

## COMPETITION ACT 1998

### DECISION OF THE DIRECTOR GENERAL OF FAIR TRADING

No CA98/3/2001\*

6 APRIL 2001

#### DIXONS STORES GROUP LIMITED\*/COMPAQ COMPUTER LIMITED/PACKARD BELL NEC LIMITED\*

Relating to a finding by the Director General of Fair Trading (the 'Director') that agreements have not infringed the prohibition imposed by section 2 (the 'Chapter I prohibition') of the Competition Act 1998 (the 'Act'), and that conduct has not infringed the prohibition imposed by section 18 (the 'Chapter II prohibition') of the Act.

#### **I. INTRODUCTION**

1. This decision relates to an agreement between DSG Retail Limited ('DSG') and Compaq Computer Limited ('Compaq') dated 27 August 1999 (the 'Compaq Agreement') and to an agreement between DSG and Packard Bell NEC Limited ('Packard Bell') dated 12 November 1999 (the 'Packard Bell Agreement') (collectively the 'Agreements') concerning the exclusive distribution in the UK of personal computers.
2. This decision is made pursuant to the Act in accordance with rule 15(1) of the Competition Act 1998 (Director's rules) Order 2000 (the 'Director's rules')<sup>1</sup> It states the facts on which the Director relies and his reasons for the decision.

#### **II. THE FACTS**

##### **A. THE COMPLAINT**

3. Following the execution of the Agreements and announcement of the consequent cessation of supplies of personal computers to the John Lewis Partnership plc ('John Lewis') and Tempo Holdings Limited, ('Tempo') (collectively referred to hereinafter as 'JLT' unless otherwise specified) the Office received a complaint ('the

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\* Certain information has been excluded from this document in order to comply with the provisions of section 56 of the Competition Act 1998 (confidentiality and disclosure of information). Excisions are denoted by [...], and/or in the Annexes, an explanation indicating where information has been excluded.

\* Dixons Stores Group Limited is the wrong company, the correct company is DSG Retail Limited.

\* Packard Bell has told us that Packard Bell NEC Limited has now changed its name to NEC Computers (UK) Limited.

<sup>1</sup> The Competition Act 1998 (Director's rules) Order 2000 SI 2000 No 293. This document is available on the Office's web site [www.offt.gov.uk](http://www.offt.gov.uk).

Complaint') from JLT. The Complaint alleged that there were grounds for the Director to investigate the Agreements under the Act for infringements of the Chapter I and Chapter II prohibitions.

## **B. THE PARTIES**

4. DSG and its subsidiaries comprise the following businesses: Dixons, The Link (The Link Stores Limited) and Mastercare (Mastercare Coverplan Service Agreements Limited). DSG is a wholly-owned subsidiary of Dixons Group plc, the holding company of a group of companies including Currys Group plc and PC World Limited,\* specialising in, *inter alia*, the retail sale of high technology consumer electronics, personal computers, domestic appliances, photographic equipment, communication products and related financial and after sales service.
5. Compaq is a company engaged in the marketing and distribution of computer equipment manufactured by Compaq Computer Corporation and Compaq Computer Manufacturing Limited. The ultimate parent undertaking of Compaq is Compaq Computer Corporation, a company incorporated in the United States of America.
6. Packard Bell is a company engaged in the marketing of computer products. It is part of the Packard Bell NEC Europe group of companies.\* The ultimate controlling party is Packard Bell NEC Europe BV.\*

## **III. LEGAL AND ECONOMIC ASSESSMENT**

### **A. INTRODUCTION**

7. Section 2(1) of the Act provides that, subject to section 3, agreements between undertakings, decisions by associations of undertakings or concerted practices which (a) may affect trade within the UK, and (b) have as their object or effect the prevention, restriction or distortion of competition within the UK, are prohibited unless they are exempt in accordance with the provisions of Part I of the Act.
8. Section 18(1) of the Act provides that, subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the UK. Under section 18(3), 'dominant position' means a dominant position in the UK.
9. In assessing whether there is dominance, the Director will consider whether an undertaking holds a position of economic strength, such that it can behave

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\* DSG has told us that the company structure reflected in this paragraph is inaccurate. DSG does not operate with subsidiaries and the Mastercare company is dormant. Both Currys and PC World are also dormant companies and are trading names used by DSG.

\* Packard Bell has told us that the Packard Bell NEC group of companies is now the NEC Europe group of companies.

\* Packard Bell has told us that Packard Bell NEC Europe BV is now NEC Computers International BV.

independently of competitive pressures and consequently is able to prevent effective competition within the relevant market. This will entail looking not only at the undertaking's market share but also at the conditions of competition in the relevant market.

10. Under section 60 of the Act, the Director is required to ensure that so far as is possible, (having regard to any relevant differences between the provisions concerned) questions arising in relation to competition within the UK are dealt with in a manner which is consistent with the treatment of corresponding questions arising in Community law in relation to competition within the Community. In particular, the Director must act (so far as is compatible with the provisions of Part I of the Act) with a view to securing that there is no inconsistency with either the principles laid down by the EC Treaty<sup>2</sup> and the European Court and any relevant decision of the European Court in determining any corresponding questions arising in Community law.<sup>3</sup> The Director must also have regard to any relevant decision or statement of the European Commission.

## **B. THE RELEVANT MARKET**

### **(a) The relevant product market**

11. The relevant product market comprises all those products which are regarded as reasonably interchangeable by reason of the product's characteristics, price or intended purpose.<sup>4</sup> Market definition forms only one part of an investigation. It provides a frame of reference for making a full assessment of market power and the behaviour of undertakings.<sup>5</sup>
12. The Complaint refers to vertical agreements between manufacturers of personal computers ('PCs')<sup>6</sup> and a retailer of PCs. In principle, therefore, there is both an upstream and a downstream market to consider. The upstream level refers to the

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<sup>2</sup> Treaty of Rome, 1957.

<sup>3</sup> The European Court is defined as the Court of Justice of the European Communities and includes the Court of First Instance (Section 59(1) of the Act).

<sup>4</sup> Case 27/76 *United Brands Co and United Brands Continental BV v Commission* [1978] 1 CMLR 429; Case 85/76 *Hoffman –La Roche & Co. AG v Commission* [1979] 3 CMLR 211.

<sup>5</sup> Paragraph 1.4, OFT 403.

<sup>6</sup> The Director notes that Apple computers run on a different operating system from PCs. Manufacturers suggested that Apple competes with the leading manufacturers of PCs. The Director has found no evidence to suggest that Apple computers should not be considered to compete with PCs. For the purposes of his assessment of the conditions of competition on the relevant market, the Director has included sales of Apple computers in his analysis. Excluding sales of Apple computers would not materially have altered the conclusions of the analysis.

manufacture of PCs. The downstream level is analysed as referring to the operations of retailers *and* the operation of manufacturers when they sell directly to consumers.<sup>7</sup>

### *Downstream Market*

13. Consumers purchase PCs from a number of outlets, for example, multibrand retailers, single brand showrooms, direct from manufacturers or via mail order.<sup>8</sup> The Director has considered whether these channels form distinct relevant markets or whether they should be considered to form part of the same relevant market. The analysis includes consideration of the possibility of a narrow relevant market for home PCs sold through multibrand retailers; the possibility of separate markets for first and second time buyers, and the issue as to whether retail and direct channels form separate markets.

14. Second hand PCs have not been considered as part of the relevant market.<sup>9</sup>

#### *i. Multibrand Stores Versus Single Brand Stores*

15. JLT suggested the possibility of a narrow relevant market of PCs sold through multibrand retailers i.e., that multibrand retailers were not in the same market as single brand (or showroom) stores. Showroom stores are those where only one make of PC is sold in-store (e.g., Time retail stores only sell Time computers). However, the evidence suggests that single brand and multibrand retailers compete in the same market.<sup>10</sup>

16. First, Taylor Nelson Sofres ('TNS') survey data provided by John Lewis, indicates that a relatively small percentage of consumers (17%) cite "wide choice of brands" as a reason for their choice of retailer/direct supplier. The most important reason given was "competitive prices" (given by 44% of consumers); "wide choice of brands" was eighth on the list.<sup>11</sup> The same survey also finds that of the 178 consumers who gave more than one reason for buying from a retailer or a department store, 32% cited "competitive prices" whereas only 4% cited "wide choice of brands".

17. Further support for considering single-brand outlets to be in the same market as multi-brand retailers is provided by Mintel, Computer Hardware and Software, 1999

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<sup>7</sup> Since the Agreements relate to the distribution of PCs targeted at the consumer market, sales to businesses are not considered.

<sup>8</sup> Direct sales channels are defined below at paragraph 35.

<sup>9</sup> PCs and PC software are updated rapidly – the new product innovation cycle is estimated to be around 6-12 weeks. Second hand PCs may therefore rapidly become a "generation" out of date and will sometimes not have the capacity to run many of the latest software packages. The price of new PCs is not constrained by the price of second hand PCs. On the basis of the foregoing, the Director concludes that second hand PCs do not form part of the relevant product market.

<sup>10</sup> Brands are discussed further at III, D below, where it is established that manufacturers have not been able to differentiate themselves strongly by brand.

<sup>11</sup> Sample based on the responses of 436 computer owners to the question "For which of the following reasons did you choose to buy from that source?"

(‘Mintel (1999)’). This states that only 1% of respondents thought that wide range of brands was the “most important” factor in determining where a consumer buys a PC. Only 6% cited wide range of brands as being a “particularly important” factor. This compares with 21% who thought that competitive prices were the most important factor (32% thought competitive prices were particularly important). Good package deals were also cited as being an important determinant (12% thought it was the most important, 23% thought it was particularly important). Indeed, 16 factors were cited as being more important than a wide range of brands, with only one (the ability to provide free access to the Internet) said to be less important.<sup>12</sup>

18. The TNS and Mintel (1999) survey results suggest that, other things being equal, consumers do not have a strong preference for purchasing PCs through multibrand retailers as opposed to showrooms. Multibrand retailers and showrooms are most likely to be viewed by consumers as demand side substitutes.
19. Second, the rapid growth of showroom stores such as Time and Tiny seems to have impacted on multibrand retailers. Although there are not sufficient data to establish a clear trend, the data examined by the Director relating to the period Q4 1998 to Q2 2000 are not inconsistent with the suggestion that showrooms have gained market share at the expense of multibrand retailers (see Annex 1).<sup>13</sup>
20. Third, DSG cites Time and Tiny as two of its closest competitors. Time also cited DSG as a key competitor when the Office investigated the market in 1999 (the ‘1999 Inquiry’),<sup>14</sup> [...].
21. Fourth, the profile of buyers in multibrand stores is very similar to the profile of buyers in showrooms. This is partly due to the recent growth in the number of second time buyers purchasing in multibrand retailers. This is important because it is argued that second time buyers are the most “informed” purchasers. Therefore, they are likely to be highly sensitive to price differences between multibrand and showroom outlets. Their presence should ensure that, other things being equal, multibrand retailers cannot persistently and profitably increase prices without losing a substantial part of their sales to showrooms.

#### *Conclusion on Multibrand Versus Single Brand Stores*

22. The survey data suggest that the range of brands stocked by retailers is of limited importance in the choice of retailer. Furthermore, the rapid growth of showroom

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<sup>12</sup> Based on the responses of 896 adults with a PC or those without who are likely to buy in the next 6 months.

<sup>13</sup> Based on the quarterly survey of 200 consumers conducted by Gartner’s Dataquest service (supplied by John Lewis). Percentages relate to share of all new PC sales.

<sup>14</sup> In November 1998, following a request from the Secretary of State for Trade and Industry to investigate the pricing of home PCs in the UK, the Office conducted an inquiry into the market for home PCs in the UK to determine whether there were any anti-competitive practices preventing the market from working properly. The Office uncovered no such practices. Most information gathered in the 1999 Inquiry has been updated since then.

stores appears to have impacted upon multibrand retailers, suggesting that consumers view showroom and multibrand stores to be close substitutes. This is confirmed by the views of DSG and Time. Finally, a large share of multibrand sales will go to price sensitive and informed buyers, who would switch to showrooms if prices in multibrand outlets rose significantly above competitive levels. The Director considers that, taken as a whole, this evidence strongly suggests that multibrand and showroom outlets are demand side substitutes which compete in the same market.

*ii. First Time Buyers Versus Second Time Buyers*

23. JLT suggested that first time buyers and second time buyers are not in the same market. However, the evidence does not support this claim.

*Profile of First and Second Time Buyers in Retail Outlets*

24. The Director has examined DSG's share of sales according to first and second time buyers based upon Gartner's Dataquest survey data for the period Q1 1998 to Q2 2000 (see Annex 2). The share of sales in DSG stores accounted for by second time buyers has been increasing over the last two years from around [...]% to [...]%. It is therefore reasonable to argue that second time buyers are becoming just as important to DSG as first time buyers.
25. Much of the same is true for other (i.e., non DSG) multibrand retailers; indeed, if anything, second time buyers make up a greater share of sales than first time buyers (see Annex 3). Over the last two years approximately 52% of other multibrand customers were second time buyers. Sales through showroom stores are split more or less evenly between first and second time buyers (see Annex 4).

*Second Time Buyers as Informed Consumers*

26. Second time buyers are often said to be more informed (and have a greater price elasticity of demand) than first time buyers.<sup>15</sup> This is because their previous experience of purchasing and using a PC means they are more aware of their specific needs and so better placed to shop around for the best deals.
27. Given the strong presence of "informed" second time buyers in retail stores, there will be a relatively large number of "marginal" consumers (i.e., those most likely to switch if prices rise). This will constrain the ability of one retailer to charge second time buyers higher prices than other retailers.<sup>16</sup> Unless retailers can discriminate between first and second time buyers, first time buyers (even if they are not as likely

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<sup>15</sup> The extent to which first time buyers will shop around may fluctuate according to consumers' knowledge of various suppliers. It is arguably too simplistic to suggest that first time buyers are always less informed than second time buyers, since first time buyers may obtain information from other sources such as: colleagues, friends, sales staff and specialist magazines. Nevertheless, JLT, Mintel (1999) and some PC manufacturers suggest first time buyers tend to be less informed than second time buyers.

<sup>16</sup> As discussed below, PC sales through direct channels will also constrain the retail price of PCs.

to switch as second time buyers) will benefit from the lower prices that second time buyers can secure for themselves.

28. As discussed below, the evidence which the Office has examined does not suggest that retailers price discriminate in a way that leads to first time buyers paying more than second time buyers. This suggests that first and second time buyers are in the same market.

*Can Retailers Price Discriminate Against First Time Buyers?*

29. A hypothetical monopolist might be able to discriminate between “captive” customers who are not very price sensitive and non-captive customers who are price sensitive. In such a case, the monopolist may persistently and profitably set prices above competitive levels for those captive customers, such that captive customers form a separate market.<sup>17</sup>
30. However, in this case, the above argument does not apply. The Director considered whether retailers could price discriminate between first and second time buyers. In general, the evidence suggests that such discrimination is unlikely due to the mix of first and second time buyers across both sales channels and price points.<sup>18</sup>
31. Nevertheless, one manufacturer suggested that second time buyers may be less likely to buy PCs which are bundled together with complementary hardware such as a monitor and a printer (which they may already possess). Hence, it might be possible for retailers to discriminate between first and second time buyers by the way that PCs are bundled together with complementary hardware.
32. However, manufacturers suggested that the bundled offers targeted at first time buyers are likely to be very competitively priced. Mintel (1999), for example, describes the bundled offers purchased by “value-focused buyers” as being low margin.<sup>19</sup> Indeed, one manufacturer expressed surprise that such bundles made any margins at all.
33. Therefore, even if a pool of “captive” first time buyers exists, the evidence suggests that retailers do not price discriminate against them. It is unlikely that first and second time buyers pay substantially different prices for identical products.

*Conclusion on First and Second Time Buyers*

34. Second time buyers are, in general, the most informed purchasers and the most likely to switch between outlets if prices rise. Second time buyers make up around 50% of the customers in retail outlets and their presence should ensure that less informed buyers also benefit from competitive pressure. Even if a pool of “captive” first time

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<sup>17</sup> Paragraphs 3.7 – 3.8, OFT 403.

<sup>18</sup> This issue is addressed further at III, D below in the discussion of value focus and feature focus.

<sup>19</sup> Mintel (1999), page 11.

buyers exists, the evidence suggests that retailers do not price discriminate against them. The Director therefore concludes that first and second time buyers purchase in the same relevant market.

*iii. Retail Channels Versus Direct Channels*

35. This section addresses the question of whether PCs sold by manufacturers through direct channels are in the same relevant market as sales through retail outlets. Direct channels refer to sales direct from the manufacturer (i.e., not via a retail outlet but via telephone, fax or the internet), sales through mail order (e.g., in response to a newspaper advertisement) or some other “direct” way which bypasses the retailing stage.
36. Retail sales might be argued to be a distinct market for the following reasons. First time buyers tend to prefer to shop in retail outlets. Retail outlets are differentiated from direct sales channels because they offer consumers the opportunity to touch and see the PC and to discuss a purchase face-to-face with someone whom they perceive to have expert knowledge. Retail outlets may also be more convenient for consumers and may be perceived to offer better after sales service or to be more accessible in the case of having to return a faulty PC.
37. The existence of a “type” of consumer who prefers retail outlets is supported by responses from many of the computer manufacturers. Some manufacturers noted that there is a ceiling to the number of first time buyer sales that can be achieved through selling direct because there is a significant pool of first time buyers who have a strong preference for purchasing through retail outlets. Of the twelve manufacturers that gave a response, nine suggested that first time buyers would have a preference for retail purchases.
38. However, for the reasons set out in the section above, even if there is a significant pool of first time buyers who prefer to purchase their PCs through retail outlets, this does not necessarily mean that first time buyers are a separate relevant market. The share of second time buyers in retail sales is roughly the same as that of first time buyers and, given that they are better informed in general, a large proportion of price sensitive consumers is likely to be second time buyers. Those consumers are highly likely to compare offers across *both* channels – direct and retail. This view is supported by the fact that second time buyers are more likely to purchase from the direct sales channels than first time buyers (see Annex 5).<sup>20</sup> It is therefore likely that retail prices of PCs are constrained by the price of PCs which are available direct from the manufacturer.<sup>21</sup>

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<sup>20</sup> The proportion of first time buyers purchasing direct is nevertheless significant. Of all first time buyers surveyed over the period from Q3 1998 to Q2 2000, 22.3% purchased direct from the manufacturer. Source: Gartner’s Dataquest service.

<sup>21</sup> Manufacturer responses to the Office confirm that direct sell prices for a given PC are typically lower than the retail price. This is because direct sellers are likely to have lower overheads as a result of not operating or supplying a retail outlet. Note that the fact that retail prices may be higher

39. In the 1999 Inquiry, as well as looking at first and second time buyers, the Office considered a second proxy for informed buyers – those consumers who used specialist magazines to help inform themselves when choosing a PC. These buyers were more likely to purchase from direct channels than first time buyers as a whole, although a significant proportion chose, nevertheless, to purchase in the retail sector. As with the analysis of second time buyers, the finding that a significant share of “informed” consumers were willing to purchase in the retail sector supported the view that many retail consumers would be likely to compare prices across both retail and direct channels.<sup>22</sup>
40. Further demand side evidence supports the view that retail and direct channels compete with each other. When asked to cite their closest competitors, manufacturers often cited manufacturers in both sales channels. [...]. This is consistent with the two channels being in the same market. Those suppliers operating in the direct channel identified the £999 + VAT price point, as the key battleground in the PC market for all sellers, whether in the direct channel or otherwise.
41. [...].
42. Mintel (1999) is consistent with this view: ‘In 1999, the fastest growing distribution channel for PC hardware was the direct channel, principally the direct from manufacturer channel. This channel will increasingly take sales from the specialist electrical retailers and department stores’.
43. Finally, manufacturers were asked by the Office the hypothetical question of how likely consumers would be to switch from purchasing through the retail channel to the direct channel if prices in the former rose by 5-10%. Of the twelve responses, eight manufacturers indicated that consumers would switch channels. Only four manufacturers gave an indication of how much retail sales would fall – three said that direct sales would increase by more than 5-10%, the other one by between 5-10%. It is not clear from these four responses whether or not a 5-10% price increase in the retail channel would be persistently profitable.<sup>23</sup>

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does not, in itself, mean that the retail channel is a distinct market. If retailers have a higher cost base because they provide greater services (e.g., convenience, the opportunity to touch and see the product) then retail prices may be greater than direct prices even though both prices are “competitive”.

<sup>22</sup> The Office also considered whether its evidence on market definition was affected by the *cellophane fallacy* (described in paragraph 5.13, OFT 403). The Office found that it is *not* the case that PC prices in the direct channel constrain prices in the retail channel only because PC prices in the retail channel are excessive. Evidence from the Office’s 1999 Inquiry supported the view that PC prices in the retail sectors were not excessive (OFT Press Statement 38/99). This included evidence on retail margins on PCs in DSG stores – these were found to be low in relation to margins on other electrical goods and had fallen in the three years to 1999. That retail margins had fallen in the last couple of years was supported by comments made by JLT and manufacturers in this present investigation.

<sup>23</sup> The evidence of the one manufacturer which speculates that between 5-10% of consumers would switch channels is consistent with retail and direct sales channels being separate markets. The

44. However, hypothetical evidence such as this cannot be relied upon too heavily, particularly, as in this case, when other evidence points to a wider market. For example, evidence from manufacturers which reveals who they monitor as their closest competitors is likely to be more informative than their speculation as to how many consumers would switch channels in response to a hypothetical price rise. In addition, evidence from independent surveys undertaken by TNS, Gartner and Mintel also suggests a market wider than sales through retailers. Again this evidence is more reliable as the surveys attempt to quantify past behaviour of consumers who purchased PCs. Furthermore, notwithstanding the responses of four manufacturers on switching by consumers, most manufacturers described consumers as being either very price sensitive or price sensitive.

*Conclusion on Retail and Direct Channels*

45. On the demand side, manufacturers confirm that consumers are price sensitive. There is a strong presence of informed second time buyers who compare prices across sales channels. Many of these consumers would be likely to switch to direct sales channels if retail prices were excessive and this suggests that a single market is appropriate. This view is also supported by the Mintel report and manufacturer responses – many manufacturers cite their main competitors to be selling via both direct and retail sales channels. Although manufacturers' responses to the hypothetical question of whether or not a 5-10% price rise in the retail channel would be profitable are inconclusive, the Director considers that the balance of reliable evidence points to the conclusion that retail and direct channels are in the same market.

*iv. Supply side substitution*

46. Supply side substitution may be relevant to market definition. If, in response to a price rise by incumbent firms, other firms which do not currently supply a product would supply that product at short notice, this may constrain the ability of incumbents to increase prices.<sup>24</sup>
47. For example, if a retailer which did not sell PCs thought that it would be profitable to do so, because other retailers had increased prices by 5-10%, then it may consider beginning to retail PCs itself. Evidence from manufacturers suggests that such a retailer would be able to obtain supplies without much difficulty from the many PC manufacturers that supply UK retailers. Such a retailer might also be able to induce direct only manufacturers to begin to supply the retail channel. Two direct only manufacturers indicated that a 5-10% increase in retail prices would provide a retailer enough scope to offer them a margin that would make supplying the retail channel

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evidence from the three manufacturers who speculate that more than 5-10% of consumers would switch is ambiguous. On the one hand, if direct sales take substantially more than 5-10% of customers from the retail channel, a 5-10% price increase is not likely to be profitable since it would lead to a substantial fall in revenue. On the other hand, if the proportion of consumers switching channels in response to a 5-10% price rise is only a little more than 5-10%, the price rise may be profitable given that the total revenue will be similar but input costs are likely to be lower.

<sup>24</sup> Paragraph 3.13, OFT 403.

profitable (e.g., to cover their contributions to support costs and policies in respect of returns, advertising and staff training). In sum, it would appear that retailers could obtain PCs relatively quickly and without the need for substantial sunk investments.

48. Furthermore, there would appear to be many retailers who could start to sell PCs in their stores. For example, Tesco, Lidl and Toys 'r' Us offer Fujitsu Siemens PCs for sale in their stores which indicates that retail partners need not be limited only to retailers of electronic or electrical goods.<sup>25</sup> Indeed, the Office was also told by a direct manufacturer [...] that it was establishing links with a national retailer [...] which was not a specialist seller of electronic or electrical goods.
49. Analysing supply side substitution raises similar issues to the analysis of barriers to entry. In both cases the question is whether undertakings would start supplying a particular product if prices rose. The distinction is timing: supply side substitution occurs when undertakings start supplying the market in the short run, whereas new entry into the market occurs over a longer time scale.<sup>26</sup>
50. To the extent that retailers not currently selling PCs could introduce PCs into their stores in the short run, this suggests that the downstream market (defined as the supply of new PCs to consumers through both retail and direct channels) could be widened further. The market would then include the likely capacity that retailers not selling PCs would devote to selling PCs if prices rose significantly. However, while such supply side substitution is possible in some cases, in general the decision to enter the retail market would be a longer term decision and therefore more appropriately analysed as new entry.

#### *Conclusion on supply side substitution*

51. The Director considers that while supply side substitution by retailers not selling PCs is possible in some cases, in general, it is more appropriate to account for the ability of retailers to introduce PCs to their stores in the analysis of barriers to entry (at III, D(a)iii below).

#### *Upstream Market*

52. The process of market definition starts by looking at a relatively narrow potential definition on the demand side. This would normally be the products which parties to an agreement produce or the products which are the subject of a complaint.<sup>27</sup> At the upstream level, Compaq and Packard Bell PCs are the subject of the Complaint. At the extreme, therefore, the narrowest potential market definition would be to define the market by each manufacturer's brand.

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<sup>25</sup> Mintel (1999), page 140.

<sup>26</sup> Paragraph 3.15, OFT 403.

<sup>27</sup> Paragraph 3.1, OFT 403.

53. A manufacturer can sell its PC either to retailers or directly to consumers or both. The Director considers that a manufacturer of one brand of PC would not be able to impose a significant, persistent and profitable increase in prices because retailers and consumers would switch to buying different brands. This view is supported by the substantial amount of evidence set out at III,D below.<sup>28</sup> This shows that while each make of PC can be considered a brand in its own right (whether the retailer's own brand or a manufacturer's brand), there is a large number of competing brands and PCs are not strongly differentiated by brand. The evidence demonstrates that the upstream market should not be segmented by individual brand or by groups of brands. Therefore, the Director concludes that the relevant upstream product market is the manufacture of home PCs for sale in the UK<sup>29</sup>, including PCs manufactured by vertically integrated firms such as Time and Tiny.<sup>30</sup>

#### **(b) The relevant geographic market**

54. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.<sup>31</sup>

##### *Downstream Market*

55. The Director concludes that the UK is the appropriate downstream geographic market. This is supported by the following evidence. First, PCs tend to be retailed and advertised at national prices.<sup>32</sup> Second, direct sales channels are national with prices set on a national basis. Since a substantial portion of consumers will be sensitive to prices in direct channels, a national market definition is appropriate. A retailer would not find it persistently profitable to target consumers in any particular region of the UK with prices above competitive levels, since many consumers would switch and purchase PCs whose prices are determined nationally.<sup>33</sup>

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<sup>28</sup> The impact of brand is best assessed at the downstream level as opposed to the upstream level and so is not discussed further here, but at III,D(a)(ii) 'Product differentiation and the importance of brand'. This is for the following reasons. First, manufacturers are able to sell directly to consumers. Second, retail demand for manufacturers' brands is *derived* from consumer demand for brands. If, from the consumer point of view, PCs are not differentiated by brand then retailers will not have a strong preference for any particular brand of PC.

<sup>29</sup> See footnote 6 above which refers to Apple computers.

<sup>30</sup> Manufacturers of PCs who produce only for the business sector are considered below as potential new entrants.

<sup>31</sup> Case 27/76 *United Brands Co. and United Brands Continental BV v Commission* [1978] 1 CMLR 429.

<sup>32</sup> Although store managers may occasionally have some discretion to account for local factors in the very short term, local deviations would not persist for very long.

<sup>33</sup> On the supply side, it is possible that some manufacturers of PCs not currently selling to UK consumers could quickly and profitably sell directly to UK consumers if prices rose significantly above competitive levels. However, in doing so, they may have to market their PCs in order to cater

### *Upstream Market*

56. The narrowest potential market definition at the upstream level is the UK. Many buyers in this market have a national presence and are likely to contract on a national basis (as in the Agreements). A narrower market than the UK, say regional, is implausible due to the likelihood that most buyers would be able to source their PCs from other regions (if not further afield) in the event that prices rose significantly.
57. Some evidence indicates that the geographic market could well be wider than the UK. PCs are of a high value relative to their transport costs as evidenced by the fact that one retailer imported PCs from Taiwan for sale in the UK. This suggests that buyers in the upstream market would be able to obtain PCs from outside of the UK should UK distributors or manufacturers increase the price of their PCs significantly.
58. The Office was also told that manufacturers generally purchase their components on a world-wide basis and then assemble PCs in their own factories. Since transport costs are relatively low, it seems likely that manufacturers could profitably supply UK buyers from factories outside of the UK. For Example, Dell's European factory is in Limerick in Ireland. If it is cost effective for PC manufacturers based outside of the UK and, indeed outside of Europe, to sell into the UK without having their own UK manufacturing arm, then this may be consistent with a global manufacturing market.
59. The Director therefore concludes that the relevant upstream geographic market is at least as broad as the UK but is more likely to be wider.

#### **Conclusion on the relevant market**

60. The Director concludes that the relevant downstream market is the market for the supply of new PCs to consumers through both retail and direct sales channels in the UK. The relevant upstream product market is the manufacture of home PCs for sale in the UK. The relevant upstream geographic market is at least as broad as the UK but is more likely to be wider.

### **C. MARKET STRUCTURE**

#### *Manufacturer share of sales in the UK home PC market*

61. The geographic upstream market is likely to be wider than a national market. Nevertheless, the share of manufacturers' sales of home PCs in the UK is informative about the importance of brands in the UK and how the many different brands for sale in the UK have performed in the downstream market. Table 1 below provides shares of UK home PC sales by manufacturer by value and volume for the calendar years

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for national preferences, e.g., through advertising, keyboard configuration and language of operating system and perhaps setting up a UK distribution arm. Therefore, this possibility is analysed below as the potential for new entry instead of supply side substitution.

1996-1999.<sup>34</sup> Table 2 demonstrates that the approximate value of the Herfindhal-Hirschman ('HHI') index is not high. The rapid expansion of Time and Tiny is also worth noting. Their sales volumes increased from almost 0% of the market in 1996 to [...]% and [...]% by 1999.

**Table 1: Shares of the Home PC Market by Value and Volume for Each Brand 1996-1999<sup>35</sup>**

Brand	1996		1997		1998		1999	
	Value	Volume	Value	Volume	Value	Volume	Value	Volume
Packard Bell <sup>36</sup>	[...]%	[...]%	[...]%	[...]	[...]	[...]	[...]	[...]
Tiny	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Time	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Compaq	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Gateway	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Apple	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Dell	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Acer	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Fujitsu Siemens	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
IBM	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Other Branded	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Unbranded <sup>37</sup>	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]

**Table 2: Ranges and Approximate HHI Index Values for 1998 and 1999 by both Value and Volume<sup>38</sup>**

Market	1998		1999	
	Approximate value	Range	Approximate value	Range
Value	952	(883, 1021)	1024	(981, 1068)
Volume	1011	(933, 1089)	1011	(954, 1070)

<sup>34</sup> Shares in volume terms can be computed from the survey data although they are less reliable than the shares presented in Table 1.

<sup>35</sup> Based on data [...] derived from Gartner's Dataquest service. Note that DSG own brands represent [...]% and [...]% of the unbranded shipment category in 1998 and 1999, corresponding to a [...]% and [...]% share of the overall PC market by value for these years.

<sup>36</sup> [...].

<sup>37</sup> Refers to non-manufacturer brands and is primarily own brand PCs. For example, this category includes DSG own brand PCs.

<sup>38</sup> It has not been possible to derive a precise estimate since the data on unbranded shipments (i.e., retailer own labels such as DSG's Advent range) cannot be fully disaggregated. The HHI index equals the sum or the squared market shares of all the firms in the market. It ranges from 0 (ultra fragmented) to 10,000 (pure monopoly). Industries with an HHI of 1,000 or below are often thought of as unconcentrated, based on the US Merger Guidelines.

62. Packard Bell’s share has remained below 25% in both value and volume terms. Although Packard Bell had the greatest share throughout the period, in terms of both volume and value, the Director does not consider that this means that Packard Bell is significantly differentiated by brand, for the reasons set out below at III.D.<sup>39</sup> Compaq’s share in terms of both value and volume remained at less than 10% throughout the period.

*Market Shares – Downstream*

63. Table 3 below sets out the best market share estimates available for total UK sales of home PCs of DSG, Tiny and Time. The Director notes the expansion by Tiny and Time in 1997 and 1998 respectively which has impacted on both DSG sales (see Tables 1 and 3) and sales of other retailers (the impact of multibrand and showroom stores on DSG is also illustrated by Annex 1).

64. Data are not available to calculate shares of other retailers and direct sellers using the same methodology. However, the table at Annex 6 sets out a breakdown of sales by value and volume derived from Gartner’s Dataquest survey data and provides an indication of market position of DSG stores and for other *types* of outlet, including direct sales.

**Table 3: Market Share Estimates for DSG, Tiny and Time (1998 and 1999)<sup>40</sup>**

	1998 value	1998 volume	1999 value	1999 volume
DSG <sup>41</sup>	[...]%	[...]%	[...]%	[...]%
Tiny	[...]%	[...]%	[...]%	[...]%
Time	[...]%	[...]%	[...]%	[...]%

65. Many of the categories in the table at Annex 6 can be broken down further. For example, sales from “retail showrooms” can be broken down into Time, Tiny, Gateway and other showroom sales. Likewise, sales “direct from manufacturer” can be broken down by manufacturer.

<sup>39</sup> One manufacturer suggested that much of Packard Bell’s share is explained simply by the fact that DSG – the largest player in the downstream market - distributes and promotes Packard Bell PCs. Indeed, as noted below, sales through DSG account for a great majority of Packard Bell sales.

<sup>40</sup> Source: Gartner’s Dataquest service.

<sup>41</sup> [...].

*Implications of Market Structure for Competition in the Upstream and Downstream Markets*

66. The Director considers that the data on market shares and concentration levels suggest that both the upstream and the downstream market structures are not highly concentrated.<sup>42</sup> The Director also notes that market shares have varied over time and notes the recent growth of Time and Tiny. This is consistent with the market being relatively competitive.<sup>43</sup>

**D. THE CHAPTER II PROHIBITION**

67. The Complaint alleged that DSG holds a dominant position. The Complaint also alleged that the continued implementation by DSG of the Agreements constitutes an abuse of a dominant position prohibited by the Chapter II prohibition.
68. Chapter II prohibits any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market if it may affect trade within the UK. Under Section 18(3), ‘dominant position’ means a dominant position in the UK or part of it.

**(a) Assessment of Dominance**

69. The Director has considered whether DSG holds a dominant position on the relevant market.

*Definition of Dominance*

70. The European Court has defined a dominant position as:

‘a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers’.<sup>44</sup>

71. The European Court has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%.<sup>45</sup> The Director considers it unlikely that an undertaking will be individually dominant if its market share is below 40%, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in

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<sup>42</sup> At III, D(a)(ii) below it is established that that manufacturers have not been able to differentiate themselves strongly by brand. This suggests that it is not appropriate to further segment the market.

<sup>43</sup> Paragraph 4.2, OFT 415.

<sup>44</sup> Case 27/76 *United Brands v EC Commission* [1978] ECR 207; [1978] 1CMLR 429.

<sup>45</sup> Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359.

that market) provided strong evidence of dominance.<sup>46</sup> In assessing whether there is dominance the Director considers whether, and to what extent, an undertaking faces constraints on its ability to behave independently.

**i. The Position of DSG Within the Relevant Market**

72. The Director notes that for the calendar year 1999, DSG's share of the UK market for home PCs in the UK was [...] % based on value and [...] % based on volume.<sup>47</sup> The Director believes that shares for 2000 and 2001 will be comparable. This view is supported by the market shares derived from Gartner's Dataquest survey data as are shown in the Annexes, which present information up to Q2 2000 and by DSG raw sales levels, which show comparable sales levels between 1999 and the first two quarters of 2000. On the basis of DSG's market shares the Director considers it unlikely that DSG is dominant. However, as part of his analysis, the Director has also considered the conditions of competition and barriers to entry to the relevant market.

**ii. Product Differentiation and the Importance of Brand**

73. JLT has consistently stressed the importance of brand in the consumer's purchase decision. JLT's submission was that retailers needed to stock prominent brands in order to compete. However, the evidence described above that brand is not an important factor in the choice of retail outlet and the evidence below, which demonstrates that there is not strong product differentiation by brand, does not support JLT's claim.

*Manufacturers' Views*

74. Most manufacturers thought brands were important. However, they were not united in their explanations. One manufacturer thought brand was important to first time buyers since it represented the reassurance of a reputable make, although two manufacturers thought first time buyers were not brand conscious. Some manufacturers suggested brand loyalty was important, while others disagreed. For example, one manufacturer mentioned that Apple was the only manufacturer likely to command significant brand loyalty. Quality, fashion and reliability were also given as reasons as to why brand might be important.

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<sup>46</sup> Paragraph 3.13, OFT 402.

<sup>47</sup> While a narrower market definition that excludes direct sales is not appropriate for the reasons given at III, B above, it is possible to estimate, using information from Annex 6, that DSG would have an approximate share of such a market of less than 40% (by value) and less than 40% (by volume). Even under this narrow definition it is by no means clear that DSG would be able to behave independently of competitive pressures. For example, competition from single brand stores such as Time and Tiny would remain important. In addition, it would be possible for retailers not selling PCs to enter the market without great difficulty thereby providing more competition at the retail level. Furthermore, many of the factors describing the conditions of competition cited at paragraph 97 below would remain relevant.

### *Consumer Survey Evidence*

75. The consumer survey evidence suggests brands are not particularly important to consumers. The 1999 Inquiry found that little more than 5% of purchases were brand related. When asked about the single main reason for their purchase, 20% of consumers cited best value for money, 17% said lowest price, 12% features available, and 11% the package deal offered. Fewer than 1% cited trusted brand as a reason, about 2% cited past experience of the brand and 2% said it was the same brand they used at work – a total of 5% of purchases related to brand.<sup>48</sup>
76. The finding that brand is not particularly important is consistent with the survey evidence cited above that single brand retailers compete in the same market as multibrand retailers. It is also consistent with Mintel’s statement that there is a “lack of differentiation and brand loyalty in the market, with companies competing on price and specification”.<sup>49</sup>
77. The consumer survey evidence might appear to be at odds with the views of most manufacturers that brand, for whatever reason, is important. However, the explanation is that having a reputable brand is important, but there are a number of reputable brands, so individual brands are not important given that they are well known.<sup>50</sup>
78. For example, the TNS survey provided data from people with a computer at home that they owned. Consumers were asked which brand of computer they had bought. A total of 21 brands were cited demonstrating just how many well known names there are.<sup>51</sup> As a follow up to this question, consumers were asked why they chose that brand of computer. Reputable brand was the most common response at 17%. This indicates that brand is important in that the name is seen as “reputable” but that the number of names is such that overall – as survey data confirms – consumers are far more concerned with price and value for money than brand.<sup>52</sup>

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<sup>48</sup> Based on Gartner’s Dataquest survey data.

<sup>49</sup> Mintel (1999), page 140.

<sup>50</sup> Neither is it sensible to differentiate the market by *groups* of brands (e.g., brands located at a certain price point) since any manufacturer outside of that group could reposition itself or introduce a new brand which lies within the group. This is discussed further below in the discussion below of value and feature focus brands and of product complexity.

<sup>51</sup> 22% of respondents did not know the brand of their computer which might indicate that brand was not particularly important to them.

<sup>52</sup> “Price and value for money are clearly top of the consumer’s list of priorities when seeking a dealer or retailer.” Mintel (1999), page 117. Also, based on the responses of 436 computer owners to the question “For which of the following reasons did you choose to buy from this source?”, the TNS survey found that the most important reason given was “competitive prices” (given by 44% of consumers).

### *Own brands*

79. Retailers can establish a “brand” for a PC themselves by their reputation as retailers or by their own advertising and so retail own labels such as DSG’s Advent range (DSG own brands comprise over [...] % of sales by volume or value) should be treated as comparable to manufacturer brands.<sup>53</sup>

### *Value Focus and Feature Focus*

80. Mintel (1999) states that “price and value for money are the most important factors determining what product to buy and where to buy from” (page 8). The report goes on to distinguish between “value-focused” and “feature-focused” buyers. The former are price and value for money conscious, while the latter concentrate on other features such as sophisticated software and the latest technology. Neither JLT nor any of the manufacturers have suggested that the market should be split up by value-focused and feature-focused buyers, and such a segmentation would seem inappropriate.
81. First, there do not appear to be distinct “value” and “feature” segments. Annex 7 shows average spend by brand for ten of the many brands of PCs available.<sup>54</sup> The average spend, according to the Gartner’s Dataquest survey data, was £ 1,100 for new PCs purchased between Q1, 1999 and Q2, 2000. The average spend for each brand is fairly evenly distributed around the average with no obvious segmentation of the market.<sup>55</sup>
82. Second, even if there were some segmentation according to “value” and “feature,” the Mintel report suggests that “experienced buyers” (i.e., second time buyers) are found in *both* the value segments and the feature focused segments. This suggests that a substantial proportion of consumers – who are “informed” second time buyers – would be sensitive to changes in price and would switch across segments. The heavy discounting required to sell “older” models is evidence to support this view. Third, manufacturers would, in a short period of time, be able to reposition a brand or introduce a new brand at either the “value” or the “feature” end if prices rose substantially above competitive levels.

### *Impact of Technological Change*

83. Much of the analysis has so far discussed price competition. However, manufacturers compete on the quality of PCs as well as price. Continued technological developments mean that PCs have a short shelf life, being constantly replaced by updated versions. This intensifies price competition, since as models become “older,” they must be discounted heavily to make them attractive to consumers. As Mintel (1999) notes:

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<sup>53</sup> John Lewis and Temp o also stock own brands.

<sup>54</sup> The TNS survey data listed 21 brands. Gartner’s Dataquest survey data has even more.

<sup>55</sup> The figures include any additional hardware, software and warranties purchased as well as tax. However, this is unlikely to distort the overall picture significantly.

“The introduction of new, faster and more powerful processors, has necessitated quick replacement purchasing in order to keep up to date with the latest developments. It has been suggested by some market commentators that the processing speed of PCs is currently doubling every nine months, faster than any time in history, making price cutting of “older” stock a characteristic of the industry. It was possible, in mid 1999, to purchase a PC that was state-of-the-art at the beginning of the year at over 40% discount, which allows a more sophisticated buyer to pick up a potential bargain (page 24).”

84. The Mintel (1999) report also describes the market as one where the consumer is becoming more sophisticated (with more information, and more buyers who have previously bought), where prices are falling and where change is rapid.<sup>56</sup> Its forecast includes the prediction that “manufacturers and distributors will continue to keep prices low”.<sup>57</sup> This means that today’s “feature focus” PCs are tomorrow’s “value-focus” PCs and confirms that it is not sensible to partition the market by price point.

#### *Product Complexity*

85. As noted above, manufacturers compete on quality as well as price. Consumer switching therefore would be on the basis of quality-adjusted prices or “value for money”. Some manufacturers suggest that estimating the value of the bundle is complex, although second time buyers are better placed to make this judgment. Such consumers are well represented across both sales channels and price points. Their stronger ability to evaluate value for money would, diminish the ability of retailers and manufacturers to price excessively on the basis of product complexity.
86. Furthermore, to the extent that the complexity of the bundle might make switching more difficult, manufacturer repositioning would be an important offsetting factor. It seems reasonable to argue that a manufacturer already producing and distributing PCs at the “feature” end would be able to distribute rapidly at the “value” end of the market if a profitable opportunity arose and *vice versa*. Thus, if an excessive margin were available on a bundled product, due (say) to consumers finding it hard to judge the value of the bundle, then manufacturers should be able to reposition themselves quickly and profitably. This should have the effect of eroding the excessive margin.

#### *Conclusion on Product Differentiation and the Importance of Brand*

87. Consumer survey evidence, the rapid updating of the quality of PCs and the ability of manufacturers to reposition their products all suggest that market segmentation on the basis of brand or on the basis of “value” or “feature” or product complexity is not appropriate. The Director concludes that PCs are not strongly differentiated by brand or by groups of brands.

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<sup>56</sup> See Mintel (1999), page 30 .

<sup>57</sup> See Mintel(1999), page 141.

### iii. Barriers to Entry

88. An assessment of entry barriers is an important part of the assessment of market power.<sup>58</sup> The Director's view is that barriers to entry are not high into the upstream or the downstream market.

#### *Manufacturing Level*

89. Computers are becoming ever more standardised and there would not appear to be significant technological entry barriers to producing a PC. TNS survey data suggest that 4% of their sample of respondents who had recently purchased PCs had built their own PCs and so there is no reason to presume that a new entrant would find it difficult to manufacture a PC, although establishing a reputable brand may still be necessary.

90. The responses of manufacturers suggested that it would be relatively easy for a manufacturer specialising in the sale of PCs to businesses to enter the market for sales to consumers [...]. Manufacturers not supplying PCs to the UK but supplying PCs to other countries would also be able to enter the market without great difficulty. Manufacturers also suggested to us that it would be possible for an established manufacturer of, for example, other electronic goods to manufacture and establish a brand for its own home PCs.

#### *Downstream Level*

91. New entry into the downstream market could occur through the following routes. First, retailers not selling PCs could start to do so without great difficulty by linking up with one or more of the many established computer manufacturers.<sup>59</sup> It has been established above that PCs are not strongly differentiated by brand and that there are many suppliers of branded PCs. Therefore, there is a widespread availability of PCs in the upstream market, notwithstanding the Agreements.

92. Not only are there many brands available to retailers but, as noted above (at paragraphs 47 and 48), there are many retailers who could introduce PCs to their stores relatively quickly and without making substantial sunk investments. Gateway's partnership with BT stores is a recent example of a supplier-retailer partnership. Potential entry is not limited to retailers of electronic and electrical goods but also includes stores such as supermarkets and toy shops.

93. Second, manufacturers could establish their own retail outlets. Time and Tiny, for example, have successfully opened national chains of showroom outlets over the past few years. While Time and Tiny already operated in the downstream market as direct sellers, their experience suggests that a manufacturer not currently selling direct could

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<sup>58</sup> Paragraph 5.1, OFT 415.

<sup>59</sup> More than one manufacturer suggested that there is little to prevent a retailer from forming a link with a manufacturer provided they can negotiate an acceptable policy in respect of stocks and returns.

enter the downstream market successfully by establishing its own showrooms. The Office was also told of another direct seller who had recently opened or was planning to open additional showrooms.

94. Third, manufacturers in the upstream market who supply PCs to retailers but who do not sell directly to UK consumers could enter the downstream market relatively easily by establishing their own direct selling operations.
95. While it should be noted that the market for the supply of new PCs to consumers through both retail and direct sales channels in the UK is an advertising intensive market,<sup>60</sup> advertising would not appear to be a barrier to entry in the sense of being asymmetric as between new and incumbent firms. While advertising is a sunk cost, there is no reason to suggest that new entrants could not make headway into the downstream market by undertaking similar amounts of advertising as incumbents.

*Conclusion on Barriers to Entry*

96. The Director concludes that barriers to entry are not high at either the upstream or the downstream level, a view supported by evidence of new entry in the past few years.

**(b) Conclusion on Dominance**

97. The evidence in respect of both market definition and the conditions of competition suggest the following. First, DSG's market share of [...], is considerably less than 40%.<sup>61</sup> This is in the overall context of a market structure which is not highly concentrated, which is not segmented by brand or by direct and retail channels, and where market shares move over time. Second, there is evidence that significant growth is possible in a short space of time and that entry barriers are not high. Third, there is a large and growing pool of "experienced" buyers with most manufacturers describing the market as one which is price sensitive and where margins have declined in recent years. Fourth, the rapid product innovation cycle is expected to continue so that competitive pressure from the discounting of "older" stock will remain.
98. The above factors indicate that DSG is not in a position such that it may prevent effective competition being maintained on the relevant (downstream) market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers. The Director therefore concludes that DSG does not possess a dominant position in respect of the supply of PCs.

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<sup>60</sup> Mintel (1999), page 87 describes advertising expenditure in the PC hardware market at 4-5% of sales as "very high for a consumer durable market" where the norm is around 1-2%.

<sup>61</sup> This is a 1999 figure. There is no evidence that the DSG market share will have increased materially between 1999 and 2001. In fact between 1998 and 1999 the DSG market share fell.

**(c) Abuse**

99. Given that the Director has concluded that DSG is not dominant, there is no need for him to consider the question of abuse.

**(d) Chapter II Non-Infringement**

100. On the basis of the facts and for the reasons set out above, the Director has decided pursuant to the Act that DSG has not infringed the Chapter II prohibition by implementing the Agreements.

**E. THE CHAPTER I PROHIBITION**

101. The Complaint alleged that DSG has a significant share of the relevant market and that the implementation of the exclusivity provisions of the Agreements cement and reinforce that situation and have as their object or effect the prevention, restriction or distortion of competition within the UK.

102. Section 2(1) of the Act provides that, subject to section 3, agreements between undertakings, decisions by associations of undertakings or concerted practices which (a) may affect trade within the UK, and (b) have as their object or effect the prevention, restriction or distortion of competition within the UK, are prohibited unless they are exempt in accordance with the provisions of Part I of the Act.

**(a) The Packard Bell Agreement**

103. The Packard Bell Agreement was concluded on 12 November 1999. It appoints DSG as Packard Bell's exclusive distributor for the resale of certain products including home PCs from 1 January 2000. [...]. DSG is appointed as distributor for the territory of the United Kingdom and Northern Ireland. The contract term is until [...].

**i. Agreements Between Undertakings**

104. DSG and Packard Bell are undertakings for the purposes of section 2 of the Act. The Packard Bell Agreement is an agreement for the purposes of section 2 of the Act.

**ii. Effect on Trade Within the UK**

105. The Packard Bell Agreement relates to the distribution of home PCs and other products throughout the UK. The Packard Bell Agreement may therefore affect trade within the UK, within the meaning of section 2 of the Act.

### **iii. Exclusion Order**

106. The Exclusion Order provides that the Chapter I prohibition does not apply to an agreement to the extent it is a vertical agreement. The Packard Bell Agreement is a vertical agreement within the meaning of Article 2 of the Exclusion Order. Article 2 of the Exclusion Order defines a vertical agreement as:

“an agreement between undertakings, each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services and includes provisions contained in such agreement[s] which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of the agreement and are directly related to the use, sale or resale of goods or services by the buyer or its customers.”

107. For the purposes of the Packard Bell Agreement, DSG and Packard Bell operate at a different level of the production or distribution chain. The Packard Bell Agreement relates to the conditions under which the parties may purchase, sell or resell certain goods or services and includes provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights that do not constitute the primary object of the Packard Bell Agreement and are directly related to the use, sale or resale of goods by the buyer or its customers.

108. Therefore, pursuant to Article 3 of the Exclusion Order, the Chapter I prohibition does not apply to the Packard Bell Agreement. This exclusion is automatic and no individual notification needs to be made to benefit from its provisions.<sup>62</sup>

#### **Withdrawal of the Exclusion Order**

109. Pursuant to Article 7 of the Exclusion Order, the Director may give a direction to withdraw the benefit of the exclusion in respect of an agreement if he considers that (a) (i) the agreement will, if not excluded, infringe the Chapter I prohibition; and (ii) that he is not likely to grant it an unconditional individual exemption.

110. The Exclusion Order excludes vertical agreements from the application of the Chapter I prohibition because they do not generally give rise to competition concerns unless one of the parties to the agreement has significant market power or a network of similar agreements exists which has a cumulative effect on the market. In practice, it is likely that the Director will exercise these powers only rarely.<sup>63</sup>

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<sup>62</sup> Paragraph 2.1, OFT 419.

<sup>63</sup> Paragraphs 5.1 & 5.2, OFT 419.

111. The Director has considered withdrawal of the exclusion in the case of the Packard Bell Agreement. Having regard to the foregoing analysis of the relevant upstream and downstream markets, including the widespread availability of PCs on the upstream market, the Director did not consider there were sufficient grounds to exercise the power to withdraw the exclusion. The Director therefore has not made a direction withdrawing the benefit of the Exclusion Order from the Packard Bell Agreement.

### **Chapter I Non-Infringement**

112. In light of the application of the Exclusion Order and Director's decision that withdrawal of the benefit of the Exclusion Order was not warranted, the Director has decided that the Packard Bell Agreement does not infringe the Chapter I prohibition.

#### **(b) The Compaq Agreement**

113. The Compaq Agreement was concluded on 27 August 1999. It appoints DSG as sole distributor for certain products manufactured by or for Compaq under the Presario trademark, including software, accessories and manuals thereto, in the territory (England, Scotland, Wales, the Channel Islands and the Isle of Man) for a [...] period from 27 August 1999 expiring on [...]. The products covered are the range of PCs bearing the registered trade mark 'Presario.' These are the Compaq PCs which are designed to target the UK home PC market. Subject to certain limited exceptions,<sup>64</sup> Compaq agree not to appoint any other person as a distributor in the territory, or to itself supply the products in the territory.

#### **i. Agreements Between Undertakings**

114. DSG and Compaq are undertakings for the purposes of section 2 of the Act. The Compaq Agreement is an agreement for the purposes of section 2 of the Act.

#### **ii. Effect on Trade Within the UK**

115. The Compaq Agreement relates to the distribution of PCs in England, Scotland, Wales, the Channel Islands and the Isle of Man. The Compaq Agreement may therefore affect trade within the UK, within the meaning of section 2 of the Act.

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<sup>64</sup> [...].

### **iii. Exclusion Order**

116. The Compaq Agreement is a vertical agreement within the meaning of Article 2 of the Exclusion Order. The Director refers to the reasoning with respect to the applicability of the Exclusion Order to the Packard Bell Agreement. The Director concludes that the Exclusion Order applies to the Compaq Agreement. Therefore, pursuant to Article 3 of the Exclusion Order, the Chapter I prohibition does not apply to the Compaq Agreement.

#### **Withdrawal of Exclusion Order**

117. The Director refers to the reasoning with respect to the Packard Bell Agreement and withdrawal of the benefit of the Exclusion Order. In practice, it is likely that the Director will exercise these powers only rarely.<sup>65</sup>

118. The Director has considered withdrawal of the exclusion in the case of the Compaq Agreement. Having regard to the foregoing analysis of the relevant upstream and downstream markets, including the widespread availability of PCs on the upstream market, the Director did not consider there were sufficient grounds to exercise the power to withdraw the exclusion. The Director therefore has not made a direction withdrawing the benefit of the Exclusion Order from the Compaq Agreement.

#### **Chapter I Non-Infringement**

119. In light of the application of the Exclusion Order and Director's decision that withdrawal of the benefit of the Exclusion Order was not warranted, the Director has decided that the Compaq Agreement does not infringe the Chapter I prohibition.

### **IV. NON-INFRINGEMENT**

120. On the basis of the facts and for the reasons set out above, the Director has decided that the Agreements do not infringe the Chapter I prohibition. The Director has also decided on the basis of the facts and for the reasons set out above, that in implementing the Agreements, DSG has not infringed the Chapter II prohibition. This decision is given pursuant to rule 15(1) of the Director's rules and constitutes a decision pursuant to the Act.

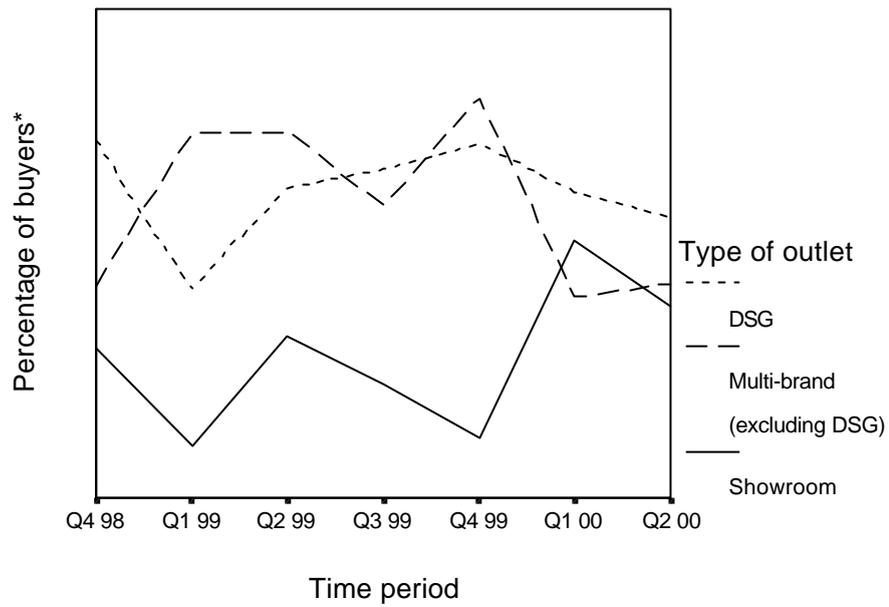
**Penny Boys  
Deputy Director General of Fair Trading**

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<sup>65</sup> Paragraphs 5.1 & 5.2, OFT 419.

## ANNEX 1

### Annex 1: Survey evidence on PC sales through DSG, other multibrand retailers and showrooms<sup>66</sup>



\* Figures and calibrations on vertical axis are excluded in order to comply with the provisions of section 56 of the Competition Act 1998

<sup>66</sup> Based on the quarterly survey of 200 consumers conducted by Gartner's Dataquest service. Percentages relate to share of all new PC sales.

## ANNEX 2<sup>67 68</sup>

[All graph data, text and footnote 67 excluded to comply with the provisions of section 56 of the Competition Act 1998. Footnote 68 to the text remains below.]

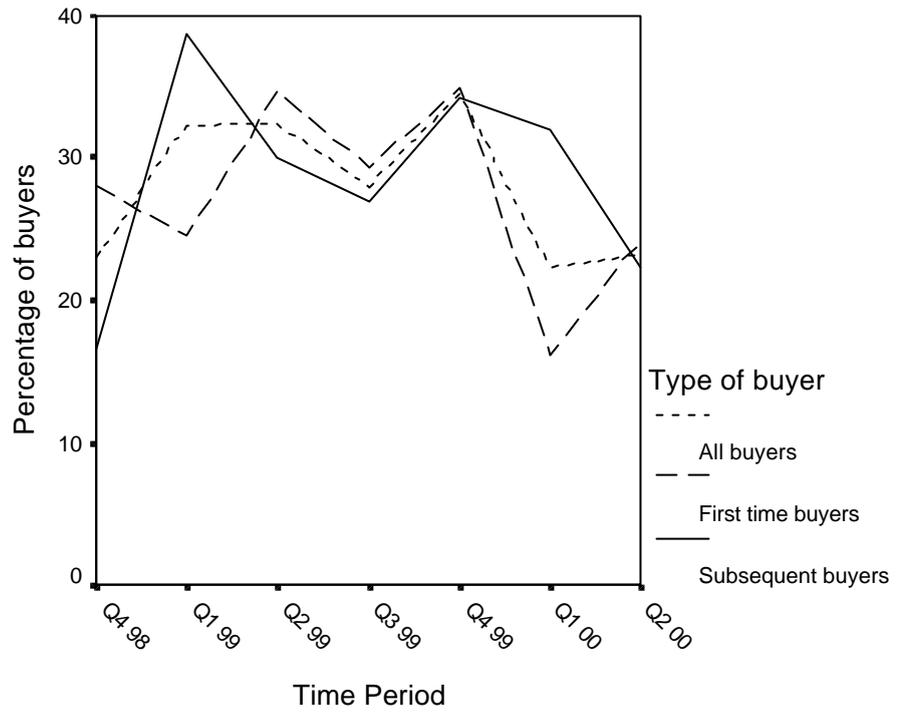
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<sup>67</sup> [...].

<sup>68</sup> For the sample as a whole, sales to second time buyers accounted for 49% of sales and sales to first time buyers accounted for 51% of sales when averaged over the period from Q1 1998 to Q2 2000 (Source: Gartner's Dataquest service).

### ANNEX 3

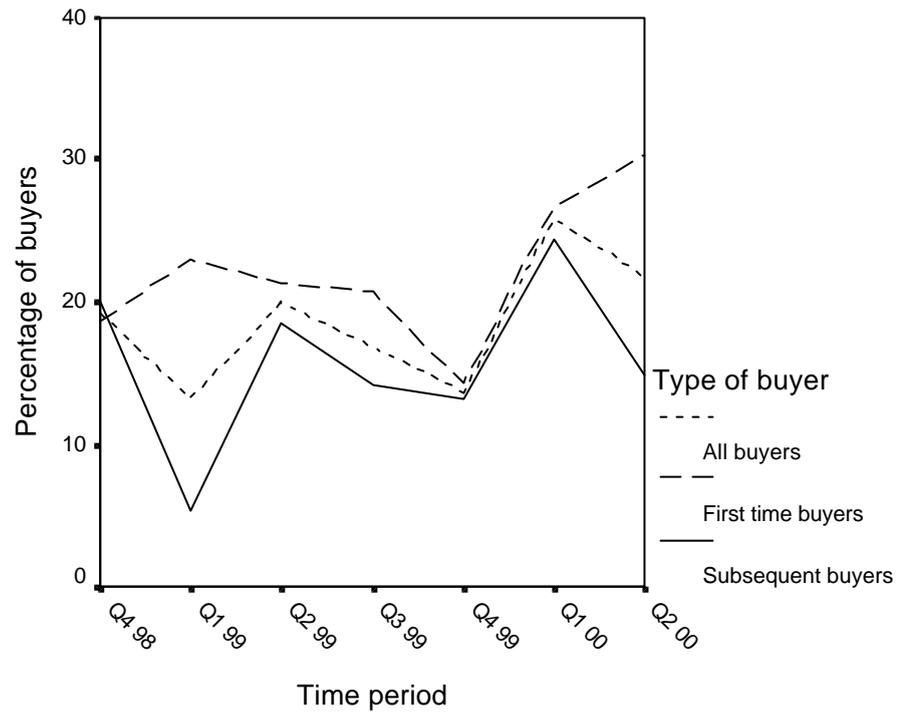
#### Annex 3: Survey evidence on PC sales through other (non DSG) multibrand stores by first and second time buyers<sup>69</sup>



<sup>69</sup> Based on the quarterly survey of 200 consumers conducted by Gartner's Dataquest service. Percentages relate to share of all new PC sales.

## ANNEX 4

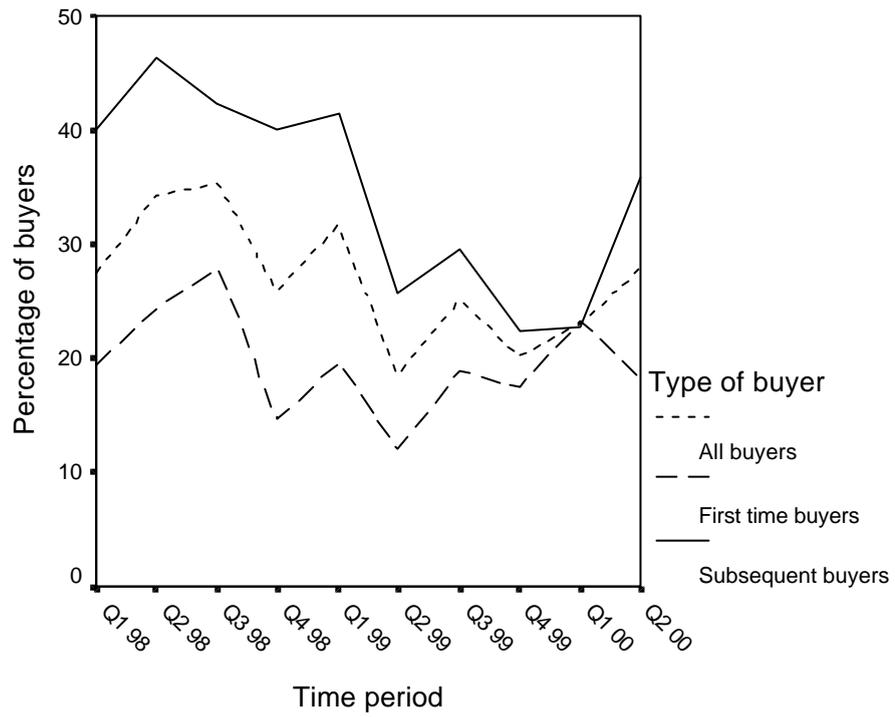
### Annex 4: Survey evidence on PC sales of showroom stores by first and second time buyers<sup>70</sup>



<sup>70</sup> Based on the quarterly survey of 200 consumers conducted by Gartner's Dataquest service. Percentages relate to share of all new PC sales.

## ANNEX 5

### Annex 5: Survey evidence on PC sales through direct channels by first and second time buyer<sup>71</sup>



<sup>71</sup> Based on the quarterly survey of 200 consumers conducted by Gartner's Dataquest service. Percentages relate to share of all new PC sales.

## ANNEX 6

### Breakdown of sales by value and volume derived from Gartner's Dataquest survey<sup>72</sup>

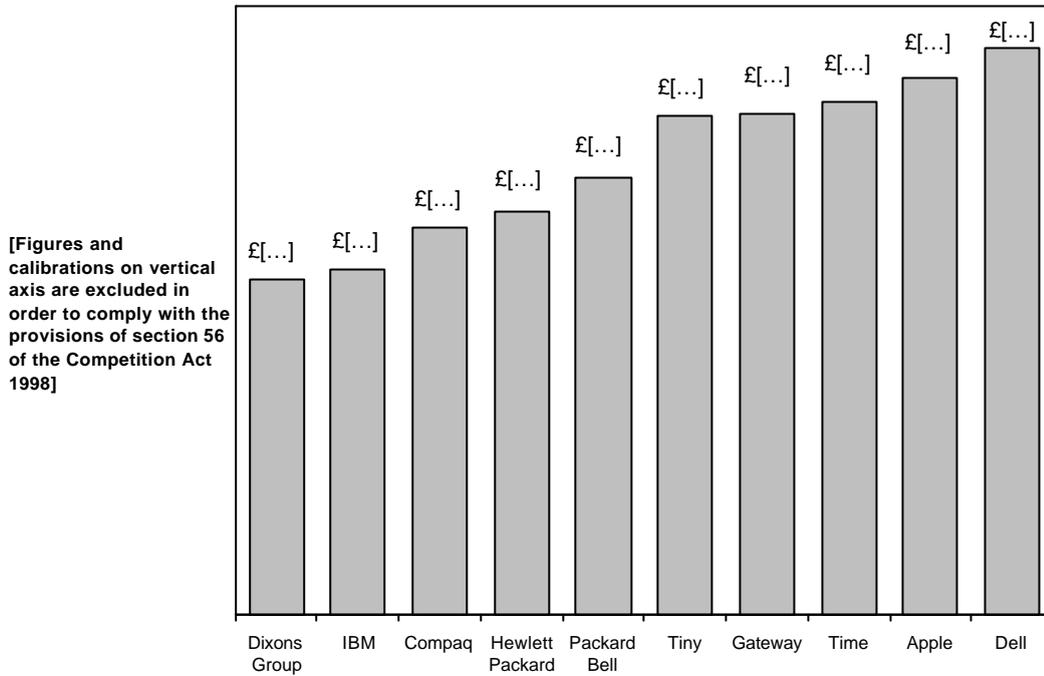
Outlet type	Percentage of Sales	
	Share by value	Share by volume
DSG	[...]%	[...]%
Retail showroom	[...]%	[...]%
Direct from manufacturer	15.7%	14.1%
Independent computer shop	9.8%	12.5%
Mail order	7.5%	8.3%
Consumer electronics store	5.7%	6.9%
High street retailer	2.8%	3.2%
Superstore	2.5%	2.8%
PC dealer	1.9%	1.7%
Internet	1.2%	1.0%
Office superstore	0.7%	0.9%
Others	1.4%	1.0%

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<sup>72</sup> Based upon the quarterly survey of 200 consumers conducted by Gartner's Dataquest service, amalgamated over the period from Q4 1998 and Q2 2000, giving a sample of 977 consumers, (market defined as all new PC sales).

## ANNEX 7

### Annex 7: Average PC cost by brand including any additional hardware and software bought at the time of purchase, warranty and tax <sup>73</sup>



<sup>73</sup> Based on the quarterly survey of 200 consumers conducted by Gartner's Dataquest service averaged over the period from the Q1 1999 and Q2 2000.