

Abuse of Dominant Position : Predation

Introduction

- Over the past years : many discussions on merger control.
- The European Commission : « per se » rules on strengthening or creation of dominant position has to lead to forbid some mergers that would have been authorized under a more economic approach.
- For the economists: focus on the effects on competition (test of « substantial lessening of competition»)
- Finally, modification of merger regulation; test a bit intermediate

Introduction (2)

- This debate reaches art. 82 EC Treaty (L. 420-2 French Commercial Code): on the abuse of a dominant position.
- At the core of the debate : practices (per se) or effects (rule of reason)
- Or rather : to refine the per se rules so that the categories only contain practices having anti-competitive effects.
- This drives (with Chicago School) to a degree of strictness more stronger for the CA-s
- Leaves however number of problems unsolved : Short-Term/Long-Term, etc...

Practices and effects

- Practices usually considered from the abuse of dominant position perspective : predation, tied sales, discounts, ...
- Are they anti-competitive when they have the following effects (*potential is sufficient*):
 - exclusion from the main market of the firm
 - exclusion from the adjacent market
 - exclusion from the vertically linked market.

Combined practices, with « separated » effects

- Practices often combined
 - Example : an undertaking offers price reduction or offers a bonus (ex. other good for free) when the buyer buys in couple, a good of a main market and another;
 - Combine tied sales + eventual discount + eventual predation (at least marginally)
 - potential effects : on the main market, on the adjacent market
 - Discrimination + exclusion.
- Idea : to refine the categories, to analyse the effects, to take the efficiency gains into account.

Predation : Introduction (1)

- Predation : a tricky problem for the competition authorities!
 - 1) Low prices : rather a good thing
 - 2) Insufficient criteria of proof may risk to push the undertakings to fix higher prices (in order to avoid proceedings).
- But direct evidences difficult to collect.
- In particular in sectors where predation cases appear the most (telecoms, ...), other very good reasons to fix low prices (network effects, learning by doing, R&D)
- Plaintiffs often less efficient than the presumed predator.

Introduction (2)

- Lot of perplexity from the economists' side, and from CA's: how to explain strategies which drive to losses for undertakings?
- “Reference article” Areeda & Turner (1974) : suggests to think on the question, tests, etc...
- Before A & T, 77% the complaints for predation in the US are examined to be favourable, after only 8%.
- Since A & T, many discussions on the relevant cost concept.
- But for the economists, the most important :
 - To define exactly what is predation
 - Understanding the strategies involved

The « little story » of predation

- 1) The predator, an undertaking in a **dominant** position, which can bear losses, sacrifices the profits through low prices.
- 2) The rivals (or potential entrants) leave the market, because they are not able to be profitable under such competition conditions.
- 3) Thanks to its dominant position, the predator recovers its losses.

But each stage is a problem for the competition authorities.

The first problem

- Sacrifice the profits : in theory that simply refers to a price below the optimal price for the undertaking (profit below optimal but positive).
- In practice, what is the optimal price ?
- Finally, demand for negative profits,
 - The history has already been changed!!
 - Leads to other questions : price below the cost
 - But which cost?
 - Etc...

For the authorities, predation requires

1. Proof of the **dominant position** of the predator.
2. Proof that the price is **below a certain concept of cost**.
3. Idea of the **strategy** followed by the predator
4. Proof that the **recovery** of losses, is at least in theory possible ex post.
5. **Absence of other** convincing **defence** (network, externalities, learning, etc...).

Possible definitions of the predation (1)

Predation is not clearly defined

1. Strategy which would not be profitable if it did not take into account the effects on entry and on exit.
2. 1 + which authorises the predator to increase its prices ex post above the competitive level.
3. 1 + 2 + which excludes the less efficient competitors.

Definitions (2)

Not at all equivalent.

- 3. Demands to prove that the competitors who are more efficient than the predator left the market.
- 2. Allows to sanction only the socially inefficient predation.

Which concept of cost?

- Areeda and Turner (1974) : marginal cost in theory, in practice average variable cost:
- $p \geq AVC$, OK, $p < AVC$: suspicious.
- Joskow and Klevorick (1979) : average total cost, supposes that firms must always cover their fixed costs (?)
- Bolton, Brodley, Riordan (2000) : average incremental cost, i.e. cost combined with the output « increment » generated by the predatory strategy.
- Incremental cost : better based on theory, but not really easy to calculate.

Where are we? (1)

- 1) Proof of the predatory behaviour requires, before anything to show that the firm is **dominant** : conditions capacity to recover its losses ex post (but not necessarily by higher prices).
 - If not, abandon the case.
 - It is important to avoid to prevent a non dominant firm from reducing its prices in order to gain market shares.

Where are we? (2)

2) Prices below a certain concept of costs, for example :

- Prices $>$ average total cost, OK.
- Price below average variable cost : probably illegal.
- Between the two : investigation (with the reversal of the burden of the proof for example? To be discussed).

Where are we? (3)

- 3) Lack of convincing **strategy** to explain predation.
- Recent economic theory: the predation requires the asymmetry of the information
 - Either between predator and prey,
 - between predator and another actor.
 - It has to be proved to the minimum extent that such an asymmetry exists.

The predation strategies

- Three kinds of strategies.
- **It is important to know which strategy has been implemented to be able to analyse it.**
 - Signal
 - Reputation
 - « Deep pocket argument » (financial predation).

Reputation/Signal (1)

- **Reputation** : the predator creates itself an aggressive reputation against the entrants (even if the entrant has once entered, it would be optimal “to adjust” in the sense of the rules of the game).
- Idea : to discourage the entrance of the other competitors in the future, on the other markets, “chain store paradox” etc..
- CA : has to show that the predator is active on many markets (products, invitation to tenders), or is going to face new entrants in the future.

Reputation/Signal (2)

- **Signal:**
- The predator wants to convince the prey that the costs are high, the demand is low, etc...
- CA : has to show that costs, demand (etc.) can not be observed by the entrant.

Deep pocket (1)

- Classic story : the predator has a better access to the financial market than the prey; is able to suffer (temporary) losses contrary to the prey. This drives the prey out of the market.
- “Modern” story: the prey may turn to an external investor. The predator manipulates the relationship investor/prey (loan contract for example).
(Holmström & Tirole 1997)

Deep pocket (2)

- To support a financial predation strategy, CA has to prove :
 - Dependence of the prey towards an external financing;
 - Dependence of such financing towards prey's performances;
 - Easier access to the financial markets for the predator.

Other Questions (1)

Is recoupment (recovery of losses) ex post necessary?

- According to European law, no; often debated.
- Economists' response : rather reinforces this position.
 - Increase in prices ex post : surely not necessary to convince the predation.
 - Predation might be profitable without an increase in prices
 - The possibility of recovery has to be evaluated ex ante, not ex post
- « No recoupment ex post » : cannot be accepted as a defence

Other Questions (2)

Do we have to prove welfare losses of the consumers?

Idea : if predation = success, (i.e. elimination of competitors + higher prices), this generates losses for the consumers.

These losses : not necessarily observable during the investigation.

- But the proof of these existence is not necessary : always an idea of evaluation ex ante.
- « No losses for the consumers » : not acceptable as a defence

Other questions (3)

- *What shall we do with the « proofs » of the will to exclude the competitors?*
- Internal documents testifying the will of excluding the competitors from the market, to eliminate them, etc...
- Rather normal in the world of competition.
- There is nothing to do with such proofs, unless they explicitly mention the « sacrifice of the profits ».

Conclusion on predation

Predation often interferes with other problems, other strategies, etc. For example:

- Cross subsidies (some markets finance losses suffered on other markets)
 - Connected or not to legal monopoly or state aids.
 - Squeeze : same kind of issues in vertically integrated firms.
 - Strategic allocation of costs between several activities : regulation issues in the markets to be opened to competition.
 - French example : *Vendée sea crossings*.
 - European example : AKZO.
- It is then crucial to understand the presumed strategy of an undertaking.