

CRA Competition Memo



Tomra v Commission: reversing progress on rebates?

In March 2006 the European Commission found that Tomra, a Norwegian producer of Reverse Vending Machines, had abused its dominance through the use of contracts that included exclusivity provisions, quantity commitments and retroactive rebates. The General Court of the European Union (the “General Court”) upheld the Commission’s decision in September 2010.

Tomra is the General Court’s first decision on loyalty rebates since the Commission’s adoption of an effects-based approach in its Guidance Paper on exclusionary conduct under Article 82 (now Article 102) in February 2009, and its decision on *Intel* in May of the same year (which relied on the Guidance Paper). Effects-based arguments were presented by Tomra before both the Commission and the General Court.¹ Against this backdrop, the General Court’s judgement in *Tomra* is important as it provides an early indication on whether the General Court is prepared to start embracing a more explicit economic approach when analysing abuse of dominance and rebates.

From this perspective the *Tomra* judgment is a disappointment. The judgment essentially endorses a traditional form-based approach. Moreover, to the extent it concerns itself with consumer harm, it accepts a novel theory put forward by the Commission. For reasons that are explained in this memo this theory lacks solid economic foundations, and creates an unhelpful precedent.

The Commission’s Decision

In its decision in *Tomra* in March 2006, the Commission took an essentially form-based approach to exclusionary abuse. The Commission found that Tomra had offered contracts with potentially exclusionary form, and that these contracts had allegedly extensive market coverage (measured on average at roughly one third of the market, over a 4-year period and in 5 countries²). The form of Tomra’s contracts was seen as sufficient to conclude that they were likely to have a foreclosing effect, without an in-depth analysis of the terms of these contracts and the ability of competitors to match them. Tomra’s economic defence focused instead on whether an efficient competitor would have been able to compete against the rebates offered by Tomra, using an approach that was similar to the one eventually contained in the 2009 Guidance Paper.³

¹ Economists from CRA advised Tomra during the administrative proceedings before the European Commission. The views expressed in this memo represent those of the author only, and do not necessarily reflect the opinions of other CRA staff or of CRA’s clients.

² See the summary of the *Tomra* case in the Commission’s Competition Policy Newsletter, Number 2, Summer 2006.

³ For a summary of this approach see the CRA Competition Memo “When are Rebates Exclusionary?”, of April 2005.

The General Court’s Judgement

The General Court upheld the Commission’s decision, accepting its line of reasoning on two important grounds. The first relates to the general treatment of retroactive rebates and their design; the second to the issue of the coverage of potentially foreclosing conduct, and the related theory of harm. We review these below.

Retroactive rebates: is form enough?

In its judgement the General Court reiterated the argument that retroactive rebates imply that the price offered by a dominant firm on some incremental units is very low, and that this can make it hard for smaller rivals to compete, especially if they can only sell a few units. The General Court found that a “competitor’s average price will remain structurally unattractive” (¶270) in the presence of a retroactive rebate, even if it could compensate for the low price offered on some units with higher prices on other units (e.g. those above the discount threshold). The fact that the volume thresholds in a rebate scheme may fall below the demand of some customers (as recognised by the General Court at ¶85) is viewed as essentially not being relevant to establish the presence of foreclosure effects on those customers.

According to the General Court’s approach, it is therefore not necessary to establish whether the average effective price that an efficient rival would need to offer in order to match a dominant firm is above or below cost. This stands in sharp contrast with the methodology endorsed by the Commission in the 2009 Guidance Paper and applied in detail in *Intel*. The Commission’s Guidance Paper explicitly recognises that the fact that one particular incremental unit of sales is priced very low under a retroactive rebate structure is not sufficient to conclude that a particular rebate scheme is exclusionary. It is necessary instead to look at the rebate system as a whole, and establish whether it is profitable for a rival to compete for the entirety of the volumes that it may be able to supply to a given customer (i.e. its “contestable share”). These sales can logically include both infra-marginal volumes “below” a given discount threshold (i.e. sales included under the rebate scheme), and additional volumes “above” the threshold.⁴

The fact that the resulting average price is most likely lower for a smaller rival than for the dominant firm (which is presumably what the General Court refers to with the expression “structurally unattractive”) does not imply that the competing firm cannot profitably match the dominant undertaking’s offer on its contestable share. Of course the rival would need to make a loss on the incremental unit that

⁴ This latter possibility is recognised in the Guidance Paper (¶44).

triggers the loss of the retrospective rebate offered by the dominant firm. But this loss is exactly the same as the loss suffered by the dominant firm at the margin. There is no reason *a priori* to expect that a dominant firm should be able to afford this loss (by spreading it on its infra-marginal units) but that a smaller rival would not be able to do the same if necessary. A price-cost analysis (or some alternative form of economic evidence) is required before being able to reach such a conclusion.

Market coverage and the theory of harm

The General Court also found that the incidence of Tomra's conduct was relatively extensive (covering up to roughly 40% of the market on average), and therefore that it was capable of leading to significant anti-competitive foreclosure effects. In making this finding the General Court accepted the Commission's argument that conduct by a dominant firm can result in anti-competitive foreclosure, because it reduces the number of competitors potentially active in a market. The General Court found that "consumers on the foreclosed part of the market should have the opportunity to benefit from whatever degree of competition is possible on the market", and that a dominant undertaking should not "dictate how many viable competitors will be allowed to compete" (¶241).

This is a novel and potentially very open-ended test for anti-competitive behaviour, since any conduct which materially restricts the share of the market available to competitors may be deemed as anti-competitive under this approach. A test of this type does not seem to be able to adequately distinguish between pro-competitive conduct (e.g. conduct which renders a part of the market non-contestable through the offer of terms which actually benefit consumers), and anti-competitive conduct leading to likely consumer harm. It is effectively a test aimed at protecting a given market structure but not at enhancing consumer welfare.

In particular it is hard to see how this test relates to the mainstream economic theories of competitive harm. The approach does not fit a predatory theory of harm, whereby a dominant firm would use targeted rebates (and similar conduct) in order to monopolise a market, and subsequently raise prices. If a significant part of the market is still contestable despite the rebates, the remaining competitors would limit the ability of the dominant's firm to raise prices to recoup the initial losses from predation, thus undermining the profitability of strategy (and sheltering consumers from harm). Moreover, consumers in the "foreclosed part of the market" would benefit from the conduct in the short term, contrary to the findings of the General Court.

The General Court (and the Commission) must therefore be relying on some alternative non-predatory theory of harm, whereby consumers are made worse off by the conduct of the dominant undertaking in *both* the short term and the long term, and exclusion entails no profit sacrifice (as the General Court asserts at ¶267). This theory of harm however was made explicit neither in the Commission's decision nor in the General Court's judgement, and is as such difficult to assess.

The fact that in *Tomra* the discounts were paid directly to final consumers implies that one cannot apply a theory of harm whereby rebates are paid to intermediate buyers, who then allegedly reduce the product choice available to

their consumers without passing on the benefit of the rebate. A theory of this type may have been implied by the Commission in *Intel* (even though it was not articulated and explored in detail) and is applicable to a case like *British Airways* where rebates were paid to travel agents and not final consumers.

There exist possible economic models of rebates paid to final consumers which can lead to anti-competitive foreclosure without profit sacrifice. These apply under specific circumstances, such as the presence of coordination failures between buyers, or threats by the dominant firm to raise list prices above monopoly levels if a given volume commitment is not met. However, these alternative theories were not pursued nor demonstrated by the Commission or the General Court in *Tomra*. In addition, these theories often rely on complete or near complete foreclosure by the dominant firm, rather than simply on conduct which reduces the number of viable competitors in a market.

The issue of the total coverage of a given practice is closely linked to the assessment of the foreclosing effect of a specific individual contract. While the total demand affected by Tomra's contracts stood at roughly 40% (as noted by the General Court), as summarised above the Commission found that only one third of the market could be considered as actually foreclosed to competitors (given the terms of Tomra's contracts). In its defence before the Commission, Tomra had estimated an even lower level of effective coverage, based on analysis of the ability of an efficient competitor to match its offers (see Commission decision at ¶390). Whether a particular practice is assessed using an economic approach, or simply assumed to have a foreclosure effect due to its form, can have a significant impact on the overall market coverage that is attributed to a given set of contracts.

Implications for future abuse cases

The Commission's Guidance Paper on Article 82 (now Article 102) published in early 2009 represented a welcome and useful step in the transition to a more economically sound treatment of exclusionary abuse in Europe.

This transition is however likely to be a protracted and at times difficult process, given the legacy of form-based decisions on abuse of dominance adopted in the recent past. The Commission's decision in *Tomra* and the subsequent judgement by the General Court now form part of this legacy, and highlight some of the shortcomings of adopting a formalistic view of potentially exclusionary practices.

The decision and now the judgment represent a step backwards relative to both the Guidance Paper and to the approach taken in *Intel*, where the Commission studied in detail whether rebates were capable of foreclosing an efficient rival. This was perhaps inevitable given the timing of the Commission's decision in *Tomra*, which was taken in the midst of the reform of Article 102. The hope is that as the Commission's future decisions in this area build more explicitly on the Guidance Paper, they will be based on stronger economic foundations and the General Court will likewise come to accept that such evidence is essential for sound decisions in abuse of dominance cases.

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