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Foreclosure: an economic approach

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Exclusionary Behaviour – General Points

- **Exclusive dealing can be pro-competitive or anti-competitive.**

- Hence economists prefer to focus on case specific effect – we prefer not to have "*per se* rules" and favour so-called "**effects-based analysis**":
  - We need to be careful with interventions that restrict the contractual freedom of firms…
  - Yet we need to scope to act when dominant firms are *likely* to be using their contracts to harm competition and consumers.

- But we don't want to re-invent the wheel on every case… so we look for common features that may indicate where exclusionary behaviour is more likely to be a concern (so called "anticompetitive foreclosure" in Europe).

- **Initial screens** may help rule out foreclosure quickly, or identify where further, careful investigation is required.
  - Useful both for Competition Authorities and firms that need to self-assess competition risk of their proposed contractual arrangements

Foreclosure by Unilateral Conduct

- The hypo focuses on foreclosure established by contracts which give rise to **exclusive dealing**

- **"Anticompetitive" foreclosure** can be thought of as:
  - a practice whereby a dominant supplier prevents one or more rival suppliers (existing or potential competitors) from accessing sufficient inputs or customers…
  - ...such that (potentially) important rivals to the dominant firm operate at a substantial competitive disadvantage…
  - ...the effect of which is to raise prices for end customers. [See, for example, European Commission Enforcement Priorities Guidance, December 2008, para. 19.]

Customer Foreclosure – Initial Screens

Dominant Supplier

Rival supplier

1: dominance?

- *What degree of market power?*
- *Do buyers inevitably purchase some units from Domco?*

'Locked-in' buyers

Other buyers?

3: how exclusive?

- *Contractual?*
- *De facto?*
- *Contract length/ competition "for" the contract?*
- *Contestable units allow rivals to obtain sufficient scale?*

End customers

2: alternative routes to market to become a viable competitor?

- *Are 'locked-in' buyers the gateway to the market?*
- *How much of the market is tied to the dominant firm?*
- *Is forward integration viable? (No entry barriers in downstream market) Is direct supply viable?*
- *How great are scale economies?*

Ability, incentive, effect: **ability**

- **Another way to think about it…**
  - Can the following cumulative conditions be demonstrated: **ability**, **incentive**, **harmful effect**?

- **<u>Ability</u> to foreclose?**
  - **Substantial market power**? To what degree is Domco an "unavoidable trading partner" – how credible is it for Domco to say: if you deal with me, you deal only with me?
  - Can Domco **target buyers selectively** – e.g. those most likely to be important for Domco's rivals? Domco maybe had first mover advantage – the chance to contract before its rivals (e.g. relevant when foreclosure relates to new entrants)?
  - Are **scale economies** are important (whether supply side economies or demand side network effects), otherwise why does it matter if rivals operate on a smaller scale? NB – issue is harm to <u>competition</u> and not competitors.

Ability, incentive, effect: **incentive**

- **<u>Incentive</u> to foreclose?**
  - Purchasers do not usually have an incentive to see competition harmed among their suppliers, so how does Domco persuade buyers to forego buying from its rivals? Offers lower price or investments in the buyer (e.g. its distributor)? (NB could be quintessentially pro-competitive!)
  - In intermediate markets (e.g. where the buyer is a distributor or retailer that sells on downstream) the buyer may gain where its rivals pay higher prices (easier to persuade such a buyer to sign up to exclusivity).
  - Do sufficient buyers remain that can be harmed in a way that allows Domco to recover any costs of locking-in certain buyers? (Is foreclosure a profitable strategy?)

Ability, incentive, effect: **effect**

- **Harmful <u>effect</u>?**
  - How much weaker do rivals become as a result of the agreements in terms of their ability to compete?
  - Are the rivals that are harmed substantially of great importance to ensuring Domco offers low prices, high quality or high innovation? In other words, what is the actual (or potential) competitive significance of the rivals that are foreclosed?
  - Are there likely “counter-strategies”? Can those that are harmed (rivals and customers paying higher prices or suffering lower quality) “team up” to undermine the dominant firm’s foreclosure strategy?
  - To what extent do efficiencies (e.g. specific investments benefiting tied distributors) that would otherwise not have taken place offset any possible price raising or quality lowering effects?

Concluding remark

- **Case-by-case assessment required…**

- But a helpful framework exists against which to test the evidence:
  - Initial screens
  - Key “questions to ask”: Ability? Incentive? Harmful effect?