A framework for the economic analysis of exclusionary conduct

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Disclaimer

- Comments are based in part on “A Framework for the Economic Analysis of Exclusionary Conduct,” with B. Douglas Bernheim, forthcoming in the *Oxford Handbook of International Antitrust Economics*, Roger Blair and Daniel Sokol, editors.

- Views expressed should not be attributed to anyone other than the speaker, and may not represent the views of others at Bates White, including coauthors.

Agenda

- The most important mechanism of practical concern: Monopolist weakens rivals to protect its (usually future) market power
- Rule of reason approach to address this mechanism
- P<C for price-only allegations; analysis of exclusionary conditions for rest
- Four necessary conditions to have anticompetitive effects
- Analysis and balancing of procompetitive justifications
- Diagnosing procompetitive and anticompetitive effects
  - Procompetitive and anticompetitive effects leave distinctive empirical traces in the record
- *ZF Meritor LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012)* gets it right
- Implications for counseling clients

Economic consensus over predation

- Predatory pricing
  - Price < Appropriate measure of the monopolist’s own cost
- Multi-product bundled discount
  - Attribution of discount to contestable product in predation framework
- First dollar discounts (a.k.a. quantity-forcing discounts)
  - Revisit multi-product attribution notion: “Single product bundling” (must carry brands; differentiated consumers)
  - Attribution of discounts to contestable portion of demand
- What is the appropriate measure of cost?

Conduct involving exclusionary conditions is where the action is

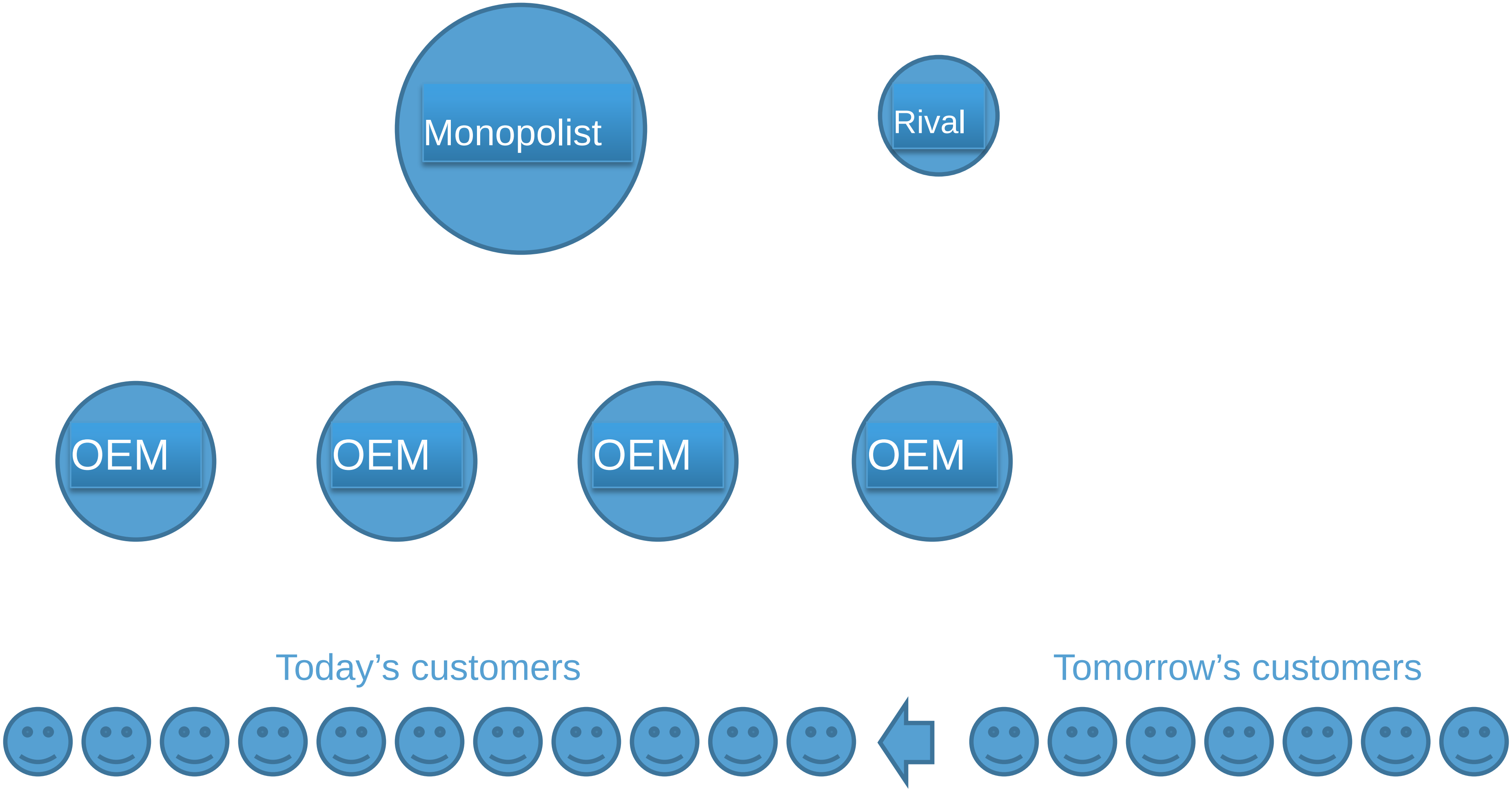
- Exclusive dealing
- Loyalty discounts (discounts depend on rivals' share of purchases)
- Partial exclusivity
- Restrictions on customers' dealings with rivals, such as:
  - Channel restrictions
  - Advertising restrictions
  - Restrictions on prices of rivals' products
- Negative tying

- Why would P<C be informative about these potentially exclusionary mechanisms?

Exclusionary conditions (or contracts referencing rivals)

- Four necessary conditions to have anticompetitive effects:
  - Diminished ability of rival to compete
  - Enhanced market power of monopolist
  - Harm to consumers
  - Negative contracting externality
- Analysis and balancing of procompetitive justifications
  - Requires existence of (different) contracting externality to rationalize unusual contracting forms or pricing mechanisms
- Procompetitive and anticompetitive externalities leave a distinctive empirical trace in the record
  - Negative contracting externality must exist for exclusionary conditions to defeat Bork Critique
  - Different contracting externality must exist to rationalize pro-competitive justifications

A simple visual aid: primary mechanism of antitrust harm in both predation and exclusion cases



A simple visual aid: *ZF Meritor v. Eaton*

EATON
Powering Business Worldwide

ZF

- Databook restrictions
- Databook removal
- Pricing penalties
- ?? Other threats ?? (e.g. supply reliability)




LTAs: 78% 92% 95% 97.5%

Today's customers

Tomorrow's customers

Key take aways

- P<C is useful to diagnose predation; not useful for exclusionary conditions
- The most important and common mechanism of harm is to prevent the rival from becoming a competitive threat in the future by depriving the rival of sales today
  - Sales by rival today typically lead to a more competitive rivalry in the future for there to be AT harm
- AT harm requires a negative contracting externality (NCE)
  - The AT harm is generally not to current purchasers
  - Simple stories that rely on single period intuition will lead you astray
- NCE can be exploited by carrots or sticks (or both)
- Pro-competitive justifications involve an externality or other market failure for which the exclusionary conditions are the solution
- Examination of the NCE and the pro-competitive rationale (market failure) will typically distinguish anti- versus pro-competitive situations

Counseling clients

- Market power screen - only monopolists need be careful with exclusionary conditions
- Restrictions on dealings with rivals often have procompetitive justifications
  - These always involve contracting externalities
  - Explore least objectionable alternatives to overcome contracting problems
  - Document those contracting problems
  - Document alternatives explored
- Don’t confuse desire to sell more or sell more profitably with being procompetitive
  - If selling more occurs because rival is weakened, it is anticompetitive
- Price above cost in the competitive increment
- If objective is to weaken rival, consider clearly procompetitive alternative strategies

What did the dissent in *ZF Meritor v. Eaton* get wrong from an economic perspective?

- Coercion (both majority and dissent got this wrong)
  - Carrots or sticks, or both, can be used for exclusion
- Exclusivity mean 100% exclusive
  - Judge Greenberg rails against “de facto partial exclusivity”
- Looks at the pro- v. anti-competitive balance as a static question:
  - Dissent balanced Eaton’s motives to “win the business” against current impact on ZF
  - Real AT harm is in the future
  - Current impacts on the rival are source of future AT harm
- Saw no actual foreclosure (!)
- Commodity versus differentiated products
  - Cites A&H and HH, who also get this wrong
- Worried more about clever lawyers’ craftily worded complaints than about clever monopolist’s craftily structured exclusion

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