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# Some remarks on pricing abuses

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

# Introduction

- Guidance on enforcement priorities
- Not meant to be a statement of the law
- General approach
  - Safeguarding the competitive process and not the protection of competitors
  - Effects on consumers
  - Objective necessities and efficiencies
- To ensure that dominant firms do not impair effective competition by foreclosing rivals in an anti-competitive way thereby having an adverse impact on consumer welfare

# Introduction

- Implementation of the guidance paper
- Intel decision
- Discuss the anti-competitive effects associated with (retroactive) rebates
- In particular without predation
- Take stock of the experience with the implementation of the as efficient competitor test

# Article 82 Guidance Paper

- Need to show:
  1. Foreclosure: Conduct is very likely to foreclose rivals
  2. Negative effects on consumer welfare: Such foreclosure is more likely than not to reduce (consumer) welfare relative to the counterfactual
- Anti-competitive foreclosure.

# Anticompetitive foreclosure

- No general test. However priority when:
  - Foreclosure: Conduct is very likely to foreclose rivals
  - Negative effects on consumer welfare: Such foreclosure is more likely than not to reduce (consumer) welfare relative to the counterfactual
- Assess the actual or likely future situation in the relevant market relative to an appropriate counterfactual
- The conditions of entry, the existence of scale/scope economies, network effects, the counterstrategies of competitors, ...

# Assessment of pricing practices

- Vigorous price competition is generally beneficial to consumers.
- As efficient competitor test as a useful benchmark to establish sacrifice in predatory pricing cases, anti-competitive foreclosure in "rebates" cases, anti-competitive foreclosure in "margin squeeze" cases
- Taking a dynamic view of the constraint exercised by a seemingly less efficient competitor in the context of a well defined counterfactual (e.g. where there are network effects, learning effects etc)
- Use defendant's own costs where available

# Asymmetry

- Weak safe harbour: "If the data clearly suggest that an as efficient competitor can compete effectively with the pricing conduct of the dominant firm, the Commission will in principle infer that the dominant undertaking's pricing conduct is not likely to have an adverse impact on effective competition, and thus on consumers, and will be therefore unlikely to intervene.
- No automatic presumption of harm: "If, on the contrary, the data suggest that the price charged by the dominant undertaking has the potential to foreclose as efficient competitors, then the Commission will integrate this in the general assessment of anticompetitive foreclosure (see Section B above), taking into account other relevant quantitative and/or qualitative evidence.

# Rebates and exclusivity

- The guidance paper emphasizes the anti-competitive effects of rebates as mechanisms to induce exclusivity
- Emphasize two relevant sets of circumstances
  - The dominant has some special characteristics such that the entry cannot challenge its entire sales. There is a non-contestable part of demand.
  - Buyers downstream compete : downstream firms will be willing to sign exclusive contracts to limit competition by preventing entry.
- Consider the harm from rebates inducing exclusivity in these alternative paradigms

# Rebates and exclusivity – non contestable demand

- A dominant firm which is a "monopolist" in one sub-market (the non-contestable part of demand) that faces competition in a second market (the contestable part of demand) can use loyalty discounts in which customers receive a discount on the monopoly good (the non contestable purchases) in exchange for making all purchases from the monopolist - Greenlee & Reitman (2005)
- Thereby extending its dominance from one market into another market and increasing its overall profit.
- Analyses in what circumstances the monopolist would profit from offering a per unit loyalty program that links the monopolized and "contestable" market

Set up

Refer to monopolized product as the branded product and the rivalrous market as the generic market

Branded sector: Large customers with demand L(p), small customers S(p)

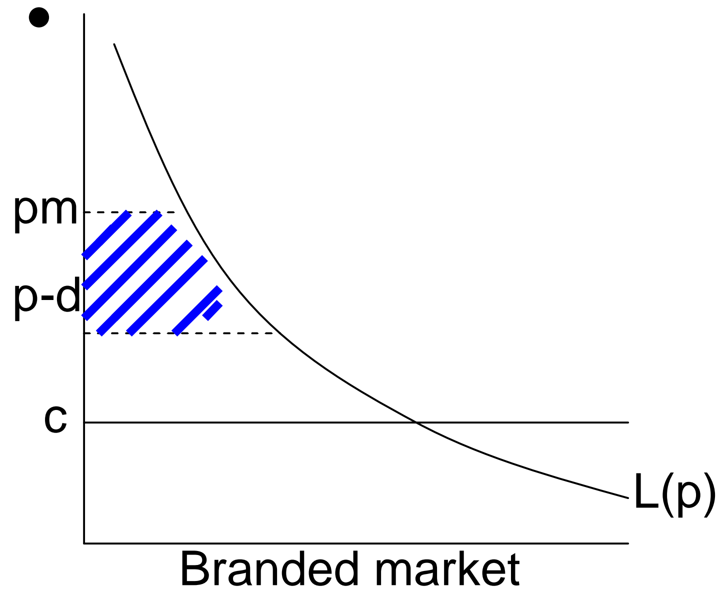
Generic sector: Large customers with demand G(k)

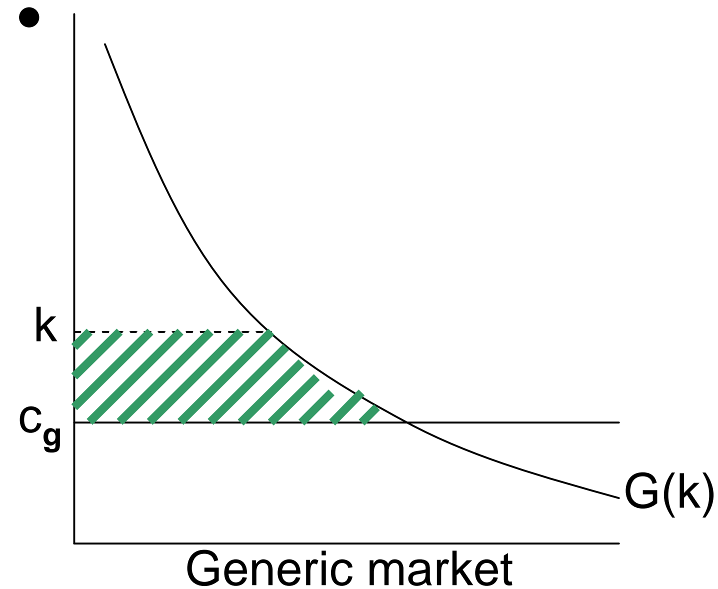
Small customers either do not buy generic products or are not candidates for a program

Large customers who accept the offer get a per unit discount d off the regular price p on all branded purchases provided they buy generic product exclusively from monopolist at price k

Customers must enjoy at least as much combined consumer surplus in the branded and generic markets as they would receive from buying branded products at the non-discounted price and obtaining generic product from a rival firm at price $c_g$

$$\int_{p}^{\infty} L(x)dx + \int_{cg}^{\infty} G(x)dx \leq \int_{p-d}^{\infty} L(x)dx + \int_{k}^{\infty} G(x)dx \qquad \text{or} \quad \int_{cg}^{k} G(x)dx \leq \int_{p-d}^{p} L(x)dx$$

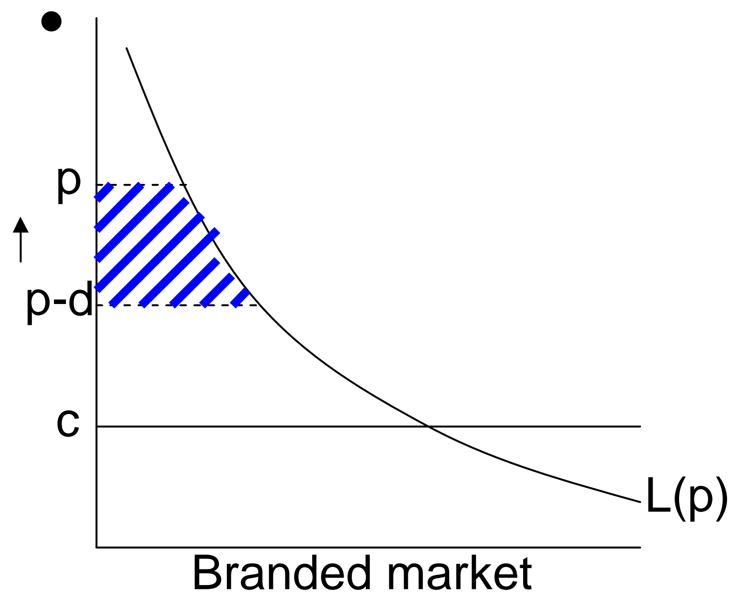
- 

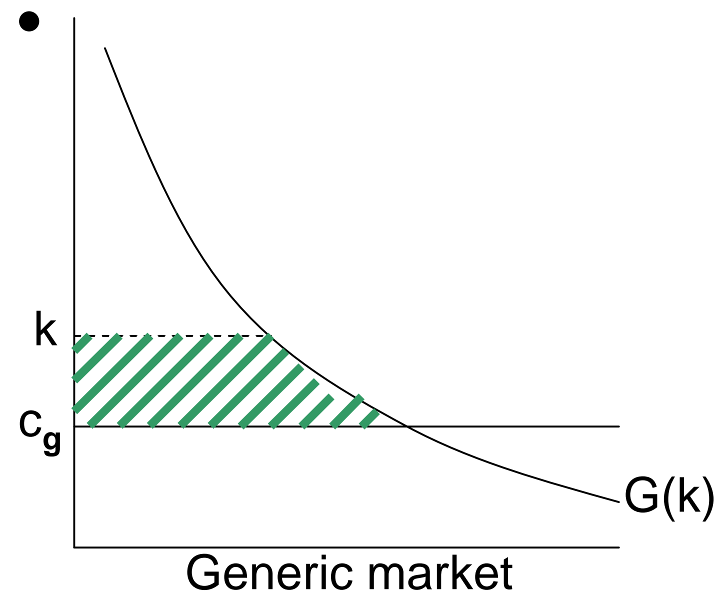
- 

The dominant firm has an incentive to trade-off a discount in the monopoly good against an increase in price for the generic good

The non discounted price (p) is increased beyond the monopoly level (so tha the discounted price is slighlty below )

or



Equilibrium:

- A small discount below the monopoly price causes only a second order loss in the monopolist's profits from branded sales to large customers, but a first order gain in profits in the generic markets, and so is always advantageous.
- In equilibrium, monopolist offers an all-or-nothing program that includes a positive discount, $d > 0$
- Raises the branded spot price (and generic price)
- In the absence of small buyers, the price for non exclusive purchases can be arbitrarily high – acting like a commitment not to sell the monopoly good only (leverages the entire monopoly rent)
- With small buyers, an increase the spot price for the branded good is less

Small customers

- The monopolist increases the spot price in the branded market in order to accommodate the discount

  The discount linkage spills over to small customers even though they only buy branded products. Small customers are unambiguously harmed.

Large customers

- They get a discount on the monopoly good – but relative to an inflated price – and their pay a higher price for the generic good then large customers are unambiguously harmed.

Attractive for the monopolist ?

- Depends on the price/share that it would get in the generic market in the absence of the loyalty rebate

# Rebates and exclusivity – non contestable demand

- Mechanism very similar to Whinston (1990)
- Restrictive assumptions on demand.
- But exclusivity can be induced and can be harmful for different distributions of consumers' willingness to pay
- As efficient competitor test can be used as a safe harbour. If the effective price (revenues less cost including the cost of the rebate) is above avoidable cost, as efficient competitors should be in a position to challenge the dominant firm

# Exclusivity and downstream competition

- Exclusive contract is anticompetitive because it may deter efficient entry and thereby reduce welfare.
- If buyers are competing firms and they compete intensively, then an exclusive contract can deter efficient entry because exclusive dealing increases the joint surplus between contracting parties by extracting surplus from final consumers. Simpson and Wickelgren (2007) and Abito and Wright (2008).
- Upstream: Incumbent manufacturer (I), potential entrant (E)

  Downstream: Two retailers competing for final consumers

  Stage 1: Exclusive contract by I who offers fixed compensation
  Stage 2: Entry (E) decision after observing retailers' decisions
  Stage 3: I and E (if entered) make offers to each available retailer
  Stage 4: Retailers compete by setting prices

# Exclusivity and downstream competition

- Assume intense competition downstream
  - Downstream firms have little rents
  - An upstream monopolist can extract rents (no double marginalisation)
  - In case of upstream entry, rents downstream will remain small
  - So, the upstream incumbent (who moves first) can easily « bribe » the downstream into an exclusive contract (at the expense of the final consumers)
  - Whatever the fixed cost of entry, exclusion is the only equilibrium
- Assume some differentiation downstream
  - An upstream monopolist has lower rents and downstream firms are harder to « bribe »
  - But the entrant may face a coordination problem (he may need to attract both downstream firms) if fixed costs are high
  - Then if downstream competition is weak enough, there is both an exclusion and an enttry equilibrium ,

# Exclusivity and downstream competition

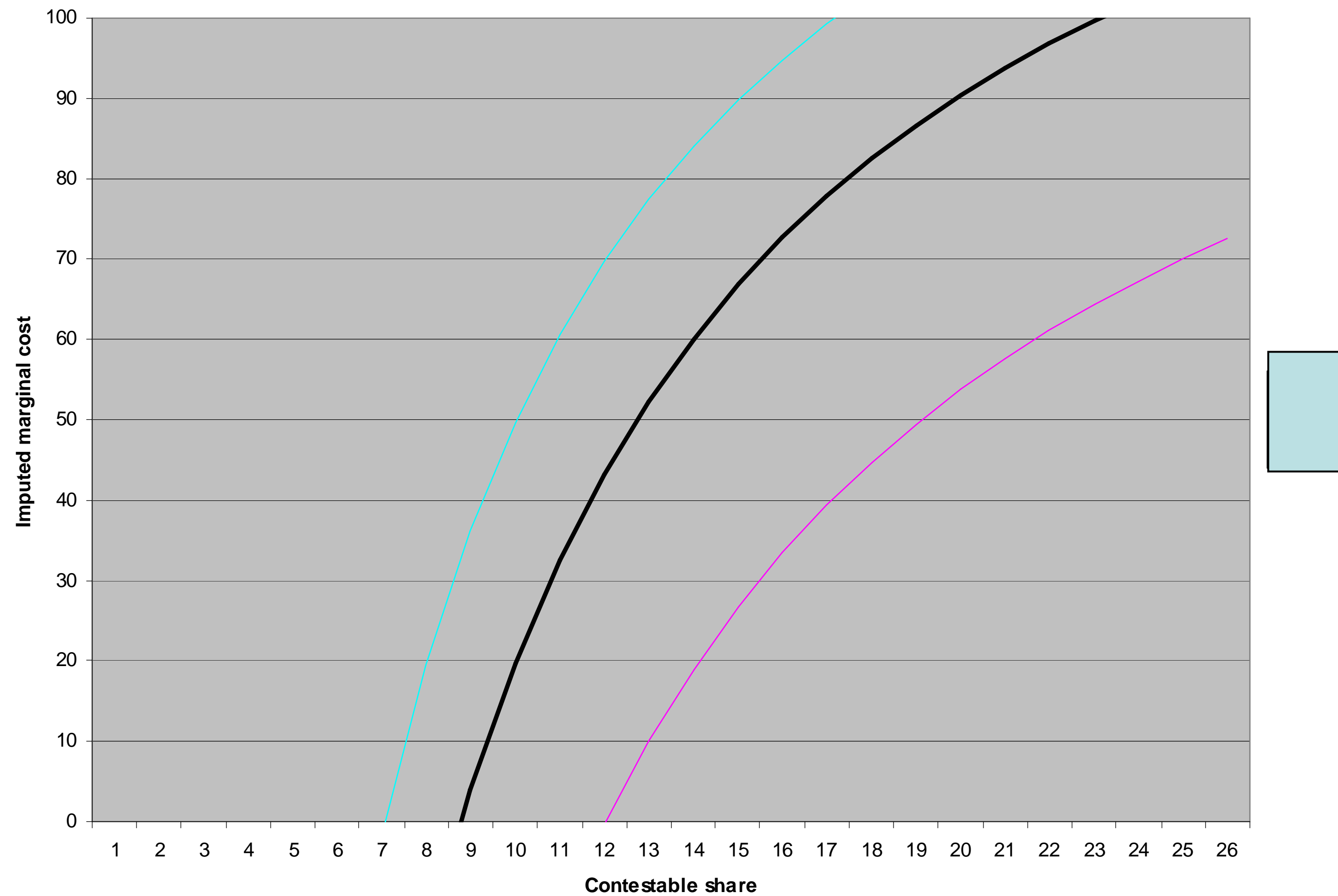
| | Min diff | | Max |
|---|---|---|---|
| Mechanism | Easy | | Difficult |
| Coordination | Difficult | Easy | Easy |
| Equilibrium | Exclusion | Exclusion | Exclusion/entry |

# As efficient competitor test

- Estimate what price a rival would have to offer in order to compensate the customer for the loss of the conditional rebate if the latter would switch part of its demand ('the relevant range') away from the dominant undertaking:
  - For incremental rebates, the relevant range is normally the incremental purchases that are being considered.
  - For retroactive rebates, it will generally be relevant to assess in the specific market context how much of a customer's purchase requirements can realistically be switched to a rival (the 'contestable share')
- The effective price that the rival will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate it loses by switching, calculated over the relevant range of sales and in the relevant period of time.

- Consider hypothetical example :
  Retroactive rebate of 3000 (contingent on meeting target)
  Average selling price : 150
  Volume : 250
- Look at effective price as a function of the share which is contested (say 10 %)

  Effective price = 150 – (3000 / 25) = 30


Imputed marginal cost
Contestable share
0
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100
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# Rebates

- Assessing the contestable share precisely is more important than assessing marginal cost
- Sources for the contestable share : business plans (projected penetration under different scenarios), experience in similar markets
- Time horizon
- Sources for the marginal cost. Profit and loss accounts.
- Sensitivity analysis

# Conclusion

- Static theories of harm vs predation
- Exclusion vs expansion
- Dynamic element (ability for the entrant to challenge the incumbent related to current sales)
- Not difficult for dominant firms to stay out of a « danger zone »
- Experience suggests that dominant firms may have a good understanding of the exclusion mechanism and think in terms of contestable shares

# Abito & Wright (2006)

- Abito and Wright (2008) extend Fumagalli and Motta (2006) by considering the case where the downstream firms imperfectly compete with each other. They prove that, provided those firms are not too differentiated or provided upstream firms can use two-part tariffs, exclusive dealing by the incumbent forecloses the entry of a more cost-efficient rival. The difference stems from the fact that with product differentiation, retailers make positive profits and remain active in all configurations. Thus, in the crucial subgame when a retailer deviates from the exclusivity scheme and buys from the efficient entrant, it can capture a large chunk of the market, just as previously, but it cannot make monopoly profits because of the competitive pressure exerted by the incumbent's contractor. As a result, the incumbent needs only offer a small fee to induce retailers to sign the exclusivity contract.

Price discrimination

- If small customers have more inelastic demand than large customers, then the discount program not only allows the monopolist to extract profits from the generic market, but also to gain additional profits by price discriminating among branded customers
- By giving large customers a discount, the monopolist effectively introduces separate prices in the two branded market segments

Therefore, two distinct components to the monopolist's profit margin:

- Monopolist can offer a discount on the bundled product that is worth more to customers than it costs the monopolist
- Monopolist can use the loyalty discount program as a segmenting device that enables price discrimination across branded customers