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# Predatory Pricing Policy under EC and US Law

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# Summary

Predatory pricing poses a dilemma which perplexed and intrigued the competition community for many years. It is one of the most discussed topics in the area of antitrust economics, as the critical issue is to meld economic insights with sound legal rules. Despite the energy devoted to the subject by many distinguished observers from the economic and legal professions and their attempts to find proper rules that can be applied by competition policy authorities, little agreement has emerged.

Predatory business behaviour has various forms, p.ex. non-price predation. This paper, however, deals with the particular significant category of predatory conduct, which could be called the “traditional” model of predatory pricing. The discussion will further be based on the consensus in modern economics that predatory pricing can be a successful and therefore rational business strategy.

The basic concept of predatory pricing can roughly be described as follows. When a company is accused of predatory pricing, its being accused of pricing at levels that are unreasonably low, whether because there are below some measure of cost or because they otherwise generate an inadequate return. So far, there seems nothing wrong with the low pricing, since low prices are apparently beneficial for the customer and in fact usually the result and aim of a free market and healthy competition, low prices being the hallmark of competition.

On the other hand, history and economic theory teach that predatory pricing can be an instrument of abuse. The predator offers its goods or services at unrealistically low prices in order to achieve a longer-term objective. The predatory company may be attempting to deter a rivals entry on the market or to drive him out of the market, so that the former attains a monopoly position, then being able to recoup its losses from the below-cost selling period along with making even more profits by holding the prices on high level. This subsequently turns the apparent benefit of the former lower price around into the opposite, hurting the costumer and the rival and thus competition as such by the unfair practice.

However, even tough this basic theory seems straight forward, the crux of determining predatory pricing lies in detail. The difficulty of assessing predatory pricing is rooted within the arrangement of the economic elements and the legal aspects, hence to merge economic insights with practically workable rules. The critical issue for antitrust analysis is to distinguish in a practical manner predatory conduct from merely healthy competition.

Tests on how to determine the thin line between unlawful conduct and healthy competition are disputed in the academic debate in mind-numbing detail. The only basic agreement in the wide ranging approach suggestions appears to be that scrutinizing a company`s conduct requires careful examination and factual inquiry which has to be guided by a sound legal rule and a thorough economic analysis.

However, disagreement is vast concerning the recognition of a proper and workable rule. It ranges from the acknowledgment that predatory pricing occurs rather seldom and any attempt to restrict competition harms more than it helps, to detailed economic analysis tests which seem to overload the courts ability to work efficiently.

The concept of predatory pricing has thus been a familiar one for many years. It was not until the last two decades however, that a new literature in economics and law has emerged which re-examines the logic of predatory pricing strategy more general, involving strategic, game-theoretic analyses of imperfectly competitive behaviour in contrast to the more standard economic logic embodied in the Chicago school of thought, along with a deeper understanding of imperfect information between competitors.

In the United States, predatory pricing has been of concern at least since the perceived activities of J. D. Rockefeller's Standard Oil Company helped to give birth to the Clayton Act in 1914. In the EC however, it was not until the late 1980s that the ECJ and the Commission had the chance to deal with predatory pricing cases, most prominently the renowned AKZO case. Therefore one may perceive that EC competition law can draw from the US experience. This is not lastly illustrated by the fact that for the most part theories on predatory pricing have been developed by legal and economic scholars in the US.

Courts and competition authorities subsequently had the chance to investigate predatory pricing claims and develop their own tests, incorporating the theories which emerged in the academic debate over the last 20 years.

In the EC, the Commission and the ECJ in recent times decided on predatory pricing cases involving market dominating companies such as AKZO, Tetra Pak and Irish sugar. The US Supreme Court on the other hand set new standards on identifying the issue in its landmark Brooke Group decision. These decisions were both criticized and welcomed by the competition community, clarifying the approaches on predatory pricing, but at the same time leaving several problems unsolved.

The aim of this paper is to illustrate the problem of predatory pricing with a view to both sides of the Atlantic and to analyse the different approaches put forward by the scholarly legal and economic debate and their utilization by the competition authorities.

To achieve this, the phenomenon of predatory pricing will be described in a general manner followed by a look at the economic situation behind a predatory business strategy. Then the main theories on how to assess predatory pricing will be scrutinised. These theories cover a wide array of approaches, recognising that on the one hand predatory pricing can be an abuse and on the other hand that price reductions are the hallmark of competition. After that, the legal provisions in the EU and US under which predatory pricing is dealt with will be explained.

Subsequently, the leading decisions on the topic by the ECJ, the Commission and the US Supreme Court are examined and the different approaches of the

competition authorities are compared, illustrating the difficulties they face when dealing with predatory pricing. Concluding the discussion, the paper will identify the main elements of a workable theory by scrutinising the way the competition authorities have incorporated the academic debate in their decisions and how they were able to work with these approaches.

# Abbreviations

Art.	Article
ATC	Average Total Costs
AVC	Average Variable Costs
CFI	Court of first Instance
DOT	Department of Transportation (of the United States)
DP	Deutsche Post AG
ECJ	European Court of Justice
ECLR	European Competition Law Review
ECR	European Court Reports
et seq.	et sequentes
fn.	footnote
FTC	Federal Trade Commission (of the United States)
i.e.	id est
ibid.	ibidem
L.J.	Law Journal
L.Rev.	Law Review
O.J.	Official Journal (of the European Communities)
OECD	Organisation for Economic and Cultural Development
p.ex.	per exemplum

RIW

Recht der Internationalen Wirtschaft

TRR

Trade Regulation Reports

U.S.

United States Supreme Court Reports

U.S.C.A.

United States Code Annotated

v

versus



# 1 Introduction

*“Price competition is the essence of free and open competition. It favours more efficient firms and it is for the benefit of consumers both in the short and the long run. Dominant firms not only have the right but should be encouraged to compete on price”*

as Advocate General Fennelley stressed the importance of price competition in his opinion in the *Compagnie Maritime Belge* case<sup>1</sup>.

Low prices are apparently the hallmark of competition. They are beneficial for the consumer and in fact usually the result of a free market and healthy competition, yet they could harm competition and ultimately the consumer when a firm uses unrealistically low prices to achieve a longer-term objective by engaging in unfair practises.

In most general terms, predatory pricing can be described as a price reduction that is profitable only because of the added market power the predator gains from eliminating, disciplining or otherwise inhibiting the competitive conduct of a rival or potential rival<sup>2</sup>. Thus, the phenomenon of predatory pricing poses a dilemma which perplexed and intrigued the competition community for many years. It is one of the most discussed topics in the area of antitrust economics, as the critical issue is to meld economic insights with sound legal rules. Despite the energy devoted to the subject by many distinguished observers from the economic and legal professions and their attempts to find proper rules that can be applied by competition policy authorities, little agreement has emerged.

Tests on how to determine the thin line between unlawful conduct and healthy competition are disputed in mind-numbing detail. The only basic agreement in the various approach suggestions appears to be that scrutinizing a firm's conduct requires careful examination and factual inquiry which has to be guided by a sound legal rule and a thorough economic analysis. However, disagreement is vast concerning the recognition of a proper and workable rule. It ranges from the acknowledgment that predatory pricing occurs rather seldom and that any attempt to restrict competition harms more than it helps, to detailed economic analysis tests which seem to overload the courts ability to work efficiently<sup>3</sup>.

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<sup>1</sup> Joined cases C-395/96 P and C-396/96 P *Compagnie Belge Transports and others v Commission*, Opinion of Mr Fennelley ECR. 2000 I-1411.

<sup>2</sup> Bolton/Brodley/Riordan at 3 with further references. There are other forms of predatory business behaviour which can involve such strategies as predatory investment, excessive product differentiation, predatory advertising or predatory product innovation, see p.ex. Hovenkamp (2001) at 281 et seq and below fn. 33.

<sup>3</sup> See below under 3.

Although predatory pricing had legal recognition for about a century<sup>4</sup>, it was not until McGee's work<sup>5</sup> in 1958 that it was subjected to economic analysis. Since then there has been academic debate to assess the problem carried out by a vast flow of literature and court cases. However in the last two decades new literature in economics and law has emerged which re-examines the logic of predatory pricing strategy more general, involving strategic, game-theoretic analyses of competitive behaviour<sup>6</sup>, along with a deeper understanding of imperfect information between competitors.

In the United States, predatory pricing has been of concern at least since the activities of J. D. Rockefeller's Standard Oil Company helped to give birth to the Clayton Act in 1914. In the EC however, it was not until the late 1980s that the ECJ and the Commission had the chance to deal with predatory pricing cases, most prominently the renowned AKZO case. Therefore one may perceive that EC competition law can draw from the US experience<sup>7</sup>. The decisions by the courts and competition authorities were both, criticized and welcomed by the competition community, clarifying the respective approaches to predatory pricing but regrettably at the same time leaving several problems unsolved.

The aim of this paper is to illustrate the problem of predatory pricing with a view to both sides of the Atlantic and to analyse the different approaches put forward by the scholarly legal and economic debate and their utilization by the competition authorities.

To achieve this, the phenomenon of predatory pricing will be described in a general manner, followed by a look at the economic situation behind a predatory business strategy. Then the main theories on how to assess predatory pricing will be scrutinised. These theories cover a wide array of approaches, recognising that on the one hand predatory pricing can be an abuse and on the other hand that price reductions are the hallmark of competition. After that the legal provisions in the EU and US under which predatory pricing is dealt with will be explained. Subsequently, the leading decisions on the topic by the ECJ, the Commission and the US Supreme Court are examined and the different approaches of the competition authorities are compared, illustrating the difficulties they face when dealing with predatory pricing. Concluding the discussion, the paper will identify the main elements of a workable theory by scrutinising the way the competition authorities have incorporated the academic debate in their decisions and how they were able to work with these approaches.

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<sup>4</sup> O'Hagan at 1.

<sup>5</sup> McGee (1958) at 137 et seq.

<sup>6</sup> Which stands in contrast to the more standard economic logic embodied in the Chicago school of thought, followed largely by US courts. For a more detailed appraisal see p.ex. Hovenkamp (2001) at 257.

<sup>7</sup> This is not lastly illustrated by the fact that the majority of the theories on how to assess predatory pricing have been developed by legal and economic scholars in the US.

# 2 The Concept and Economic Background of Predatory Pricing

The possibility of damage to competition arises when one firm takes action which will harm the interests of a competitor. Such occasions are, however, ubiquitous in industrial life. Competition causes harm. The task is to identify the special category of actions which go too far, which hurt competition rather than just competitors. In order to do so, the understanding of business conduct, involving the wide array of economic rationales is essential.

## 2.1 Concept of predatory pricing

The basic concept of predatory pricing can roughly be described as follows. When a company is accused of predatory pricing, it is being accused of pricing at levels that are unreasonably low, be it because there are below some measure of cost or because they otherwise generate an inadequate return. So far, there seems nothing wrong with the low pricing, since low prices are apparently beneficial for the customer and in fact usually the result and aim of a free market and healthy competition.

On the other hand, history and economic theory teach that predatory pricing can be an instrument of abuse. The predator offers its goods or services at unrealistically low prices in order to achieve a longer-term objective<sup>8</sup>. The predatory company may be attempting to deter a rivals entry on the market or to drive him out of the market, so that the former attains a monopoly position, then being able to recoup its losses from the below-cost selling period along with making even more profits by holding the prices on high level. This subsequently turns the apparent benefit of the former lower price around into the opposite, hurting the costumer and the rival and thus competition as such by the unfair practice.

## 2.2 Economic background of predatory pricing

Taking a close look at the economic situation on the market where the alleged predatory pricing behaviour is to be taken place is crucial for assessing the problem at hand. Subsequently the conduct of the alleged predator is to be

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<sup>8</sup> This price cutting strategy most often involves price discrimination in the "target" area of the predator and may constitute an infringement of competition provisions as such, without involving below-cost price cutting, see p.ex. Martinez at 125.

examined before this background. It is therefore necessary to examine the measures and prerequisites on the market involved. Even though there is a lively discussion on what the prerequisites for successful predatory pricing strategy are, there is nevertheless consensus on the main aspects on which market conditions are necessary.

However, any person entering into the field of predatory pricing should be aware of the most striking danger, the relationship between the law and economic reasoning on the subjects<sup>9</sup>. This becomes painfully clear when competition authorities and courts have to decide on complex economic theories. It is not only, that if a court is confronted with a complex and research intensive theory, it will not be able to work efficient. The problem runs deeper than that. There are differences within the economic and legal work with that respect, that the former will do academic work which will produce data that is minimally consistent with theory but can not rule out alternative explanations. Even worse, the fact-finding power of economists is considerably greater compared to that of the court when examining an individual case<sup>10</sup>. In the US this problem is enhanced due to the procedural differences to the EC, regarding the fact that in antitrust cases the multifaceted evidence is presented to a lay-jury, which has been identified as one of the main factors in judicial inability to confront strategic complexity in predatory pricing cases<sup>11</sup>.

### **2.2.1 Cost measures involved in predatory pricing**

Central to the debate on assessing predatory pricing is the role and meaning of costs. It is therefore necessary to determine briefly the basic costs involved in the economic analysis of predatory pricing behaviour<sup>12</sup>.

Generally speaking, fixed costs are those that continue even if the firm produced more output, p.ex. interest on debt, taxes, depreciation and irreducible overhead and which do not vary with the output. Variable costs are those that vary with changes in output, p.ex. raw materials, energy and labour. Out of these two costs emerge the total fixed costs, which are the fixed costs plus variable costs.

Average variable costs (AVC) are the variable costs involved in the production of one unit, i.e. the total variable costs divided by units of output. Average total costs (ATC) are the total costs involved in the production of one unit, to be calculated by the total fixed and variable costs divided by units of output.

Marginal costs are the change in total costs brought about by increasing or decreasing the output by one unit. Fixed costs do not enter into the computation of the marginal costs, because they are the same at all levels of output.

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<sup>9</sup> See Smith at 209.

<sup>10</sup> Hovenkamp (2001) at 268.

<sup>11</sup> Ibid.

<sup>12</sup> For a more detailed appraisal on the cost issue see p.ex. Posner/Easterbrook at 684 et seq, including further references.

Costs that are attributable to a product when a product is attributed to a company's existing product line are referred to as incremental costs.

## **2.2.2 Market conditions**

Predatory pricing may prove to be a successful business strategy only if the market conditions allow it. Such a market structure exists when a dominant firm or a small group of jointly acting firms has high market share and when there are both, entry and re-entry barriers<sup>13</sup>. Only when these conditions exist may predation be a feasible strategy for the firm and may thus harm competition. This is consistent with the two-tier approach first taken by Joskow and Klevorick<sup>14</sup>, according to who the market structure determines whether a predatory pricing scheme may potentially impair competition<sup>15</sup>.

The starting point of the rationally underlying such a market conditions analysis is based on the notion of "error costs". Such costs could be of two kinds. Firstly the error that involves labelling a truly competitive price cut as predatory, the false positive error, and the error that involves the failure to identify a truly predatory price cut, the false negative error. Both types of errors pose a serious threat to competition policy. To minimise these errors, a thorough analysis of the market conditions is consequently inevitable.

### **2.2.2.1 Dominance**

In theory, any undertaking could engage in predatory pricing conduct. In practice on the other hand, only a dominant company would do so for various reasons. Firstly, there is the need of large capital reserves in order to sustain the losses during the below-cost selling period, which are most likely only present within large dominant firms<sup>16</sup>. Secondly, it would make little sense for a company to sustain these losses and invest its capital when the market would remain relatively competitive as it would have no expectation of recoupment. This is virtually only the case when an already dominant firm can strengthen its position on the market and eventually have monopoly power in order to dictate the prices.

When analysing the dominance of a company, the market has to be scrutinized with regards to the relevant product and geographic market by examining the potential demand and substitutability of the products or services<sup>17</sup>. Predatory pricing may however not only take place in the market where the predator holds a dominant position but in an adjacent market with the aim of deterring entry or expansion of rivals to other markets where the predator operates<sup>18</sup>. Even if the

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<sup>13</sup>This is now widely accepted by the scholarly debate and the courts. See p.ex. Bolton/Brodley/Riordan at 31 with further references.

<sup>14</sup> Joskow/Klevorick at 234 et seq.

<sup>15</sup> See below under 3.5.

<sup>16</sup> Furse at 234.

<sup>17</sup> see p.ex. the Commission Notice on definition of the relevant market in OJ C 372 (1997).

<sup>18</sup> For a critical appraisal of the Commissions decision on Tetra Pak II see Levy at 104 et seq.

prey has a significant market power in which predatory pricing is taking place, the economic strength of the predator may derive from its positions on other markets<sup>19</sup>.

### **2.2.2.2 Barriers to entry and re-entry**

Successful predatory pricing necessitates a certain level of entry barriers to the market. Otherwise a victim of predation or other potential rivals would immediately (re-) enter the market once the predator raises its prices and by adding their output to that of the predator drive prices back to competition level. Consequently the predator could not use its monopoly power to maintain price at a supra-competitive level in order to recoup its losses.

Entry barriers exist when a new market entrant faces costs that the incumbent predatory need not bear or no longer faces<sup>20</sup>, most frequently sunk costs, i.e. a fixed costs investment p.ex. the building of infrastructure such as railroad tracks in order to provide the services. The entrant on the other hand must incur such costs and hence faces the risk of underpricing by an incumbent with sunk costs, the latter acting as a barrier to entry, giving the incumbent the power to raise prices above the competition level<sup>21</sup>.

Re-entry barriers on the other hand exist when a firm that has left a market bears significant costs in seeking to reopen its business, p.ex. for a firm to rebuild its through the exit of the market damaged reputation with costly marketing campaigns. In the absence of re-entry barriers the firm which has been forced to exit the market because it was unable to sustain the artificially low prices dictated by the predator could enter the market again once prices are raised to monopoly level, thus being able to undermine the predators pricing policy<sup>22</sup>.

### **2.2.2.3 Deep pocket requirement**

Only firms possessing sufficient financial reserves may be successful in engaging in a predatory pricing strategy. Financial reserves may in turn be possessed by firms with large market shares with relative efficiencies and competitive costs or other advantages over their rivals or with operations in independent relative markets. A firm with multi market operations p.ex. might have easier access to funds derived from profits of other markets in which it successfully operates<sup>23</sup>.

Since in the first phase of a predatory scheme, i.e. when selling at artificially low prices, the predator will incur losses over a substantial period of time, it becomes clear that the predator`s financial resources must be greater than the ones of his rival and the latter will may not be as able as the predator to withstand losses.

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<sup>19</sup> Newton at 131.

<sup>20</sup> Bolton/Brodley/Riordan at 31.

<sup>21</sup> Ibid at 32.

<sup>22</sup> Past predation itself can also operate as such a barrier where reputation effects are present. See *ibid.* at 32, Newton at 128 and below 2.3.3.

<sup>23</sup> Mastromanolis at 216.

However, this traditional “war chest” has to be seen in the light of the economics in functioning capital markets, which would enable the prey to raise funds, enabling it to sustain the price war for a longer time and even eventually survive it<sup>24</sup>.

## 2.3 Rationality and strategies of predatory pricing

Despite the widespread belief in the existence of predatory pricing, the logic of the practice was not subjected to adequately reasoned economic analysis until McGee’s 1958 re-examination of the Standard Oil case<sup>25</sup>. He argued that predatory pricing was not a rational strategy because it was very unlikely to yield a positive return and therefore rarely adopted.

However, economic development over the last 20 years of rigorous analysis now enables economists to explain when predation can be rational. These works involve a broader strategic game-theoretic analysis of imperfectly competitive behaviour and reputation effects<sup>26</sup>, recognising the possibility of recouping the losses of the below-cost selling period and thus the rationality of a predatory pricing strategy.

### 2.3.1 Recoupment

The alleged predator must have rational ground for expecting to recoup the losses which occur during the first phase of predation when he is selling below costs. Without such an expectation predatory pricing is not sensible economic behaviour<sup>27</sup>. Recoupment is thus the ultimate long term objective of a predatory pricing scheme<sup>28</sup>, which harms through the monopolistic prices charged the consumer. Moreover, unless predation can be followed by a period when the lost profits can be recouped, there is no threat to competition, since consumers will benefit from the low prices during predation and if the firm has insufficient market power to recoup later, consumers will not be hurt<sup>29</sup>.

Recoupment can also be defined more broadly than merely retrieving the initial monetary losses. It could also be seen as a reputational benefit<sup>30</sup> that occurs not only in the market where the predation has taken place but in other markets where the predator is active. In that case anticipated recoupment is magnified and predation becomes more plausible<sup>31</sup>.

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<sup>24</sup> See Milgrom/Roberts at 118 et seq. for further discussion.

<sup>25</sup> McGee (1958) at 137 et seq.

<sup>26</sup> See below at 2.3.3.1.

<sup>27</sup> Elzinga/Mills at 2479.

<sup>28</sup> See C-395/96 P and C-396/96 P *Compagnie Belge Transports and others v Commission*

<sup>29</sup> *Korah* at 125.

<sup>30</sup> This is part of the reputation strategy described below at 2.3.3.1.

<sup>31</sup> Hovenkamp (2001) at 280.

## 2.3.2 Mergers

It has been argued that a better strategy of gaining monopoly power would be to simply merge with the rival, as a merger would avoid the large losses to the dominant firm of a predatory pricing campaign<sup>32</sup>.

However, on the one hand, the rival may not be willing to merge and to maintain its independence. On the other hand, since a merger requires regulatory approval, while a predatory strategy, though illegal, is more difficult to detect and to prosecute. What is more, in order to succeed with gaining monopoly power, the merger must result in a monopoly which is contrary to both competition policies in the US and the EC. Predatory pricing is hence a more subtle, though illegal, business strategy.

## 2.3.3 Strategies of predation

Economists have identified various business strategies which make predation a rational conduct for a firm. Predatory business behaviour can involve such strategies as predatory investment, excessive product differentiation, predatory advertising or predatory product innovation<sup>33</sup>. Here the focus shall be exclusively on predation strategies which involve predatory pricing as such.

### 2.3.3.1 Game theories

The game-theory challenges the static framework of perfect information on which scholars that dismissed the rationality of predatory pricing had relied<sup>34</sup> and explains predatory pricing in a dynamic world of imperfect and asymmetric information in which strategic conduct can be profitable<sup>35</sup>. The predator as the established firm has an information advantage over potential new entrant concerning costs and his own, due to his experience on the market<sup>36</sup>.

This information asymmetry gives therefore rise to aggressively low prices and high outputs to attempt to influence a rivals behaviour, by making him believe that competition faced by a rival which is new to the market is substantial or future entry into the market will be unprofitable.

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<sup>32</sup> McGee (1980) at 295 et seq., OECD at 10.

<sup>33</sup> for a detailed appraisal of the latter see Ordovery/Willig at 8 et seq and on non-price predation OECD at 13.

<sup>34</sup> As McGee did in his Standard Oil Case re-examination. Selten used game theory to demonstrate how rational players could unravel threats of predation in multiple markets in his "Chain Store Paradox" article. However, subsequently economic scholars demonstrated that the logic of his game theory would only hold for multiple markets with perfect information, see OECD at 11.

<sup>35</sup> See Bolton/Brodley/Riordan at 8.

<sup>36</sup> Bolton/Brodley/Riordan at 73 and OEDC at 12



Asymmetries in the information available to predator and prey, as described above, and linkages between competitors' interactions in different markets allow this attempt to influence the rivals' behaviour through their beliefs to be successful. The predator may establish a reputation for aggressive conduct of applying predatory pricing schemes when faced with hard rivals and on the signalling side. The predator may be able to send misleading signals about market demands and costs to competitors, making them believe that market conditions are unfavourable<sup>37</sup>. By this the predator induces the prey to believe that demand is too low to justify market entry and abandons further entry attempts.

These strategies include reputation effect, cost signalling, test market and signal jamming. Cost and demand signalling is designed to induce the prey to mistakenly believe that demand is low in a market the prey seeks to enter. In cost signalling a predatory drastically reduces prices to mislead the prey to believe that the predator has lower costs than themselves. In signal jamming, the predator openly cuts prices in order to distort the test market results of the potential entrant, foiling the test and consequently making it impossible for the latter to determine whether market demand for its product is sufficient to support entry<sup>38</sup>. These may prove to be plausible strategies because a firm's decision to enter or to leave a market is necessarily based on its evaluation of future revenues and costs.

### **2.3.3.2 Financial market predation**

Financial market predation is closely connected with the deep pocket requirement, where the predator must be able to sustain losses for a longer period of time than his prey and by that forcing it out of the market. However, under a financial market predation strategy, the predator focuses on the relationship between the prey and its investors, since in flexible economic capital markets there exists the possibility that profit seeking investors may be willing to finance the prey.

The predator tries to manipulate this relationship by inducing termination threats by the rival's investors in order to dry up the financing of the firm. This strategy becomes viable because of imperfections on the economic capital markets, with investors facing problems when managers of the prey take excessive risks to shield assets from its creditors or otherwise fail to protect the investor's interests and consequently imposing an implicit or explicit threat of termination of the investment contracts<sup>39</sup>.

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<sup>37</sup> see Bolton/Brodley/Roirdan at 73 and 86; Hemphill at 16.

<sup>38</sup> Ibid. at 90 et seq., with further references, O'Hagan at 2

<sup>39</sup> Ibid. at 54, with further references.

## 2.4 Predatory pricing in the different industries

As demonstrated above, predatory pricing will occur when the market conditions are favourable, i.e. when the predator holds a dominant position and high entry barriers which make recoupment likely. This is especially the case when regulatory framework and the structure of the industry itself is in favour of these conditions. These conditions exist particularly in deregulated industries, where former monopolists still have dominant positions and market power which may be used to discourage entry of potential competitors<sup>40</sup>. As regulations in such industries are liberalised the scope of predatory action may increase. The abolition of legal privileges of former state owned monopolists does most often not result in immediate increased competition, since the former monopolists still have a dominant positions and market power, which they are willing to defend by all means necessary.

The airline industry gives such an example, since new airline carriers are able to compete head-to-head with incumbent dominant national carriers on their prime profitable routes which have been previously restricted through regulatory control. Generally speaking, network industries provide fruitful ground for predators. This becomes apparent in the telecommunications area, where services require a network, which to create from scrap is neither easy nor cheap<sup>41</sup>. The software industry presents a third example. Software companies can give away products at next to zero prices for which there are important network economies in order to turn those products into the industry standard, which rivals could not have access to. Losses are subsequently recouped once the standard is gained<sup>42</sup>. Lastly, the maritime shipping sector should be mentioned, in which establishing fighting ships may prove a successful predatory pricing strategy by modifying freight tariffs in order to offer lower rates than the competitor for vessels sailing on the same route around the same date<sup>43</sup>.

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<sup>40</sup> See Faure-Grimaud at 850 and below under 5.3.

<sup>41</sup> P.ex. Nicolaidis/Polmans at 21 et seq.

<sup>42</sup> See Niels/TenKate at 808 and below under 5.1.4.

<sup>43</sup> See and Niels/Ten Kate 806.

# 3 Theories for Assessing Predatory Pricing

Proposals of identifying harmful predatory pricing have been brought forward by the academic debate ever since McGee subjected the matter to economic analysis<sup>44</sup>. Although his results ran counter to standard intuition, they held sway as late as 1980, as no other theory emerged to refute it. Since then, however, economic analysis of the subject has taken a new approach yielding models of predation as a profitable and likely strategy for firms. When Areeda and Turner introduced their cost-based test to determine if pricing is predatory in 1975, no theoretical model of predatory pricing existed. However, this test has been criticised and a number of alternative tests emerged. Advances in economic theory over the last twenty years provide the tools to conduct the close analysis that recent court decisions have called for.

The goal of each of the approaches is to offer the most effective means to achieve a balanced predatory pricing policy and to protect competition in a world of increasingly complex business transactions and strategies. The test chosen to identify predatory pricing has to overcome two main difficulties. Firstly, that it must foster competition on the merits allowing more efficient firms to drive out of the market less efficient rivals and, secondly, at the same time it has to deter the behaviour of dominant firms which could take advantage of their position to eliminate or discipline socially desirable competitors. The equilibrium between these two poles is difficult to achieve and might explain the wide range of theories and tests provided by the commentators.

Tests on how to determine the thin line between unlawful conduct and healthy competition are indeed disputed in the academic debate in mind-numbing detail. The only basic agreement in the various approach suggestions appears to be that scrutinizing a company's conduct requires careful examination and factual inquiry which has to be guided by a sound legal rule and a thorough economic analysis. However, disagreement is vast concerning the recognition of a proper and workable rule. It ranges from the acknowledgment that predatory pricing occurs rather seldom and any attempt to restrict competition harms more than it helps, to detailed economic analysis tests which seem to overload the courts ability to work efficiently<sup>45</sup>.

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<sup>44</sup> By scrutinizing the case *Standard Oil Company of New Jersey v US* 221 U.S. 1, 47, 76 (1911), see fn. 5.

<sup>45</sup> Hovenkamp (2001) at 288.

## 3.1 No rule approach

Some economists, namely the Chicago school of thought, argue that predation is so rare that there should be no legal rule against it. Bork holds the very existence of predatory pricing in question, since it would be self-detering and therefore government intervention unneeded<sup>46</sup>. Any rule would do much more harm than good by running the risk of false positive errors with the courts having grave difficulties distinguishing predatory from legal competitive behaviour. As Easterbrook puts it, the antitrust offence of predation should be forgotten<sup>47</sup>.

Given the long history of predatory pricing litigation, the very existence of the phenomenon seems hard to deny<sup>48</sup>, while at the same time the risk of false negative and positive errors harming competition on the merits is to be recognised.

## 3.2 Price-cost tests

The greater number of authors have suggested an approach which would condemn a firm when the price charged for the product or service does not cover some measure of its costs, using the relationship of the dominant firm's prices to its costs as the primary tool for identifying predatory pricing. However, there is a great deal of disagreement amongst scholars on which costs and which time frame should be applied when defining the appropriate benchmark once competition on the merits turns into illegal predatory pricing.

### 3.2.1 Areeda-Turner test

The most influential test for analysing allegations of predatory pricing was put forth by the Harvard law professors Areeda and Turner in 1975<sup>49</sup>. It has been widely adopted by US courts and has been generally considered the standard test for identifying predatory pricing<sup>50</sup>, even though it has been applied with variations<sup>51</sup>.

The test focuses on short-run costs and presumes prices to be predatory if they are below the short-run marginal costs of providing the product or service, unless it is higher than ATC. Since marginal costs are notoriously difficult to determine, they would substitute them with AVC as a more practical proxy. The advantage of such a rule, focusing solely on price-cost comparison, is its simplicity which avoids complicated structural analysis or subjective enquiries about the intent of the alleged predator. It establishes an objective, uniform test for all kinds of

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<sup>46</sup> Bork at 154.

<sup>47</sup> Easterbrook (1981) at 336.

<sup>48</sup> See Viscusi/Vernon/Harrington Jr. at 284.

<sup>49</sup> Areeda/Turner at 697 et seq.

<sup>50</sup> See Bishop/Walker at 129.

<sup>51</sup> Circuit courts augmented the test with other factors such as intent and market structure. The Supreme Court did not explicitly pass on the merits of the test, but indicated that only prices below some measure of costs would establish unlawful predation, see Bolton/Brodley/Riordan at 17, Hovenkamp (1996) at 834 and below under 5.2.

predatory behaviour<sup>52</sup>. On the other hand it is this simplicity that has been criticised for not taking into account the broader economic and strategic aspects of predatory pricing and for only achieving rough justice by relying merely on cost data<sup>53</sup>.

### 3.2.2 Long-term cost-based rules

Posner dismisses the short-run analysis and proposes that long-term costs are a better guideline when approaching predatory conduct since the predator, by pricing at short-run marginal costs, could eliminate an equally or more efficient rival who lacks the ability or will to sustain losses in the short-run<sup>54</sup>. Furthermore it is criticised that a short-run cost based test does not take into account that what really worries a firm is a long-term profit maximisation and other prerequisites such as intent and possible defences of the pricing conduct need would be added<sup>55</sup>.

Lastly it can be argued that short-run marginal costs are not the unquestionable parameter of optimal resource allocation, seeing that when taking into account the various market imperfections, the difference between this measure of costs and price does not necessary reflect the opportunity cost of “sacrificed” resources and that the dominant firm’s marginal cost is determined by previous investment decisions which are not necessarily optimal<sup>56</sup>.

## 3.3 Performance tests

Two other tests focus as well on long-term evaluation, though in different ways, by scrutinising the alleged predators performance after the exit of a rival from the relevant market.

The output expansion rule put forward by Williamson focuses on the output of the alleged predator. A firm confronted with a potential new entrant would produce at high output without violating the marginal cost or AVC rule and would however restrict output and raise price until the actual entry occurs, maximising profits at that level of capacity<sup>57</sup>. If the output of a firm would be constant or lower in the face of entry of new rivals to the market, it would be held free of predatory pricing charges. The negative effects could be avoided by prohibiting the established firm from expanding output in response to entry for a period of 12 to 18 months.

However, this test would nevertheless involve a complex set of rules, including a rule based on AVC and does therefore not avoid the problems on determining the

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<sup>52</sup> Martinez at 99.

<sup>53</sup> See p.ex. Hovenkamp (1996) at 836 et seq. with further references.

<sup>54</sup> Posner at 190 et seq.

<sup>55</sup> See Martinez at 99 and OECD at 25, Scherer at 869 et seq.

<sup>56</sup> Koller at 301.

<sup>57</sup> Williamson at 213 et seq.

costs discussed above. Furthermore, the prohibition of flexible output over a longer period of time does not allow the firm to adjust to the varying economic environment<sup>58</sup>.

This argument becomes even more clear when applying Baumol's approach, who would require any price cut made in response to entry to continue for a period of 5 years in order to limit the incentives for a predator since he would not be able to recoup his losses<sup>59</sup>. However, controlling the price may prove to be difficult for reviewing authorities, since the predator could claim changes in costs and demand which would be difficult to refute. Furthermore, the rule would be effective only after the exit of the prey, so that the predator was already successful in the first stage of the predation period, harming competition by eliminating its rival.

### 3.4 Rule of reason tests

In contrast to the tests that focus mainly on cost-price relations, the rule of reason tests attempt to achieve the goal of establishing predatory conduct with all available evidence at hand<sup>60</sup>, rejecting the idea of successfully detecting predatory pricing on the basis of a single reference.

Scherer proposed a wide-ranging inquiry into many factors surrounding the predators conduct, including an in-depth economic and historic analysis as well as the focus on intent and consequences of the conduct, dismissing any pure short-run cost-based rules<sup>61</sup>. He argues that a short-run cost test will miss the goal of long-run allocative efficiency and that cost-based formulas generally would result in passive behaviour by the dominant firm and chronic excess capacity.

However, even if these thorough enquiry approaches reduce the probability of false positive and false negative errors, they appear to turn out unworkable due to the overwhelming flow of information which can not practically and sufficiently evaluated by the competition authorities. Such an approach might further result in legal uncertainty<sup>62</sup>, given that in the absence of exact parameters, firms engaged in price competition could not know when their pricing policy crosses the line into illegal predatory conduct. Indeed it has been said that while Areeda and Turner's test is good law based on bad economics, Scherer's recommendations are bad law based upon good economics<sup>63</sup>.

### 3.5 Structural tests

Structural tests seek to incorporate aspects of the rules described above, by using structural analysis of the relevant market as a first screen and consequently limit

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<sup>58</sup> For further arguments against these approaches see Mastromanolis at 217.

<sup>59</sup> Baumol at 1 et seq.

<sup>60</sup> Philips at 67.

<sup>61</sup> Scherer at 869 et seq.

<sup>62</sup> See Martinez at 114 and McGee (1980) at 306 et seq.

<sup>63</sup> Koller at 286 et seq.

investigation to markets where favourable conditions for a successful predatory campaign exist in order to minimise the costs of enforcement errors.

Such two-tier approach was first proposed by Joskow and Klevorick<sup>64</sup> and could be taken as the prototype for structural tests<sup>65</sup>. Where predatory pricing is alleged, the market structure question accordingly should be determined first before opening up an inquiry into the defendants conduct regarding price-cost analysis and intent. In the initial screening, the market share of the alleged predator would be scrutinised in order to determine its monopoly power, followed by an analysis of entry barriers to the relevant market and the dynamics of competitors and entrants. Only if predation is found to be likely to occur, they would move on to the second screen, incorporating a number of price-cost tests not unlike the Areeda-Turner test and the rule of reason tests<sup>66</sup>. Prices below AVC would be deemed predatory unless the alleged predator could show that this strategy is justified due to excess capacity. Prices between AVC and ATC would be presumed predatory unless the firm could prove that industry was declining or that the scale of new entry depressed prices. Prices which remained above ATC would be presumed legal unless a price cut in response to entry was reversed within two years without a cost- or demand-based reason<sup>67</sup>.

Taking a look at the market conditions would allow the competition authorities to efficiently dismiss unfounded claims and thus avoiding complex and time consuming price-cost analysis to be conducted in each case investigated.

The US Supreme Court now established a two tier approach<sup>68</sup>, holding that the prospect of recoupment is the primary test for determining predatory pricing, letting the price-cost test developed by Areeda and Turner a merely ancillary role. The ECJ in its AKZO decision also used a two tier approach<sup>69</sup>, however focusing on the cost and the strategy of the alleged predator. It condemned prices below AVC as abusive and prices between ATC and AVC as abusive when determined as part of a plan to eliminate a competitor.

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<sup>64</sup> Joskow/Klevorick at 213.

<sup>65</sup> See Martinez at 103.

<sup>66</sup> See Joskow/Klevorick at 249ff.

<sup>67</sup> Ibid. at 249.

<sup>68</sup> Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 224 et seq. (1993)

<sup>69</sup> Case C-62/86, AKZO Chemie BV v. Commission (1991) ECR I-3359 at para 71.

## 4 The Laws

Competition law on both sides of the Atlantic governs predatory pricing on different levels. In Europe it is regulated on the Community level and within the Member States legislation, rather similar to the US antitrust legislation on the federal and state level. However, it is beyond the scope of this paper to scrutinise the EC Member State as well as the State legislation of the US.

### 4.1 EC laws

Art. 82 EC Treaty is the relevant provision in the EC concerning predatory pricing<sup>70</sup>.

It prohibits a firm's conduct which abuses a dominant position within the Community and may affect trade between Member States. Art. 82 EC Treaty puts forth a non-exhaustive list of examples<sup>71</sup>, two of which could be applied against predatory pricing conduct.

Art. 82 (a) prohibits unfair pricing and trading conditions, while Art. 82 (c) concerns price discrimination. The former provision is applicable to predatory pricing conduct involving unreasonable low prices, whereas the latter condemns selective price cuts in the respective markets.

#### 4.1.1 Dominant position

Under Art. 82 only a dominant firm can be condemned of predatory pricing behaviour. According to the ECJ, a firm is in a dominant position, when it has the discretionary power to act independently, set its prices and makes other market decisions without being tightly constrained by competitive pressures<sup>72</sup>.

In order to establish this prerequisite, the relevant market has to be defined first, followed by assessing the firm's market power, taking into account their share of the market and other factors<sup>73</sup>. The market has to be scrutinized with regards to the relevant product and geographic market by examining the potential demand and substitutability of the products or services<sup>74</sup>. This alone has proven to be a difficult task, as the definition of a market has been controversial, since unduly

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<sup>70</sup> Multi-firm predatory conduct could be also condemned under Art. 81. However, the pricing scheme under cartel predation and single firm predation is rather similar, therefore only Art. 82 shall be scrutinised in the following, see OECD at 47 and Janow at 5. A cartel agreement seeking to carry on predatory conduct would clearly fall within the per se prohibition of Art. 81, see Merkin at 192.

<sup>71</sup> See p. ex. Steiner/Woods p 256. Any conduct by a dominant firm which threatens the structure of competition in the Community may establish an abuse, see OECD at 47.

<sup>72</sup> Case C-27/76 United Brands Co. v Commission (1978) ECR 207 at para 65.

<sup>73</sup> See Case 6/72 Europemballage Corporation and Continental Can Co. v Commission ECR 215 (1973) and Case C-85/76 Hoffmann LaRoche v Commission (1976) ECR 461.

<sup>74</sup> see p.ex. the Commission Notice on definition of the relevant market in OJ C 372 (1997).



limiting the outer boundaries of those markets may lead to unjustified interferences of power and predation<sup>75</sup>.

### **4.1.2 Abuse**

Even though Art. 82 identifies several examples of conduct that are abusive, it does not provide a definition of what constitutes the abuse. However, in the case of predatory pricing conduct, the abuse could be found in the pricing behaviour, condemned as unfair under Art. 82 (a) because of unreasonable low prices and when pricing involves discrimination under Art. 82 (c).

Predatory pricing can involve both exclusionary and exploitative abuse. The former occurs when a firm's conduct is not based on performance alone and whose objective is to harm the competitive position of rivals or to drive them out of the market. The latter involves the attempt of a dominant firm to use its market power to harm those who it deals with, rather than monopolisation<sup>76</sup>. In the first phase of the predatory conduct, a predator would exclude its prey from the market, even though at this stage, short-term benefits due to low price are present for the customer. In the second phase, the predator raises its prices to supra-competitive level by using its monopoly power, thus engaging in exploitative behaviour.

## **4.2 US laws**

In the US, the relevant federal provisions are to be found in three laws, which were enacted at different times and not as a unit, but must be understood as a totality or body of law, since a considerable overlap of coverage exists among those acts<sup>77</sup>. A general approach to the issue is contained in the Sherman and Federal Trade Commission Act, while a more specific one can be seen in the supplementary Clayton Act. However, the essence of the predatory pricing claim is essentially the same under either statute<sup>78</sup>.

### **4.2.1 Sherman Act**

Section 2 of the Sherman Act<sup>79</sup> condemns monopolisation or the attempt to monopolise any part of commerce among US States. The mere possession of monopoly power is not prohibited<sup>80</sup>, rather the undue acquisition of it. The offence under Section 2 involves two elements. Firstly the establishment of monopoly power of the alleged predator in the relevant market and secondly the

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<sup>75</sup> see Mastromanolis at 216.

<sup>76</sup> See Faull/Nikpay at 146 and Korah at 106.

<sup>77</sup> TRR Vol.1 at 2539.

<sup>78</sup> Bolton/Brodley/Riordan at 20 under fn 70.

<sup>79</sup> U.S.C.A. Title 15, Section 1-7.

<sup>80</sup> See U.S. v. Grinnell Corp. 384 U.S. 563 (1966) at 571.

wilful acquisition of that power as distinguished from growth as a consequence of a superior product, business acumen or historic accident<sup>81</sup>. A successful predatory pricing campaign would involve these two elements, with the pricing first at artificially low levels, followed by supra-competitive prices after the predator achieved monopoly power.

## 4.2.2 Federal Trade Commission Act

Section 5 of the Federal Trade Commission Act<sup>82</sup> declares unlawful unfair methods of competition and unfair or deceptive acts or practises, which can be enforced by the Commission. However, the offences under this Act are covered mostly by the Sherman and Clayton Act, so that there is no need to go into further detail<sup>83</sup>.

## 4.2.3 Clayton Act

Section 2 (a) of the Clayton Act<sup>84</sup> renders price discrimination as unlawful when it may substantially lessen competition, tend to create a monopoly or injure, destroy or prevent competition. In particular primary line discrimination, i.e. local price cutting and cognate practises, that a firm employs to injure its rivals may be considered predatory<sup>85</sup>.

The Act is fairly technical in its requirements and prohibits a discrimination in price between two buyers of the same seller, of commodities of like grade and quality where such discrimination may substantially injure competition in any line of commerce. It expressly establishes specific defences such as meeting prices offered by competitors and takes into account special circumstances such as the sale of perishable or obsolete goods<sup>86</sup>.

One significant development over the past decade is that primary line discrimination under the Clayton Act has been interpreted more harmoniously with predatory pricing under the Sherman Act<sup>87</sup>.

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<sup>81</sup> Ibid. at 570.

<sup>82</sup> U.S.C.A. Title 15 Section 41-58.

<sup>83</sup> In addition to the offences covered by the above mentioned acts, the FTC Act prohibits generally business behaviour that has direct impact on the consuming public, making it the broadest provision on the federal level. Indeed, it has been said that the FTC Act provides no added dimension, judging from the records on the issue, see Stack at 811 and TRR Vol 1, at 2521 and 2541.

<sup>84</sup> As amended by the Robinson-Patman Act, which detailed and broadened the provisions, see U.S.C.A. title 15, Section 12-27.

<sup>85</sup> OECD at 66.

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

# 5 Cases of Predatory Pricing in the EC and the US

Despite the large economic literature on predatory pricing and the considerable case law in the US, there is limited case law in the EC. Thus, when examining predatory pricing decisions, it must be borne in mind not only that there are relatively few judgements of the ECJ upon which to base conclusions, but that on the other hand an analysis may possibly draw from the rich experience US authorities have with the matter. However, the ECJ established its own approach towards predatory pricing well within the last two decades.

## 5.1 EC case law

### 5.1.1 AKZO

In its AKZO decision<sup>88</sup>, the ECJ for the first time addressed the issue of predatory pricing. AKZO, a Dutch producer holding approximately 50% of the organic peroxide market in Europe, engaged in systematic conduct, inter alia below-cost pricing, selective price cuts and threats, aiming to prevent ECS, a small competitor originally operating in the English market of flour additives from expanding in the related plastics sub-market. AKZO first threatened ECS to drive them out of the flour additives market and eventually offered large discounts to ECS' customers. ECS claimed an infringement of Art. 86 (now Art. 82) EC Treaty to the Commission, which found that AKZO had abused its dominant position by offering below-cost prices.

The ECJ used a cost based test and maintained the reference to intent as another element of its predation test, thus applying a two-tier test by using the cost based analysis of the pricing strategy as a first screen and as a second screen scrutinising the firms strategic behaviour when the pricing is found not to be clearly below a cost measure.

According to the ECJ, prices below AVC almost certainly indicative of predatory pricing and are to be considered abusive, since a firm has no interest in setting such prices unless it is to eliminate a rival because each sale entails a loss. Prices that are set above AVC but below ATC are to be considered predatory only if the price is part of a plan for eliminating competition<sup>89</sup>.

The ECJ rejected the view of the Commission which emphasised the meaning of intent by referring to its Michelin decision, identifying the concept of abuse as an

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<sup>88</sup> See fn. 59.

<sup>89</sup> Ibid. at paras 71 and 72.

objective one<sup>90</sup>. However, the ECJ could not totally avoid an element of subjectivity in the sensitive area between AVC and ATC, since the pricing is regarded as predatory when part of a business strategy intended to eliminate the rival. Intent should not be relevant unless it materialises in practice through systematic exclusionary behaviour. The intention of the dominant firm is thus identified objectively through the development of a positive exclusionary strategy<sup>91</sup>.

The ECJ moreover appears to have left open the possibility for other tests to be applied and therewith the possibility of prohibiting price differentials in other cases if the market situation so requires in order to determine whether the pricing conduct at issue was abusive. The ECJ found merely that the cost based test was appropriate in view of the specific circumstances<sup>92</sup>. The submission therefore is that the ECJ supports a certain flexibility in moulding the competition policy against abusive pricing conduct.

### **5.1.2 Tetra Pak II**

In its decision from 1997<sup>93</sup>, the ECJ further elaborated the principles laid down in AKZO. Tetra Pak, producer of aseptic machines and cartons with a market share of 92% sought to monopolise the neighbouring market for non-aseptic machines and cartons by engaging inter alia in selling below-costs on the Italian market and to eliminate its rival Elopak from the market.

Of particular interest is the ECJ's finding that Tetra Pak engaged in predatory pricing on a market in which it was not dominant. The question to be solved was in what circumstances a dominant firm on one market can anticipate that the conduct implemented on another market where it is not dominant, will be caught by Art. 82 or, in other words, the main issue was to establish a link between the dominant position in one market and the abuse in the other<sup>94</sup>. Art. 82 gives no guidance as to what kind of link, if any, needs to exist between the two markets. However, the ECJ found that such a close relationship existed between the markets and that this reinforced Tetra Pak's economic power in the market where the abuse took place. This may be interpreted in that way that a firm dominant in one market is put under a special responsibility on those markets where these links are present and could weaken competition<sup>95</sup>, which is consistent with the ECJ's approach in Michelin, which imposes a special responsibility on

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<sup>90</sup> Ibid. at para 69.

<sup>91</sup> Martinez at 120

<sup>92</sup> AKZO at para 73, see also Soames/Ryan at 158 et seq.

<sup>93</sup> Case C-333/94P Tetra Pak International SA v Commission (1997) ECR I-5941.

<sup>94</sup> Levy at 104 et seq.

<sup>95</sup> Levy at 106.

dominant firms not to allow their conduct to impair genuine, undistorted competition<sup>96</sup>.

The ECJ further rejected Tetra Pak's argument that it did not have reasonable prospects to recoup the losses of a predatory pricing strategy in the market in which it was not dominant by stating that it is not necessary for the Commission to prove concisely that the predator will be able to raise its prices following the elimination of the rival. This argument was put forward by Tetra Pak in the light of the court decisions in the US, where recoupment is a constitutive element in predatory pricing analysis<sup>97</sup>. The ECJ held that such an additional prerequisite was not established in its AKZO decision<sup>98</sup>, since in the CFI in its decision merely made the explanatory point that recoupment is the ultimate object of a predatory pricing scheme and that it must be possible to penalise predatory pricing whenever there is a risk that competitors will be eliminated<sup>99</sup>.

However, the ECJ held that a recoupment requirement would not be appropriate in the circumstances of the present case<sup>100</sup>. This indicates that the ECJ may well include the recoupment test in other decisions under different circumstances and that it will consider recoupment on a case-to-case basis.

### 5.1.3 Irish Sugar

In 1997, the Commission found that the company British Sugar abused its legal monopoly for producing sugar<sup>101</sup>. This case involved, as many predatory pricing cases, also the issue of selective pricing. The company enjoyed a legal monopoly for the production of sugar in the UK, selling sugar for both industrial and retail use, and furnished Napier Sugar, one of its customers, at prices that did not permit it to operate profitably and compete with British Sugar at the retail level. At the same time, their retail prices were low enough to prevent imports from outside the UK. Napier Brown was eventually removed from the retail sugar market as a result of British Sugar's actions.

The Commission found an abuse in the selective nature of process, even though none of the prices were below ATC. Instead, the prices offered were aligned with those of its competitors and did not significantly undercut them. In its decision, the Commission found an abuse in the selective pricing strategy, relying again on the principles set out in Michelin<sup>102</sup> that a company in a dominant position has a special responsibility not to diminish further the degree of competition remaining on the market. It also made reference to the AKZO decision, where the court

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<sup>96</sup> Case 322/81 *Nederlandsche Banden-Industrie Michelin v. Commission* (1983) ECR 3461 at 3511.

<sup>97</sup> See below at 5.2.

<sup>98</sup> contrary to Tetra Pak's argumentation.

<sup>99</sup> Tetra Pak II at para 44.

<sup>100</sup> *Ibid.* at para 44.

<sup>101</sup> *Irish Sugar* (Case IV/34.621) O.J. 1997 L258/1.

<sup>102</sup> See fn. 96.

condemned discriminatory pricing whereby traditional customers were charged prices above ATC while equivalent customers of a rival or rivals were charged prices below ATC, thus finding price discrimination as demonstrative of predatory intent<sup>103</sup>.

#### 5.1.4 Compagnie Maritime Belge

The ECJ in *Compagnie Maritime Belge*<sup>104</sup> found that various shipping companies abused their dominant position by employing the strategy of “fighting ships”. The firms were members of a shipping conference which engaged in a predatory pricing conduct by selectively offering low prices on routes of their rival Grimaldi and Cobelfret, not being a member of the shipping conference, in order to eliminate the competition. Whenever a sailing was announced by the latter, the members of the conference would employ their ships on that route. The freight prices were drastically reduced and different from the ones normally charged, with the sharing of the loss of revenues by the conference members.

As the prices charged were not below their total costs, *Compagnie Maritime Belge* argued that these prices could not be deemed to be predatory under the criteria laid down in *AKZO*. That the Commission did not challenge, but focused on the practice itself, which the ECJ confirmed. Accordingly it decided that where a liner conference in a dominant position selectively cuts its prices in order to match those of a competitor it eliminates the principle of competition<sup>105</sup> and thus deemed the practice as an abuse of a collectively held dominant position, as the shipping conference constituted a collective entity vis-à-vis their competitors<sup>106</sup>.

However, the ECJ refused to rule generally on the circumstances in which a liner conference may legitimately adopt lower prices in order to compete with its rivals and thus did not provide an answer whether low prices were abusive<sup>107</sup>. AG Fennelly in his opinion furthermore suggests that the need to establish an intention or a possibility of recoupment should be part of the test for abusively low pricing by dominant undertakings<sup>108</sup>. Even though the ECJ did not follow this suggestion, the ECJ was silent on this aspect and appeared, as done so in its earlier decisions, to hold open the possibility whether it would require proof of the possibility of recoupment in future cases.

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<sup>103</sup> See Andrews at 54.

<sup>104</sup> Cases C-395 and 396/96P, *Compagnie Maritime Belge and others v Commission* (2000), 4 CMLR 1076.

<sup>105</sup> Ibid. at para 117.

<sup>106</sup> Ibid. at para 39.

<sup>107</sup> Ibid. at para 118, see also Korah at 130.

<sup>108</sup> Opinion of Mr Fennelley – Joined Cases C-395 and 396/96P, (2000) ECR I-1420 at para 136.

## 5.2 US case law

The US Supreme Court has faced predatory pricing and allied issues ever since the enactment of the Statutes regarding the problem. During the past thirty years, the Court's approach to predatory pricing has ranged from one broadly protective of competitors with little attention to market structure to one in which the US dominating view that predatory pricing is a complex matter and does indeed occur, is fully embraced<sup>109</sup>.

### 5.2.1 Utah Pie

In its first "modern" decision on predatory pricing, the Supreme Court in 1967 condemned the pricing conduct of three wholesale baking companies that operated in several different geographical markets<sup>110</sup>. In the Salt Lake city area they were in fierce competition with a small local company, Utah Pie Co., which only operated locally. The national companies sold bakery goods at lower prices in Salt Lake City than they did elsewhere, selling at prices below their costs. The market share of Utah Pie Co. fell substantially, but at the end of the price competition they still held a market share of over 45%.

What is more, they made profits the entire time. Nonetheless, the Court held that the declining price structure had lessened competition as a result of discriminatory pricing by the national companies. More likely, the three defendants were stripping the plaintiff of its monopoly position rather than predatory conduct<sup>111</sup>.

### 5.2.2 Matsushita

Although the lower courts largely adopted one or other versions of the Areeda-Turner test in the years after the Harvard article, the Supreme Court did not address the predatory pricing issue until its 1986 decision regarding claims by American TV-set manufacturers against competing Japanese companies<sup>112</sup>. Zenith claimed that the Japanese companies conspired and sold their products below-costs in the U.S., while selling similar products in Japan at higher than costs levels in order to cross-subsidise the loss sales in the U.S.

The Court rejected these claims as economically implausible, using what has now come to be standard recoupment analysis. Because the plaintiff was claiming that the predatory pricing along with the conspiracy had been conducted over a period over 20 years, the defendants, even if eventually successful in the attempt to monopolise, would never be able to recover the losses they would need to sustain along the way. Furthermore, the Court defined predatory pricing as pricing

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<sup>109</sup> For a historic overview see Gifford at 432 et seq.

<sup>110</sup> Utah Pie vs Continental Baking Co., 386 U.S. 685 (1997).

<sup>111</sup> Hovenkamp (1993) at. 128; Gifford at 441.

<sup>112</sup> Matsushita Electric Industrial Co. vs Zenith Radio Corp., 457 U.S. 576 (1986).

below the level necessary to sell their products or pricing below some measure of costs<sup>113</sup>, recognising the controversy surrounding the cost problem, but declining to address a solution. Moreover, the Court concluded that there is a consensus among the commentators that predatory pricing schemes are rarely tried and even more rarely successful<sup>114</sup>. In this decision the Court first revealed the pivotal role recoupment was to play in predatory pricing analysis.

### 5.2.3 Cargill

In its Cargill decision<sup>115</sup>, the Supreme Court reconsidered its view held in *Masushita* the same year. The plaintiff sought to enjoin the impending acquisition of the second and third largest beef packer companies in the US, contending that it would alter the market structure in a way that would subject them to elevated costs, lower prices and reduced profits by the means of injury from below-cost pricing.

The Court reasoned that these losses stem from fierce competition rather than constituting an antitrust injury and that the merged company would not have been capable of successfully pursuing a predatory scheme due to the lack of entry barriers and a low market share. Its definition of predatory pricing now allows for the possibility that some below cost pricing may be well intended and lawful. What is more, the Court recognises that the practise of predatory pricing does in fact occur.

### 5.2.4 Brooke Group

In its 1993 decision<sup>116</sup> the Supreme Court for the first time in over 25 years provided a detailed analysis of the substantive standards to be applied on predatory pricing claims. The decision took place in the oligopolistic cigarette market where Liggett (Brooke group had been renamed during the course of the litigation), holding 2% of the market share, introduced generic cigarettes and began taking sales away from the major companies. Its competitor Brown & Williamson, holding only 12% of the market share, introduced as a counterstrategy their own generic brand, but sold them to wholesalers at lower prices than Liggett, along with discount and rebates. Liggett claimed that Brown & Williamson was attempting to force them to raise the prices as the means of slowing the growth of the generic market, which would enable the latter to reap supracompetitive profits from its branded lines for a longer period of time.

The Court firstly equated the standards of the Sherman and the Robinson-Patman Acts, so that a plaintiff firstly must prove that the prices complained of are below

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<sup>113</sup> Ibid. at 584.

<sup>114</sup> Ibid.

<sup>115</sup> *Cargill Inc. v Monfort of Colorado Inc.*, 479 U.S. 104 (1986).

<sup>116</sup> *Booke Group Ltd. v Brown & Williamson Tobacco Corp.*, 509 U.S. 224 (1993).



an appropriate measure of costs and, secondly, that he needs to demonstrate that the alleged predator had reasonable prospect or that there is the dangerous probability of recouping its investment in below-cost prices, thus hurting competition. The Court viewed oligopoly recoupment as highly unlikely and held that Liggett failed to prove the possibility of recoupment by Brown & Williamson. However, the Court declined, as it did before, to solve the issue of what measures of costs was most appropriate to analyse the pricing conduct, since the parties in this case agreed that the relevant measure of costs is AVC<sup>117</sup>.

## 5.3 Recent developments in the EC and US

### 5.3.1 EC

#### 5.3.1.1 Deutsche Post AG

In its decision against the Deutsche Post AG (DP) in 2001<sup>118</sup>, the Commission found that DP engaged in predatory pricing in the market for business parcel services. DP's competitor on the parcel-delivery sector UPS complained to the Commission that DP could sell parcel-delivery services below costs, only because of its revenues from the letter-mail monopoly. In addition to that it was found that DP had given fidelity rebates to its large mail-order customers and was fined 24 million Euros for this.

However, the predatory pricing was not fined, since the relevant measure of costs that a multi-product or multi-service postal operator benefiting from a reserved area has to meet competitive activities has not been clarified previously, with the Commission adding that the economic cost concepts used to identify predation were not sufficiently developed at the time the abuse occurred<sup>119</sup>. Now however, situations where a firm can cross-subsidise between a monopoly market and a competitive market a monopolist's activity in the competitive market are considered predatory if they do not cover their incremental costs, i.e. the costs which occur only when a certain activity, p.ex. a new product line, takes place and which would be avoided if the activity ceased<sup>120</sup>. This was the first formal Commission's decision in the postal sector under Art. 82 EC Treaty, prohibiting predatory pricing conduct as an abuse of a dominant position.

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<sup>117</sup> See Denger/Herford at 557.

<sup>118</sup> Deutsche Post AG (Case Comp/35, 141) O.J. 2001 L125/27.

<sup>119</sup> Since the abuse took place as early as 1974.

<sup>120</sup> See Bergman at 5.

### **5.3.1.2 Commission notice on application rule to access agreements in the telecommunications sector**

The Commission also stressed the importance of incremental costs in its notice on the application of competition rules to access agreements in the telecommunications sector<sup>121</sup>. The Commission addresses the problem of common costs in the notice and indicates that it will use incremental costs as the lower threshold for predatory pricing in the telecommunications sector. This sits well with the Areeda-Turner approach, since they advocate a short-run marginal cost test. If AVC cost is deemed to be a good proxy for short-run marginal costs where there are no common costs then short-run incremental costs should be considered a good proxy where there are common costs<sup>122</sup>.

### **5.3.1.3 Draft notice on the application of the competition rule to anticompetitive practices in air transport**

In the draft notice regarding the rules on anticompetitive practices in air transport<sup>123</sup>, the Commission, as in the notice concerning the telecommunications sector, recognises the difficulty in applying the AKZO test to this market, here specifically concerning the calculation of the measure of output in the airline industry. A further point is that it would be unrealistic to consider whether any individual fare is predatory, but rather that the entire fare mix has to be considered. It is suggested that the characterisation of costs as fixed or variable is more difficult in the air transport sector than in manufacturing industries, since many costs which would be considered as fixed, such as depreciation on aircraft which varies in relation to age of the aircrafts and the frequency of use as regards to the number of take offs and landings<sup>124</sup>.

Another demonstration of the complexity of pricing in this sector is that seats are sold over a considerable period of time, right up to the time of departure of the plane. If the AKZO test would be properly applied, a comparison of fares against those costs which were available at the time of the sale, which would be rather complicated and time consuming<sup>125</sup>. This illustrates the fact that a test for predatory pricing in the air transport industry needs to be developed with view to the specific circumstances of the industry and that the simple reception of the AKZO test would lead to dissatisfying results.

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<sup>121</sup> OJ 98/C 265/02.

<sup>122</sup> Grout at I.2.3.

<sup>123</sup> Draft notice on the application of the competition rule to anticompetitive practices in air transport, September 1992, unpublished.

<sup>124</sup> see Soames/Ryan at 159.

<sup>125</sup> Ibid at 160.

## 5.3.2 US

### 5.3.2.1 Department of Transportation guidelines

Perhaps the most striking development in the US since the Brooke case has been the proposed Department of Transportation (DOT) guidelines<sup>126</sup> which explicitly recognize predatory pricing as a strategic problem and would allow proof of recoupment based on reputation effects. These Guidelines focus on the ability of a major air carrier dominating a city hub to exclude competition and potential competition<sup>127</sup>.

The Guidelines would identify as predatory any response to new entry by a hub-dominant airline that makes economic sense only because it can exclude the entrant from the market and thereafter charge high fares. Further rely the Guidelines on a gross revenue measure to identify predation. This substitution of the traditional cost test may be justified because the special characteristics of the airline industry markets makes output expansion a particularly effective predation strategy<sup>128</sup>. The Guidelines attempt therefore not to define predatory pricing under a single legal formulation, but rather identify the particular predatory strategy involved in local airline markets.

### 5.3.2.2 American Airlines

American Airlines had allegedly engaged in predatory price cutting to keep low-cost rivals from competing at its Dallas-Fort Worth airport hub, using tactics such as cutting prices, increasing the number of flights on the respective routes and to monopolise other routes through its reputation for predation.

However in April 2001, a federal district judge dismissed the Antitrust Division of the Department of Justice's claim by granting a summary judgment motion, ruling that the Division had failed to, firstly, prove below-cost pricing and to, secondly, adduce objective evidence proving that there was a dangerous likelihood that American Airlines would recoup its losses<sup>129</sup>. This decision underscores the difficulty of successfully prosecuting a predatory pricing case in the US, even more so that the Department of Justice was thought to have a strong case at hand.

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<sup>126</sup> See DOT proposal – unfair exclusionary conduct in airline transportation industry policy, 7 TRR (CCH) para 49,227 et seq.

<sup>127</sup> See Bolton/Brodley/Riordan at 26 et seq.

<sup>128</sup> Ibid. at 27 et seq. with further references.

<sup>129</sup> See Cavanagh at 3.

# 6 The Different Approaches in the EC and the US and its Implications for Predatory Pricing Analysis

Predatory pricing conduct has been viewed upon with considerable suspicion by the courts and authorities on both sides of the Atlantic. Even though the EC could to draw from the rich experience in the US, the approaches of the authorities towards predatory pricing differ in a number of aspects.

In order to provide workable economic and legal rules to assess predatory pricing, it remains to be discussed what the implications for the analysis of the problem are and how authorities can use their experiences and the scholarly debate in order to deal with future predatory pricing cases.

## 6.1 The different approaches in the EC and the US

The US antitrust doctrine is exceedingly skeptical about predatory pricing.<sup>130</sup> In the US two test screens, sales of below cost and a market structure conducive to recoupment, have made it extremely difficult for a plaintiff to succeed in a predatory pricing claim. Failure to prove the possibility of recoupment is an independent defence to a predatory pricing claim and most courts have looked first to the recoupment standard, especially when the measure of costs is unclear<sup>131</sup>. The Supreme Court, however, did not pass on the merits of the Areda-Turner test, but indicated that a price could not be predatory unless below some measure of incremental cost<sup>132</sup>. The Supreme Court let the test play only an ancillary role and instead focused on the possibility of recoupment which should be considered first before proceeding to cost calculations.

The ECJ also uses a two-tier test, not unlike the Joskow-Klevorick test, based on the cost and the strategy of the alleged predator, but contrary to the US practise using a cost based test as the first screen. The ECJ in AKZO rejected the Aeeda-Turner test as inappropriate given the facts of the case, but nevertheless incorporated the idea that prices below AVC should be presumed predatory of the judgement<sup>133</sup>. The ECJ then turns to a presumption of predation

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<sup>130</sup> Hemphill in 53 Stanford LR (2001), 1581 et seq.

<sup>131</sup> For examples of recent US Circuit Court decisions see McCareins at 6 et seq.

<sup>132</sup> See Brooke Group at 223.

<sup>133</sup> AKZO at para 71.

and a rule of reason test, going into detail on market structure and intent as part of the alleged predators plan to abuse its dominant position<sup>134</sup>.

In the AKZO case, AKZO would not have been able to recoup its profits lost in the siege of predation. The ECJ focused on the problem of eliminating or disciplining a competitor, in contrast with US jurisprudence, which reflects the worry that legal protection against a competitor's low prices is likely to be costly to consumers, who are denied the advantage of low pricing.

The ECJ subsequently confirmed its position in Tetra Pak II, that recoupment is not a necessary element of a predatory pricing case. The ECJ, contrary to Tetra Pak's argument that recoupment was essential, held that it does not introduce recoupment as a further legal requirement and that the CFI in its judgement appealed against merely made the explanatory point that recoupment is the ultimate object of an unlawful predatory pricing scheme.<sup>135</sup> However, the ECJ appears to have left open the possibility of scrutinising the possibility of recoupment in future predatory pricing cases, recognising the utility of such a screen now used by the US Supreme Court.

Further the ECJ stressed that it must be possible to penalise predatory pricing whenever there is a risk that competitors will be eliminated and that the aim pursued, which is to maintain undistorted competition, rules out waiting until such strategy leads to the actual elimination of a competitor.

When assessing the market structure in order to determine the dominance of a firm, the proxy of market share is another element which is used differently across the Atlantic. Whereas in the EC lower levels might suffice to establish a firm's dominance, high shares are required in the US<sup>136</sup>.

Moreover, EC treatment of predation, consistent with EC law generally, suggests a concern to protect competitors as well as future concerns from both exclusionary and exploitative abuses. The wider objective of competition provisions in the EC as compared to the US becomes further apparent from AG Fennelly's opinion in *Compagnie Maritime Belge* when he states that the pursuit of the objective of Art. 3 (g) EC Treaty of ensuring the establishment of an internal market in which competition is not distorted would be significantly impaired, if only a price cost comparison would be used as an absolute yardstick against which all possible abusive or exclusionary practices had to be assessed<sup>137</sup>.

The ECJ in Tetra Pak II held that the actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case which show a weakened competition situation, which makes clear that the main goal of EC competition policy is more than merely efficiency as a goal pursued by US jurisdiction

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<sup>134</sup> See Martinez at 120.

<sup>135</sup> 4 CMLR (1997) 662, opinion of Mr Colomer at para 76 and in Tetra Pak II at para 44.

<sup>136</sup> In *United Brands* the ECJ held a 45% market share as sufficient to establish a dominant position, see Janow at 1.

<sup>137</sup> Opinion of Mr Fennelley – Joined Cases C-395 and 396/96P, (2000) ECR I-1420 at para 131.

## 6.2 Implications for antitrust analysis

The discussion above demonstrates all too well that antitrust law continues to demand a careful and most likely fairly complicated economic analysis of the challenged conduct. The question to be solved is in how far the competition authorities can use their experiences in order to effectively solve upcoming predatory pricing cases.

### 6.2.1 The future of predatory pricing claims and policy

From the recent developments it can be seen that the US courts look at the predatory pricing issue in a less strict way than it is viewed at in the EC.

In the US, it appears that predatory pricing claims are fairly unlikely to succeed in view of the fact that the introduction of the recoupment standard severely limits the plaintiff's ability to prove predatory pricing<sup>138</sup>. The Supreme Court's Brooke Group decision thus sends a chilling message to potential predatory pricing plaintiffs<sup>139</sup>. The recoupment standard is rigorous and this screen doubtless will be used to strengthen pre-trial summary judgements. It is difficult enough for a simple monopolist to recoup its investment in predation, for an oligopolist the obstacles to recoupment are even greater. In fact, no case since Brooke Group has progressed to a successful final judgement<sup>140</sup>.

When viewed through an efficiency lens, as done so under US competition policy, the immediate consequence of predatory pricing conduct is lower prices and thus the benefit for customers. Here US law has generally been more concerned with protecting the competitive process than protecting firms or competitors<sup>141</sup>.

In the EC, competition authorities are more receptive toward predatory pricing complaints<sup>142</sup>, as has been illustrated by the recent cases brought before the ECJ and the Commission. In the EC, concern about single market integration, protection of competitors and the viability of small businesses have been a more central concern to competition authorities than in the US than economic efficiency alone. EC law incorporates values other than efficiency. Values such as fairness, opportunity and legitimacy are heeded under EC law and it pays special attention to the viability of small businesses. This reflects the interest in using Community-wide law to address the economic fragmentation of Europe and thus foster the further economic integration of Europe and trade between the member states<sup>143</sup>.

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<sup>138</sup> Some authors go as far as seeing the Brooke Group decision as the death knell of predatory pricing claims, see p.ex. Glazer at 607.

<sup>139</sup> Denger/Herford at 556.

<sup>140</sup> See Hemphill at 4 and Hovenkamp (2001) at 278.

<sup>141</sup> See Janow at 12.

<sup>142</sup> See Niels/Ten Kate at 808.

<sup>143</sup> Janow at 4 et seq.

This is demonstrated further by the ECJ in its Michelin<sup>144</sup> decision, where it stated that a dominant undertaking is under a special responsibility not to diminish further the degree of competition remaining on the market and by AG Fennelly when he agrees with AG Jacobs<sup>145</sup> that there may be a greater responsibility for dominant firms not to exclude competitors<sup>146</sup>.

In the US on the other hand, the danger which some of the Chicago scholars see is that intervening in predatory pricing issues hurts more than it helps is a rather specific US problem. In the EC one can not speak of waste of resources when the competition authorities investigate in predatory pricing claims, simply due to the relative small number of cases investigated, which at the same time eliminates the danger of misuse of the laws by competitors which try to slow down competition. This has to do with three main aspects of US laws. Firstly, in the US around 90% of the predatory pricing claims are filed by private persons or entities and not by the competition authorities. The legal institute of treble damages creates a tremendous incentive to take legal action. Another reason which should not be underestimated is that the plaintiff under US civil procedural law does not generally have to bear the costs of the defendant when he loses the cases<sup>147</sup>.

To sum it up, predatory pricing in the EC is viewed upon with more suspicion by the authorities than in the US due to the different goals that competition policy pursues<sup>148</sup>. In the EC, competition authorities are willing to accept more predatory pricing claims, whereas in the US it seems under current case law virtually impossible to have a successful case.

### **6.2.2 Essential elements to a workable predatory pricing approach**

Developing a workable approach to identify predatory pricing which takes into account the need for legal certainty on the one hand and leaves enough room for an evaluation of all the facts involved in each individual case seems to pose a hopeless task. It is beyond the scope of this paper to identify one proper rule on predatory pricing, to overcome the difficulties presented above.

However, the essential elements of a workable approach to the problem can be identified in a broad manner, which could be perceived as the cornerstones of such a rule. There appears to be the consensus in the scholarly debate and in the approaches taken by competition authorities and courts on both sides of the Atlantic that a workable rule has to involve a cost-based analysis as well as a

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<sup>144</sup> see fn. 96.

<sup>145</sup> Opinion of Mr Jacobs on Oscar Bronner v Mediaprint, C-7/97 (1998) ECR I-7817 at para 65.

<sup>146</sup> At para 135.

<sup>147</sup> Möschel at 505

<sup>148</sup> See Fox (1986) at 981et seq and Fox (2000) at 5.

structural one, providing two screens in order to detect predatory pricing conduct of a company. Bearing in mind the controversy within the debate, merely a mechanical comparison between price and cost is not enough, but instead a comprehensive assessment of the effects and aims of the price conduct is necessary in order to identify predatory pricing conduct.

The problem of determining the appropriate measure of costs is mind-boggling given the complexity of business decisions and the subtle nature of the firms behaviour and the inferences involved<sup>149</sup>. However, the need for such a cost-based rule is apparent to avoid false positive and false negative errors<sup>150</sup>. To deem prices below AVC as predatory as such creates problems in industries where excess capacity is present, p.ex. when there is a risk that a product becomes obsolete or perishes or in the event of introductory promotion campaigns. Hence these prices do not necessarily imply that the firm engages in predatory behaviour. This can also be seen in the software industry, where the variable costs tend towards zero due to the low multiplication costs of software programs<sup>151</sup>. Therefore it has been suggested to use incremental costs as a lower threshold<sup>152</sup>.

The Commission in its notice regarding competition rules on the telecommunications sector recognised that structures in network industries tend to be quite different to most other industries and gives as an example the low variable costs, reflecting that in network industries in general, a simple application of the AKZO rule would not reflect the economic reality of network industries<sup>153</sup>.

Recognising the difficulty to, firstly, identify the appropriate measure of costs and, secondly, to calculate the costs itself, it appears to be most fruitful to turn to other screening methods before performing complex price-cost analyses. That is even more so, since performing an in depth analysis would be inefficient due to lengthy inquiries in the relevant industries pricing calculations.

Such a first screen should involve an analysis of the market structure, the prospect of recoupment and intent. This would focus enforcement on cases where economic conditions make predation strongly plausible and where market conduct makes anticompetitive effects dangerously probable. Recoupment is only possible where high (re-)entry barriers to the market exist. If the probability of recoupment is not high, a firm would refrain from applying a predatory pricing strategy, as it would only engage in such a conduct when it will later earn supra-competitive profits. Reliance of intent has, however, the disadvantage that the elimination of rivals is inherent in competition. Economists frequently use the word “intent to exclude” to refer to conduct that would not be commercially sensible

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<sup>149</sup> Milgrom/Roberts at 134.

<sup>150</sup> See above under 3.5.

<sup>151</sup> See Hilberdinck at 36.

<sup>152</sup> P.ex. Bolton/Brodley/Riordan at 39 and Grout at I 2.3.

<sup>153</sup> OJ 98/C 265/02 at para 110 et seq.



unless it excluded. This interpretation has the advantage of being objective and avoiding chasing for documents with macho statements<sup>154</sup>.

Therefore, the key to a proper assessment to predatory pricing appears to be the combination of a cost-based test with a first screening of the market conditions to decide whether predatory pricing is indeed possible and as a second test look into a price cost analysis, which oftentimes is hard to accomplish.

Amid all the complexity and uncertainty on which is the proper rule to assess predatory pricing, one last point should be made. Since a firms predatory pricing behaviour oftentimes involves selective and hence discriminatory pricing, courts have been able to avoid the entanglement in complex price-cost analyses by condemning the discriminating pricing itself, be it as an abuse under Art, 82 (c) EC Treaty or under Section 2 (a) of the Clayton Act.

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<sup>154</sup> Korah at 125.

## 7 Concluding Remarks

The past 25 years have featured extraordinary ferment in judicial and scholarly analysis of predatory pricing analysis of predatory pricing allegations. To an extent unequalled in other areas of competition laws and regulation, the research of industrial organisation by economists and antitrust attorneys has led courts to re-shape legal rule governing claims concerning predatory pricing<sup>155</sup>.

However, as the discussion shows, there is little agreement on the details on how to deal with the matter at hand. What becomes nevertheless clear is that a purely cost-based approach will not suffice and does not recognise the complexity of predatory pricing business strategies. Another screen is needed in order to correctly identify illegal pricing practices. On the other hand, there is the general agreement amongst scholars and the jurisdiction that a cost-based test is still needed. About the other elements of a test is however no consensus.

In order to find an economically and legally workable rule, two factors are crucial. Firstly can the court not be “overloaded” with facts, which would make it impossible to come to a decision in an acceptable time frame<sup>156</sup>. Secondly mistakes have to be avoided by making false positive and negative errors, which would undeniably rather harm competition than enhance the welfare of the public. Indeed, the most workable test appears to be a two-tier test, which would include a screening of the market first, and if predation seems highly unlikely, the case could be dismissed. Such an approach would involve in the first screen test, an investigation of the market structure which would have to show that predatory pricing is likely to occur, including such aspects as the dominance of the alleged predator, the existence of high entry barriers and market dynamics. Only cases in which an affirmative finding is made should pass on to the second stage test. If the claim survives the first screen, then the courts have the ungrateful task to decide on a cost based test, whether a companies comply with the laws and competition policy. The courts on both sides of the Atlantic now apply such a two-tier test, however with different elements, as has been illustrated by the case law of the last 20 years.

In the US it appears that predatory pricing claims are fairly unlikely to succeed, in view of the fact that the introduction the recoupment standard limits the plaintiff's ability to prove predatory pricing to a great extent. In the EC, the Commission and the ECJ seem more perceptive towards predatory pricing behaviour, which can be attributed towards the wider objectives of EC competition policy, namely

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<sup>155</sup> See Kovacic at 69.

<sup>156</sup> After all judges are trained in the legal profession and not economists.

the concern about single market integration, protection of competitors and the viability of smaller businesses.

# Supplement A

## Article 3 EC Treaty

1. For the purposes set out in Article 2, the activities of the Community shall include, as provided in the Treaty and in accordance with the timetable set out therein:

...

(g) a system ensuring that competition in the internal market is not distorted;

...

## Article 81 EC Treaty

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions

...

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them under competitive disadvantage;

...

## **Article 82 EC Treaty**

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

...

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

...

# Supplement B

## **Sherman Act**

1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, of within foreign nations, is declared to be illegal.

...

2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony...

...

## **Clayton Act**

2 (a) It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States...and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers with either of them...

...

## **Federal Trade Commission Act**

5 (a) (1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts of practices in or affecting commerce, are declared unlawful.

...

5 (a) (2) The Commission is empowered and directed to prevent persons, partnerships, or corporations...from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce

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