Exclusive Dealing
Framework for Assessment

Ekaterina Rousseva
European Commission,DG Competition

ICN Unilateral Conduct
Regional Workshop
Stockholm, Sweden
September 17-18, 2013

Plan of the presentation

- **Characteristics of unilateral conduct: a reminder**
  - Definition and types
  - Risks, challenges and possible solutions

  ICN's Unilateral conduct workbook, chapter 1

- **Exclusive dealing as a type of unilateral conduct**
  - Definition and forms
  - Concerns and benefits
  - Legal basis
  - Elements of the analytical framework:
    - ➢ dominance
    - ➢ anticompetitive foreclosure
    - ➢ efficiency justifications

  ICN's Unilateral conduct workbook, chapter 5

Unilateral conduct: a reminder

- **Exclusion as anticompetitive behaviour**
  - firm(s) raise costs and reduce revenues of competitors; deny profitable access to the market
- **Unilateral exclusionary conduct**
  - a company misuses its market power
  - reduces competitors' ability to constrain the exercise of market power
  - strengthens/maintains market power
  - increases prices, reduces output, diminishes quality or consumer choice
- **Types of unilateral conduct:** non-exhaustive list, different classifications
  - price *(e.g. predatory pricing, margin squeeze),* non-price *(exclusive dealing, tying)*
  - depending on where the exclusion takes place
    - on the market where market power is held *(exclusive dealing, rebates)*
    - on adjacent market *(refusal to deal, margin squeeze)*

International Competition Network

Challenges in the assessment of unilateral conduct

- Exclusion may be result of misuse of power but also of superior performance

- Conduct that excludes may be efficiency enhancing

- Risks of enforcement errors
  - wrong condemnation (false positive)
  - wrong acquittal (false negative)

- How to distinguish anticompetitive exclusion from healthy competition on the merits?

Possible solutions (1)

- What objectives ?

  "..antitrust policy cannot be made rationale until we are able to give a firm answer to one question: What is the point of the law – what are its goals?"

  R.Bork

  - **the objectives** of unilateral conduct laws vary across jurisdictions but most commonly enforcers aim to ensure effective competitive process, promote consumer welfare or enhance efficiency (ICN's Unilateral conduct workbook chapter 1)
- What approach?
  - Formalistic (based on presumptions for positive or negative effects) or
  - Effects-based or
  - Hybrid (most often)
    - Balancing administrative costs and risks of enforcement errors

Possible solutions (2)

- Economic tests for assessment of effects
  - Consumer welfare test: balances positive and negative effects of dominant firm's conduct on consumers
  - As efficient competitor test: does the conduct exclude competitors as efficient as the dominant undertaking
  - Profit sacrifice test: profit sacrifice that is irrational absent the tendency to exclude
  - No-economic sense test: is the conduct irrational absent the exclusion
  - Combinations of those (*See ICN's Unilateral conduct workbook chapter 1)*

International Competition Network

Exclusive dealing: definition

- Arrangements that require a buyer on a particular market to concentrate its purchases to a large extent with one (dominant) supplier
  - an obligation to abstain from purchasing rivals' products
  - known also as single branding or exclusive purchasing
- Requirements on a supplier to sell mainly to one buyer (exclusive buying)
- Exclusive buying less enforced, focus on exclusive purchasing

International Competition Network

Forms of exclusive dealing arrangements

- Explicit clauses in contracts

- *De facto* exclusivity
  - threats to terminate supplies (ex. the United Brands case)
  - requirement to keep minimum quantity of goods in stock
  - incentives: discounts but also other advantages e.g. providing equipment (ex. the Van den Bergh Foods case)
  - requirement for exclusive shelf space
  - English clause: requiring the buyer to report any better offer, allowing acceptance only if the dominant supplier does not match the competitor's offer

Legal Basis

- Exclusive dealing arrangements usually based on agreement
  - can be addressed by unilateral conduct rules and/or
  - by rules governing vertical restraints

- Both sets of rules require significant market power but for unilateral conduct the market power should amount to dominance

- Our focus on the first set of rules

What are the competitive concerns?

- Possible negative effect: foreclosure of the market to competing and potential suppliers
  - hinders or limits the access of upstream rivals to customers/downstream firms
    - not necessary to cover the entirety of purchases; enough to deny competitors a minimum efficient scale
  - reduces or hinders the growth of upstream competition → maintains or strengthens dominance
  - ultimately creates or perpetuates lower output and higher prices to the detriment of consumers

What are the possible benefits?

- Possible efficiency gains:
  - encourages suppliers to provide dealer-specific investments e.g. in training and marketing
  - prevents free riding and resolves hold up problems
  - enhances dealers' attention to quality assurance
  - allows suppliers to control distribution quality more easily
  - ensures volume necessary to achieve scale economies

Elements of the analytical framework

- Market power/Dominance
- Anticompetitive foreclosure
- Efficiency justifications

Dominance

- Market power: ability to maintain supra-competitive prices
- Dominance: substantial and durable market power;
  - ability to behave with appreciable freedom from competitive discipline imposed by rivals or customers
  - assessment: market definition, market share, barriers to entry and expansion; buyer power (detailed assessment in ICN's Unilateral conduct workbook, chapter 3)
- The stronger the dominance of the supplier, the easier to impose exclusivity

- The dominant supplier may be an **unavoidable trading partner**
  - its brand is a 'must stock item' preferred by many final consumers)
  - Competitors may have capacity limitations, may not be able to compete for an individual customer's entire demand

Anticompetitive foreclosure relevant factors(1)

- **Proportion of the relevant market covered by the exclusivity arrangement**
  - how much of each customer's requirements is subject to exclusivity + cumulative coverage of all exclusivity arrangements
  - larger proportion – anticompetitive foreclosure more likely
  - but small proportion also relevant if it the exclusivity affects sources of supply important for competitors' entry or expansion
- **Duration**: usually the longer the duration, the stronger the potential for foreclosure, however:
  - long term duration may be illusionary if there are no penalties for early termination
  - short term with automatic renewal clause could be similar to long term duration
  - short term duration may be misleading if the life cycle of the product is long
  - renewal at different periods of time – still problematic if achieving economies of scale is important

Anticompetitive foreclosure relevant factors(2)

- Feasibility of competitors finding or developing alternative sources of supply or alternative distribution channels
  - is direct distribution effective
  - does the exclusivity concerns distribution or end customers
    - more difficult for competitors to find counter strategies if end customers are tied (ex. the Tomra case)
- Countervailing buyer power
  - the arrangements may be contributing to efficiency
  - but may also benefit only one powerful buyer and not necessarily other customers and final consumers
- Specific market conditions: entry barriers, expanding demand, rapid innovation

➢ A balanced assessment of all factors

Efficiency Gains

- The efficiency gains should be serious, not minimal

- Are the efficiency gains or the anticompetitive foreclosure greater?
  - difficult task, no universal solution
  - usually appreciation for the relative magnitude of both the efficiency and the anticompetitive effects

- The EU approach: four cumulative conditions
  - the efficiencies realised as a result of the exclusive dealing
  - exclusive dealing is indispensable to the realisation of those efficiencies
  - the efficiencies outweigh any likely negative effects on competition and consumer welfare
  - the exclusive dealing does not eliminate all effective competition