ABUSE OF DOMINANCE:
PREDATORY PRICING

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Chapter 1
General Overview

Competition law consists of rules that are intended to protect the process of competition in order to maximize consumer welfare. Competition law has grown at phenomenal rate in recent years in response to the enormous changes in the political thinking and economic behavior world over. Competition law is concerned with applying legal rules and standard to address market imperfections and to preserve, promote and sometimes restore market conditions conducive to competition. In other words it is law used to protect the competition\(^1\).

In USA, Sherman Act, 1980 was enacted to keep a check on the competition prevailing in the market. The provisions of the said Act provided that every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Sherman Act seeks to promote fair competition and protects consumers and businesses from anti-competitive business policies.

In UK, Competition Act, 1998 was enacted for prohibiting anti-competitive practices adopted by the entrepreneurs in the market. The Act contains two prohibitions, one modeled on Article 81 EC which forbids agreements, decisions by associations of undertakings and concerted practices that have as their object or effect the restriction of competition and the other is modeled on Article 102 EC which forbids the abuse of dominant position.

India has finally adopted its Competition Act in 2002 and has been made effected from 20-5-2009. Before the passing of the Competition Act, the Monopolies and Restrictive Trade Policies Act, 1969 (MRTP Act) was in operation. The MRTP Act dealt with the concept of monopolistic and restrictive trade practices and subsequently with the unfair trade practices. The MRTP Act was designed to avoid economic concentration of the power in the Indian economy. The need for

\(^1\) EC and UK Competition law Commentary, Cases and Materials by Maher M. Dabbah Pg 6
Competition Act had arisen because the MRTP Act had become obsolete in certain areas in the light of international economic developments relating to competition laws.

The Competition Act, 2002 aims to prevent the practices having adverse effect on competition and abuse of dominance of enterprises either by entering into anti-competitive agreements or combinations. There are four important limbs of the said Act:

1) Prohibition of anti competitive agreements (S-3);

2) Prohibition of abuse of dominance (S-4);

3) Regulation of Combination (S-5 & 6); and

4) Competition advocacy (S-49)
1.1 Introduction

Predatory pricing in simple terms means that a dominant firm in the relevant market reduces the prices of its products to a loss making level i.e. below the cost of the product and thereby eliminating its existing rivals in the market and also making the entry barriers for the new players who want to enter the relevant market. It is a commercial strategy by which a dominant firm first lowers its price to a level which will force its competitors out of the market. When the latter have been successfully expelled, the former can raise its prices again and reap the rewards. Where a dominant undertaking has a reputation for acting in the predatory manner, this in itself may deter new entrants because not only predatory pricing itself but also the reputation for the predation may be a barrier to entry.

The very basic essence of competition is that the firms should compete by reducing their prices in the market but this should not lead to a situation where a dominant firm starts abusing its dominant position in the relevant market. The main objective which the Competition law seeks to achieve is that there must be a fair competition prevailing in the market and the big players in the market must not be allowed to abuse their dominant position in the market in order to eliminate their rivals.

The theory of predatory pricing is such that it states that monopolist or a future monopolist may sell its products at below cost process in an effort to drive the competitors out of the market. On the event that the strategy works out, the monopolist can then, in the absence of competition charge higher prices and more than recouping losses. Predatory pricing exists if there is the intention of eliminating a competitor.

The Competition Act 2002 specifically includes predatory pricing [section 4(2)(a)(ii)] as an act of abuse of dominance. The Act defines predatory pricing in Explanation (b) of section 4(2)(e) as the sale of goods or provision of services, at a price which is below cost as may be determined.

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3 Cargill Inc. v. Montford of Colorado 479 US 104 (1986)
by regulations, of production of the goods or provision of services, with a view to reduce
competition or eliminate the competitors.

The main issue with which the Commission has to deal with is the difference between predatory
pricing and fair competition. It is very important for the commission to adopt such a theory or
different cost tests which in reality are able to distinguish between fair competition and predatory
pricing. Many economic theories have been propounded on this topic and various cost and non
cost test have been applied by various authorities.

The Indian Competition Act has been designed to curb such practices prevailing in the market
and promote fair competition in the market. This will help in social welfare as the consumers in
the society will be benefited as they will have more options to choose from at almost the same
prices. If any of the firms abuses its dominant position in the relevant market then their market
dominance will be scrutinized by the commission and if they will be found guilty then penalty
will be imposed on them for abusing their power in the market.
Chapter 2

Abuse of Dominance

The competition law of the countries focuses on the abuse of dominant position by the firms in the market. The extent of dominance can be defined as the position of strength enjoyed by an undertaking that enables it to operate independently of the competitive pressures in the relevant market and also to affect the market, competitors by its actions.

Abuse of Dominance provisions typically embodies three common elements:

a. It is necessary to establish the existence of a dominant position held by a firm or group of firm in a market, which requires delineation of the ‘relevant market’ in which such a position is held.

b. It is necessary to identify specific that are harmful to competition.

c. Lastly, the overall effects in the relevant market have to be assessed.

2.1 Dominant Position

Article 102 EC states that ‘any abuse by or more undertakings of a dominant position within the common market or in substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between member states.

In United Brands v. Commission the ECJ defined ‘dominance’ referring to Article 82 EC as relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave

5 Competition Law Today by Vinod Dhall Pg 98
to an appreciable extent independently of its competitors, customers and ultimately of its consumers.

Section-18 (1) of the UK Competition Act prohibits any conduct on the part of one or more undertakings which amounts to the abuse of dominant position in the market if it affects the trade within United Kingdom.

Under the anti-trust law in the United States, the term corresponding to ‘dominant position’ is ‘monopoly’. Monopoly Power is defined as the power of the concerned entity to control the prices or to restrict or exclude competition. Section 2 of the Sherman Act states: "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." In United States v. E.L. du Pont de Neumours and Co 351 US 377 (1956), it was observed that, "Our cases determine that a party has monopoly power if it has, over any part of the trade or commerce among the several states a power of controlling prices or unreasonably restricting the competition." In Jefferson Parish Hospital Distt No. 2 v. Hyde 466 US 2 (1984), citing inter alia United States Steel Corp. v. Fortner Enterprises, 429 U.S. 610, (1977), it was observed that market power is the ability to raise prices above that those would be charged in a competitive market.

In our Competition Act 2002, Section-4 deals with the prohibition of abuse of dominant position.

Section 4 Abuse of Dominant Position

[(1) No enterprise or group shall abuse its dominant position.]

(2) There shall be an abuse of dominant position [under sub-section (1), if an enterprise or a group].

(a) directly or indirectly, imposes unfair or discriminatory

(i) condition in purchase or sale of goods or service; or

(ii) price in purchase or sale (including predatory price) of goods or service.
Explanation. For the purposes of this clause, the unfair or discriminatory condition in purchase or sale of goods or service referred to in sub-clause (i) and unfair or discriminatory price in purchase or sale of goods (including predatory price) or service referred to in sub-clause (ii) shall not include such discriminatory condition or price which may be adopted to meet the competition; or

(b) limits or restricts

(i) production of goods or provision of services or market there for or

(ii) technical or scientific development relating to goods or services to the prejudice of consumers; or

(c) indulges in practice or practices resulting in denial of market access [in any manner]; or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Explanation. For the purposes of this section, the expression

(a) dominant position means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to

(i) operate independently of competitive forces prevailing in the relevant market; or

(ii) affect its competitors or consumers or the relevant market in its favour.

(b) predatory price means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors.

[(c) group shall have the same meaning as assigned to it in clause (b) of the Explanation to section 5.]
The Competition Act, 2002 does not prohibit the mere possession of a dominant position, but only its abuse. Dominance per se is not considered bad under the competition law rather the abuse of such dominance is considered to be bad and anti-competitive. This is the difference between the Competition Act and the MRTP Act. In MRTP Act dominance in itself was considered to be bad but in the Competition Act dominance must be coupled with the abuse of such dominance.

The Act also lays down number of factors which the commission has to inquire about to determine whether an enterprise holds a dominant position or not under section 4, namely:\footnote{\textit{Section 19(4), Competition Act, 2002}}:

- Market share of the enterprise;
- Size and resources of the enterprise
- Size and importance of the competitors;
- Economic power of the enterprise including commercial advantages over the competitors;
- Vertical integration of the enterprise or sale or service network of the enterprise;
- Dependence of the consumers on the enterprise;
- Entry barriers;
- Market structure and size of the market;
- Social obligations and social costs.

Thus, it can be said that the abuse of dominance of an entrepreneur has to be proved under the Section 4 of the Act even if he holds a dominant position in the relevant market and it is upon the commission to decide after investigation whether the entrepreneur has abused his dominant position or not in the relevant market. The focus of the research paper is to examine the various factors to be present for predatory pricing and how it constitutes abuse of dominance. Predatory pricing have been defined as per clause (b) of Section 4 of the Competition Act.

2.2 Relevant Market

The obvious step that must be taken in order to be able to make a particular assessment is to define a market. In order to establish existence of dominant position under Section 4 of the Act the definition of market plays an important role. Too broad or to narrow market definitions lead
to understanding or overstating in market share and concentration measure\(^8\). Therefore it is described as the means and not an end. The authorities can do the following:

- Define the boundaries of the competition in a particular market, including identifying in a systematic way whether competitive constraints on the behavior of firm exists;
- Calculate the market shares of the operators in the market;
- Establishing a framework for applying the various competition rules.

The determination of the relevant market is therefore a key to most abuse of dominance cases. In one the cases of the CCI the issue was that at which stage the relevant market has to be identified by the CCI. The High Court held that it was not necessary for the commission to first find out the relevant geographical market, relevant product market or relevant market. Such things can be found or concluded upon the investigation and not necessarily before that\(^9\).

The Competition Act defines the Relevant market, Relevant Geographical market and Relevant Product market in Section-2 (r), (s) & (t) respectively.

"Relevant market" means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;

"Relevant geographical market" means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighboring areas;

"Relevant product market" means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

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\(^8\) World Bank/OECD, Glossary of Industrial Organisation Economics and Competition Law

\(^9\) Kingfisher Airlines Limited v. Competition Commission of India [2011] 100 CLA 190 (Bom)
‘Relevant Market’ cannot be determined by a straight jacket formula. The commission has to determine the relevant market with reference to both the relevant geographical market and relevant product market.

‘Relevant Product’ market as defined above has to be read with the section- 19(7) which enumerates various factors that are to be considered while determining the relevant product market: namely

a. Physical characteristics or end use of goods;
b. Price of goods or services;
c. Consumer preferences;
d. Exclusion of in-house production;
e. Existence of specialized producers; and
f. Classification of industrial products.

The key to determine the relevant product market is substitutability or interchangeability. In du Pont case, Court stated that, in determining, for purposes of Sherman Act, whether substitutes are available in the market for a product controlled by one interest, an infinite range cannot be given to definition of substitutes, but neither is it a proper interpretation of the Act to require that products be fungible to be considered in the relevant market. The key test mentioned in United States v. Grinell Corpn. states that in case of a product, the relevant market may be such that substitute products must also be considered, as customers may turn to them if there is a slight increase in price of main product.

Relevant Geographical market

The relevant geographical market is the area in which the sellers sell the products or service in question and in which the buyers realistically purchase the same. The relevant geographical area can either be a country or even a part of a city. There are various factors enumerated in the section-19(6) for determining the relevant geographical market: namely

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a. Regulatory trade barriers;
b. Local specification requirements;
c. National procurement policies;
d. Adequate distribution facilities;
e. Transport costs;
f. Language;
g. Consumer preferences;
h. Need for source or regular supplies or rapid after sales services.

The U.S Supreme Court in the **Tampa Electric Co.** case, defined the relevant geographical market as “the market area in which the seller operates, and to which the purchaser can practicably turn for supplies.” In **United States v. Philadelphia National Bank**, the Supreme Court applied the geographic market approach of **Tampa Electric**, in an action brought under section 7 of the Clayton Act 1914, to the proposed mergers of the two banks. The Court defined the geographic market to be the four county Philadelphia metropolitan areas in which the majority of the bank customers could turn for their banking needs.

Therefore it becomes important that the relevant market must have ingredients of both product and geographical market. Hence it can be said that relevant market must be a “collection of products in a given area.”

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15 *Bishop and Walker, —The Economics of EC Competition Law*, Sweet & Maxwell 1999   Chapter4
Chapter 3

Predatory Pricing

Predatory pricing is the practice of a dominant firm selling its products at low prices so as to drive the competitors out of the market, prevent new entry, and successfully monopolize the market. Predation is a strategic behavior whereby an undertaking deliberately incurs losses in order to eliminate a competitor so as to able to charge excessive prices in the future. Predatory prices as per defined in the Act means ‘the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors’\(^{16}\).

As it stands, it is for the commission to issue regulations stipulating what costs will be considered for this purpose.

According to the definition any enterprise which is selling its products or providing its services to the consumers in the market below its cost with the intent to reduce or eliminate the competition in the market would be said to be indulging in the practice of the predatory pricing and the commission will be entitled to make an investigation against such an enterprise and if proved guilty, a penalty can be imposed upon it. While making the analysis, the commission will examine the relevant market and the position of the enterprise in that market i.e. whether it holds a dominant position or not. After this the commission will look into the cost factor, whether the prices of the products or the services provided by the enterprise are below its cost and once below cost pricing has been established, evidence has to be shown for the intent to reduce or eliminate the competition.

Although consumers may benefit in the short term from such lower prices, in the longer term consumers will be worse off due to weakened competition which leads to higher prices, reduced quality and less choice. There are number of issues which are relevant for assessment of whether predation is taking place or has taken place\(^{17}\). But the major issues are:

\(^{16}\) *Section 4 Explanation (b) Competition Act, 2002*

\(^{17}\) *Maher M. Dabbah EC and UK Competition Law Commentary, cases and Materials Pg 398-408*
• Pricing below the cost;
• Intention to eliminate a competitor; and
• The feasibility of recouping the losses.

There are different opinions about how often predatory pricing actually occurs. Some economists have argued that it is hardly ever a rational business strategy and that it is very rare. This view was famously adopted by Bork and said that it seems unwise to construct rules about a phenomenon that probably does not exist or which, should it exist in very rare cases, the courts would have grave difficulty in distinguishing from competitive price behavior. Most economists do not take this position and consider that predatory pricing can be a rational strategy where the conditions are right. In particular, predatory pricing may be rational in new economy markets.

Predatory pricing is often considered to be feasible only where the firms operate multi-market because if the firm operates only in one market it is more rational for it to absorb the new entrant (by merger or takeover) or to accommodate it, rather than incur great losses by undercutting. Losses suffered by the predator are suffered today, and may be heavy but the profits above the competitive level are tomorrow if and when the predation strategy works. Where a firm is multi-market, however, it may be able to set off the losses on one market from the profits on another. Moreover, a firm which establishes a reputation of for aggressive reaction to competition in one market may deter entrants into other, so predation in one market may protect several others.

It is also said that predation can be a rational strategy only for a firm which is very dominant, in the sense that it has a very high market share. But mere market power is not enough. The predator’s sales must account for a sizeable fraction of the market sales. If not, loss making prices attract sales from the entire market which makes the strategy unworkably expensive. What is more, eliminating only one of many rivals leads to insufficient gains. All the incumbents stand to benefit from that turn of events and the prior investment by any one of them in loss-making.

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19 Alison Jones and Brenda Sufrin, *EU Competition Law, Text, Cases and Materials*
prices never pays off\textsuperscript{20}. In short, there is great controversy about predatory pricing. Mainstream opinion can be summed up as saying that it can occur, but only in certain conditions.

3.1 Reasons for Predatory Pricing

There are two phases in the practice of the Predatory pricing by an enterprise:

a. **Sacrifice phase**: In this phase the enterprise suffer from heavy losses due to the predatory pricing which it has resorted to in order to drive away its competitors from the market.

b. **Recoupment phase**: In this phase the enterprise make up for the losses which was caused to her in the sacrifice phase.

There are two major reasons because of which the enterprises indulge in the practice of predatory pricing. First is the recoupment of the losses after successfully eliminating the competitor and second is to have a monopoly in the market rather than going for the mergers with the competitors.

1. **Recoupment**: The dictionary meanings of the word recoup means Òto reimburse as for a lossÓ or Òmake up for a lossÓ. Recoupment simply means that the enterprise which is in a dominant position will make up for its losses occurred during the sacrifice phase by increasing its prices after the elimination of the competitors. Whenever an enterprise indulges in the activity of predatory pricing it has already formulated a plan for the recoupment of the losses which it has incurred earlier. No enterprise will enter into predatory pricing without pre-planning for recoupment, otherwise it will cause harm to herself. The consumers will be benefited from this strategy in the short term but if the enterprise will not be able to recoup its losses then the enterprise itself will be eliminated from the losses as it will not be able to survive in the market after incurring such heavy losses.

\textsuperscript{20} P. Areeda and D. Turner, ‘Predatory pricing and Related Practices under section 2 of the Sherman Act’ (1975)
2. **Alternate for Merger:** Usually a dominant enterprise would not like to go into a merger with its competitor as he would like to have a monopoly in the market. If the enterprise will go for the merger then it has to share the profits which are derived from the market by its products or services. Therefore the enterprise always wants to eliminate its competitors from the market for the simple reason that when the competitors will be eliminated from the market then there will be no competition for it and it can easily gain profits.

### 3.2 Requirements for Predatory Pricing

Predatory pricing as already defined in the Act is a tactic employed by the dominant enterprise in order to eliminate its competition from the market. There are various pre-requisites which are to be taken into account in order to prove that the enterprise has indulged in predatory pricing.

1. **Dominant Position:** As stated earlier, ‘dominant position’ has a specific meaning under section 4 of the Act, and in the European Community Law, in Article 102, on which both the Indian Competition Act and the Competition Act 1998, UK, are based. It does not contain the commonly understood connotations of dominant position, as constituted by size or market of an enterprise, though they are relevant in ascertaining dominant position. The substance of the definition is that a dominant enterprise is the one that has the power to disregard market forces, that is, competitors, customers and others and to take unilateral decisions that would benefit itself and also, in the process, cause harm to the process of free competition, injuring the consumers by saddling them with higher prices, limited supplies, etc.21

   The capacity to engage in the market in this manner is what is called ‘market power’ which is quite different from ‘market share’ though, the structure of a particular market, may aid an enterprise with a significant market share in acquiring market power. The elements that constitute a dominant position are:

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21 *T. Ramappa Competition Law in India Policy, Issues and Developments Pg 141-142*
A position of strength;
That position being enjoyed in a relevant market in India (both product and geographical markets); and
Such a position that gives the enterprise the power to operate independently of competitive forces in the relevant market meaning thereby that it can at will, disregard the market forces and conditions and impose its own trading conditions, which will include the prices at which it is prepared to supply goods or service

The corresponding law in other jurisdictions is similar to that of India. In Hoffmann-la Roche & Co. AG v. Commission of the European Communities\textsuperscript{22}, Court held that in determining dominant position of an enterprise the relationship between the market shares of the undertaking concerned and of its competitors, especially of those of the next largest, the technological lead of an undertaking over its competitors, the existence of a highly developed sales network and the absence of potential competition are relevant factors. In this case the ECJ quashed the Commission\textsuperscript{22} decision that Roche was dominant in the vitamin B3 market where its market share was 43 per cent, as it was not satisfied that there were sufficient additional factors indicating dominance for so deciding. The commission has said that it takes the view that a dominant position can generally be taken to exist when a firm has a market share of 40-45 per cent and even that one cannot be ruled out in the region of 20-240 per cent\textsuperscript{23}.

In AKZO v. Commission, the ECJ referred to the presumption of dominance and continued that a market share of 50 per cent could be considered very large so that, in the absence of exceptional circumstances pointing the other way, an undertaking with such a market share will be presumed to be dominant and that undertaking will bear the burden of establishing that it is not dominant. The decision in Virgin/British Airways\textsuperscript{24} marked the first occasion on which an undertaking with a market share of less than 40 per cent was found to be in a dominant position under Article 102. British Airways was held to be dominant in the UK market for the procurement of air travel agency services with a market share of 39.7 per cent. On appeal, the

\textsuperscript{22} Hoffmann-la Roche & Co. AG v. Commission of the European Communities [1979]3 CMLR 211
\textsuperscript{23} Commission’s Xth Report on Competition Policy (1980), point 50
CFI agreed that British Airways was dominant considering that its market share was larger than its rivals. The CFI also considered that British Airways was an obligatory business partner for travel agents.

2. **Barriers to entry and re-entry:** Successful predatory pricing requires certain level of entry barriers to the market. Otherwise 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 the prices back to competitive level.\(^{25}\) Entry barriers exist when a new market entrant costs that the incumbent firm need not bear or no longer faces, i.e., fixed cost investments etc. The entrant on the other hand must incur such costs and hence faces the risk of under-pricing 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. 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. 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.

3. **Excess Capacity:** One of the fundamental requisite for predatory pricing is the production capacity of the enterprise. When the dominant enterprise indulges in predatory pricing then the prices of its products reduces and therefore the demand for their products increases automatically. Even the customers of the competitor shifts to the product of the dominant enterprise. If the enterprise will not be able to cope up with the increasing demand in the market, then the price of product will increase which will eventually help the rivals and the strategy of the enterprise will not work.

4. **Deep Pocket Requirement:** Only the enterprises which have strong financial reserves can indulge in predatory pricing. Although it is not one of the main pre-requisites of predatory pricing but it is important for the simple reason that if the enterprise will not

\(^{25}\) Bolton, Brodley, Riordan, *Predatory pricing: Response to critique and further elaboration, Georgetown Law Journal, August 2001*
have more financial resources than its rival then it will not be able to eliminate him from
the market and in that process he himself will get destroyed. As already discussed,
predatory pricing has two phases. In the first phase the enterprise has to suffer from
heavy losses, therefore, it must have sufficient financial resources in order to complete
this phase. After this, in the second phase, that is, recoupment the enterprise will be able
to be able to recoup its losses which it has suffered during the sacrifice phase.

5. **Miscellaneous Requirements: Low price elasticity of demand** is an important, though
not essential condition. A low price elasticity of demand facilitates recoupment as
demand will decline relatively less when the firm raises the market price.²⁶ **Brand
royalty** is also one of the requisites of predatory pricing. If the predator has a greater
brand royalty then it will be then it will be less costly for the predator to enter into
predatory pricing.²⁷ The **relative efficiency** of the incumbent firm can also be examined.
The more **efficient** the incumbent is to its rivals, the less expensive it will be conduct a
predatory pricing campaign.

Elgar, 2010
²⁷ Journal article by Greg Le Blanc; Rand Journal of Economics, Signaling Strength: Limit Pricing and Predatory
Pricing, Vol. 23, 1992
Chapter 4

Cost Tests for Predatory Pricing

Predatory pricing happens on below cost pricing, which brings before the authorities a significant dilemma of ascertaining, what kinds of costs must be considered in determination of predatory pricing.28

The CCI has after consultations with the ICWAI, put up the Draft CCI (Determination of Cost of Production) Regulations 2008 (Cost Regulations) to determine the cost in predatory pricing cases under Section 4 of the Competition Act. It is essential to look at what types of costs may arise in an enterprise and, so, the basic cost definitions have been provided below.

4.1 Various Costs Important for Predation29

**Total Cost:** It means the actual cost of production including items, such as cost of material consumed, direct wages and salaries, direct expenses, work overheads, quality control cost, research and development cost, packaging cost, finance and administrative overheads attributable to the product during the referred period.

**Total Fixed Cost:** Those costs which do not change with output over a given period of time.

**Total Variable Cost:** It means the total cost minus the fixed cost and share of fixed overheads, if any, during the referred period.

**Total Avoidable Cost:** The total cost that could have been avoided if the enterprise had not produced the quantity of extra output during the referred period.

**Average Avoidable Cost:** The total avoidable cost divided by the total output considered for estimating total avoidable cost.

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28 Alison Jones and Brenda Sufin, EC Competition Law: Text, Cases and Materials, Oxford University Press
29 No. L-3 (5)/Reg-Cost/2009/CCI, clause (a) sub section (2) of section 64
**Long run Average Incremental Cost:** It is the increment to long run average cost on account of an additional unit of product, where long run cost includes both capital and operating costs.

**Market Value:** It means the consideration which the customer pays or agrees to pay for a product which is sold or provided or can be sold or provided, as the case may be.

**Marginal Cost:** It is the change in the total cost that arises when the quantity produces changes by one unit.

**Stand Alone Cost:** the costs that are involved in the production of a product without taking into account that some of the costs are shared with the production of other products (i.e. there are common costs).

### 4.2 AREEDA TURNER TEST

Areeda and Turner (1975) suggested that pricing below short run marginal cost (SRMC) was inconsistent with normal profit maximizing behaviour. Under this test a price lower than reasonably anticipated SRMC is predatory, whilst a price equal to or higher than reasonably anticipated short run marginal cost is not predatory. *Reasonably anticipated* means that a firm's conduct is not judged *ex post facto*.

SRMC is, however, almost impossible to compute in practice. The Areeda- Turner test therefore uses Average Variable Cost (AVC) as a surrogate for SRMC. The following test is laid down by Areeda and Turner:

- A price at or above reasonably anticipated AVC should be conclusively presumed lawful.
- A price below reasonably anticipated AVC should be conclusively presumed unlawful.

Under this rule pricing below ATC and above AVC is not considered predatory. However predatory conduct is possible where an undertaking price above its AVC and below its ATC\(^30\). In AKZO, the European Court held that if prices are above AVC and below ATC, conduct is to be

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\(^{30}\) *Maher M. Dabbah, PP401*
regarded as predatory where it can be established that the purpose of the conduct was to eliminate a competitor.31

4.3 Pricing below Average Total Cost

Greer (1979) proposed an alternative to the Areeda-Turner rule based on average total cost. Pricing below average total cost should be viewed as predatory only if it is accompanied by substantial evidence of predatory intent.32

An average total cost test is clearly stronger than one based on average variable costs, and is often stronger than one based on short run marginal costs. A firm makes a loss if price is below average total cost but the firm is still profit maximizing by continuing production so long as price does not fall below average variable cost.33 Intent therefore becomes fundamental in such circumstances.

Legitimate Commercial Reasons for Pricing below AVC

- **Loss Leading** - it occurs where a retailer cuts the price of a single product in order to increase sales of other products. It would not be considered illegal unless it was clear that the intention was to eliminate the competitor.

- **Short run Promotions** - this involve pricing below AVC for a limited period of time to introduce a new product in the market. However a series of short term promotions could, taken together amount to predation.

- **Network Effects** - there are some services where the addition of more customers to the network adds to the value of the service sold to existing customers. In these circumstances, it can be beneficial to sell the part of the service to the customer at below

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32 Greer 1992, Business, Government and Society, p166
33 Indeed, and in contrast to Greer, Carlton and Perloff (1994, p390) note that —[a] strength of the Areeda-Turner rule is that it explicitly recognizes that pricing below average total cost is not, by itself, proof of predatory behavior. Indeed price often is below average total cost in competitive industries such as agriculture due to short-run demand or supply fluctuations.
34 International and Comparative Competition Law Maher M. Dabbah
AVC. This will encourage the expansion of the network and the undertaking can recoup the losses by charging higher prices for other related services.

- **Economies of Scale and new products** - In some cases an undertaking may introduce a new product to the market at a loss making price in order to build up a large enough customer base to allow it to achieve the benefit from economies of scale, at which point the price would become profitable.

- **Unanticipated shocks** - in some markets demand or costs can be volatile and difficult to anticipate. For e.g. in some cases an undertaking may temporarily fail to cover its AVC because of unanticipated increase in input costs, or unanticipated reductions in demand.

- **Option Value** - in some cases in response to an unexpected fall in demand, an undertaking may wish to maintain a presence in the market in case demand returns to profitable levels. This would be more likely to occur in a market which, once exited, would involve substantial sunk costs to re-enter.

### 4.4 Pricing below Average Avoidable Cost

Baumol (1996) supports a predation rule based on average avoidable cost\(^{35}\). The idea behind the avoidable cost test is like that behind an average variable cost test. A firm may engage in predatory pricing if any combinations of its products generate revenue that fails to cover the avoidable cost of the combination, even if every product in the combination is priced above its average avoidable cost. This can occur whenever there are common costs of producing the group of products. These common costs do not enter any individual products avoidable costs, but are part of the product group's avoidable cost\(^{36}\).

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Often the AAC benchmark is the same as the AVC benchmark because only variable costs can be avoided. If the company expand its capacity to predate, the fixed or the sunk costs incurred in the investments made for this excess capacity is also taken into account.37

4.5 Indian Standard

The Indian competition law has adopted AVC as the appropriate measure of cost, which is by and large the measure of cost adopted in all jurisdictions. There is a presumption in most cases that where the enterprise sets its sale price below its AVC, it has engaged in a predatory pricing practice. However, prices falling between the ATC and AVC are also subject to inquiry, but in such case specific intent would have to be shown. Prices set above the ATC are unlikely to be challenged. The CCI also has proposed certain regulations with respect to determining cost in cases of multi-product enterprises (Reg. 5), Joint products and By-products (Reg. 6), transfer pricing (Reg. 7) And captive consumption (Reg. 8). Once a predatory price allegation is established, the enterprise would be said to have abused its dominant position. Where after inquiry, the CCI finds that an enterprise in a dominant position is in contravention of the provisions of Section 4, it may pass any of the orders specified under Section 27 of the Act and may further under Section 28 of the Act direct the division of an enterprise enjoying a dominant position to ensure that such an enterprise does not abuse its dominant position.

37 Einer Elhange & Damien Geradin, pp336)
Chapter 5

Case Laws

5.1 EC case laws

AKZO Chemie BV v. Commission of the European Communities

In this case the Commission refused to adopt the Areeda and Turner test and held that AKZO had dominant position in the market and has practiced predatory price-cutting against ECS a small firm of UK. ECS was a small UK firm producing benzoyl peroxide. Until 1979 it has sold this product to customers requiring it as the bleach in the treatment of flour in UK and Eire. It then decided also to sell it to the users in the polymer industry. AKZO, a Dutch company in a dominant position in the market, informed ECS that unless it withdrew from the polymer market it would reduce its prices, in order to harm it. Subsequently AKZO did indeed reduce its prices. The Commission imposed a penalty of €10 million for practicing predatory price-cutting.

On appeal the ECJ upheld the commission’s finding of predatory pricing, saying that not all price competition can be considered legitimate. The ECJ held that where prices were below AVC predation had to be presumed, since every sale would generate a loss for the firm but this presumption can be rebutted. The ECJ went on to hold that where prices are above AVC but below ATC they will be regarded as abusive if they are part of a plan which is aimed at eliminating a competitor. The ECJ therefore upheld the Commission’s rejection of the Areeda/Turner test.

Tetra Pak International SA v. Commission of the European Communities

In this case the Commission found Tetra Pak guilty of predatory pricing in relation to its non-aseptic cartons. The commission considered that Tetra Pak was able to subsidize its losses from

its substantial profits on the market for aseptic cartons, where it had virtually no competition. The commission said that in seven member states the non-aseptic had been sold at a loss.

However, the commission concentrated on Italy where the cartons had been sold below AVC. The commission did not merely relied on the AKZO presumption of predation where prices are below AVC but said that it had gathered sufficiently clear and unequivocal data to be able to conclude that, in the country at least, sales at a loss were the result of a deliberate policy aimed at eliminating competition. The ECJ upheld the Commission’s finding of abuse and made them liable.

**Wanadoo Interactive case (France Telecom v. Commission)**<sup>40</sup>

In this case the Commission applied the rule in AKZO case and imposed a fine of €10.35 million. The European Commission found that, up to October 2001, the retail prices charged by Wanadoo Interactive, a subsidiary of France Telecom, were below cost and had abused its dominant position by predatory pricing in ADSL-based Internet access services for the general public. This practice restricted market entry and development potential for competitors, to the detriment of the consumers, on a market essential for the development of the information society. In commission’s view Wanadoo’s behavior was designed to take lion’s share of the booming market.<sup>41</sup> On appeal ECJ also upheld the order of the Commission.

### 5.2 UK Case laws

**The Napp Pharmaceuticals case**<sup>42</sup>

In this case the OFT concluded that Napp was guilty of charging predatory prices for sustained release of morphine by selling some products to hospitals at less than direct cost, which it considered, on the facts of the case, to be a proxy for AVC.<sup>43</sup> The OFT rejected the contention of

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<sup>40</sup> Extract from Press Release IP/03/1025, 16 July 2003

<sup>41</sup> Commission Press Release IP/03/1025, 16 July 2003

<sup>42</sup> Case No 1000/1/1/01 Napp Pharmaceuticals Holdings Ltd v. Director General Fair Trading [2002] CAT 1, [2002] Comp AR 13

<sup>43</sup> OFT Decision, 30 March 2001, [2001] UKCLR 597, para 188-196
Napp that sales below cost to hospitals were objectively justified since Napp will be able to recover the full price from the follow on sales to patients in the community.

On appeal the CAT held that the Napp, as an undertaking which it considered to be ‘super dominant’ had abused its dominant position by charging prices below cost to hospitals in order to ward off the competitors. The CAT also found out that Napp had the intention to eliminate the competition when it reduced the prices below AVC to hospitals.

**The Aberdeen Journals case**

In this case the OFT had held the Aberdeen Journals guilty of predatory pricing. On appeal against the decision the CAT held that the Aberdeen Journals had sold advertising in one of its newspaper at less than the AVC. There are some important points quoted in the judgement by CAT, namely:

- The rules are not an end in themselves and ought not to be applied mechanistically.
- Time period over which cost is to be calculated is significant because longer the period, longer will be the variable cost which will give rise to presumption of predation.
- A dominant firm can justify pricing below the cost in certain circumstances but it would be difficult when such pricing is in response to eliminate a competitor or new entrant in the market.

**5.3 U.S Case Laws**

**Matushita Case**

In this case the action was initiated under sections 1 and 2 of the Sherman Act, 2(a) of the Robinson-Patman Act by certain American companies manufacturing and selling television sets, against a group of Japanese companies or Japanese controlled American companies. The charge was that the Japanese companies had entered into an illegal conspiracy to drive American firms

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45 Matushita Elec Industrial Co. and others v. Zenith Radio Corp. and others 475 US 574 (1986)
from the American consumer electronic products market by engaging in a scheme to fix and maintain artificially high prices for the television sets sold by the petitioners in Japan and, at the same time, to fix and maintain low prices for the sets exported to and sold in US.

The Court explained the concept of predatory pricing conspiracy as a predatory pricing conspiracy is by nature speculative. Any agreement to price below the competitive level requires the conspirators to forego the profits that free competition would offer them. The forgone profits may be considered an investment in the future. For the investment to be rational, the conspirators must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered.

The Court also held that predatory pricing conspiracies were generally unlikely to occur where the prospect of attaining monopoly power, necessary for recouping the losses caused by below cost prices, seemed slight, as in this case. Two American companies held the largest share of the American retail market in colour television sets and it was held that the Japanese companies did not resorted to predatory pricing.

**Cargill Inc case**

The decision of this case came in the same year as of Matushita case. It made certain observations about predatory pricing. Predatory pricing was defined as a practice of pricing below an appropriate measure of cost, aimed at eliminating competition in the short run and reducing competition in the long run. In this case the plaintiff wanted an injunction against 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.

In contrast to price cutting aimed simply at increasing market share, predatory pricing has as its aim the elimination of competition. Therefore for it to be successfully established both conditions, elimination of competition and recoupment must be taken into consideration. The merged company would not have been capable of successfully pursuing a predatory scheme due

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to the lack of entry barriers and a low market share because of which it will not be able to recoup its losses.

**Brooke Group Ltd v. Brown & Williamson Tobacco Corp**

In this case, Liggett (new name of Brooke Group Ltd) charged that the volume rebates offered by Brown & Williamson to wholesalers amounted to price discrimination that had a reasonable possibility of injuring competition in violation of section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act. The complaint was that the system of rebates was part of a predatory pricing scheme under which Brown & Williamson set prices for generic cigarettes below average variable costs, forcing Liggett to raise its list prices on its generics, restraining the growth of the economy segment. This helped preserve Brown & Williamson supra competitive prices on branded cigarettes.

The first requirement for a claimant seeking to establish competitive injury resulting from a rival’s low prices was to prove that the prices complained of were below an appropriate measure of the rivals cost. The second requirement was a demonstration that the competitor had a reasonable prospect, or, under s-2of Sherman Act, a dangerous probability of recouping its investment in below-cost prices.

The Court added that recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.

The Court decided that there was no evidence to support the likelihood of an oligopolistic price coordination and sustained supra competitive pricing in the generic segment of the national cigarette market. In the absence of these, there was no reasonable prospect of Brown & Williamson recouping its predatory losses and no injury to the competition could be caused.

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**5.4 Indian Case Law**

**MCX v. NSE**

The question of predatory pricing came up for the Competition Commission of India in the MCX case. The NSE and MCX-Stock Exchange (MCX-SX) had entered into currency derivatives trading in August 2008 and October 2008 respectively, followed by United Stock Exchange (USE) in 2010. However, in November 2009, MCX-SX filed a complaint against NSE for abusing its dominant position and thus violating the Competition Act. MCX alleged that NSE had abused its dominant position in the form of waiver of transcription fees, data feed fees and admission fees. The commission found out that the Currency Derivative (CD) and Over the Counter Exchange (OTEC) market are the relevant market and NSE has dominant position in it and has abused its dominant position.

NSE countered this asserting that there was no concrete evidence to impute any intent to capture the market to NSE. Further, they credited the low pricing to the nascent stage of the market, claiming that the pricing was penetrative and promotional, not predatory. Further, NSE claimed the waivers were made with a view to expand the market and make it more lucrative to buyers having been introduced in 2008, following the economic downfall.

The Commission found out that the segment was no longer in its nascent stage – it had moved on to its immature/infant stage, so there was no need for the zero pricing policy. NSE’s pricing was found to be beyond promotional and penetrative. However, the CCI did not consider the pricing to be predatory. Instead it was considered to be unfair. NSE’s zero pricing was considered a consequence of its deep pockets and declared unfair by the CCI due to its inability of its weaker competitor to sustain such policies. The Commission noted, if even zero pricing by dominant player cannot be interpreted as unfair, while its competitor is slowly bleeding to death, then this Commission would never be able to prevent any form of unfair pricing including predatory pricing in future.

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Thus, NSE’s zero pricing policy was declared anti-competitive, due to its unfairness, as the two firms were not competitors placed on equal footing. The NSE was asked by the CCI to immediately cease and desist from unfair pricing, exclusionary conduct and unfairly using its dominant position in other markets to protect the relevant CD market. The Commission imposed a penalty of Rs 55.50 crore on NSE for contravention of the provisions of the Competition Act in its order dated June 23, 2011. NSE was also asked to maintain separate accounts for each segment from next financial year and modify its zero price policy in the CD market and levy appropriate transaction costs.

5.5 Cases where Predatory pricing was not proved

There are some cases in which a complaint of predatory pricing was not upheld. In The Association of British Travel Agents and British Airways plc the OFT concluded that British Airways was not guilty of abusing a dominant position by reducing the commission it paid to the travel agents for the sale of the tickets for its flights with the consequence that it could sell those same flights at lower fees through its own website because the sale of tickets on-line as opposed to through travel agents was cheaper and there was an objective justification for this price differential.

In Claymore Dairies Ltd v. OFT the CAT was critical of the OFT’s investigation into whether Robert Wiseman Dairies was guilty of predatory pricing in relation to sale of milk in Scotland. The CAT in particular was not satisfied that OFT had sufficiently investigated whether Wiseman prices were above ATC and it therefore set aside the finding on this point.

In complaint against BT’s pricing of digital cordless phones OFCOM dealt with a complaint that BT was guilty of charging predatory prices for digital cordless telephones. OFCOM concluded that BT was not dominant. However it also conducted an extensive analysis of

49 Association of British Travel Agents and British Airways plc, 11 December 2002, [2003] UKCLR 136
50 Case 1008/2/1/02 [2005] CAT 30,[2006] CompAR 1
51 OFCOM decision of 1 August 2006, [2007] UKCLR 1
whether, if BT was dominant, it would have been guilty of predatory pricing and concluded it was not so.
Chapter 6
Recoupment

The dictionary meanings of the word recoup means ‘to reimburse as for a loss’ or ‘to make up for a loss’. Recoupment simply means that the enterprise which is in a dominant position will make up for its losses occurred during the sacrifice phase by increasing its prices after the elimination of the competitors. Whenever an enterprise indulges in the activity of predatory pricing it has already formulated a plan for the recoupment of the losses which it has incurred earlier.

The concept of predatory pricing rest on the assumption that the predator sacrifices short term profits for future gains. It hinges on the possibility that the predator can recoup its losses, i.e., that short term loss of profitability is more than compensated for by long run profitability when, after the competitor’s exit the undertaking can raise prices to monopoly level. If there are no barriers to entry to the market the undertaking will not be able to recoup if it is having to price low in order to fight off new competitors.

Recoupment is one of the most important tests recognized in the U.S Courts whereas in EU, it is the intent test which is given more preference. In the United States, recoupment is deemed to be the ultimate object of an unlawful predatory pricing scheme. It is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.\(^\text{52}\)

The present position in the U.S is that the courts do not find predatory pricing to have occurred unless the plaintiff demonstrates that the alleged predator had a dangerous possibility of recoupment of its investments in below cost prices. This stems from the Supreme Court ruling in \textit{Brooke Group Ltd v. Brown & Williamson Tobacco Corp}. It means in effect that even if the plaintiff can show below cost prices and an anti-competitive intent, there will be no anti-trust

\(^{52}\text{See Brooke Group Ltd v. Brown & Williamson Tobacco Corp.}\)
violation. The result of this case when read with the Matsushita case, it becomes very hard for the claimants to succeed in predatory pricing actions in U.S Courts.

But the position is very much different in EU than U.S, as here preference is given to the intent of the enterprise to eliminate the competitor and not to the possibility of the recoupment. In **AKZO v Commission** the Court acknowledged the significance of recoupment, where it noted that a dominant firm has no interest in applying prices below AVC except that of eliminating competitors so as to enable it subsequently to raise the prices by taking advantage of monopolistic position\(^{53}\) However it did not expressly incorporate the need to prove recoupment as part of the offence.

In **Tetra Pak II** the Commission imposed a fine of ECU 75 million in respect of various abuses to have been committed. One of these was that Tetra Pak had engaged in predatory pricing in the non-aseptic carton market. This included selling at below AVC in Italy. On appeal the Tetra Pak argued that economic theory found predatory pricing plausible only if losses can be recouped after the competitor’s exit. The Commission had not found that it did have a reasonable chance of recoupment but the ECJ held that Commission did not have to prove that Tetra Pak could recoup. In **France Telecom v. Commission** the CFI was invited to introduce a recoupment requirement into the test of predation. The Court concluded that the Commission was therefore right to take the view that proof of recoupment of losses was not a precondition to making a finding of predatory pricing.

In UK, the question which came up to the Court was that in different cases was, whether there is a need to prove recoupment of losses? In **Napp Pharmaceuticals** and **Aberdeen Journals** case the CAT held that it was a form of recoupment for a dominant firm to engage in predatory pricing in one market so that it could protect its market share or supra competitive profits in another market and that, in the circumstances of those cases, further evidence of recoupment was unnecessary.

In the most recent decision in US, in **link Line case** (Pacific Bell Telephone Co. v. link Line Communications, Inc., No. 07-512, 555 U.S. 2009), Supreme court reconfirmed the analytical framework stated in Brooke Group, i.e. a Plaintiff must prove: (1) the alleged predator's prices

were "below an appropriate measure of its rival's costs;" and (2) that the suspected predator had a "dangerous probability of recouping its investment in below-cost prices."
Conclusion

Competition law is burdened with the responsibility of protecting consumers as well as rival competitors from the ill effects of predatory pricing, while simultaneously ensuring that those enterprises enjoying dominance in a particular market are not dissuaded from competitively reducing prices due to the stringent law applicable in these cases. This leads to the requirement to create an appropriate all-encompassing test to detect instances of price predation. It is now amply clear that the key indicators used in such tests are prone to error—mostly due to evidentiary problems. For instance, in some cases, there is a need to calculate costs incurred by a firm (operating in several markets) in only one market this task proves difficult due to inability to identify which costs were incurred in what market.

Suggestions

- Antitrust courts should make use of the economic evidences in detecting predatory pricing. Also economic evidences are now able to show the rationality of predatory pricing like the possibility of recoupment which is an essential element in determining the rationality of predatory strategy of a firm.

- It is also necessary for the anti-trust authorities to make sure that the market structure supports the prospects of predatory pricing. This requires a complex analysis of the markets where anticompetitive effects have occurred or are probable. This includes defining the dominance of the predatory firm, the barriers to entry, and the market power of the competitors.

- As in the AKZO test the intention of the firm becomes the crucial factor when the prices are between AVC and ATC. Since such pricing is considered to be non-predatory as the firm is covering its variable costs and some parts of its fixed cost. However the anti-trust authorities should make a difference between intention of eliminating the competitors on the basis of performance which is the case under normal competition and elimination of
competitors by anti-competitive practices such as predatory pricing. The courts should also consider direct and indirect evidences in proving the act of predation. Direct evidences include documents from the company such as a detailed plan demonstrating the use of predatory prices to exclude a rival, to prevent entry or evidence of concrete threats. Indirect evidences include the scale, duration and continuity of the low pricing, the possibility of recoupment etc.
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