EU COMPETITION PRACTICE ON PREDATORY PRICING

Introductory address to the Seminar "Pros and Cons of Low Prices"

Stockholm, 5 December 2003

by Philip Lowe

Ladies and Gentlemen,

- It is a great pleasure for me to join this company of distinguished researchers, practitioners and competition officials and to have the opportunity to deliver an introductory address on one of the subjects that is currently concentrating the minds of the competition community.

- I want to thank Director General Claes Norgren for the opportunity to take part in this seminar and for having succeeded in providing us all a warm welcome in Stockholm at this time of the year!

DOMINANCE: IMPLICATIONS

- You are no doubt well aware of one of the central features of Article 82 EC that is worth recalling as a starting point to any presentation on predatory pricing: predatory pricing strategies, like other unilateral behaviours by companies, are only prohibited when they are conducted by undertakings **holding a dominant position** within the common market or a substantial part thereof. Thus, unlike other jurisdictions, the prohibition is only enforced against companies enjoying a *position of economic strength enabling them to prevent effective competition being maintained on the relevant market by giving them the power to behave to an appreciable extent independently of their competitors, customers and consumers*[1]. Since a dominant company is not exposed to efficient competitive constraints, it is – as the case law puts it- "subject to a special responsibility not to allow its conduct to impair genuine competition in the market"[2].
- The enforcement of Article 82 EC also requires evidence that the company engages in predatory pricing either in the dominated market or - as in the Tetra Pak case[3] - in a market very closely associated to the dominated market. Finding dominance entails, amongst other analyses, a detailed assessment of barriers to entry.

- In a few minutes, when I will refer to the issue of loss-recoupment, the two aspects that I have just mentioned will again be relevant: that Article 82 only applies to already dominant companies and that this implies that the relevant market is characterised by significant barriers to entry.

[1] Paraphrases of the definition in United Brands.

[2] Michelin I, case 322/81 [1983] ECR 3461 par. 57.

3 In Tetra Pak II, both the CFI and the ECJ stressed Tetra Pak's leading position in the non-aseptic packaging market and its quasi-monopolistic position (90%) on the aseptic packaging markets and the evidence that customers in one sector were also potential customers in the other and that the most relevant competitor was present in all four markets.

ABUSE: "PREDATORY PRICING", A BROADER CONCEPT THAN "PREDATORY PRICES"

- Let me now turn to the objective conduct liable to "impair genuine competition in the market" which constitutes the abuse**.** Commission practice deals with the concept of **"predatory pricing", as** encompassing not only predatory prices, but also predatory pricing strategies.

- "Predatory prices" as such are prices deemed to be a threat to the survival or entry of efficient competitors, because they are set at a level that can only be explained by the purpose of eliminating equally or more efficient[4] competitors or deterring their entry. The classical example of predatory prices are prices below average variable costs, following the second version of the Areeda-Turner test[5].

- "Predatory pricing strategies" may include predatory prices, but they may as well include below cost price levels that are not in themselves unequivocally predatory, but which in the relevant case could have the same effect as predatory prices and which have been devised for that purpose. Thus, "predatory pricing strategies" may cover different sorts of below cost prices inserted in an illegitimate pricing strategy to eliminate an efficient[6] competitor or deter its entry by temporarily charging customers prices below certain levels of the relevant costs.

- Furthermore, Article 82 may also be applicable to above cost pricing devised to starve out a new entrant. In the case *Compagnie maritime belge*[7]*,* the Court of Justice considered the members of a liner conference to be jointly dominant and abusing their collective dominant position by selectively cutting their prices in order to match those of a competitor. One can conclude from this case that in the presence of a collective boycott constituting the "exercise" of a collective dominant position, even above cost prices could drive out of the market or deter entry from efficient companies. I will not devote more time to this very specific case, which would lead us to distinguish these strategies from concerted above-cost pricing behaviours, such as rebate schemes and discounts, which are not the subject of my intervention today.

ABUSE: THE TEST

- The ECJ summarises the general approach to predatory pricing in two leading cases (AKZO[8] and Tetra Pak II): *"In AKZO this Court did indeed sanction the existence of two different methods of analysis for determining whether an undertaking has practiced predatory pricing. First, prices below average variable costs must always be considered abusive. In such a case, there is no conceivable economic purpose other*

[4] The targeted competitor is at least as efficient as the predator, because otherwise the predator would not need to go as far as charging prices below average variable cost, thereby losing money in each and every sold unit.
[5] The first version referred to "marginal cost" instead, but "marginal cost" was difficult to establish, since it is not a figure one can find in the balance sheets for the companies and it involved a static approach based on historical or actual costs. Therefore, Areeda & Turner adapted the test to "average variable costs".
[6] If the competitor is not efficient, it is unlikely that a dominant company embarks on predation, and anyway, it would not be a concern from the point of view of competition enforcement.
[7] Judgement of the Court of Justice of 16 March 2000 in Joined Cases C-395/96 P and C-396/96 P.
[8] Judgement of the Court of Justice of 3 July 1991 in case C-62/86, AKZO Chemie BV v Commission, European Court reports 1991, page I-03359.

than the elimination of a competitor, since each item produced and sold entails a loss for the undertaking. Secondly, prices below average total costs but above average variable costs are only to be considered abusive if an intention to eliminate can be shown" (ECJ in Tetra Pak II, par. 41).

SHOWING THE INTENTION TO ELIMINATE A COMPETITOR (for prices above average variable costs):

- The ECJ links the predatory intention to the fact that the prices are *"part of a plan for eliminating a competitor"*[9]. This aspect has caught my attention after having read Professor Baumol's excellent written contribution to today's debate. He refuses to discuss the "intentions" of alleged predators. He writes: *"there is no good way to determine what the management of a firm really had in mind (...) and economists have no particular professional qualifications for delving into anyone's mental state"*. As an enforcer of Article 82 and bound by the duty to prove intention under the second AKZO test, I am not that worried by the need to identify the intentions of the dominant firm, since it seems reasonable to me that prices above average variable costs should not be automatically outlawed without further evidence.

- Read in isolation, the requirement to prove intentions seems difficult to fulfil and hardly compatible with judicial precedents stating that the "abuse" is an objective concept. However, that standard was met in Tetra Pak on account of a number of convergent factors. Those were the duration, the continuity and the scale of the sales at a loss, the accounting data showing that the dominant company imported some products only to resell them below cost in the targeted area, deliberately incurring losses. The file showed as well that the prices in the targeted area were lower by 20% at least and often by 50% than the prices applied in other geographic markets. Finally, the file contained reports of the board of directors referring to the need to make major financial sacrifices in prices and supply terms to fight competition[10].

- In AKZO, the ECJ considered that the relevant prices were part of a plan to eliminate ECS relying explicitly or implicitly on several facts[11] leading to the conclusion that *"AKZO's intention was not to pursue a general policy of favourable prices, but to adopt a strategy that could damage ECS"*. The selectivity in the use of prices below average total costs but above average variable costs showed that AKZO was deliberately targeting a certain competitor.

- It may be possible for our officials (or those of a national competition authority) to find in a dawn raid documentary proof such as statements by the company or its decision making bodies. On the other hand, the proof of intent would be more straightforward when (as it often happens in abuse cases) dominant companies

9 Par. 72 of the AKZO judgement.

10 Judgment of the Court of First Instance of 6 October 1994 in case T-83/91, Tetra Pak International SA v Commission of the European Communities European Court reports 1994 Page II-00755

11 In the first place, the prices below average total costs but above average variable costs were part of a pricing policy including as well prices below average variable costs, which were deemed to be predatory. Then, paragraphs 113 to 115 of the judgment read: "113 AKZO has not denied that it charged differing prices to buyers of comparable size. It has, furthermore, not advanced arguments to show that these differences related to the quality of the products sold or to special production costs. 114. The prices charged by AKZO to its own customers were above its average total costs, whereas those offered to customers of ECS were below its average total costs. 115 AKZO is thus able, at least partly, to set off losses resulting from the sales to customers of ECS against profits made on the sales to the 'large independents' which were among its own customers. This behaviour shows that AKZO's intention was not to pursue a general policy of favourable prices, but to adopt a strategy that could damage ECS. The complaint is therefore substantiated".

combine the suspected prices with other concurrent exclusionary practices targeting the same competitor or sharing the same aim. In the same way, sometimes it is possible to find documented threats to competitors or internal documents, schemes, projections and prognosis work used in the decision-making process to support the decision to incur short term losses with the prospect to eliminate or discipline a competitor.

- In order to establish the existence of predatory intention, it is useful to consider the duration and continuity of the practice, since the existence of a predatory strategy should necessarily last long enough to influence competitors' decisions to leave or enter a given market.

OTHER CONSIDERATIONS:

- In reminding you of the case-law establishing that prices below average total costs but above average variable costs may be part of a predatory strategy forbidden under Article 82 EC, I do not do so just out of respect for the case-law of the European Courts and coherence with our current practice. It should be noted that even some of the economists who are most reluctant to enforce anti-abuse rules in these cases, do accept two ideas:

- One is that those prices may, at the very least, be an instrument of a wider plan to eliminate a rival[12]. Then they also warn us that an alleged predator might plan to lower prices after it has made capital investments, which have strategically lowered its variable costs[13]. In this way it can avoid being caught by the first AKZO test for predatory pricing, (i.e. prices below average variable costs).

OTHER TESTS: INCREMENTAL COSTS

- In some industries, the simple application of the AKZO test would not reflect economic reality. It is widely admitted in the literature that for industries characterised by high fixed costs and low variable costs, even a price covering the variable costs could be predatory if it does not cover the incremental cost of the product in question for a significant period of time[14].

- The Commission has condemned Deutsche Post's practice[15] of charging prices not covering the costs incremental to providing a mail-order delivery service for a period of five years. The provision of mail-order delivery is one of several distinct lines of services provided in a market open to competition by this 'multi-product' postal incumbent (enjoying a legal monopoly in another closely related market).

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[12] E.g. Professor Robert O'Donoghe, who is generally opposed to banning prices above variable costs, tells us that this should only be different where there is cumulative evidence of abuse as a plan to eliminate a competitor (i.e. together with other exclusionary measures) in his paper "Over-regulating lower prices: time for a rethink on pricing abuses under Article 82 EC", Florence, 2003.

[13] E.g. Professor Einer Elhauge refers to this question in the paper "Why above cost price cuts to drive out entrants are not predatory – implications for the definition of "costs" and market power", Florence, 2003.

14 "Incremental costs" are those costs that would disappear if the undertaking stopped producing and selling the product in question while continuing to produce and sell all other products it is producing and selling. They include the variable costs and those fixed costs which are specific to the product in question.

15 OJ 2001 L125, p. 27.

- In that case, the Commission condemned pricing below incremental cost because it forecloses market entry by efficient competitors, and therefore prevents a wider offer at better prices and service conditions. Although no fine was imposed for this infringement on account of the novel nature of the analysis applied, the decision points at the price level that a postal monopolist must charge when "branching out" into fields open to competition.

LOSS RECOUPMENT:

- For a dominant company to engage in predatory pricing it has to be confident that it will recoup its losses in the medium/long run, once predation has succeeded. Although this certainly involves the elimination or the short term deterrence of the targeted (potential) competitor, a dominant company would also need to be convinced that future high prices will not attract an undesirable number of efficient entrants.

- Assessing these questions is certainly critical for any dominant firm embarking upon predatory pricing strategies. Therefore, it is not surprising to find that these issues are concentrating the minds of economic scholars and competition experts. They logically constitute key issues for the enforcement of antimonopolisation rules, particularly in those jurisdictions, where the ban on predatory pricing is not confined to companies already holding a dominant position. In these jurisdictions, it is indeed relevant to assess whether the firm charging below cost wins any monopoly power in the process, or if instead it has made a "wrong investment" in driving out a rival only to find out that it cannot recoup losses without encouraging new entry from other companies.

- However, our current practice in applying Article 82 EC in predatory pricing cases does not contemplate the need to prove that the dominant company has a realistic chance of recouping losses once its competitor has been eliminated. This does not mean that such evidence would be irrelevant for the purposes of proving an infringement. To the extent that the evidence exists, it could be a factor amongst other indications showing that the dominant company pursued a predatory strategy.

- In markets with very specific features, where a product or service is not provided on a one-time basis, but subject to subscription, the estimation of a date for recoupment may be an important element to consider that a certain pricing behaviour constitutes predatory pricing. This was the case in the recent "Wanadoo case", Decision not yet published[16], where the Commission found that the incumbent French operator abused its dominant position by charging predatory prices for its high-speed Internet access services that did not enable it to cover its variable costs until a certain date or cover its total costs from that date onwards, as part of a plan to pre-empt the market in high/speed Internet access during a key phase in its development.

- From a European enforcement perspective there are several important reasons not to require evidence that the recoupment of losses is likely to occur. Let me mention some of them:

- This approach reflects the position of the ECJ in case ***Tetra Pak II*****,** who found that it would not be appropriate to require evidence that the dominant company "*had a*

16 Commission Decision COMP/38233, Wanadoo Interactive, of 16 July 2003.

realistic chance of recouping its losses". Instead, *"it must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated. The Court of First Instance found, at paragraphs 151 ad 191 of its judgment, that there was such a risk in this case. The aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors"*[17].

- Our enforcement activity would target below-cost pricing practices implementing strategies to eliminate efficient competitors, whether they are well-designed for their purpose of recouping the losses or not. Those competitors are entitled to access markets competing on the merits.

- Unlike in pre-merger scrutiny cases, the enforcement of Article 82 EC entails the finding of an infringement by an already dominant company, rather than the prevention of merely envisaged practices. Therefore, our concern in the assessment of individual cases is to challenge the on-going exclusionary abuse, rather than the consequent prevention of a foreseeable exploitative abuse by the dominant company, such as excessive or discriminatory prices to recoup the losses incurred.

- The finding of an infringement under Article 82 requires a detailed examination of barriers to entry, since that provision only applies to dominant companies. Therefore, most of the time it may be assumed that the dominant company has a realistic possibility to recoup the losses and foregone profits.

- When the finding of predatory conduct under Article 82 requires evidence of predatory intention, the relevant enforcer will normally have identified who are the actual or potential competitors targeted by the strategy, since dominant companies usually only charge below cost the minimum amount of products and customers necessary to eliminate a competitor or deter its entry. This reduces the relative amount of the losses and facilitates a recoupment strategy. Therefore, recoupment is a likely prospect if a dominant company engages in predation.

- A dominant undertaking can obtain a benefit from foregoing profits to discipline a competitor, without going as far as eliminating it. The same can be said about creating a reputation of toughness that would discourage entry[18]. This outcome would have an impact on the timing and scope of recoupment, which would not necessarily have been foreseen by the dominant firm when it took the decision to predate. In such circumstances, recoupment might be easier than foreseen.

OBJECTIVE JUSTIFICATIONS:

- A dominant company may refute the existence of an abuse by providing the competent authority with proof of an objective justification for its conduct. At least in the case of an allegation of predatory pricing above average variable costs, the dominant firm might refute the existence of predatory intent and demonstrate that the pricing scheme is rational even if the competitors remain on the market or finally enter it.

17 Par. 44.

18 This point is mentioned in Professor Baumol's contribution to this discussion.

- Finally, I would not exclude, from the outset, loss-minimising justifications for a dominant firm such as sales below average total costs to clear stocks of obsolescent, phased out, perishable goods or due to spare capacity or in the event of promotions for new products[19].

FINAL REMARKS:

- The objective of these opening remarks regarding the current EC approach to predatory pricing has been to set the scene for the detailed contributions and the lively discussion that will no doubt follow on the different approaches to below-cost pricing and the challenges ahead.

- I do not want to finish my intervention without saying that I have found the written contributions to this seminar, - written by eminent economists -, particularly valuable. These texts will be extremely helpful to those officials in DG COMP who are currently reflecting on our enforcement policy in the field of Article 82. I am also confident that the interventions and discussion that will follow will be equally relevant to our reflections in DG COMP.

- Thank you for listening to me.

[19] The first sales in a new market will hardly ever cover variable costs. In Digital, the Commission accepted short-term promotional programs that were published and available on a non-discriminatory basis and did not result in below-cost pricing.