# Assessment of exclusive dealing and conditional rebates

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# Plan

Two questions:

- Where are we?
    - Following Intel, is there a presumption of harm for exclusive dealing arrangements by dominant (and unavoidable) sellers?
    - Don’t know. Anyone?
- Where should we be (and are we going there)?
    - How should exclusive dealing be assessed?
    - Seems that everyone knows where we should be. But not if we are going there. Happy if someone disagrees.

# Efficient exclusive dealing

- At first glance: conditional rebates and exclusivity prevent competition for some buyers (or for some part of their demand) and cannot be pro-competitive. But no one is so innocent these days.
- When all firms can offer exclusivity rebates, competition is often enhanced
    - Conditional rebates allow for a more effective extraction of intra-marginal rents:
        - Simply put, exclusivity increases the stakes in competition – all or nothing – so firms compete more intensively at the margin (Marvel & Yang, 2008)
    - Conditional rebate is a form of price discrimination – can increase output and enhance welfare

# Efficient exclusive dealing

- The concern is often with individualized rebates and retroactive rebates - but
    - Individualized rebates: when purchasers differ, competition "at the margin" is only possible if one can locate the margin of individual purchasers (Cooper et al., 2005, Thisse & Vives, 1988)
    - Retroactive rebates: do not allow larger rent extraction in Marvel and Yang (2008)
- Competitive outcomes: the observation that in a market one firm competes with exclusive contracts (conditional rebates) does not mean that consumers are worse off compared to the situation without such contracts.

# Efficient exclusive dealing

- Resolving the free-rider problem
  - Eg. internalize the positive externalities of advertising
- Recovery of fixed costs – hold up
  - Eg. when the supplier makes relationship specific investments
- Alignment of incentives
  - Eg. Inducing sales efforts

# Summary: presumption of harm is not warranted

- Exclusivity can lead to a more intensive competition and can address certain externalities which cannot easily be internalized by the use of complex contracts
- Ex-post (quasi-)exclusivity is not necessarily indicative of absence of ex-ante competition – by construction, when firms compete with exclusivity rebates the market outcome will involve exclusivity
- Even if some firms compete with exclusivity rebates, while others do not, it does not follow that consumers are worse off relative to the situation in which all firms set a uniform price (Greenlee and Reitman, 2006).

# When are exclusivity rebates harmful?

- Two sets of theories of harm:
    - Rebates involve profit sacrifice
        - The dominant firm offers a sufficient rebate to induce exit and later recovers the sacrifice (eg. Klein and Zenger, 2010).
    - No (or very little) profit sacrifice involved
        - We will deal with these in what follows

# When are exclusivity rebates harmful?

- No profit sacrifice:
  - Coordination between buyers missing, the entrant must cover fixed costs to cover the costs of entry (Rasmussen et al., 1991; Segal and Whinston, 2000)

- But: scale economies or network effects must be present (externalities from a contract – benefit to one buyer is cost on other buyers).

# When are exclusivity rebates harmful?

- When buyers are not final consumers (typically the case) downstream competition plays a role – depending on the nature of competition anticompetitive exclusion more or less likely.
- One of the EC's theories of harm in Intel relied on downstream competition.

# When are exclusivity rebates harmful?

- If buyers compete downstream, they care most about the relative levels of input prices (not about absolute levels).
- The dominant firm may commit to charge a very low price in the contestable part of the demand to buyer A if other buyers do not sign exclusive deals. In this case, it may be that all the buyers will sign an exclusive deal. Intel "played" off OEMs against each others. (Simpson and Wickegren, 2007) Abito & Wright, 2008, and Shaffer & Inderst, 2009)
- You need a non-contestable part of the demand
- The relevance of "contestability" and scale economies – the EC guidance

# When are exclusivity rebates harmful?

But: when competition between downstream buyers is intensive, a small cost advantage to a single remaining buyer may translate into large demand for final product and therefore large demand for input .

- Exclusion of a more efficient entrant is then less likely as it will achieve the required scope or network effects (Fumagalli and Motta, 2006)

# Summary - what should we be doing

No basis for a presumption of harm.

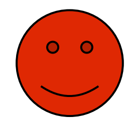
Because exclusivity rebates are often efficient, even when offered by a dominant firm, a well-developed theory of harm is important in order to avoid wrongful convictions, harming consumer in the process.

- Analogy to low uniform prices.

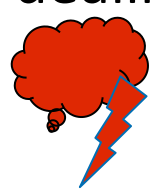
A well developed theory of harm: (1) lays out all the required assumptions and provides proofs for these; (2) lays out all the logical steps and verifies that these are consistent with the incentives of all the parties; (3) clearly outlines the most likely counterfactual  (and verifies it with evidence).

# But what are we doing?

The EC guidance paper (on enforcement priorities) lays out effects based analysis informed by the economic literature. Firms formed legitimate expectations.



The GC's Intel judgment turned this upside down – per-se prohibition on exclusive dealings by a dominant company with uncontestable demand.



How will the EC go about this?

Does cartes bancaire resolve the dilemma? Hardly in my view.

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