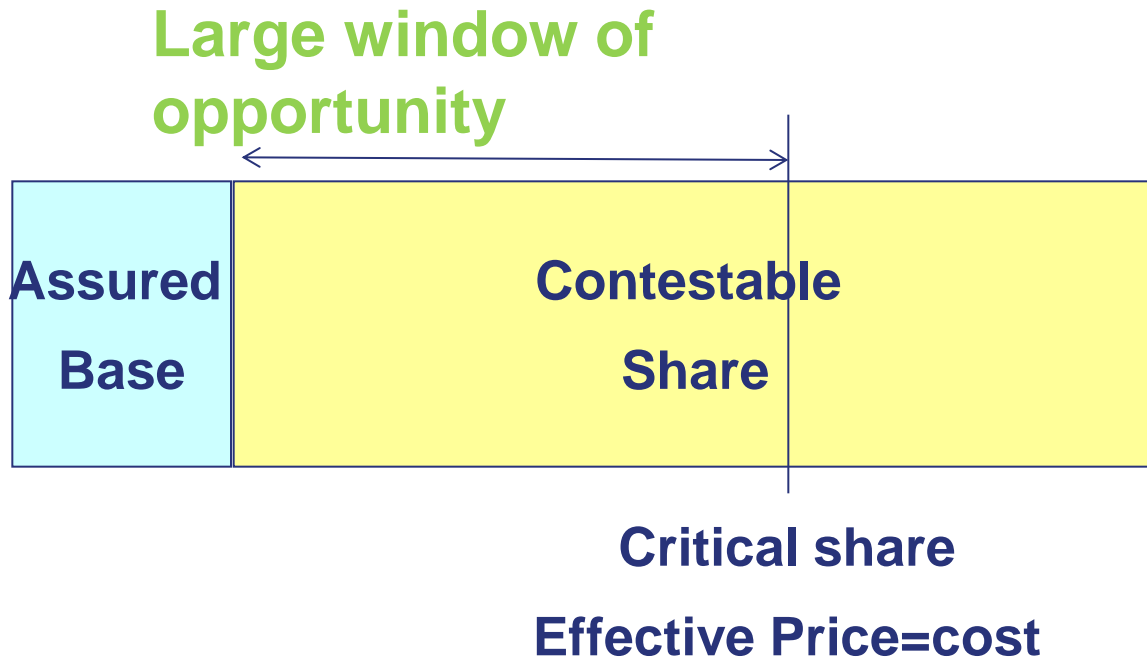


Window of opportunity

Small window of opportunity



Window of opportunity



Is assured base test necessary?

Effective price below cost over contestable share is sufficient to establish de facto exclusivity

Is effective price below cost over contestable share necessary to establish strong inducement to exclusivity?

Counter example:

Suppose cost =£8,000 and assured base sold is 70 units so effective price is above cost and exclusivity not automatic

Purchase of next ten units from competitor could save £20,000 but to do so loses the buyer the option of the £50,000 rebate

Buyer needs to commit to buy all 30 units from the competitor to achieve savings

Mechanistic application of test could lead to under-enforcement

Intel and Tomra

	Tomra	Intel
Timing	Pre article 82 guidance	Post article 82 guidance
Commission Decision	No discussion of assured base or costs	150+ pages of assured base, cost analysis
General Court	No engagement with details of effects analysis	?

Tomra - Effects on overall market

According to Tomra across whole market, including customers not on 'exclusive' deals, contestable share was 2000 units and minimum efficient scale is 500-1000 units

Therefore scope for efficient competitor to win business

General Court argues that it is not for dominant firm to determine number of competitors

A finding of abuse only if contestable share was less than minimum efficient scale, would mean that only de facto monopolisation is an abuse

- **Commission decision 2009**
- **Fine in excess of €1bn**
- **The market**
 - Central processing units (CPUs) used by original equipment manufacturers (OEMs) in PCs, laptops using the x86 architecture
 - No wider – non-x86 CPUs not demand or supply substitutes for x86 (Windows)
 - Possible submarkets (for PCs, laptops), but Intel's market share high for all

Substantial Dominance

- **High market share >80%+ in x86 CPUs. High market shares >70% in sub-markets. Sustained over 6 years**

“Market shares between 70% and 80% have, according to the case law, been held to be in themselves a clear indication of the existence of a dominant position”

- **High sunk and fixed costs – technology, design, marketing**
- **Significant economies of scale**
- *“It can therefore be seen that lower or minimised average costs of production are achieved at higher levels of production. What is more, these levels of production are high relative to the overall size of the market. A good illustration of this is AMD which, with its market shares of 10-20%, supplied virtually its entire stock of x86 CPUs from just one production facility until the end of 2005,. (para 863)*
- **Reputation/brand – Intel a ‘must have brand’ according to OEMs**
- **High gross margins**
- *“Intel’s financial data are indicative of the fact that the company has substantial market power that cannot be explained by the need to cover fixed costs alone. In fact, Intel’s operating margins are comparable to those of Microsoft, which enjoys a near-monopoly in its market and has been found to be dominant in a previous Commission Decision”*
- **Intel’s arguments – buyer power (but ‘must have’), and declining prices (but possibly a response to changing costs, technology, not evidence of no dominance)**

Abuse

- **Conditional rebates to key OEMs**

- Rebates to Dell conditional on them buying exclusively from Intel
- Rebates to HP conditional on them buying at least 95% of their CPU requirements from Intel. Restrictions on the remaining 5% e.g. had to be sold to SMEs only
- Rebates to NEC conditional on them buying at least 80% of their CPU needs for laptops, notebooks from Intel
- Uncertainty about the exact amount of rebate lost if switched to AMD but OEMs thought to be significant and disproportionate loss – internal documents

- *The Court of Justice of the EC has consistently ruled that ‘an undertaking which is in a dominant position on a market and ties purchasers — even if it does so at their request — by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking abuses its dominant position within the meaning of article 82 EC, whether the obligation in question is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate. The same applies if the said undertaking, without tying the purchasers by a formal obligation, applies, either under the terms of agreements concluded with these purchasers or unilaterally, a system of fidelity rebates, that is to say discounts conditional on the customer's obtaining all or most of its requirements — whether the quantity of its purchases be large or small — from the undertaking in a dominant position.’ (1)*

Application of the Guidelines

- **Position of substantial market power. Intel is a ‘must have’ with an assured base of sales with OEMs**
- **As efficient competitor analysis**
 - Contestable share – the proportion of the OEMs requirements that can realistically be switched to a new competitor over a given period
 - Established on basis of internal OEM documentation and testimony to be low – long switching horizons
 - A relevant time horizon for assessing the contestable share
 - One year on basis of contracts and technology shifts
 - Measure of cost - Average Avoidable Cost or Cost of goods sold
 - Considerable dispute over what constituted AAC
- **What price an as efficient competitor would have to offer, and over what share of sales (required share) to compensate for the loss of rebates.**
- **If required share to compensate at a $p > AAC$ is greater than contestable share then foreclosure.**
- **Commission used conservative estimates of AAC, contestable share and rebate loss**

Harm

- **Loss of choice**

- Less of a range of CPUs available to consumers
- Weakening a competitor – reputation effects. Less incentive to invest in new CPU products

- **Intel arguments**

- AMD making in-roads. Lots of competition. No foreclosure
- Prices falling
- Meeting the competition defence
- Efficiencies - Economies of scale, Lower prices

- **Full effects based application of 102 guidelines**

- **Full foreclosure not necessary – no analysis of minimum efficient scale although economies of scale clearly evident. But what is significant share? Why are OEMs strategic customers**

- **Qs – if predation then do we need to show recoupment? Or is recoupment simultaneous?**