

An Economic Approach to Article 82

Many steps

- Report of the EAGCP, June 2005
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- Draft paper of the Commission, end 2005
- Comments

Why a more economic approach?

- Article 81 and merger control revised towards a more economics-based approach.
- Similar move for article 82 desirable.
- Today, article 82 organised by categories of conducts : predation, bundling, rebates...
 - Problem 1 : many practices often serve the same purpose.
 - Problem 2 : a given practice can have several (pro- or anti-competitive) foundations.

Example

- Price under cost :
 - may be due to « efficiency reasons » (seeking network externalities or learning by doing effects);
 - May serve an exclusionary pupose (predatory pricing).
- Price discrimination :
 - May be used to capture customers and eliminate rivals
 - Or may lead to a more intense competition (competition « on a customer basis » rather than on a « market basis » allows easier price cuts)

A more economics based approach

- A more consistent approach :
 - starts out from the *effects* of the practice on rivals on the same market or on other firms in adjacent markets;
 - Assess the competitive harm inflicted to consumers
- Guarantees that the same treatment is applied to practices that have the same impact.
- By contrast, a form based approach may induce different tests for different practices :
 - more or less lenient towards equivalent practices.

Effect based/form-based, per se rule/rule of reason

- Effect based approach can be implemented through a per se rule or through a rule of reason.
- Example : effects-based-per-se-approach to financial predation :
 - « a strong incumbent facing a weak entrant cannot invest on losses beyond » some threshold ».
 - Allows to include a number of practices serving the same purpose (low pricing, high advertising, rebates...)
 - Requires a richer description of circumstances.
- Risks of false positive/false negative still exist.
- But less risks under a rule of reason.

Implications for procedure

- Under a formed based approach :
 1. Check that the firm is dominant
 2. Check that a certain form of behaviour is at work.
- Effects based approach : requires assessment of competitive harm.
 1. Identifying it
 2. Consistent and verifiable account of comp. harm : economic analysis + facts
 3. Ingredients of a « story » spelled out,
 4. Other possible stories: why they are not relevant.

Implications for procedure (2)

- Less weight on verification of dominance (except *de minimis*):
 - competitive harm rather *reveals* dominance;
 - Verification of dominance : part of assessment of competitive harm.
- Gives sense to the « special responsibility » of a dominant firm :
 - some practices should be prohibited because of their exclusionary effects, while they are lawful as long as no competitive harm.
- Burden of proof :
 - on the anti-trust authority identifying and establishing anti-competitive effects
 - On the firm if its « story » relies on data concerning the firm.

Competitive harms

- Three main types of harms
 - Exclusion within the same market (home market)
 - Exclusion in an adjacent market
 - Exclusion in a vertically related market
- One type of exclusion may be implemented by different practices
- Objective : treat in the same way practices that lead to the same type of exclusion.

Exclusion within one market

- Rival is forced to exit or cannot enter the home market.
- Common features to many practices :
 - aggressive phase followed by a recoupment period.
 - Initial phase : the incumbent reduces the profitability of the competitor (targeted rebates, predatory price, product proliferation...), deters entry (tying, exclusive dealing...)
 - In the short run, often CS increases, incumbent's profit decreases ; in the long run, opposite direction.
 - Recoupment : essentiel in the overall evaluation of the conduct, but can be evaluated both through evidence and theory.

Exclusion within one market (2)

- Most strategic variables (price, capacity, tying, ...) can also be used in normal competitive situations.
- Ex : price cut in response to an entrant, can also be predation.
- Need to identify the precise story which is relevant in the case, and facts that are related to it, in order to distinguish abusive from competitive behavior.

Exclusion in adjacent markets

- Horizontally related to the home market
- Products sold directly to consumers
- Links : provided by a number of practices, bundling, tying, full line forcing, compatibility choices etc.
- Competitive harm : the linkage places the rival at a competitive disadvantage, either on the home market or on the adjacent market.
- Some consumers may benefit in the short run, others may be hurt.

Exclusion in adjacent markets (2)

- Bundling, tying : has been subject to the Chicago critique (only one monopoly profit to be obtained)
- But development of new theories which provide rationale for strategic leveraging of market power.
- These stories stress the role of
 - the relationship between products (compl. or subs.?)
 - the costs of entry,
 - the irreversibility of bundling (commercial or technological?)

to assess the potential anti-competitive effects.

Exclusion in vertically related markets

- The dominant firm controls a bottleneck.
- It forecloses the vertically related markets by limiting access to its bottleneck (refusal to deal, discrimination in order to favour its subsidiary).
- Can take the form of
 - vertical integration (ex: airlines with their computerized reservation systems),
 - incompatibility (ex. Itunes with MP3 players others than Ipode)...
 - Discrimination...
- Problem : leverage of market power in vertically related markets.

Exclusion in vertically related markets (2)

- Again Chicago critique (only one monopoly profit). But :
 - The bottleneck may deter competition in a vert. related market in order to protect the home market.
 - If a commitment problem arises that dissipates the bottleneck's profit, the latter may want to eliminate competition in the vertically related market to restore its monopoly profit.
- Interventions of competition policy : difficult to define optimally.
 - Ex. incentives to innovate (if bottleneck : innovation)

Implications for practices

- First question : What is the competitive harm?
 - Identification of the economic toolbox
 - Many different practices, but types of competitive harms; limited set of possible « stories »
 - Allows to outline the key facts that need to be checked
 - and a consistent of different practices which have the same effects.
- Second question : pro-competitive effects that counterbalance?
- Need for a consistent microeconomic story.

Discussion paper of the Commission

- Emphasis :
 - on consumers' harm
 - on the effects of the various practices
 - Recognition of potential pro-competitive effects
- But :
 - Mix between form and effects
 - Efficiency defence (efficiencies should be considered from the beginning)
 - No account of the « story », strategy at work
 - Heterogeneity / practices

Examples

Price discrimination (1)

- Charging different prices for different units/customers.
- Explicit (observable characteristics) or implicit (same menu offered to all, but different ex post prices)
- Often treated as a « per se » offense.
- Due to its « exploitative effect » rather than to its anti-competitive effect.

Price discrimination (2)

- May be joined to another practice : bundling, rebates...
- Can lower total welfare or increase it.
- Depends (among others) on whether, due to lower prices available with discrimination consumers who did not consume in the uniform price case now buy the good. (But the others loose).
- In general, discrimination is good for the firm.
- A good test is the variation of the total quantity (if discrimination decreases it, then it is certainly bad for welfare).

Price discrimination (3)

- In some circumstances, allowing discrimination is pro-competitive:
 - Competition on a customer basis : firm less reluctant to offer price cuts.
 - Makes switching easier (with or without switching costs)
 - Should allow an incumbent to respond non uniformly to limited entry (justifies « meeting competition » argument).
 - Banning price discrimination may help a dominant firm to resist requests for lower prices (plays the role of a commitment device)

Price discrimination (4)

- But :
 - 1) may be anti competitive : reduces the cost of selective predatory pricing.
 - 2) these arguments dont take into account impact on market structure (entry/exit).
 - Ex. : in universal service obligations, discrimination often makes competition less intense. Increases entry. Overall effect?

Tying, Bundling (1)

- Tying : selling one good (the tying good) conditional on the purchase of another one (the tied good).
- Bundling : sale of two products together.
- Pure or mixed bundling.
- Both can be achieved through technological or commercial links.
- May concern substitutes, or complements or independant goods (then only link between markets : goods bought by the same consumers).

Tying, Bundling (2)

- Mixed bundling : allows offering multiple price formulas to consumers adapted to the need of different consumers (see discrimination)
- Tying and bundling may be pro- or anti-competitive according to the context.

Anti competitive effects (3) :

- Expected exclusionary consequence of bundling on the tied market: consumers buy good A and B from the dominant firm. Competitor on market B cannot sell its product.
- Protection on the home market : if entry on market A is easier when present on market B. To avoid entry on market A from a competitor on market B exclusion from market B
- Forces competition between bundles rather than between separate goods.

Pro-competitive effects (4)

- Recovery of fixed costs (even if independent goods)
- Avoids transaction costs
- Solves compatibility problems between complementary products
- Boost of demand on market B.
- metering device for complementary products (after sale); may lower price of equipment; reduces distortions in replacement decisions.
- Reduces the double margin problem (Cournot argument)
- System based rather than component based competition may be more intense : price cuts better internalized

What CA should do (5) : Example

- Firm dominant on market A, fears entry from a competitor market B on which dominant is present (A, B complements)
- Pure bundling to prevent consumers from buying the competitor's B product.
- But Chicago critique : only one monopoly profit to be made (competition on B market increases demand for A)
- More sophisticated version (Carlton and Waldman (2002)) : entry on market A depends on successful entry on market B, incentive to block entry on B by bundling.
- But commitment problem once entry has occurred, solution is technological bundling.

What CA should do (6) : Example

- Bundling strategy : involves sacrifices with regard to a strategy where the firm would accommodate entry; like predation.
- Effects based approach :
- Does the situation present dynamic feature?
- Existence of a complementary product makes the entry of competitor more likely?
- Is the quality of the competitor higher?
- Is the bundling strategy credible?
- Possible efficiencies? (compatibility problems)

Refusal to deal (1)

- May again take several forms : the firm can
 - refuse to supply an essential good,
 - charge a high price,
 - make the bottleneck incompatible with the goods offered by competitors,
 - Tie the bottleneck with another product,
 - Sign exclusive dealing contracts with one particular firm.

Refusal to deal (2)

- Anti-competitive effects :
 - Dominant firm owns an essential input
 - Exclusion on a vertically related market
 - Extends its monopoly to downstream levels
- Pro-competitive effects :
 - Negative externalities if the upstream firm cannot control downstream firm's quality
 - Free riding from downstream on upstream
 - Hold up problem if heavy investment upstream.
 - Commitment problem.

What CA should do (1)

- Refusal to deal may increase market power if the dominant firm cannot exploit its monopoly power on the bottleneck unless it denies access.
- Contract with one downstr. firm, incentives to supply the others at more favourable conditions to increase profits at the expense of the first firm.
- But this opportunist behaviour is expected by dstr. Firms who accept only lower prices
- Reduces the profits of the monopolist.
- Case for anti-competitive effects of the practice.

What CA should do (2)

- Are there anticompetitive effects?
- What is the source of the bottleneck?
 - problems if investment and innovation efforts, espec. in the case of intellectual and property rights
- Will the intervention be effective without decreasing efficiency?
 - CA should not intervene in the price, conditions etc. at which the access may take place.
 - Any intervention affects the bargaining power of participants.