A framework for the economic analysis of exclusionary conduct

Randal Heeb, Bates White

June 23, 2014
Disclaimer


- 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

---

Today’s customers

---

Tomorrow’s customers
A simple visual aid: ZF Meritor v. Eaton

- 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 means 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
A framework for the economic analysis of exclusionary conduct

Randal Heeb, Bates White

June 23, 2014