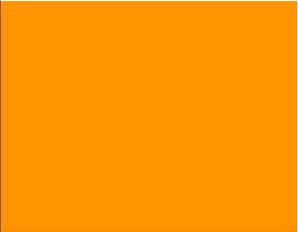# THEORIES OF HARM AND EFFICIENCY JUSTIFICATIONS IN ABUSE OF DOMINANCE CASES

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Outline

- Theory of harm
  - Notion
  - Features of a well developed theory of harm
  - How to test a theory of harm
  - How to test alternative economic (efficiency) justifications
- Categories of unilateral foreclosing strategies
- Conclusions

Theory of harm

Theory of harm

- The theory of harm is a story that explains why an agreement between two or more firms or a practice engaged by a firm may harm competition and adversely affect consumers

- It does not only take into account the structural features of the market but also the incentives and the ability of the firms involved

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Theory of harm: elements

A well developed theory of harm…

☐ should articulate how competition and, ultimately, consumers will be harmed by the practice under exam relative to an <u>appropriately defined counterfactual</u>

☐ should be consistent with the <u>incentives</u> and the <u>ability</u> of the parties involved

☐ should be consistent with the available <u>economic theory</u>

☐ should be consistent with the available <u>empirical evidence</u>

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Theory of harm: statements

A theory of harm and the justifications of the various nodes of the story will make emerge two categories of statements**:**

1. **<u>Factual assertions</u>**: description – and possibly quantification – of an economic phenomenon
    - e.g. X and Y are the closest competitors; consumers face high switching costs; demand price elasticity is 1.6

2. **<u>Logical propositions</u>**: a reasoning that, on the basis of a set of premises, (i.e. some factual assertions), derives a conclusion
    - e.g. switching costs would prevent a new entrant from reaching an efficient scale and would impede entry

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Theory of harm: testing the statements

- In general a factual assertion can be either **true** or **false**
    - When a factual assertion contains estimates it is impossible to express such a clear-cut opinion and the judgement it can only concern the **reliability** or **robustness** of the estimates

- A logical proposition is **valid** or **invalid**
    - internal consistency: conclusions must logically follow from the premises
    - economic theory: conclusion are related to the premises by an established or sound economic theory

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Examples of unsatisfactory theory of harm: margin squeeze

- What is the proper counterfactual?
  - A lower wholesale input price (constructive refusal to deal)?
  - An higher retail price (predation)?
- Very different statements to be tested… If predation:
  - need to estimate avoidable downstream costs and prove "sacrifice"
  - foreclosure unlikely if not dominant in downstream market
  - some evidence of recoupment necessary
  - no need to prove the indispensability of input
- Implications
  - Remedies (totally different for domco, rivals and consumers)
  - Damages – if predation only loss of profit, passing on arguments irrelevant, etc.

Efficiency justification

- An efficiency justification is an alternative story that explains a certain practice engaged by a firm will ultimately enhance competition and positively affect consumers

- An efficiency justification contain all the elements of a theory of harm
  - Factual statement
  - Logical proposition

Categories of foreclosing strategies

… and of efficiency justifications

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A general representation

DomCo Rivals' profit function:

$$\Pi_r = p_r Q_r(\theta_D^d, p_r, p_D) - CT_r(\theta_D^c, Q_r)$$

Where:

θ_D^d = «demand shifter» that depends on DomCo strategic choices

θ_D^c = «cost shifter» that depends on DomCo strategic choices

Examples:

θ_D^d is the decision to integrate a browser in the operating system; or it is DomCo's decision to improve the quality of its product

θ_D^c is the decision to supply an essential input at a higher price; or it is the DomCo's decision to offer higher salaries to some of its employees (e.g. football players, movies stars, engineers)

Raising Rivals' Costs

□

$$\Pi_r = p_r Q_r(\theta_D^d, p_r, p_D) - CT_r(\boldsymbol{\theta_D^c}, Q_r)$$

□ The RRC theory of harm should describe the channels through which DomCo is able to increase the cost rivals bear and the extent of this cost increase

□ Examples

- Refusal to supply a more efficient input
- Constructive refusal to deal
- Exclusive contract with suppliers or distributors
- Non linear prices (discounts) to suppliers or distributors

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Lowering Rivals' Demand

□
$$\Pi_r = p_r Q_r(\boldsymbol{\theta_D^d}, p_r, p_D) - CT_r(\theta_D^c, Q_r)$$

□ The LRD theory of harm should describe the channels through which DomCo is able to reduce the rivals' ability to attract clients and the size of this effect

□ Examples

  □ Refusal to supply an input with a higher quality

  □ Exclusive contract with end consumers (or clients)

  □ Non linear prices (discounts) to end consumers

  □ Tying or bundling

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Output strategies

- $$\Pi_r = p_r Q_r(\theta_D^d, p_r, \boldsymbol{p_D}) - CT_r(\theta_D^c, Q_r)$$

- The OS theory of harm should describe how by increasing its output/reducing its price DomCo is able to induce an as efficient rival to exit the market

- Examples
  - Below cost pricing
  - Price discrimination and target rebates

Categories of efficiency justification

- Allocative efficiency: a lower price is generally socially efficient

- Productive efficiency
  - Economies of scale and scope
  - Vertical coordination (provide the right incentives to suppliers or distributors)

- Dynamic efficiency
  - Protecting investments in tangible and/or intangible assets

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Conclusion

Economic analysis in abuse cases

- It requires a completely spelled out theory of harm juxtaposed to alternative (efficiency) justifications
- Identify the key arguments
  - Factual assertion
  - Logical propositions
- Collect evidence to test the key arguments
  - Market data and statistical analysis
  - Documents
  - Qualified opinions of market players

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