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From harm to competitors to harm to consumers: The glass is half-full

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Harm to competitors versus harm to consumers

- Ritual bowing before the consumer surplus standard
  - *"The essential objective of Article 82 when analysing exclusionary conduct is the protection of competition on the market as a means of enhancing consumer welfare […]. The concern is to prevent exclusionary conduct of the dominant firm which is likely to limit the remaining competitive constraints on the dominant company […]. This means that it is competition, and not competitors as such, that is to be protected"* (Commission DP on Article 82, § 54)

- What does this mean in practice?

Harm to competitors versus harm to consumers

- **Not the same question as effects versus form-based approach**
  - **Which effects?**
  - **We will see that the most detailed effects-based approach advocated in the DP (in the section on rebates) is also the one departing most from the consumer-welfare standard**
  - **The case of rebates illustrates the enduring divergence between US and EU approach**
    - **in spite of superficial similarities between *LePage's* and *Michelin***

- **Key conclusions**
  - **Ambiguity pervades the DP**
    - **No consistent approach for rebates, tying, and predatory pricing**
  - **Some modest suggestions**

Exclusionary abuses: the key causal chain

- Restriction on exclusionary abuses
  - Bundling/tying, predatory pricing, rebates, single-branding…
- Step 1: decrease in the demand facing the victims
- Step 2: impact on the victims' ability or incentives to exert a significant competitive pressure on the dominant firm
- Additional condition: this is enough to decrease the overall competitive pressure weighing on the dominant firm

Illustration: the standard economic theory of anticompetitive exclusive contracts

Why could exclusion make business sense?

The Chicago critique

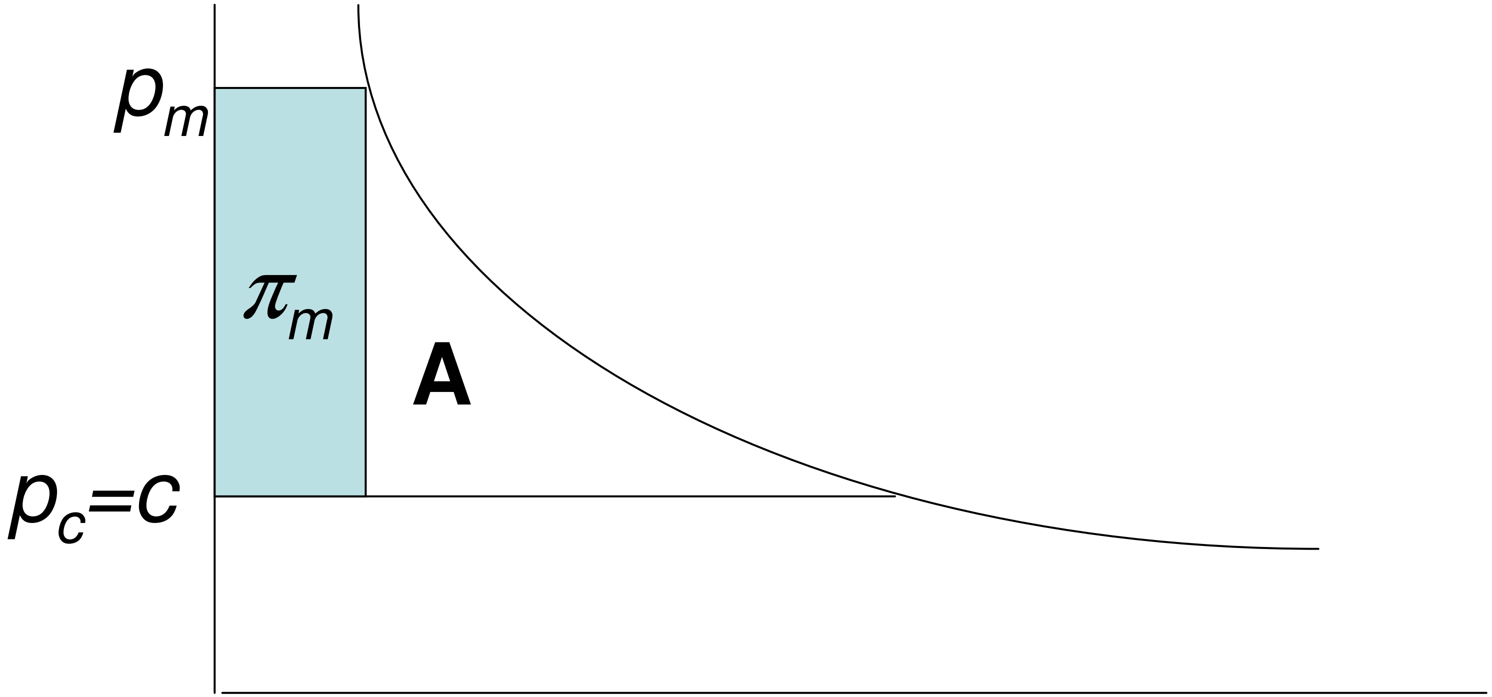
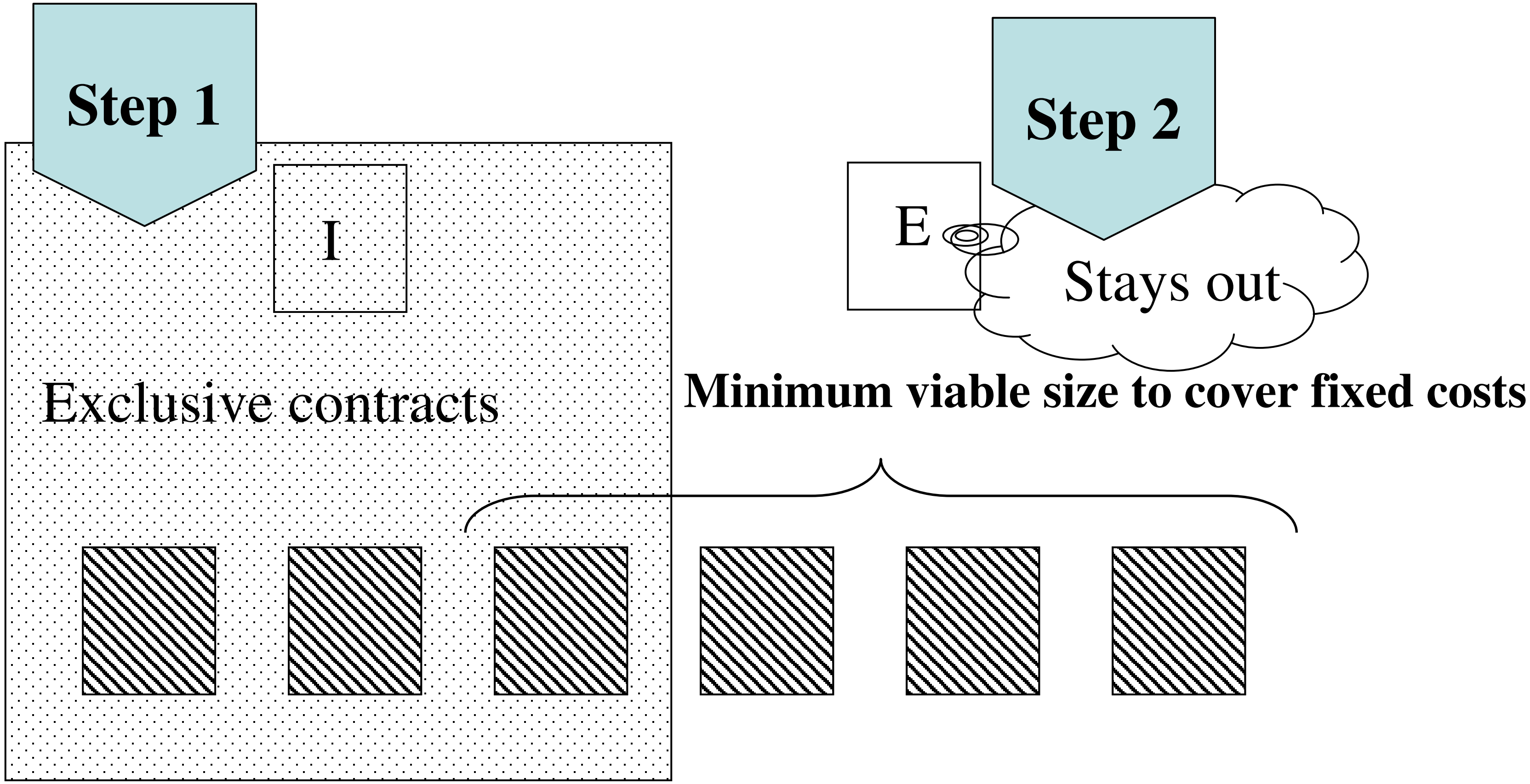


Illustration: the standard economic theory of anticompetitive exclusive contracts (Rasmusen et al., Segal-Whinston)



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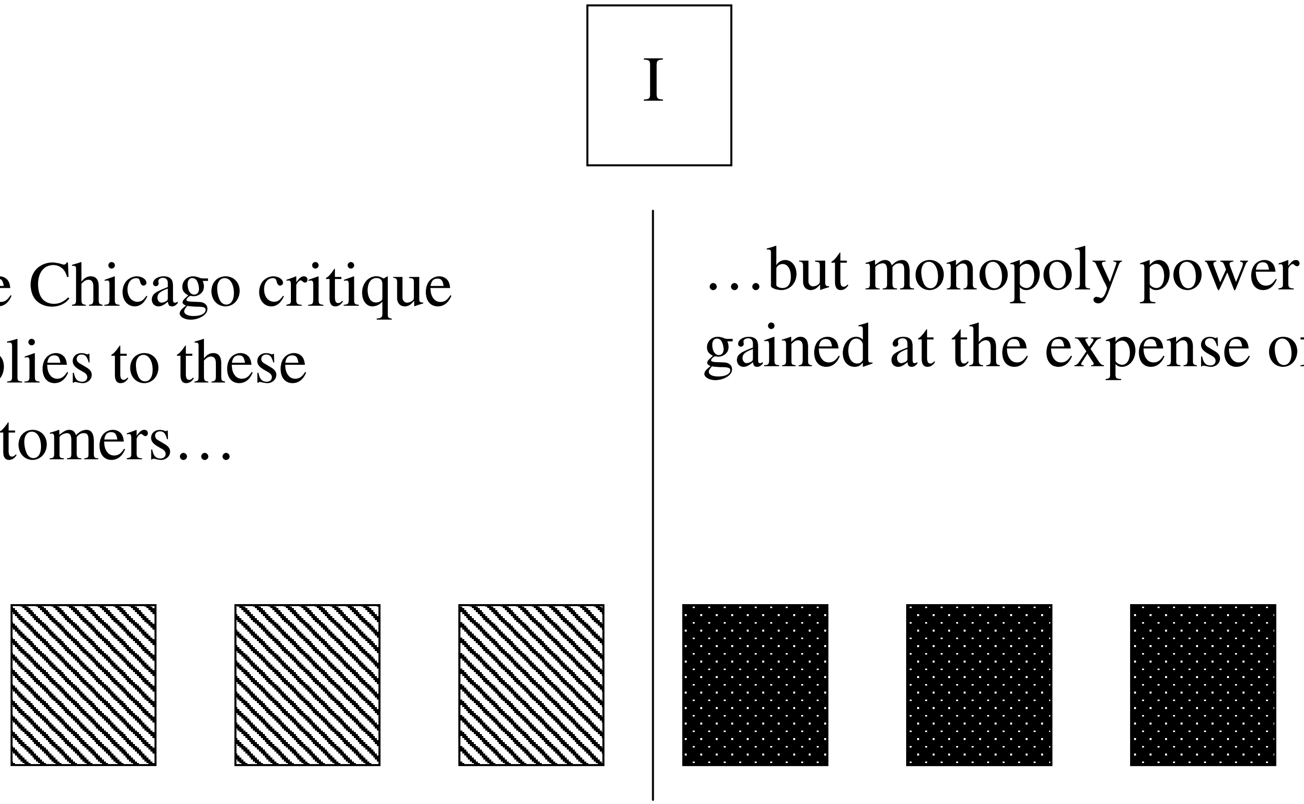

The DP's approach to rebates: *a theoretical example*

- Assume that each consumer needs 2 units of a good
- The good can be produced produced
  - By the incumbent: fixed cost = 3€/consumer (not incurred at the customer level), no variable costs
  - By many identical rivals: no fixed cost, variable cost = 1€/unit
- Demand
  - The incumbent's good is superior in some subjective dimension
  - Consumers value two units at
    - 7€ if the at least one unit is produced by incumbent
    - 4 € otherwise
- Rivals sell the good at 1€
  - Consumers are guaranteed a surplus of at least 2€ (4€ - 2*1€)

The DP's approach to rebates: *a theoretical example*

Case 1: rebates are prohibited

- Incumbent needs to leave a surplus of 2€ in order to sell something
- In order to sell 2 units, would have to set price no greater than 1€
- Prefers to set unit price equal to 4€ and sell 1 unit.
- Consumers purchase
  - 1 unit from dominant firm
  - 1 unit from rivals
  - Consumer surplus = 7€ - 4€ - 1€ = 2€.

The DP's approach to rebates: *a theoretical example*

Case 2: rebates are lawful

- Incumbent needs to leave a surplus of 2€ in order to sell something
- Offers to sell 2 units at total price of 5€
  - Consumer surplus = 2€
  - Incumbent's profit rises from 1€ to 2€ per consumer
  - Social surplus rises by 1€ per consumer
- Price of second unit must be no greater than 1€
  - Price of first unit = 4.01€
  - Price of second unit = 0.99€ (for instance)
- Consumers purchase 2 units from dominant firm
- Consumer surplus = 7€ - 5€ = 2€.

The DP's approach to rebates: *a theoretical example*

- Under a consumer surplus or social surplus standard, the rebate scheme should be considered acceptable

- Consumers are left unharmed because they still benefit from the rivals' competitive pressure
  - Incumbent must leave surplus of at least 2€ / consumer
  - This is because they would otherwise purchase from rivals
  - Rivals exert competitive pressure even though they sell nothing
  - Step 1 is there, but not Step 2

- The assessment would be different if the rebates scheme induced the rivals to stop offering their products

The DP's approach to rebates: *a theoretical example*

- **Assessment under the DP?**
  - ***As a first step the Commission will endeavour to calculate how big a share of customers' requirements on average the entrant at least should capture so that the effective price is at least as high as the average total cost of the dominant company ("the required share"). In a number of cases the size of this share, when compared to the actual market shares of competitors and their shares of the customers' requirements, may make it clear whether the rebate system is able to have a foreclosure effect. In case the shares of the customers' requirements purchased from actual rivals are smaller than the required share, the rebate scheme is likely to have a foreclosure effect where there is in addition no indication that these rivals are less efficient***
  - **Not crystal-clear, but let's try…**
  - **Required share = 2 units per customer (because effective price for 1 unit would be 0.99€ / unit, below the incumbent's average cost)**
  - **Shares of customer requirement = at most 1 unit per customer (sales in a no-rebates world)**
  - **The rebates scheme would thus not pass the test**

The DP's approach to rebates: *a theoretical example*

- The rebuttals possibilities contemplated in the DP would not help
  - No customer-level cost justifications
  - No customer-level specific investments
  - No double marginalisation problem (consumers are final users)

The DP's approach to rebates: *a theoretical example*

- **The rebuttal possibilities contemplated in the DP would not help**
  - **The dominant firm could for example *"show that the rebates system does not and will not create a foreclosure effect because most or all buyers can switch to and purchase substantial additional amounts from other suppliers without losing the rebate. Another way to rebut the Commission's preliminary conclusion may be to show that entry or expansion of competitors is in effect not limited to the amount assessed by the Commission as the commercially viable share" (DP, § 163)***
  - **The Commission will *"amongst others estimate the importance of the rebate [...] and the indications of an actual foreclosure effect such as exit or declining market shares of competitors or de-listing of their products"* (DP, § 164)**

The DP's approach to rebates versus bundling

- **The missing link: the impact on victims' ability to constrain the dominant firm's pricing policy**

- **Constrast with the approach to bundling/tying**
  - ***"The assessment of the foreclosure effect […] can be considered to consist of two parts. First, to establish which customers are 'tied'. […] Second, to establish whether these customers 'add up' to a sufficient part of the market being tied." (DP, § 188)***
  - **The *"second part of the assessment is to establish whether the market as a whole can be considered to be foreclosed"*. (DP, § 196)**
  - **Questions about implementation abound, but at least the principles are straight!**

Transatlantic divergences

- The Commission DP points towards a half-hearted embrace of the consumer surplus standard

- Contrast with the US
  - *3rd US Circuit Court of Appeals, 3M v Le Page's, 10/6/2003*
  - A ruling looking "European" at first glance

- 3M was fined for, inter alia, its practice of offering bundled rebates to retailers
  - Superficially similar to *Michelin II*
  - But the Court addressed the impact on competitive intensity
    - Claim that the disputed practice was going to force the plaintiff entirely out of the market and cause its offering to disappear

Moving from the impact on competitors to the impact on consumers

- In many cases, a dominant firm's aggressive actions make rivals a *stronger*, rather than *weaker* competitive constraint

- Example: cases in which firms' decisions are only about prices
  - Rivals face a decrease in demand due to the incumbent's practices
  - They cut prices, just like any firm facing declining demand
  - This increases the competitive pressure exerted on the dominant firm

- The opposite holds when decisions are about
  - Staying in the market versus exiting
  - Investing in R&D or any asset facilitating variable cost reduction or quality improvement

- Key question: price or quantity competition?

A few suggestions

- The key question should be whether the disputed practice wiill cause the alleged victims to stop incurring the fixed costs needed to keep offering their products, increasing quality or reducing variable costs

- Exclusion from the relevant market is not enough
  - Geographic markets are chiefly defined with respect to demand-side criteria
  - But the key question for eviction is where fixed costs are incurred
  - Example: Michelin
    - National markets due to demand and market share differences
    - But fixed costs might be incurred chiefly at supranational level (R&D, manufacturing…)
    - Could Michelin' rivals exert a competitive pressure on Michelin in France despite low market shares, because attractive products would still be offered, independently of market developments in France, or could country-specific fixed costs deter rivals from efficiently offering their products in France?

- This type of screen might simplify implementation and avoid mistakes
  - Simpler than the arcane calculations prescribed in the DP

- Impatiently waiting for the Article 82 Guidelines!