Effective Contract Prices

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Legal choices

- Predation
  - Price-cost test
  - Who is being driven out?
  - When is recoupment?
- “De facto partial exclusive dealing”
  - Not 100% share
  - Market power
- Tying
  - Need product line
  - Market power

Link tests to competitive effects

- Somehow the contract has to impact competition if it is to be an antitrust violation
- Look at effective price the contract creates
  - Relative to marginal cost
  - Relative to but-for world and recoupment
  - What does contract exclude? Full product line driven by economies of scope
    - Entrant may threaten future market power of incumbent
  - Uncontestable share: How big is it? How does that link to contract?
- Arithmetic may support some theories and not others

Numerical example

- Trucks come in 5 flavors
- The dominant firm A has made all types for years
  - Prior to entry it charged $100 per truck
  - Now it charges $105.27 per truck
- The entrant firm B makes only flavor #5
  - It charges $95 per truck
  - *Here we are clearly defining the contestable share*
- Suppose a buyer purchases 100 trucks a year
  - The buyer needs 20 of each flavor
- To date Firm B has a 15% market share (75% of flavor 5) with its innovative product #5.

CRR: loyalty rebate

- The buyer's contract with Firm A says the price is $105.27 for each truck with a 5% discount on all units if the buyer purchases at least 90% of its needs from A.
  - "its needs" draws in rival Firm B by necessity
- The buyer's contract with Firm B says the price is $95 per truck.
- The buyer would, in a case of competition on the merits and linear prices, buy 15 trucks from B and 85 from A.
- ➔ What is the effective price for the buyer induced by the contracts with Firms A and B?

Effective Contract Price – Firm A

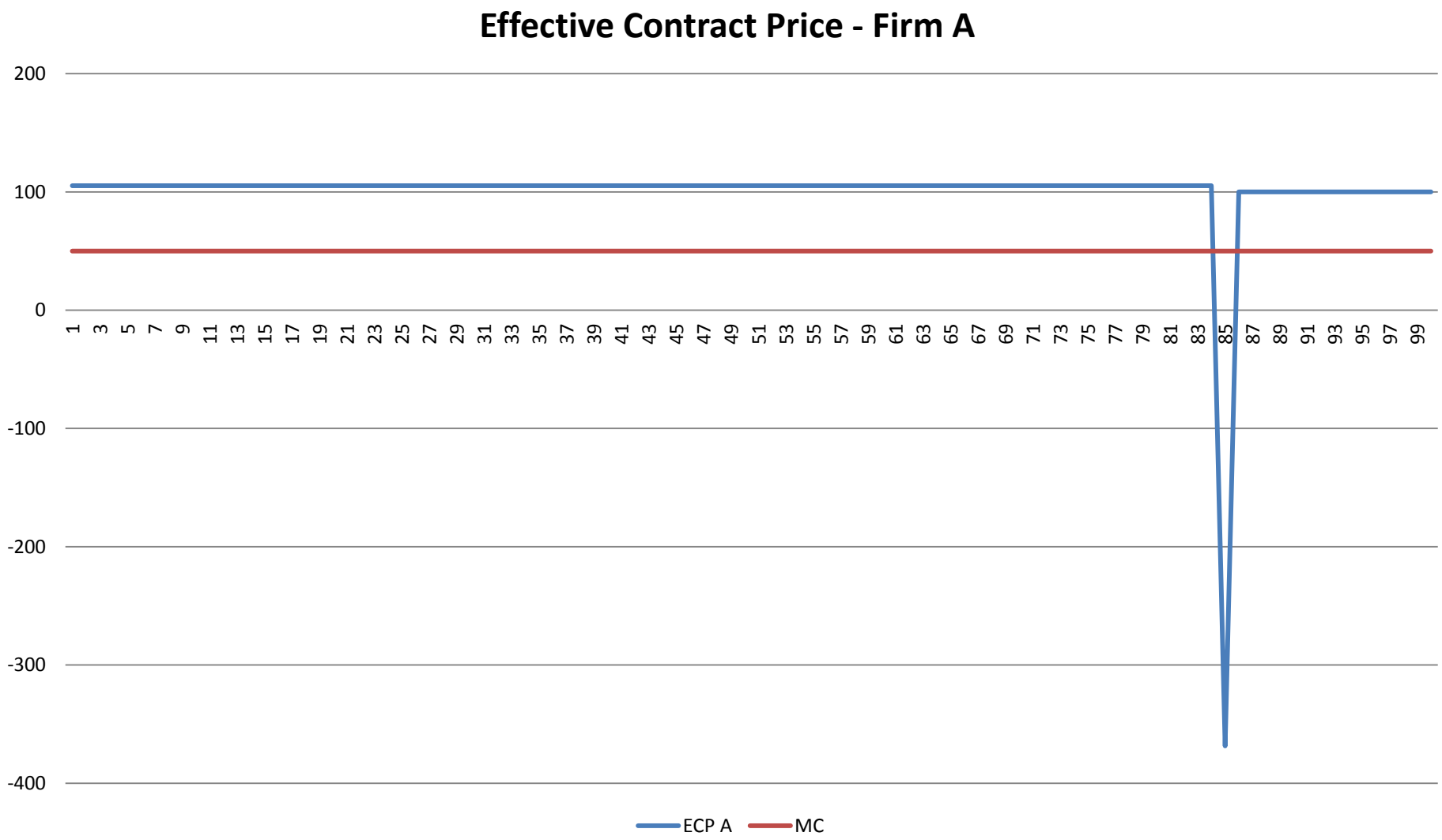
ECP if buyer buys from A:

- Trucks 1-89 cost $105.27 each
- Truck #90 costs its list price minus the total discount received for crossing the threshold

  $105 – ($5.26*90) = -$368.44
- Trucks 91-100 cost $100 each (95% of 105.27)

It is easy to see that ECP<marginal cost at truck #90:

-368.44 < 50


Effective Contract Price - Firm A
200
100
0
-100
-200
-300
-400
1 3 5 7 9 11 13 15 17 19 21 23 25 27 29 31 33 35 37 39 41 43 45 47 49 51 53 55 57 59 61 63 65 67 69 71 73 75 77 79 81 83 85 87 89 91 93 95 97 99
ECP A
MC

Loyalty rebates change the ***shape*** of the price schedule

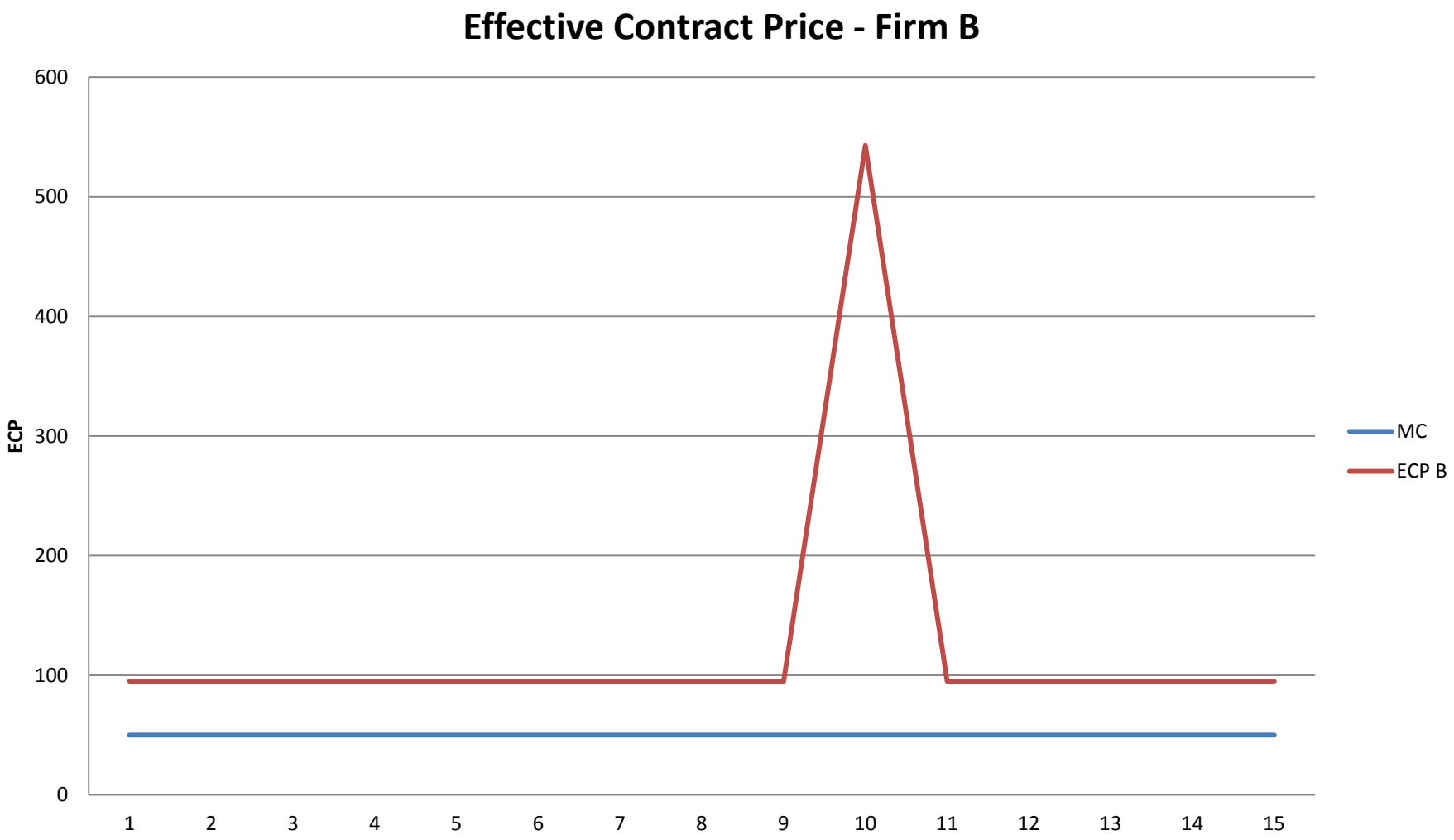
…and not necessarily the average price paid.

Effective Contract Price – Firm B

- ECP if buyer buys from B:
- Trucks 1-9 cost $95 each
- Truck #10 costs its normal price plus the forfeited discount on the 85 A trucks the buyer buys

  $95 + ($5.27*85) = $542.95

- Trucks 11-15 cost $95 each


Effective Contract Price - Firm B
600
500
400
300
200
100
0
ECP
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
MC
ECP B

What theories can be supported with ECP facts?

- Satisfies a price-cost test?
  - With this set of facts ECP < marginal cost at the moment/unit where the two firms compete
- How costly is this strategy for the dominant firm? Costless in this case, compare:
  - "ex ante" linear price: $100*90 trucks = $9,000
  - Contract: ($105.27-discount)* 90 trucks = $100*90 = $9,000
  - With entry: $100*85 trucks = $8,500
  - No recoupment required
  - No discount relative to but-for world

- What does contract exclude from the buyer?
  - A few flavor 5 trucks from Firm B
  - Are there economies of scale for B in flavor 5?
  - Are there economies of scope across flavors? Has Firm B announced an interest in entry into flavor 4?
- How big is the tying product / uncontestable share?
  - 80 units of types 1-4 are tool for Firm A
  - $8000 of uncontestable revenue; entrant @15 trucks has at most $1425 in revenue

Other factors

- Measurement error and uncertainty
- Up front payment
  - Behavioral biases
  - Managerial compensation
- Buying patterns over the contract year
  - Demand shocks
  - Corporate structure
- Bidding for the whole contract