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Further steps towards an effects-based approach

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*The views expressed are those of the authors and do not necessarily reflect those of DG COMP or the European Commission

Traditional approach

- Form-based approach:
  - Practices are per-se abusive or presumed abusive (e.g. tying, loyalty rebates, below cost-pricing)
- Foreclosure = Abuse
  - (to be abusive) “it is sufficient to show that (the conduct) tends to restrict competition (or) is capable of having that effect”

    (Michelin II, p. 239)

The discussion paper

- A practice is abusive if two conditions are met:
  - Capability to foreclose competitors:
    - “to establish such capability it is in general sufficient to investigate the form and nature of the conduct in question”
  - Market distorting foreclosure effect:
    - “foreclosure is said to be market distorting if it likely hinders the maintenance of the degree of competition still existing in the market...”
    - “...and thus have as a likely effect that prices will increase or remain at a supra-competitive level”
    - A mix of form and structural indicators (like the share of the market which is foreclosed)

Further developments

- Need to show:
  1. Foreclosure: Conduct is very likely to foreclose rivals. Possibly with the "capacity" to foreclose as an initial screen
  2. Negative effects on consumer welfare: Such foreclosure is "likely" to reduce (consumer) welfare relative to the counterfactual (with the "appropriate" level of confidence)
- i.e. Anti-competitive foreclosure.

Investigating anti-competitive foreclosure

1. Spell out a logically consistent theory of consumer harm
2. Validate that theory empirically
   - Check the realism of the underlying assumptions (ex-ante validation)
   - Check whether observed market outcomes are consistent with the predictions of the theory (ex-post validation)
3. Identify alternative pro-competitive motivations for the practice (validate ex-ante and ex-post)

4. One test : Consumer surplus (Anti-competitive effects, efficiencies) < Consumer surplus without the practice
5. Parties know about the efficiencies and the Commission should not be held responsible for not having considered them
6. The counterfactual is what happens in the absence of the practice – but it may reasonable to ask whether efficiencies could not be achieved with less anti-competitive effects
7. Efficiencies may be easier to identify than anti-competitive effects

Framework

- No general test
- Limited use of the “no economic sense” test – such that if a conduct leads to foreclosure, clearly creates no efficiencies and makes no economic sense but for its tendency to eliminate or impede competition, it would be presumed to constitute an abuse”
- Limited use of the “as efficient competitor test” – if it can be shown that the conduct leads to the exclusion of apparently more efficient rivals, it may also be presumed that the conduct will result in anti-competitive effects”
- Sound principles are more effective than simple (often misleading) rules

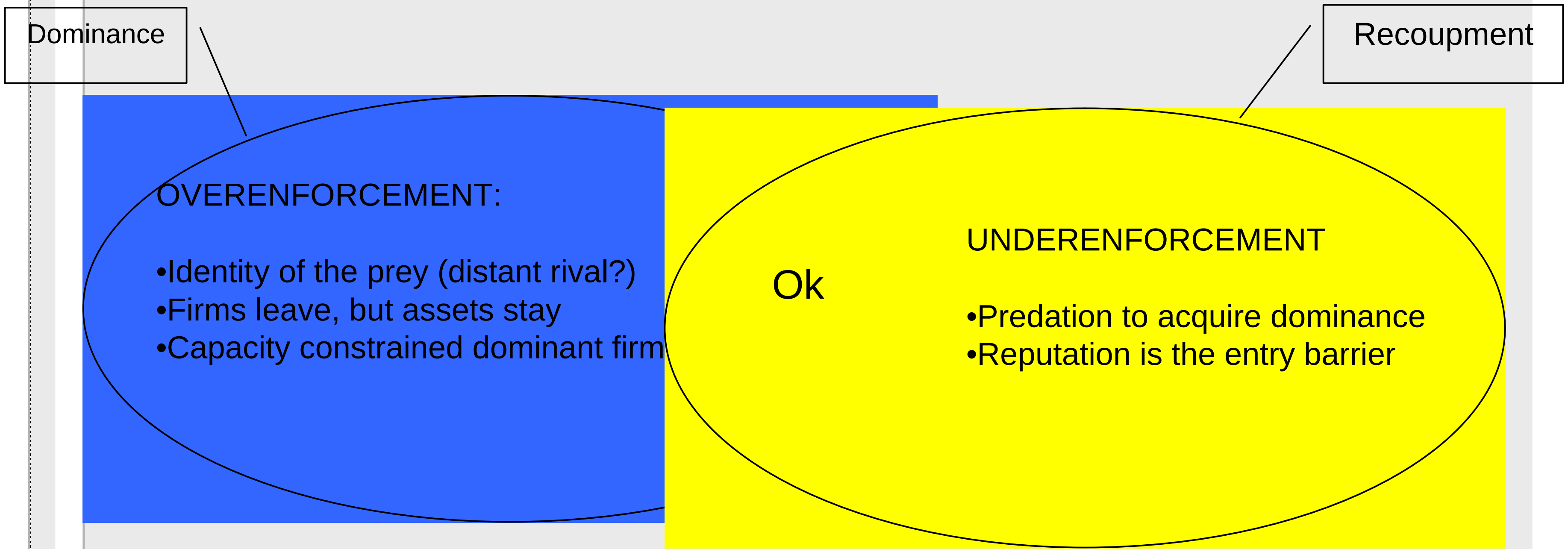
Dominance

- Dominance is about the relative ability to act independently of competitors and hence about market power
- No anti-competitive effects without market power
- But the converse is not true : dominant firms generally behave pro-competitively (that is why they are dominant)
- In assessing dominance separately from the effects the risk is that it will be a short-cut to prove anti-competitive foreclosure. And it does not add much to have a separate and sophisticated analysis of dominance.
- Still, anti-competitive effects can arise with a moderate level of market power
- Market share are a good indicator of the absence of market power
- So, a real safe harbour at relatively a low level of market shares (no exception below, no presumption above) may be attractive

Predation

- Elements of the test: sacrifice, exclusion, recoupment
  - Without recoupment there can be no harm to consumer welfare
- Sacrifice in terms of P < AAC or other relevant counterfactual
- No need to quantify recoupment. Only that the predator will be able to acquire (or protect) significant market power.
- Asymmetric barriers to entry
- Dominance is often a poor proxy for recoupment

Predation:


Dominance
Recoupment
OVERENFORCEMENT:
•Identity of the prey (distant rival?)
•Firms leave, but assets stay
•Capacity constrained dominant firm
Ok
UNDERENFORCEMENT
•Predation to acquire dominance
•Reputation is the entry barrier

Exclusive Dealing
What about empirical validation?

- Why would the customer sign up to an exclusive deal if this excludes a more efficient business partner?
- Logically consistent theory of harm based on the existence of externalities with respect to the relationship between the buyer and the incumbent. Two prominent examples:
  - Incumbent and buyer agree on a contract that extracts some of the rent the entrant would have in case of entry. The buyer is released from exclusivity if it pays a penalty to the incumbent .
  - If there are coordination difficulties among buyers, an incumbent monopolist can make discriminatory offers, to deter entry of an equally efficient rival through exclusive contracts when there are economies of scale. This will be less effective when buyers compete.
- Important variables: economies of scale and scope, network effects, market size, size of buyers, order in contract negotiation, transparency of contracts, buyers ability to coordinate

Tying
What about efficiency gains?

- Logically consistent theory of harm
  - Two product firm with monopoly power over one good faces competition from a new entrant
  - By tying, as a matter of theory, the incumbent can deny a rival adequate scale and deter entry of force exit
  - Focus on commitment, complementarity, overlapping demand, pure bundling, dynamic effects
- But prohibiting the tie can significantly harm consumers:
  - Supply-side: Tying allows a firm to meet the needs of diverse customers with a single product saving the fixed costs associated with each individual product offering
  - Demand-side: savings in search costs, standardisation

Refusal to Supply
A more demanding test ?

- The prospect that access may be mandated will reduce ex ante incentives to invest. This should only arise in exceptional and predictable circumstances
- Consider how a refusal to deal may help the dominant firm to extend or better exploit its market power. Evaluate the benefits from increased competition and the consequences for incentives to invest in follow on innovations (as well as substitute for the essential facility)
- Termination or de novo? Constructive or full? Physical input, facility or IPR? Assessment criteria shouldn't differ
- Required condition: "*Foreclosure ultimately results in an overall reduction in consumer welfare on a lasting basis*"

Rebates
What is the theory?

- Rebates may be seen as a weaker form of a more general practice. Examples:
  - Instrument of selective predatory pricing
  - Mechanism to induce exclusive dealing
  - A tie of the contestable and non-contestable market segments
  - Novel anti-competitive practices for which no general guidance can be offered
- In that case... no need for separate assessment criteria
- A safe harbor : the effective price for a range of output such that exclusion could take place should exceed average avoidable cost

Conclusion

- Few safe harbors and no strong presumptions
- Guidance on principles
- Thinking that simple imprecise rules offer more legal security than sound principles would be an offence to the legal profession