PREDATORY PRICING AND COMPETITION LAW

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Submitted By:

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4th Year, B.A., LLB (Hons.)

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Lastly, I am grateful to the staff members at CCI who have been exceedingly helpful during the period of my internship.
LIST OF ABBREVIATIONS

%: Percentage

&: And

AIR: All India Reporter

ATC: Average Total Cost

AVC: Average Variable Cost

Anr.: Another

Art.: Article

CCI: Competition Commission of India

Cir.: Circuit

Co.: Company

Corp.: Corporation

E.g.: For Example

EC: European Community

Ed.: Edition

Govt.: Government

i.e.: Id est/that is

Ibid: Ibidem

Ltd.: Limited

MC: Marginal Cost
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PART I

INTRODUCTION

1.1 Abstract:

Predatory pricing is a form of anti-competitive conduct that involves charging a price lower than the cost of production so as to eliminate competitors on grounds other than efficiency. For predatory conduct to be proved, it is essential that the player making such pricing occupies a dominant position in the relevant market, as in the absence of such position it will be unable to affect competition. This issue requires close attention as it is often difficult to distinguish between reduction of prices as fair competition and predatory pricing with intent to monopolize. Some reasons behind this are the difficulties in determining the cost of production and intention to monopolize.

This project seeks to examine the issue of predatory pricing, looking into its causes, effects, and the various tests used to determine its existence. Causes would include requirements such as holding a dominant position and having the resources to sustain itself despite low pricing. Effects include the creation of entry barriers to the relevant market with respect to some firms and the forced exit from the relevant market with respect to other firms. Predation tests include several cost/price tests that have been devised by scholars (whether the price charged is substantially lower than the appropriate cost measure) the ‘recoupment test’ (whether the firm engaging in anti-competitive predatory pricing will be able to recoup its losses in the future) and the ‘predatory intent test’ (whether the reduction of prices was accompanied by an intent to overthrow competition). All these issues will be examined through reliance on the opinion of jurists, theorists and experts in the field, and through judicial pronouncements on the subject.
Through an analysis of judicial decisions in FTC, EU and Indian law on the concerns raised by predatory conduct, the researcher will identify the accepted principles that have been applied in the determination of costs (so as to identify whether or not pricing is predatory). Further, the researcher will also inspect the cases involving allegations of predatory pricing so as to cull out the difference between predatory pricing and unfair pricing.

1.2 Scope and objective of the researcher:

The scope of the study is limited to the abuse of dominant position through predatory pricing under Indian, European and American law. The objective of the researcher is to determine a mode of identification of predatory pricing that is adequate and efficient.

1.3 Research methodology:

The researcher will employ a combination of doctrinal, analytical and comparative method of research in this report. Data will be procured from primary as well as secondary sources. Primary sources include provisions from various legal enactments. Secondary sources include books, articles from journals, law commission reports, news reports and internet articles.

1.4 Research questions:

1. What is predatory pricing, and how does it adversely affect competition?

2. How can predatory pricing be identified in a manner that curbs anti competitive conduct without giving firms disincentives for lowering prices?
1.5 Scheme of the research report:

The first part of this research report shall provide an overview of the entire report. It will include an introduction to the project and an explanation of the scheme of report.

The second part of the report will provide an introduction to the concept of predatory pricing. It contains an analysis of the various theories propounded by scholars in an attempt to examine its rationality. Further, the market conditions essential to price predation will be analysed.

The third part of the report will deal with the various tests that have been developed to identify predatory pricing as compared to competitive reduction of prices. The chapter will provide an overview of the various cost concepts that are closely associated with tests on price predation, and the CCI Cost Regulation which is concerned with the same.

The fourth part of the report will deal with the law governing situations of predatory conduct in the United States. Through an analysis and interpretation of the various legal provisions and judicial pronouncements in Antitrust law, the researcher will identify the definition of predatory pricing and the tests (to determine predation) which are adopted in this jurisdiction.

The fifth part will conduct an analysis, similar to one envisaged in the fourth part, in the jurisdiction of the EC and the United Kingdom.

The sixth part deals with the law governing predatory pricing in India – the chapter will provide the definition of predatory pricing and the test used to determine it in India. The chapter will also attempt to discuss the case of *MCX v. NSE*, in which the Competition Commission dealt with the issue of price predation.
Lastly, the final part of this research report will be the concluding part where the researcher will sum the key points identified in the course of the project. On the basis of the result yielded by the analysis in the project, the researcher will attempt to provide suggestions regarding the treatment of predatory pricing in India.
PART II

PREDATORY PRICING

Some of the basic objectives of competition law are to create a level playing field between competitors, create more choice for consumers & promote consumer welfare, ensuring effectiveness of the process of competition, and maintaining fairness and equality for all players in the market. Abuse of dominance is viewed as an anti-competitive practice world over\(^1\) and in India\(^2\) due to the adverse effects that it may have on consumers and competitors. Dominance by itself is not considered anti-competitive, but it may lead to anti-competitive results if it is misused or exploited by the entity enjoying such dominance.\(^3\) In India, abuse of dominant position occurs when an enterprise uses its dominance to impose unfair or discriminatory conditions or prices on sale or purchase of goods or services, directly or indirectly.\(^4\) This paper is concerned with one such form of abuse of dominance – predatory pricing.

Generally, low pricing is seen as a benefit of successful competition. Predatory behaviour, however, is an anti-competitive form of conduct which leads to pricing that is low enough to eliminate all competition.\(^5\) Predatory pricing, broadly, refers to the practice of selling goods or providing services to consumers at prices lower than the costs incurred in their

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1. Egs Article 82 of the EC Treaty prohibits abuse of dominance by any undertaking in any common market or substantial part thereof; Section 18(1) of the Competition Act, 1998 (of the United Kingdom) also prohibits abuse of dominant position insofar as it affects trade within the United Kingdom; Section 2 of the Sherman Act (in the United States) which makes monopolisation or attempt to monopolise a felony; Section 5 of the Federal Trade Commission Act (in the United States) prohibits unfair or deceptive trade practices; Section 46 of the Trade Practices Act, 1974 (of Australia) directs that no corporation occupying a dominant position shall misuse it to his own advantage.
4. Section 4(1), Competition Act, 2002
production, with a view to eliminate competition. Predatory pricing is a recent development in competition law – in the earlier days, usually a seller would not be held liable for under-pricing a rival and putting him out of business as this was considered to maximize consumer benefits. Gradually it has come to be viewed as an anticompetitive practice adversely affecting consumers in terms of choice and price.

2.1. The definition of predatory pricing

Price predation occurs when a dominant firm charges a price lower than the cost of production, making it difficult for equally efficient firms to operate. Predatory conduct seeks to reduce competition on some basis other than efficiency, maximising profit only because of its exclusionary tendencies. Ordover and Willig (1981) have described the process predatory pricing as follows:

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6 See Section 4, Explanation, Competition Act, 2002
8 Price predation has two effects on competition:
   i. It creates entry barriers for prospective competitors (however, its significance is questionable since new firms will not be deterred from entering the market in the recoupment phase)
   ii. It compels existing competitors to exit the market
9 Once barriers are instated and all competitors leave the market, the monopolist is free to increase the price to recoup his losses. Consumers are forced to buy at extremely high prices due to unavailability of alternate options.
10 See John Vickers, Abuse of Market Power, 115(504) THE ECONOMIC JOURNAL F244 (June, 2005), at p. F248 (Competition Law is concerned with low pricing by dominant firms and not non-dominant firms as the latter are not in a position to exclude others from the market.) Dominance, in India, is determined upon the considerations laid down in Section 19(4) of the Competition Act.
12 FEMI ALESE, FEDERAL ANTITRUST AND EC COMPETITION LAW ANALYSIS (2008 Ashgate), at p. 341
14 John Vickers, Abuse of Market Power, 115(504) THE ECONOMIC JOURNAL F244 (June, 2005), at p. F248
“Assuming that businessmen know how their actions affect their profitability and the profitability of their rivals, predatory objectives are present if a practice would be unprofitable without the exit it causes, but profitable with the exit. Thus, although a practice may cause a rival's exit, it is predatory only if the practice would not be profitable without the additional monopoly power resulting from the exit.”

Predatory behaviour occurs in two phases – the ‘predation phase’ where extremely high values are offered to the consumers to overthrow competition, followed by the ‘recoupment phase’ where consumers are provided lower values in terms of the product, as competition has been overthrown.16

In India, predatory pricing is defined by the Act as the ‘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 goods or provision of services, with a view to reduce competition or eliminate the competitors.’17

2.2 Theories justifying predatory behaviour

The rationality of predatory pricing has often been discussed by scholars who have concluded that the practice is economically irrational as it is unlikely to yield a profit in

16 See KEITH N. HYLTON, ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION (1st ed., 2003, Cambridge University Press), at p. 213; Joseph Farrell and Michael L. Katz, Competition or Predation? Consumer Coordination, Strategic Pricing and Price Floors in Network Markets, 53(2) THE JOURNAL OF INDUSTRIAL ECONOMICS 203 (2005), at pp. 203-204; Cargill Inc. v. Monfort of Colorado 479 US 104 (1986) (observed that in price predation, a monopolist or a future monopolist assumes a strategy that compels competitors to exit the market and disallows prospective competitors to enter, and on achieving this goal, the monopolist recoups its losses by increasing the price)

17 Section 4, The Competition Act, 2002
the long run.\textsuperscript{18} Even if and when predatory conduct is irrational, it does warrant attention due to its effects on competition.\textsuperscript{19}

\subsection*{2.2.1 Traditional theory}

Traditionally, the advantages of predatory pricing lay in the ability of the monopolist to recoup losses through incremental prices after the predatory pricing had created sufficient entry barriers and forced exits.\textsuperscript{20} One such model was the ‘long purse strings’ model, according to which a larger firm with substantial financial resources could outlive a firm with fewer resources, if they were to offer their goods and services at below cost prices.\textsuperscript{21} The ‘deep pocket theory’ offered similar arguments. This reasoning was rejected on the ground that competitors are free to enter or re-enter the market during the phase of recoupment.\textsuperscript{22}

\subsection*{2.2.2 The Chicago School View}

The Chicago School dismissed predation as irrational behaviour. The proponents of this school believed that predation did not reward the predator with any benefits\textsuperscript{23} as he would be unable to recoup its short term losses in the long run, owing to the ability of rivals to


\textsuperscript{19} Robert Merkin, \textit{Predatory Pricing or Competitive Pricing: Establishing the truth in English and EEC Law}, 7(2) \textit{Oxford Journal of Legal Studies} 182 (1987), at p. 188


\textsuperscript{23} However, consumers may benefit from this, if the recoupment strategy does fail.
re-enter the market (as no ‘significant’ entry barriers are created by predatory pricing). Milgrom and Roberts summarized this view, stating, “a large fraction of the economics profession would argue that... predation is an irrational strategy for attempting to gain or maintain a monopoly position and that it is, therefore, unlikely to be adopted in practice.”

2.2.2.1 Predation versus Mergers – the McGee-Posner Debate

McGee and Posner, both belonged to the Chicago School, and famously took opposing stances on this issue. McGee had asserted that mergers would provide a more viable strategy for monopolisation than predatory pricing (basing predation’s failure on ability of rivals to enter during the phase of recoupment). Posner disagreed with this view, arguing that predation would be preferred as predation is cheaper than mergers as it more difficult to detect (both predation and mergers for the purpose of monopolisation being illegal). The risk of legal interference, thus, is lower in situations of predatory pricing, due to the difficulty that lies in the identification of such conduct.

2.2.3 Strategic Theories

These theories emerged in opposition to the views of the Chicago school. The proponents of this theory argue that the failure of the Chicago approach lies in its ‘static, non-strategic

view’ of predatory pricing. Information asymmetry or asymmetry access to financial resources are presuppositions on which strategic theories are based.

2.2.3.1 Reputation

One line of thought is that predators benefit from predatory tactics through instatement of significant barriers – based on their ‘reputation to predate’. As the market is marked by information asymmetry, future entrants will gauge the predator’s strategy based on past conduct, which will act as an entry barrier. It has been found that reputation effects are likely to enable recoupment as entrants may be dissuaded from entering the market based on the incumbent predator’s reputation to sell at extremely low prices.

2.2.3.1 Signalling Models

Firms employ strategies to understand the structure of the market before entering it to determine its profitability. Signalling refers to a practice wherein the dominant firm lowers prices in order to ‘signal’ information about the market structure with the motive of dissuading them from entering the market. Signalling models are based on information asymmetry.

28 A situation in which the predator and his rival are differently situated with respect to information critical to decision-making. It is to be noted that the predator is more advantageously positioned, having additional information about production costs, demand conditions and even his own intentions.
29 This implies that the incumbent predator is significantly less dependent on external financial aid than the future entrant.
There are two forms of signalling models:

i. Cost signalling – where a predator drastically lowers prices to induce the entrant to believe that it is a low cost firm

ii. Demand signalling – where future entrants are likely to believe that the demand for the good or service are too low for their profitable survival in the market for the particular good or service.

In the absence of information regarding costs incurred by the incumbent and the nature of demand in the market, future entrants may be deterred from entering the market, for fear of incurring losses. One means to avoid such a situation could be testing the sale of the products in a test market, but even these test markets are susceptible to be manipulation by the incumbent through reduction of prices, and influence on consumers.

2.3 Condition precedent to price predation

2.3.1 Dominant position

Dominance refers to a position of economic strength in a particular market. A widely acclaimed legal test for dominance was laid down by the ECJ in United Brands v. Commission:35

‘The dominant position ... 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 affording it the power to behave to an appreciable extent independently of its competitors, customers, and ultimately of its consumers.’

In the United States, abuse of dominance is dependent on monopolisation. In the famous *Standard Oil* case, the reasons for the cautioned approach towards monopolisation were identified:

1. “That, by the common law, monopolies were unlawful because of their restriction upon individual freedom of contract and their injury to the public.
2. That as to necessaries of life, the freedom of the individual to deal was restricted where the nature and character of the dealing was such as to engender the presumption of intent to bring about at least one of the injuries which it was deemed would result from monopoly, that is, an undue enhancement of price.
3. That, to protect the freedom of contract of the individual not only in his own interest, but principally in the interest of the common weal, a contract of an individual by which he put an unreasonable restraint upon himself as to carrying on his trade or business.”

Under the Monopolies and Restrictive Trade Practices Act of 1969 (hereinafter referred to as MRTP), dominance largely depended on the market share held by the enterprise in question. An undertaking in control of one-fourth or more of the supply, production or distribution any good or service in India was considered dominant (with respect to that particular good or service). This conception of dominance changed with the enforcement of the Competition Act of 2002 (hereinafter referred to as the Act). Section 4 of the Act defines dominance as follows:

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36 *Standard Oil Co. of New Jersey v. United States* 221 US 1 (1911), at p. 52
37 Section 2(d), Monopolies and Restrictive Trade Practices Act, 1969
38 Explanation to Section 4, The Competition Act, 2002
“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;”

A conjoint reading of the definition of dominant position in the Act and the United Brands test demonstrates that dominance is viewed similarly in the European and Indian jurisdictions. The European test has two elements – the ability to eliminate competition, and the ability to act independent of competitors and consumers. Similarly, Section 4 requires the ability of independent operation and the ability to shape competition (through influence on consumers or competitors). Apart from this, the Act prescribes certain guiding factors to determine dominance.39

39 Section 19(4), The Competition Act, 2002
The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, have due regard to all or any of the following factors, namely:—
(a) market share of the enterprise;
(b) size and resources of the enterprise;
(c) size and importance of the competitors;
(d) economic power of the enterprise including commercial advantages over competitors;
(e) vertical integration of the enterprises or sale or service network of such enterprises;
(f) dependence of consumers on the enterprise;
(g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
(h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
(i) countervailing buying power;
(j) market structure and size of market;
(k) social obligations and social costs;
(l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
(m) any other factor which the Commission may consider relevant for the inquiry.
2.3.2 Significant entry barriers

No rational firm would engage in predatory pricing if no significant entry barriers to the market existed as recoupment would not be possible without such barriers.\(^40\) Entry barriers could be a result of a variety of factors such as state regulation, exceedingly high sunk costs\(^41\), reputation of predator as a low cost firm\(^42\), inadequate information about demand in the market, product uniqueness\(^43\) etc. These barriers make predatory pricing feasible, as predators are secure in terms of future recoupment (due to the assurance that rival firms will not enter the market for the particular good or service because of their predatory behaviour).

2.3.3 Financial prowess of predator

A predator who occupies a large market share in another (possibly related) market may be able to conduct itself predatorily as it may make good the losses suffered in one market through profits earned in another.\(^44\) This enables him to indulge in predatory behaviour as he is in a financially secure position.

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\(^41\) Femi Aseke, *Federal Antitrust and EC Competition Law Analysis* (2008 Ashgate), at p. 342


\(^44\) See: Case C-333/94P *Tetra Pak International SA v Commission of the European Committees* [1996] ECR 1-5951
PART III

DETERMINATION OF PREDATORY PRICING

Predatory pricing is said to occur when goods or services are provided to consumers at a price below the appropriate measure of cost. This created the need to determine what the appropriate measures of cost should be. In this pursuit, several scholars have conducted economic analyses of predatory pricing.\footnote{See, e.g., John S. McGee, \textit{Predatory Price Cutting: The Standard Oil (N.J.) Case}, 1 Journal of Law and Economics 137 (1958); Areeda and Turner, \textit{Predatory Pricing and Related Practices under Section 2 of the Sherman Act}, 88 HARVARD LAW REVIEW 697 (1975); Douglas F. Greer, \textit{A Critique of Areeda and Turner’s Standard for Predatory Practices}, 24 ANTITRUST BULLETIN 233 (1979); Paul L. Joskow and Alvin K. Levorick, \textit{A Framework for Analysing Predatory Pricing}, 89(2) YALE LAW JOURNAL 213 (1979), at pps. 245-258} The Cost Regulation of the CCI determines the cost that is to be considered in cases of predation in India. This part will discuss the various cost concepts involved in determination of predatory pricing, and the various tests that have been developed by scholars for this purpose.

3.1 Need for a cautioned approach

The spirit of competition lies in firms competing for custom and the business of people through means such as reduction of prices and innovation.\footnote{RICHARD WHISH, \textit{COMPETITION LAW} (5th Ed., Oxford University Press, 2005), at pps. 2-4, 703} This requires that a cautioned approach be adopted while determining the occurrence of predation in a firm’s conduct as, very often, the line between fair competition and unfair predation wears thin.\footnote{In \textit{United States v. AMR Corporation}, 335 F.3d 1109 (10th Cir., 2003), a US Court of Appeals observed that its approach to predation was “with caution, we do not do so with the incredulity that once prevailed”} The law on predatory pricing must maintain a fine distinction between competitive behaviour and anti-competitive conduct.
A great burden is placed on the law as it is responsible to protect competitive reduction of prices by dominant firms\textsuperscript{48}, preventing situations where they refrain from reducing prices for fear of being charged with abuse of dominance\textsuperscript{49}, and simultaneously detect instances of anti-competitive reduction of prices. The absence of ‘objective standards’, which makes the evaluation of predation difficult\textsuperscript{50}, has led to several debates regarding the appropriate test for establishing the existence of price predation.

3.2 Costs involved in determination of predation

**Variable and Fixed Costs**

Costs incurred by a firm in producing a good or rendering a service may or may not vary with the output produced. The costs that vary with the amount of the output produced are known as variable costs. Those costs that do not vary with change in the production of output are called fixed costs. For instance, costs incurred in purchase of raw materials to produce a good will fall under the category of variable costs, but the cost incurred in purchasing the land on which the factory of the good was created fall under the category of fixed costs, as they are only incurred once and do not vary with output. It must be kept it mind that variability is a function of time – once the time period is long enough, all costs vary with output to a certain degree.\textsuperscript{51}

\textsuperscript{48} In ECS/AKZO, OJ [1985] L374/1, the European Commission has noted that a dominant firm must be allowed to compete just as a small firm would.
\textsuperscript{49} See Matsushita v. Zenith Radio 475 US 574 (1986)
\textsuperscript{50} Oliver E. Williamson, Preemptory Pricing: A Strategic and Welfare Analysis, 87(2) YALE LAW JOURNAL 284 (1977), at p. 288
\textsuperscript{51} MAHER M. DABBAB, EC AND UK LAW: COMMENTARY, CASES AND MATERIALS (2004, Cambridge), at p. 399
Sunk Costs

Sunk costs refer to those costs which cannot be recovered by the firm. For instance, the amount paid to lease the land of the factory.

Marginal Cost and Incremental Cost

Marginal cost is the cost incurred to produce one extra unit of output. It is a function of variable costs, as fixed costs do not vary with increases in output. Incremental Cost refers to the additional cost of increasing output beyond a benchmark level of output by a pre-specified amount.\(^{52}\)

Total Cost

It is 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.\(^{53}\)

Total Variable Cost

It is the total cost (as explained above) minus the fixed cost and share of fixed overheads, if any, during the referred period.\(^{54}\)

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\(^{52}\) MAHER M. DABBAAH, EC AND UK LAW: COMMENTARY, CASES AND MATERIALS (2004, Cambridge), at p. 400

\(^{53}\) Regulation 2(1)(c)(i), The Competition Commission of India (Determination of Cost of Production Regulations)

\(^{54}\) Regulation 2(1)(c)(ii), The Competition Commission of India (Determination of Cost of Production Regulations)
Average Variable Cost

It is the total variable cost divided by total output during the referred period.\textsuperscript{55}

3.3 Tests to identify instances of predation

3.3.1 Areeda Turner Test (AVC)

Areeda and Turner\textsuperscript{56}, relying exclusively on a cost/price analysis, recommended that any price below the average variable cost incurred by a firm should be considered predatory.\textsuperscript{57}

The test is concerned with short-run costs and holds prices to be predatory if they are below the short-run marginal cost of providing the product or service, unless it is higher than ATC. However, due to the difficulty that pervades determination of marginal costs, Areeda and Turner, substituted SRMC with AVC and proposed a \textit{per se} rule under which prices below the average variable costs were considered predatory.

This approach has found acceptance in judicial precedents\textsuperscript{58}. However, the Areeda-Turner test has been questioned on three main grounds viz. the failure to account for intention\textsuperscript{59},

\textsuperscript{55} Regulation 2(1)(b), The Competition Commission of India (Determination of Cost of Production Regulations)
\textsuperscript{57} Ibid, at pps.685-688
\textsuperscript{58} See Case C-62/86 \textit{AKZO Chemie BV v Commission of the European Communities}. [1991] ECR I-03359, at para 71-72; Case C-333/94P \textit{Tetra Pak International SA v Commission of the European Committees} [1996] ECR 1-5951, at para 41 (Observed that when price is lower than AVC, pricing is predatory. This principle was extended in these judicial rulings – when price is less than ATC but more than AVC, it may or may not be predatory depending on intent.)
\textsuperscript{59} Ibid.
the failure to consider recoupment\textsuperscript{60} and the possibility of predatory pricing even above \textit{AVC}\textsuperscript{61}.

\textbf{3.3.2. Greer’s test (ATC + Intent)}

An alternative to the Areeda Turner rule was provided by Greer who proposed that pricing below average total cost should be viewed as predatory if there is ‘substantial evidence of predatory intent’.\textsuperscript{62} Greer argued that the scope of the Areeda Turner test, being restricted to the \textit{SRMC} or \textit{AVC}, was too narrow, and he proposed that this could be rectified through adoption of a broader test based on average total cost accompanied with intent.

\textbf{3.3.3 Williamson’s Output Restriction Rule}

Williamson questioned the sufficiency of the Areeda-Turner rule on account of its failure to account for inter-temporal problems.\textsuperscript{63} Focussing on the problem of impeded entry, he offered the output restriction rule, which essentially provides that a dominant firm would significantly increase output within 12-18 months of any entry into the market.\textsuperscript{64} As per Williamson, the purpose of such expansion in output is to signal its intention to rivals, rather than directly lead to their demise.\textsuperscript{65}

\begin{itemize}
  \item \textsuperscript{61} \textit{RICHARD WHISH, COMPETITION LAW} (5\textsuperscript{th} Ed., Oxford University Press, 2005), at p. 704
  \item \textsuperscript{62} Douglas F. Greer, \textit{A Critique of Areeda and Turner’s Standard for Predatory Practices}, 24 Antitrust Bulletin 233 (1979), at p. 235
  \item \textsuperscript{64} \textit{ALISON JONES AND BRENDÁ SUFRIN, EC COMPETITION LAW: TEXTS, CASES AND MATERIALS} (3\textsuperscript{rd} ed., 2008, Oxford), at p. 319
  \item \textsuperscript{65} Oliver E. Williamson, \textit{Williamson on Predatory Pricing II}, 88(6) THE YALE LAW JOURNAL 1183 (1979), at p. 1185
\end{itemize}
3.3.4 The Two-Tier Test

In their pursuit to identify a test that would minimize the sum of expected error costs and costs of implementation, Joskow and Klevorick suggested a two tier test to detect price predation:

i. The first tier constitutes a structural analysis of the market so as to obtain an overall picture of the market to identify whether it is a monopolistic or a competitive market and how the market structure would affect predation. For instance, predation would be less likely in a competitive market, with extremely low entry barriers.

ii. The second tier analysis is conducted when the first tier analysis of a particular market suggests that chances of predatory pricing are high. This tier constitutes a behavioural analysis of the pricing strategies adopted by the dominant firms to influence competitors. The various pricing strategies include pricing below AVC, prices between AVC and ATC, and prices above ATC.

In the second tier, prices below AVC are necessarily illegal and prices above AVC, but below ATC, may also be illegal (as it may deter competition from entering the market). Price cuts at a point above ATC are presumed to be legal, but may be considered illegal if they are reversed significantly within a reasonable period of time.

This test recognizes the attention warranted by predatory pricing, based on its tendency to affect competitors and influence the market greatly. One instance of an application of

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66 Error costs arise when the standard adopted by the law to determine is such that it declares predatory conduct to be be competitive and competitive conduct to be predatory. Such errors would result in loss in terms of their effect on consumers.
67 Paul L. Joskow and Alvin K. Levorick, A Framework for Analysing Predatory Pricing, 89(2) Yale Law Journal 213 (1979), at pps. 245-258
such a test was the famous *Brooke* ruling\(^6\) where the court found that recoupment, and therefore predatory pricing, was not plausible due to the oligopolistic nature of the market in question.\(^7\) Although, the court specified that the same exceptional treatment would not automatically apply in *every* oligopolistic market, being a function of the specific facts and circumstances of each case.

### 3.3.5. Above-Cost Pricing Test

This test was put forward by Edlin who argued that above-cost pricing should also be treated as predation to prevent an incumbent monopolist, enjoying cost advantage\(^7\) over entrants, from disadvantaging the entrants through low pricing.\(^7\) Here, a predator may be reducing prices to a level that are above the costs incurred by it, but below the costs incurred by the entrant\(^7\), so as to force the rival firm out of the market.\(^7\) This has been criticised on account of difficulty to distinguish instances of fair competition from unfair above cost pricing.\(^7\)

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\(^7\) The monopolist may even have recovered a part of or all of the fixed costs incurred in the provision of the particular good or service in question.

\(^7\) Aaron S. Edlin, *Stopping Above Cost Predatory Pricing*, 111 YALE LAW JOURNAL 941 (2002), at p. 945 (arguing that the monopolist should be prevented from lowering prices “until the entrant has had a reasonable time to recover its entry costs and become viable, or until the entrant’s share grows enough so that the monopoly loses its dominance”. Edlin argues that a period of twelve-eighteen months is sufficient for this purpose.)

\(^7\) Due to the cost advantages enjoyed by the monopolist

\(^7\) Christine P. Durrance, *Proposed Standards for Identifying Predation: Williamson’s Perspective and the Court*, 55(3) ANTITRUST BULLETIN 663 (2010), at p. 676

\(^7\) Einer Elhauge, *Why Above-Cost Price Cuts to Drive out Entrants are not Predatory: And the Implications of Defining Costs and Market Power*, 112(4) YALE LAW JOURNAL 681 (2003), at pp. 686-688
PART IV
ANTITRUST LAW ON PREDATORY PRICING

4.1 U.S. Statutory Law on Predatory Pricing

Predatory Pricing in USA is governed by the Sherman Act, the Federal Trade Commissions Act, and the Clayton Act as amended by the Robinson Patman Act.

4.2. Judicial Development on Predation

Allegations of predatory pricing have shown to be extremely difficult in the US. It has been said that “predatory pricing schemes are rarely tried and even more rarely successful.”

The first major decision regarding predatory pricing was given in the famous Standard Oil case where the court followed an ‘intent’ based approach and required the plaintiffs to provide hard instances (‘smoking gun approach’) of predation on part of the defendant.

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76 Section 2, Sherman Act, 1890 – 15USC § 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 misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

77 Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive trade practices

78 Section 3 of the Robison Patman Act - 15 USC § 13(a) prohibits price discrimination that may ‘substantially lessen competition or tend to create a monopoly’.

79 See John B. Schulte, Predatory Pricing: The Retreat from Subjective Intent Analysis and the Move Towards a Likelihood of Recoupment Enquiry, 24 SUFFOLK UNIVERSITY LAW REVIEW 975 (1990), at pps. 975-977 (explaining that claims of price predation, in America, are of a recent origin, and most of these are rejected.)

80 Justice Powell in Matsushita Industrial Electric Co. Et Al. v. Zenith Radio Et Al. 475 US 574 (1986), at p. 589; Similar arguments have been put forward by Judge Easterbrook, in Frank H. Easterbrook, Predatory Strategies and Counterstrategies, 48 UNIVERSITY OF CHICAGO LAW REVIEW 263 (1981); See also ROBERT BORK, THE ANTITRUST PARADOX (1978) (who have argued that it is not necessary to take claims of predation seriously due to their unlikelihood.)

81 Standard Oil Co. of New Jersey v. United States 221 US 1 (1911),
The *Utah Pie* ruling\(^{82}\) strengthened this approach with the court observing that ‘the existence of intent might bear on the likelihood of injury to competition’.\(^{83}\) The feasibility of recoupment was not given any primacy in this ruling. The approach of the courts attracted criticism on account of its ‘static’ nature.\(^{84}\)

In *William Inglis*, the court took the view that in order ‘to establish predatory pricing, a plaintiff must prove that the anticipated benefits of the defendant’s price depended on its tendency to discipline or eliminate competition and thereby enhance the firm’s long-term ability to reap the benefits of monopoly power’.\(^{85}\) One of the deciding factors, hence, was the ability of the firm to favourably affect prices post elimination, i.e., the possibility of recoupment. The court did, however, utilise intent to infer the occurrence of predation.

In *Barry Wright Corp. v. ITT Grinnel Corp.*\(^{86}\), Justice Breyer rejected the intent test on three grounds – the possibility of false conviction owing to the thin line of distinction between predation and competition, the tendency of lawyers to advice clients against price cuts due to possibility of false convictions and the likelihood of frivolous claims motivated by the possibility of error due to blurry distinction between predation and competition. It was suggested that intent should not play a determinative role in cases of alleged price predation.

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\(^{82}\) *Utah Pie Co. v. Continental Baking* 386 US 685 (1967)

\(^{83}\) Ibid. at p. 702


\(^{85}\) *William Inglis et al. v. ITT Continental Banking Co.* 668 F.2d 1014 (9th Cir., 1981), at p. 1035

\(^{86}\) 724 F.2d 227 (1st Cir., 1983)
Next, in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, the Supreme Court took a cautious approach towards determination of predation, observing that the success of any such scheme would depend on the ability of the predator to ‘maintain monopoly power for long enough to recoup the losses suffered and ultimately make profits as a result of the strategy’.

Essentially, three conditions required for predation were identified in this case:

i. The prospect of achieving monopoly;

ii. Monopoly pricing should *not* result in quick entry by new competitors, i.e., significant entry barriers to the market are created by the pricing strategy of the predator;

iii. Ability to maintain monopoly for long enough to recoup losses and ultimately to benefit from the pricing strategy.

In the particular instance, the conditions were not fulfilled as entry barriers to the market were not created by the alleged predation.

Even though the Court was dealing with a proposed merger, and not single firm conduct, in *Cargill Inc. v. Monfort of Colorado, Inc.*, it made certain observations about predatory pricing. It 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. Such a definition would require that the predator not only eliminate competition by its

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87 *Matsushita Industrial Electric Co. Et Al. v. Zenith Radio Et Al.* 475 US 574 (1986) - In this case, the defendants alleged that their Japanese competitors were conspiring to sell their products at extremely high prices in Japan and at predatorily low prices in USA so as to drive out the competition in the American market and ultimately cartelize the market. This claim was rejected by the SCOTUS (which took a sceptical view towards predatory pricing) as the aim to overthrow competition and attain market power was not evident in the market – the Japanese companies had not reached high levels of market power despite alleged price predation over around two decades.

88 Ibid, at p. 589

low pricing, but also create significant entry barriers that would afford it monopoly power in the long run and enable it to recoup its losses.

In A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.,\textsuperscript{90} the various modes of determination of predation were discussed and the structural approach laid down in Matsushita was accepted.

Finally this debate culminated in \textit{Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.},\textsuperscript{91} where predation allegations were rejected due to the failure to prove a ‘dangerous’ probability of recoupment. The SCOTUS developed a two pronged test to determine instances of price predation in this case. The first prong lies in proving that the ‘rival’s low pricing is below an appropriate level of its costs’.\textsuperscript{92} The second prong requires proving that the rival has a ‘reasonable prospect or dangerous probability of recouping its investment in below cost pricing’.\textsuperscript{93}

In the \textit{American Airlines} case\textsuperscript{94}, the US Department of Justice alleged that American Airlines and AMR, its parent corporation, engaged in predatory conduct with respect to three of its low cost carriers. The claim was rejected by the Court. It opined that the govt. failed to prove below-cost pricing.

\textsuperscript{90}881 F.2d 1396 (7th Cir. 1989)
\textsuperscript{91}\textit{Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.}, 509 US 209 (1993) – in this case the plaintiff, a cigarette manufacturer, was marketing a type of generic cigarettes known as ‘Black and Whites’. The hallmark of these cigarettes was the low cost at which they were sold (around 30% lower than the usual fully branded cigarettes). A competitor of the plaintiff, Brown & Williamson introduced its own brand of generic Black and White cigarettes and sold them at a price lower than the plaintiff’s Black and White cigarettes. The plaintiff alleged that this constituted predatory pricing. The claim was rejected by the District Court and the Court of Appeals and the SCOTUS accepted the rejection. The decision of the SCOTUS was based on the disability of Brown & Williamson to recoup the losses incurred by them on selling these generic cigarettes in the long run, even if the low pricing was done with the intention of out-selling Liggett, the plaintiff.
\textsuperscript{92}Ibid, at p. 223
\textsuperscript{93}Ibid, at p. 224
\textsuperscript{94}\textit{United States v. AMR Corporation}, 335 F.3d 1109 (10th Cir., 2003)
4.2.1. Cost Test

As mentioned earlier, in Matsushita’s case, predatory pricing was explained as ‘pricing below an appropriate measure of costs’.\(^95\) In the *Brooke Group* case, the SC declined to prescribe an appropriate measure of cost, as the parties had agreed upon AVC as the appropriate measure.\(^96\) Generally, prices below AVC are considered to be predatory in the United States and in some instances prices above AVC (but below ATC) may also be regarded as predatory pricing, if the other elements of predatory pricing, such as recoupment are shown to exist in the particular instance.\(^97\)

In the *American Airlines* case\(^98\), the 10\(^{th}\) Circuit Court declined to endorse the AVC test. The AVC incurred by firms in markets, such as airlines and software, is extremely low, and would make proving claims of predation near impossible.

4.2.2. Intent Test:

The US courts do not accept the intent test as a major determinant of price predation. Intent is accepted to a limited extent as a substitute or surrogate to structural evidence and to facilitate interpretation of ambiguous cost-price relationships.\(^99\) However, in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,\(^100\) it was observed that the anti-
competitiveness of the intent of the predator cannot completely substitute objective evidence of recoupment. In A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., the Court discarded the intent test in the determination of price predation, holding that a hostile intent cannot be the basis of bringing claims under the Sherman Act. Again, in Barry Wright Corp. v. ITT Grinnell Corp., the intent test was rejected as it was considered too vague to constitute proof of predatory pricing by itself.

4.2.3. Recoupment Test:

As explained above, recoupment is recognized as a significant aspect of predation in Antitrust law. A test based on recoupment had been by Franklin M. Fisher, who observed, “Whenever predatory actions are alleged, it pays to analyse how the type of predation would be successful”. Recoupment has been recognized as the ultimate object of unlawful predatory pricing, as without recoupment, the predator would not stand to gain from his predatory conduct. In the Brooke ruling, the court adopted a stringent recoupment test:

i. Pricing below some appropriate measure of cost
ii. With a likelihood, or reasonable prospect, of later recouping the investment

In *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*\(^8\) the Court focussed on the likelihood of recoupment as a determinant of price predation, as opposed to intent to predate.

\(^8\) 881 F.2d 1396 (7th Cir. 1989)
PART V

EC AND UK LAW ON PREDATORY PRICING

5.1. Statutory Law on Predatory Pricing

In the European Union, predatory pricing is governed by Article 102 of the Treaty on the Functioning of the European Union. Section 18 of the Competition Act of 1988, of the United Kingdom, similarly prohibits predatory pricing. The Office of Fair Trading (OFT) Guideline on Assessment of Individual Agreements and Conduct also deals with predation. Although UK and EC law are mostly consistent with each other, these Guidelines present a possibility of divergence between the two.

109 Article 102, The Treaty on the Functioning of the European Union
(ex Article 82 TEC)
Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far 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;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

110 Section 18 – Abuse of dominant position.
(1) Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
(2) Conduct may, in particular, constitute such an abuse if it consists in—
(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.

111 See Section 4, OFT Guideline 414a, Assessment of Individual Agreements and Conduct
112 RICHARD WHISH, COMPETITION LAW (5th Ed., Oxford University Press, 2005), at p. 727
5.2. Judicial Developments on Price Predation

In *Irish Sugar plc v. Commission*\(^\text{113}\) the commission noted with regard to exclusionary pricing, that although firms enjoying dominant position have a right to defend their dominant position and compete with rival undertakings, they must not deliberately attempt to shut out competitors. A dominant firm should not be held liable for abuse of dominance simply because its efficiency allows it to sell at prices too low for other firms to sustain, unless the low pricing was introduced specifically to target a particular.\(^\text{114}\) In the *Wanadoo* case\(^\text{115}\), the Commission noted that predating does not necessarily mean the radical elimination and ousting of rival enterprises – predation may consist in simply dictating or inhibiting the commercial behavior of a competitor.\(^\text{116}\) The Court of First Instance (CFI) upheld the decision of the Commission.\(^\text{117}\)

In the *AKZO* case, the Commission opined that the strategy of the predator must be given due weight in the ascertainment of price predation.\(^\text{118}\) A similar strategic analysis was adopted in the *Tetra Pak*\(^\text{119}\) and *Wanadoo*\(^\text{120}\) cases.

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\(^\text{115}\) *Wanadoo Interactive* [2005] 5 CMLR 5 (Wanadoo Interactive, a 72% owned subsidy of France Telecom, was held liable for below-cost pricing in the market for high speed residential internet access.)

\(^\text{116}\) Ibid, at para 266

\(^\text{117}\) Case T-340/03 *France Telecom SA v. Commission* [2007] 4 CMLR 21

\(^\text{118}\) Case C-62/86 *AKZO Chemie BV v Commission of the European Communities* [1991] ECR I-03359 (In this case, AKZO, a company enjoying dominant position in the market for benzoyl peroxide, threatened ECS, a smaller player in the same market. AKZO informed ECS that AKZO would lower its prices if ECS did not withdraw from the market. The Commission refused to adopt the Areeda-Turner Test, according to which the pricing would be lawful, as it was higher than the AVC incurred by AKZO. It opined that the question of intent becomes extremely pertinent in such cases, and the strategy adopted by AKZO was scrutinized by the Commission.)

\(^\text{119}\) Case C-333/94P *Tetra Pak International SA v Commission of the European Committees* [1996] ECR 1-5951, (Tetra Pak occupied a dominant position in the market for asceptic as well as non-asceptic cartons. It
In the *Napp Pharmaceuticals* case, the OFT held a ‘super-dominant’ undertaking liable for selling its medicines at below-cost pricing, as it was done to ward off a competitor.\(^\text{121}\) The *ABTA/BA* case presented a different question as it involved what was found to be an ‘objective justification’ for the price differential between tickets purchased online and those purchased through travel agents.\(^\text{122}\) This objective justification led to the conclusion that ABTA was not engaging in anti-competitive price predation with the purpose of ousting its competitors.

5.2.1. Cost Test

The *AKZO*\(^\text{123}\) ruling (which was relied on in the *Tetra Pak*\(^\text{124}\) ruling), one of the landmark rulings on price predation in EU, has accepted and added on to the Areeda-Turner test, observing:

i. When price is lower than the average variable costs incurred for production, conduct is abusive.

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\(^{120}\) *Wanadoo Interactive* [2005] 5 CMLR 5, Case T-340/03 *France Telecom SA v. Commission* [2007] 4 CMLR 21 (Wanadoo Interactive, a 72% owned subsidy of France Telecom, was held liable for below-cost pricing in the market for high speed residential internet access. Its prices initially fell below AVC, and subsequently were above AVC, but below ATC.)

\(^{121}\) *Napp Pharmaceutical Holdings Limited v. Director General of Fair Trading* [2002] CAT 1 (Napp Pharmaceuticals was found selling certain products to hospitals at less than direct cost. This behaviour was found to be motivated by the desire to defeat competition.)


\(^{123}\) Case C-62/86 *AKZO Chemie BV v Commission of the European Communities* [1991] ECR I-03359, at para 71-72 (AKZO’s unreasonably low and selectively charged prices for certain chemicals, vitamins and additives had come into question. AKZO was charging prices above ATC to its own clients, but charging prices below ATC to customers of ECS, another supplier of the same products. Such conduct was found to be predatory by the ECJ.)

\(^{124}\) Case C-333/94P *Tetra Pak International SA v Commission of the European Committees* [1996] ECR 1-5951, at para 41
ii. When price is higher than AVC, but lower than ATC, conduct may or may not be abusive depending upon the existence of intention to eliminate competition.

In AKZO, the defendant was arguing that their conduct could not be considered predatory since they charge a price that covers the variable costs. This argument was rejected by the Commission, noting, “Article 82 does not prescribe any cost based legal rule to define the precise stage at which price cutting by a dominant firm may become abusive and indeed the broad application of the concept of abuse to different forms of exclusionary behaviour would argue against such a narrow test”. A similar approach was adopted in the Wanadoo case, where the prices charged for ADSL initially fell below AVC, and ultimately fell above AVC, but below ATC.

The Deutsche Post case put forward an interesting departure on the question of appropriate cost measurement. The decision on predation was based on the incremental costs incurred, for the first time. It was found that the revenue accruing to Deutsche Post from its performance in the commercial parcels market did not cover the incremental costs incurred by Deutsche Post in providing the service. Through its below-cost pricing, Deutsche Post restricted the activity of its competitors who were unable to sell at similar prices.

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125 Para 75
126 Wanadoo Interactive [2005] 5 CMLR 5
127 An analysis of Wanadoo’s strategy led the commission to observe that its behaviour ‘was designed to take the lion’s share of a booming market’. See Commission Press Release IP/03/1025, 16 July 2003
128 Deutsche Post AG (COMP/35.141-Unitel Parcel Service/DP AG, 20 March 2001 (Deutsche Post was accused of using revenue from its profitable letter-post monopoly to finance a strategy of below-cost pricing in the market for commercial parcels.)
129 Incremental costs, as per the Commission, are costs incurred in providing a specific parcel service. They do not include ‘common fixed costs’, i.e. any fixed costs not incurred for providing only the parcel service. Thus the incremental costs included costs incurred solely for the purpose of the parcel service. Obviously, the resulting cost would be lower than if fixed costs were included. However, this concession was afforded to Deutsche Post because of an exceptional circumstance – the existence of universal service obligations. See Deutsche Post AG (COMP/35.141-Unitel Parcel Service/DP AG, 20 March 2001, at para 9.
below-cost prices. Additionally, it also clarified the position on cost allocation in multi-product firms, a question left unaddressed by AKZO.\(^{130}\)

Consistent with EC law, in *Aberdeen Journals Ltd. v. Office of Fair Trading supported by the Aberdeen Independent Ltd.*\(^{131}\), the CAT took the view that pricing below AVC is not a normal business under usual competitive business conditions, and in situation where prices are shown to be below the AVC, predation is sufficiently established and there is no requirement to further prove the existence of intention to predate.

### 5.2.2. Intent Test

European courts have adopted a more comprehensive approach towards predation, taking into account not only a cost/price analysis, but also an analysis of the strategy of the predator, in terms of whether they attempted to eliminate competition and what the likely result of their conduct would be. Documentary evidence may aid in determining the existence of predatory intent.\(^{132}\)

The intention test was first laid down in the AKZO case and later followed in the *Tetra Pak* case. The Commission found that Tetra Pak was selling its non-asceptic cartons at a loss (which were covered from its considerable profits in the sale of asceptic cartons) as a

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\(^{131}\) Aberdeen Journals Ltd. v. Office of Fair Trading supported by the Aberdeen Independent Ltd. [2003] CompAR 67

part of an ‘eviction strategy’. Similarly, intention to predate was culled out in cases where predator generally maintained high prices, but targeted price cuts against a rival.

The rule laid down in AKZO was approved in the OFT Guideline. In the Aberdeen Journals case, documents were relied on to demonstrate intent of the dominant firm to eliminate competition through low pricing, in accordance with the ‘smoking gun’ approach introduced in the Guideline. In the Napp case, while observing that intention to predate did exist, the OFT held that such intention does not necessarily have to be proved where prices charged fall below AVC.

5.2.3. Recoupment Test

Under EC law, the possibility of recoupment has not been directly incorporated in the tests to determine predation. The position of competition law regarding recoupment is not as clearly delineated as it is in American law. While the courts have recognized the role played by the possibility of recoupment in instances of predation, it has also been observed that wherever there is a risk of elimination of competitors, the possibility of recoupment need not be proved. This is because the weakened state of competition on

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135 Section 4, OFT Guideline 414a, Assessment of Individual Agreements and Conduct
137 Napp Pharmaceutical Holdings Limited v. Director General of Fair Trading [2002] CAT 1, at paras 228 and 307
138 In AKZO Chemie [1991] ECR I-03359, at para 71, it was observed that a dominant firm sells below AVC to eliminate competitors ‘so as to enable it to subsequently raise its prices by taking advantage of its monopolistic position.’
the market on which the undertaking holds a dominant position will, in principle, ensure that losses are recouped.  

The Guidelines espouse a view similar to the EC on the issue of recoupment after predatory behaviour. Several ambiguities pervade this area in EC law as well as English law, as courts have simply declared the proof of recoupment unnecessary in certain cases, rather than lay down guidelines to determine the same. In Napp and Aberdeen Journals (second case), it was concluded that engaging in predatory behaviour in one market so as to maintain/protect its supra-competitive profits in another market, are forms of recoupment.

140 Section 4, Para 4.25, OFT Guideline 414a, Assessment of Individual Agreements and Conduct
141 Richard Whish, Competition Law (5th Ed., Oxford University Press, 2005) (Relying on the Tetra Pak case, where it was decided, ‘on the facts of the case’, that there is no need to prove recoupment.)
143 CA 109/1/1/02 Aberdeen Journals Ltd. v. Office of Fair Trading (Number 2) [2003] CAT 11, at para 445
PART VI

LAW GOVERNING PREDATORY PRICING IN INDIA

Predatory behaviour is prohibited in India as anti-competitive abuse of dominance.\textsuperscript{144} Predatory pricing is defined by the Act as the ‘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 goods or provision of services, with a view to reduce competition or eliminate the competitors.’\textsuperscript{145}

6.1. Cost Test:

In pursuance of the requirement of the Explanation to Section, Cost Regulations were created by the Competition Commission of India, in consultation with ICWAI. India has adopted AVC as the standard to measure price predation.\textsuperscript{146} AVC is used as a substitute to MC, which is difficult to calculate.\textsuperscript{147} This position is synchronous with the approach adopted in other jurisdictions as well.\textsuperscript{148} The Commission also has the discretion of adopting any other cost standard (such as avoidable cost, long run incremental cost, or market value), if it considers doing so fit.\textsuperscript{149}

6.2. Case Law

The question of predatory pricing came up for the Competition Commission of India in the MCX case.\textsuperscript{150} MCX asserted that NSE abuses its dominant position through predatory

\begin{footnotesize}
\begin{enumerate}
\item[144] Section 4, The Competition Act, 2002
\item[145] Section 4, Explanation, The Competition Act, 2002
\item[146] Regulation 3, The Competition Commission of India (Determination of Cost of Production Regulations)
\item[147] Ibid
\item[148] US, EU
\item[149] Regulation 3
\end{enumerate}
\end{footnotesize}
pricing, in the form of waiver of transcription fee, admission free and data feed fee. The DG found NSE’s pricing to be predatory in nature as similar waivers had not been extended to the other segments of the stock exchange market by NSE. 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 CCI found NSE to be abusing its dominant position. First, it pointed 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 claim that it didn’t need to charge any price as its variable costs were zero was found to be unacceptable, in the light of the DG’s findings regarding the sources of variable costs which NSE could not deny incurring. 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 policy was considered a consequence of its ‘deep pockets’ and declared unfair by the CCI due to inability of its weaker competitors 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

151 Among other things, such as exclusionary denial of a requisite interface to ODIN, a subsidiary of MCX
152 As per Section 4 of the Competition Act, 2002, predatory pricing is a subset of ‘unfair’ pricing. However, unlike ‘predatory pricing’ which is defined in the explanation to Section 4, the term ‘unfair pricing’ has not been defined in the Act, and needs to be determined as per the facts and circumstances of each case.
Commission would never be able to prevent any form of unfair pricing including predatory pricing in future”.

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.

PART VII

CONCLUSION

The determination of predatory pricing appears to be a daunting task, both due to the grave effect of the conduct on competition as well as the difficulties that pervade the calculation of the costs involved as well as proof of intent and feasibility of recoupment.

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. Further, procuring hard evidence, commonly known as the ‘smoking gun’ approach, on the intention to predate is, again, laden with difficulties.

Suggestions:

1. It is of utmost importance that courts adopt an all-encompassing test in the ascertainment of price predation. An analysis of case law in USA, EU and UK, has

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155 Such as Deutsche Bank or the MCX case
clearly reflected that conducting cost/price analyses, determining intention and establishing the feasibility of recoupment are all equally valuable in the correct ascertainment of predatory pricing. In fact, the most thorough test for price predation is one that would comprehensively include all three factors.

2. As regards the cost/price analysis that is conducted to determine the nature of pricing, certain amount of flexibility is desirable. There may be situations where variable costs are much lower than fixed costs.\footnote{157} In these circumstances, the competition authority should be empowered to exercise its discretion on the issue.\footnote{158} Such discretionary power is provided for in the Cost Regulation of the CCI.

3. While pricing below AVC is sufficient to establish predation, it should not be considered necessary. Prices below the ATC are as likely to drive equally efficient competitors out of the market.

4. Recognition must be given to those situations where pricing below AVC is done for commercial reasons, rather than for predatory purposes.\footnote{159} For instance, in cases of loss leading or where unanticipated shocks have occurred.

5. Prior to conducting a cost/price, the first tier of the two tier test,\footnote{160} must be applied and the authority should seek to determine whether or not a particular market is structured to support predation. For instance, a market with high entry barriers, in the form of state regulation coupled with barriers created by the dominant player through low pricing, harmful effects are more likely to ensue than in a market with

\footnote{157}{For instance, in the telecommunications sector, or in laying of oil pipes. Also See the Deutsche Post case.}
\footnote{158}{See the Deutsche Post case where the Commission exercised its discretion and adopted an incremental cost approach rather than an AVC approach.}
\footnote{159}{See Section 4, OFT Guideline 414a,}
\footnote{160}{See Supra n.}
very low entry barriers. Such a test could aid the efficient identification of cases of possible recoupment.

6. Certain guidelines need to be created with respect to determination of intention to predate and the determination of feasibility of recoupment. For instance, the feasibility of recoupment could be identified by the existence of entry barriers that may dissuade other enterprises from entering the market, thereby allowing the predator to charge anti-competitively high prices in the recoupment stage. Another form of recoupment may be engaging in predatory behaviour in one market so as to maintain/protect supra-competitive profits in another market.\textsuperscript{161} Similarly, documentary evidence should be expressly allowed for determination of intent.\textsuperscript{162} Intent could also be gauged from past conduct of the dominant player.

While each case of alleged predatory pricing is likely to vary and have its own peculiarities, the need of the hour is to lay down a certain and comprehensive framework for its identification.

\textsuperscript{161} See \textit{Napp Pharmaceutical case, Aberdeen Journals case}

\textsuperscript{162} See \textit{Aberdeen Journals case}
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