Measuring exclusionary effects under Article 82

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Athens, 2 June 2007

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

Outline of the presentation

- Approaches to designing rules
- Analysis of effects under Article 82
- How could it look like in practice?
  - Predation
  - Rebates
  - Input foreclosure
- Conclusions

Alternative policy approaches

- Per se rules or form-based approach
  - Practices are per se abusive or presumed abusive (e.g. tying, loyalty rebates, below cost-pricing)
  - Foreclosure = Abuse *"... for example, a refusal by an undertaking in a dominant position to sell an essential component to its competitors in itself constitutes an abuse of that position*" (Joined Cases 6/83 and 7/73 Istituto Chemioterapico Italiano and Commercial Solvents v Commission [1974] ECR 223, paragraph 25).
- Full rule of reason (unconstrained effects based approach)
  - Consider, on a case-by-case basis, if a particular practice has led or may lead to consumer harm

Alternative policy approaches

- Structured rule of reason
  - Finding of particular circumstances triggers a full rule of reason
    - For instance Padilla et al. propose a structured rule of reason for tying (three-steps approach)
    - Finding that a practice has no efficiency justifications and only raises obstacles to competition triggers the presumption that it is anticompetitive (analysis of effects is truncated)
    - The dominance screen is the expression of a structured rule of reason: finding of dominance triggers the analysis of effects

The problem with simple rules

- In the area of exclusionary conduct, theories of harm are not very general or robust
  - The same practice (e.g. retroactive rebate or bundling) can be either pro-competitive or anti-competitive
- Errors in measurement:
  - For example, measuring the AAC is inherently imprecise
  - Relying on few simple rules may lead to significant mistakes
  - Preferable to consider several criteria and evaluate whether they lead to a consistent set of insights
  - The weight given to any single criteria can vary according to the circumstances

Investigating anti-competitive effects

1. Spell out a logically consistent theory of consumer harm
2. Validate that theory empirically
   - Check the realism of underlying assumptions (ex-ante validation)
   - Check whether the 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: market power (anti-competitive effects, efficiencies) < market power without the practice

Experience in the area of merger control – in both circumstances there is a counterfactual which is unobserved (what would happen with the merger, what would have happened without the practice)

Analysis of effects in Article 82

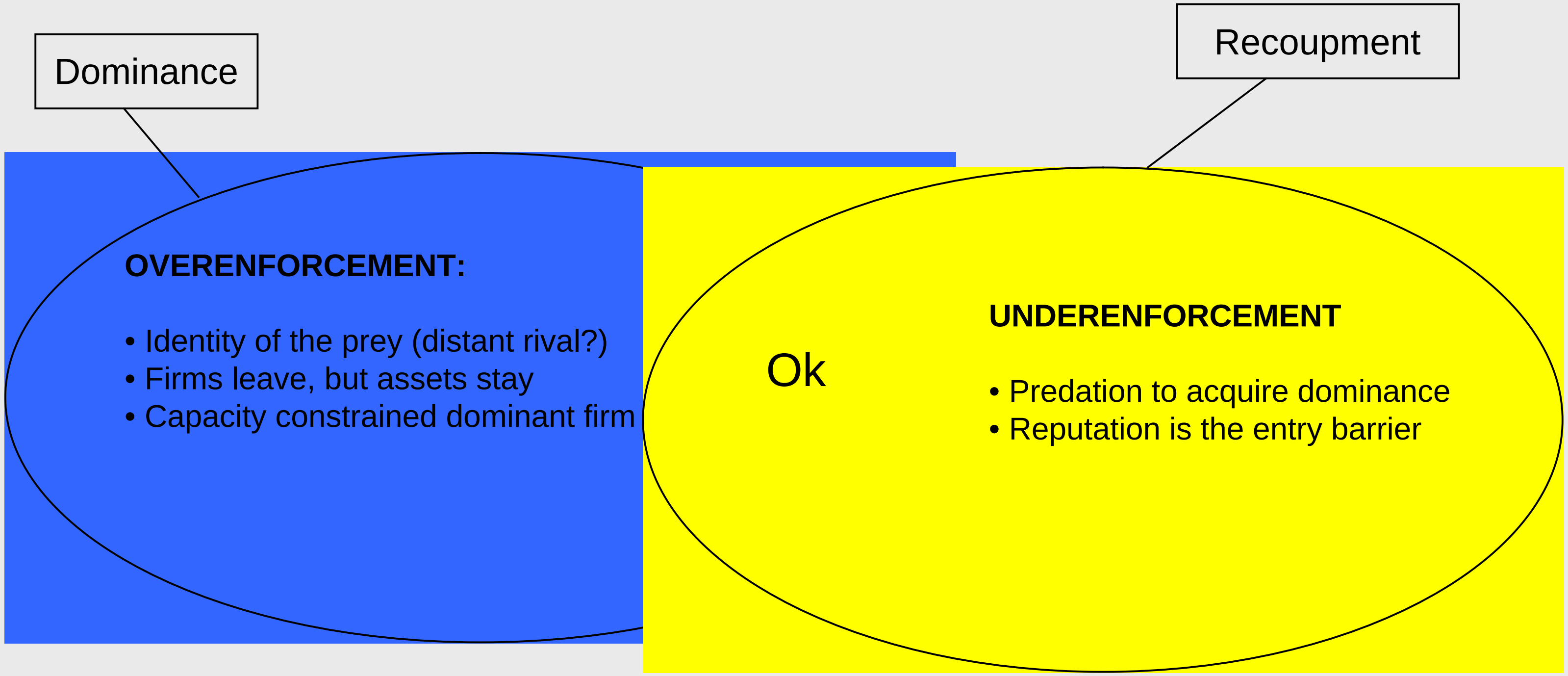
- Need to show:
  - Foreclosure: conduct likely to foreclose rivals
  - Negative effect on consumer welfare: Such foreclosure is likely to reduce consumer welfare relative to the counterfactual (with the “appropriate” level of confidence)

=> Anti-competitive foreclosure

Predation

- Elements of the test: sacrifice, exclusion, recoupment (without recoupment, there can be no consumer harm)
- Sacrifice: P < AAC or the other relevant counterfactual (e.g. capacity)
- Exclusion: P > LRAIC, duration, continuity, key customers, is target dependent on external financing, is there uncertainty about demand
- No need to quantify recoupment but only that the predator will be able to acquire (or protect) market power
- Look at capacity constraints, asymmetric barriers to entry (re-entry), acquisition of reputation

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

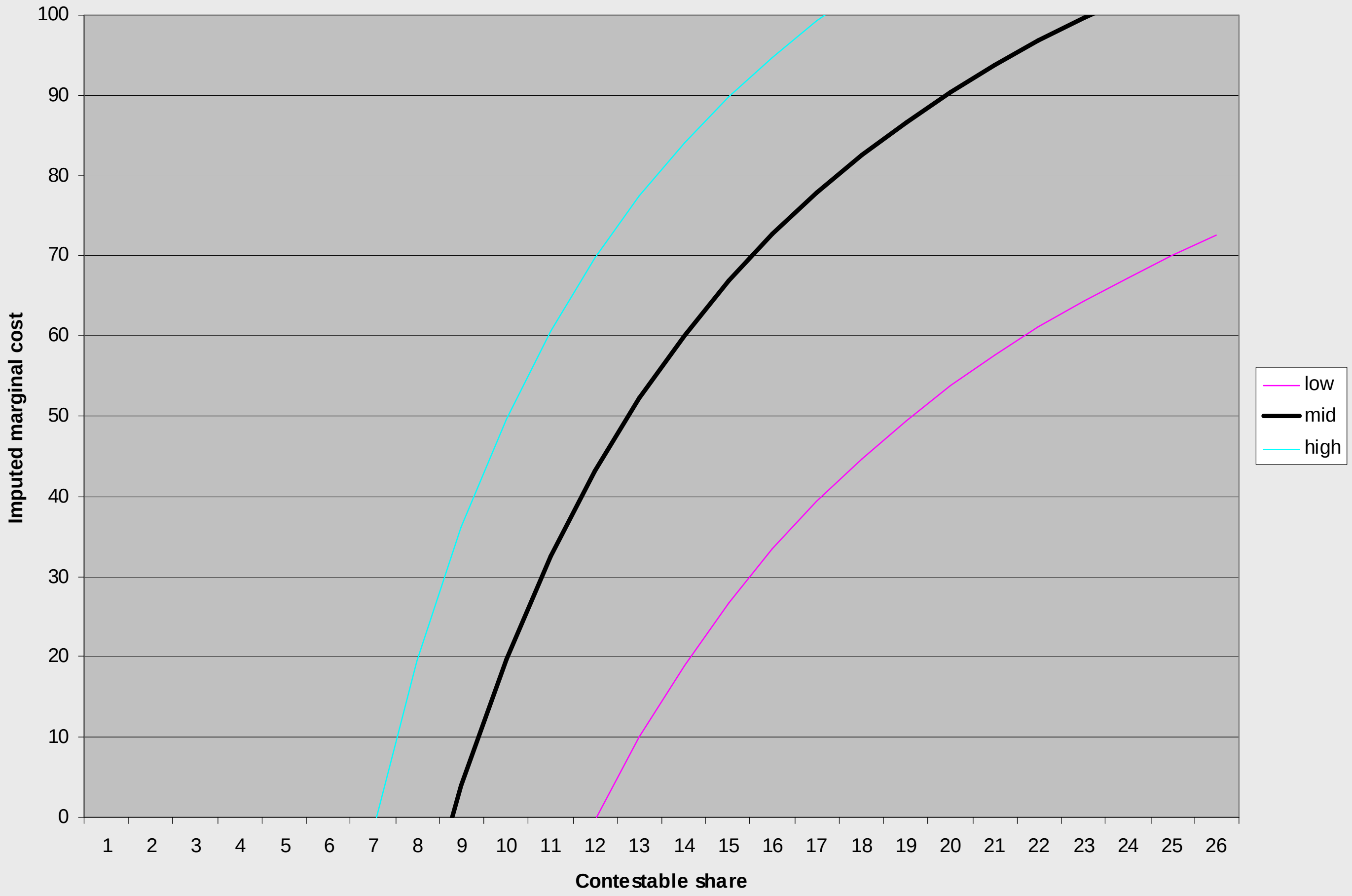
American Airlines

- Sacrifice: In the presence of low cost carriers, not adding capacity would have led to higher profits
  - Evidence on re-entry, switch between types of aircraft, excess capacity, no yield management
- Exclusion: external financing, asymmetry in finance, initial phase of entry, evidence that AA is gaining back passengers, evidence that AA simulates losses, bankruptcy
- Recoupment: acquisition of reputation, statement by competitors, no further entry, Braniff (13% price increase)

Rebates

- Safe harbor: the effective price for a range of output such that exclusion could take place should exceed AAC
- If not, consider whether consumers are likely to be harmed. Scale economies, network effects, economies of learning (tipping)
- Consider a hypothetical example:
- Look at effective price as a function of the share which is contested (say 10%)
  - Retroactive rebate of 30 M (contingent on target)
  - Average selling price: 150
  - Volume: 2.5 M
- Effective price = 150 – (30 M / 250 000) = 30

Rebates



100
90
80
70
60
50
40
30
20
10
0
Imputed marginal cost
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Contestable share
low
mid
high

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
- Sources for the marginal cost: P&L accounts
- Sensitivity analysis
- Consumer harm

Input foreclosure

- Upstream market configuration duopoly with 87 % and 13 % MS
- Downstream : 5 competitors, integrated firm with 19%, others with 28, 27, 16, 10;
- Purchase of input is 3.5 % of downstream output price
- Vertical foreclosure (refusal to supply):
  - (Reduced sales of input to rivals)x(upstream margin)
  - (Reduced sales to rivals)x(diversion ratio)x(overall margin)

Input foreclosure

- Using upstream (row) and downstream (col.) margins, compute critical diversion ratios (= minimum diversion of sales volume from downstream competitors that would make foreclosure profitable)

	20%	30%	40%
10%	6.5	9.5	12.3
15%	4.5	6.5	8.5
20%	3.4	5.0	6.5

In a merger context, need to see whether refusal to suply would affect output prices.

In 82 context, need to find out what prices would be without the practice.

Conclusion

- Methods have been developed to assess merger effects
- Even more important to apply them in Article 82 where theories are possibly less robust
- It involves looking at competitive constraints (capacity constraints, substitution, entry, incentives to enter) in a structured way
- Sounds principles should be preferred to simple, imprecise rules