An effects-based competition policy – economic perspectives

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Outline

- An effects-based approach: achievements
  - Mergers
  - Agreements
  - Abuses of dominance
- An effects-based approach: challenges
  - Hard-core restrictions: territorial protection, RPM
  - Abuses: capability vs incentives

Mergers

- First regulation: creation / reinforcement of dominance
  - Too narrow: collective (oligopolistic?) dominance
  - Too broad: efficiency offense
- Second regulation
  - “SLC”: perimeter, efficiency defence
  - Guidelines
  - Decisions
- Role of the courts

Agreements (Article 101)

- Ex ante notification regime
  - "Clear" rules
  - Block exemption regulations (categories, sectors)

  → "straight jackets"

- Ex post scrutiny regime
  - Fewer, broader but conditional BERs
  - Guidelines
  - (Case law)

Agreements (Article 101)

- Illustration: verticals
  - OECD report on franchising 1994, Green paper 1997
  - Multiple / single BER 1999
    - alternative means / end
    - combinations of practices
  - Economics
    - vertical vs horizontal cooperation
    - intra-brand / inter-brand competition
    - thresholds: same practices / different contexts

Abuses of dominance (Article 102)

- From a form-based approach
  - Dominance + practice = abuse
  - Penalty for breach / option to buy, bundling / quantity rebates, …
- … towards an effects-based approach
  - EAGCP report July 2005, DG Comp DP fall 2005, …
  - Priorities paper December 2008
  - Effects on consumers (here and there, today and tomorrow)
    protect consumers / competitors (selection process, reward innovation)
  - Courts?

Abuses of dominance (Article 102)

- Ensuring that anti-competitive behaviour does not outwit legal provisions
  - Alternative practices can serve same purpose
    - predation: price / non-price, rebates, discrimination
    - vertical foreclosure: refusing to deal, exclusive dealing, discrimination, technological choices, bundling/tying
  - Need for a consistent treatment
    - effect rather than form
    - risk of “arbitraging”, may lead to worse outcomes

      illustration: vertical foreclosure

Abuses of dominance (Article 102)

- Guaranteeing that legal rules do not thwart pro-competitive strategies
  - The same practice can
    - distort competition in some instances
    - promote efficiencies and innovation in others

    illustration: low price
  - Prevent behaviour that harms consumers without discouraging firms in their search for efficiency
    - role of competition for prices, quality, variety, ...
    - how competition works in a particular market

Abuses of dominance (Article 102)

- Implementation
  - First, identify competitive harm
    - means a negative effect on consumers
    - consistent story based on sound economics
    - supported by facts and empirical evidence
  - Second, check for efficiency gains
    - passed on to consumers
    - consistent story, grounded on facts
  - If both are present, assess overall balance

Abuses of dominance (Article 102)

- Implications for procedure
  - Focus on exclusionary effects
  - Less emphasis on separate y assessment of dominance
  - Role of economics: consistency, spelling out key ingredients
  - Burden of proof
    - competitive harm: competition authorities
    - efficiency gains: dominant firm
    - higher standard of proof for “novel” theories

Abuses of dominance (Article 102)

- Implications for predictability
  - Under a form-based approach
    - o “you cannot do this”: creative imagination

      Michelin I, Michelin II, Michelin ... ?
    - o “you can only do this”: straight-jacket, impedes innovation

      see enforcement of Article 101
  - Under an effects-based approach
    - o sound consistent story, grounded on established facts
    - o well-identified set of established exclusionary stories

      (higher standard of proof for new ones)
    - o guidelines or general principles

Challenges: hard-core restrictions

- Territorial protection
  - Active / passive sales
    - restriction in both cases on *intra-brand* competition
    - similar impact on *inter-brand* competition?
  - Anti- or pro-competitive?
    - entering a new market
    - parallel trade in pharma products (*GSK*)
      - governments as customers
      - governments as price (and volume) makers
      - externalities on policy choices (current budget, future care)
      - public good nature of R&D

Challenges: hard-core restrictions

- RPM
  - Price vs non-price restrictions
    - vertical coordination
    - sham dealer cartel
    - vertical foreclosure (OSS, Hart-Tirole)
    - competition-dampening (Rey-Stiglitz)
  - More recently
    - impact on collusion (Jullien-Rey)
      Toys
    - interlocking relationships (Rey-Vergé)
      Galland Act 1996: Biscourp-Boutin-Vergé, Dubois-Bonnet

Challenges: RPM

- Temporary RPM provision for product launch
  - Isolated instance / industry-wide practice

    number of dealers, number of manufacturers
  - Limited horizon / persistent

    duration of the provision, life-cycle of the product
  - Alternative contracting arrangements
    - monitoring: on the spot / ex post
    - enforcement
    - rival dealers' feedback

Challenges: Capability versus incentives

- Emphasis on “capability”
  - Mechanical “characterization” of presumed abuse rather than a “story”

- Stylized example (fidelity rebate)
  - Dominant firm
    - list price of 100 €
    - rebate of 15% in return for exclusivity
  - Customer
    - wants to buy 1.000 units to resell them to as many users
    - thinks that 100 of the final users would prefer a rival product, the rest would prefer the product of the dominant firm
  - Rival is willing to sell at marginal cost (50 €)

Challenges: Capability versus incentives

- Capacity

	Dominant firm	
List price	1.000 units x 100 €	100.000 €
Rebate	15%	-15.000 €
Total		85.000 €

	Dominant firm	
List price	900 units x 100 €	90.000 €
	Rival	
	100 units x 50 €	5.000 €
Total		95.000 €

as long as the 100 final users who prefer the rival product are not willing to pay more than an extra 100 € per unit, customer sticks with the incumbent

Challenges: Capability versus incentives

- Incentives?
  - Suppose
    - final users are willing to pay 100 € for incumbent product
    - users favouring the rival product are willing to pay an extra 50 €
    - both firms face the same unit cost of 50 €
  - The fidelity rebate yields achieves exclusivity
    - Multi-sourcing increases procurement cost by 10.000 €
    - but only increases revenues by 5.000 €
  - But the dominant firm would be better off charging the "full" price per unit
    - would yield a profit equal to:

      revenue – cost = 90.000 – 45.000 = 45.000 €
    - this exceeds the profit generated by the fidelity rebate:

      revenue – cost = 85.000 – 50.000 = 35.000 €

Challenges: Capability versus incentives

- Vertical foreclosure: theories of harm
  - Chicago critique
  - Vertical integration
    - raising rivals' costs: Ordover-Salop-Saloner 1990, Salinger 1988 (Allain *et al.* 2010)
    - exploiting better monopoly power: Hart-Tirole 1990
  - Exclusive dealing, fidelity rebates
    - appropriating entrant's efficiency gains: Aghion-Bolton 1987
    - exploiting buyers' coordination problems
    - customers: final users vs intermediaries:
      - Fumagalli-Motta 2006
      - Intel / AMD