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EU and UK Competition Law

Cosmo Graham

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EU and UK Competition Law

that all costs are variable. Secondly, there are a number of reasons why prices might be below average variable costs, such as promotional pricing, end of line clearances, using spare capacity in an economic downturn, etc. Thirdly, in certain markets where AVC may be minimal, but fixed costs are high, notably new economy and network markets, the test does not work well. For example, the fixed costs of a telecommunications network are very high but the variable costs of a phone call are very low and therefore do not accurately reflect the costs that a provider incurs in providing telecommunications services. It is for this reason that the Commission suggested a better test in the context of telecommunications would be the use of long-run average incremental costs.[133]

KEY DEFINITION **Box 3.10**

Different definitions of cost

Total cost: The total costs of production.

Average total cost (ATC): The total costs involved in the production of one unit of output, i.e. total cost divided by the number of units produced.

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

Variable costs: Those which do change with output.

Average variable cost (AVC): The variable costs involved in the production of one unit, i.e. variable costs added up and divided by the number of units produced.

Marginal cost: The increase in total costs of a firm caused by increasing its output by one extra unit.

Short-run marginal cost (SRMC): The marginal cost based on a firm's existing plant and output, not on that which would be the most efficient.

Avoidable costs: The costs that will not be incurred if an undertaking ceases a particular operation.

Long-run incremental cost (LRIC): The total long-run costs of supplying a specified additional unit of output, taking into account both capital and operating costs.

Long-run average incremental cost (LRAIC): The average of all the (variable and fixed) costs that an undertaking incurs to produce a particular product.

Stand-alone costs: The costs which are involved in producing a product without taking into account that some of these costs are shared with the production of other products.

Source: A. Jones and B. Sufrin, *EU Competition Law* (4th edn, Oxford University Press, 2011) at pp. 389–90. By permission of Oxford University Press.

Questions: Which approach produces the highest cost? Which one produces the lowest cost?

[133] European Commission, 'Notice on the application of the competition rules to access agreements in the telecommunications sector' OJ C265, 22.08.1998, pp. 2–28 (at paras 110–16).

EU case law on predatory pricing

The starting point for discussion is the *AKZO* case.[134] AKZO was a multinational chemicals company which produced benzoyl peroxide, which was used as a catalyst in plastics production and as a bleaching agent in flour. ECS was a small UK undertaking that produced benzoyl peroxide and conducted most of its business in the flour sector. ECS then decided to expand into the plastics sector and AKZO retaliated by threatening to attack ECS's business in the flour sector by offering low prices, in particular to ECS's best customers. After litigation in the UK, ECS complained to the European Commission, which ultimately held that AKZO had abused its dominant position, imposing a fine of ECU 10 million and ordering it to cease the infringement, which meant to refrain from offering or applying prices which would result in customers in respect of whose business it was competing with ECS paying dissimilar prices to those paid to comparable customers. The European Commission did not base its decision on any view as regards AKZO's prices in relation to costs, but focused on what it saw as the intent behind AKZO's actions. On appeal to the CJEU, the court found that AKZO was guilty of predatory pricing but set out a different test to that adopted by the European Commission (see Box 3.11).

KEY CASE EXTRACT **Box 3.11**

Test for predatory pricing

Source: Case C-62/86 *AKZO Chemie* v *Commission* [1991] ECR I-3359 at paras 71–2:

> Prices below average variable costs (that is to say, those which vary depending on the quantities produced) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss, namely the total amount of fixed costs (that is to say, those that remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced. Moreover, prices below average total cost, that is to say, fixed costs plus variable costs, but above average variable costs, must be regarded as abusive if they are determined as part of a plan for eliminating a competitor. Such prices can drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them.

Questions: Are there any circumstances in which a business would think it was a good idea to price below average variable cost? How do you prove that someone has a plan for eliminating competition? How is this different from normal market behaviour?

This seems to set down a test which says that prices below AVC *are* predatory ('must be regarded as abusive') but that prices above AVC but below ATC are predatory only if they are part of a plan to eliminate a competitor. A number of comments can be made about this test.

[134] Case C-62/86 *AKZO Chemie* v *Commission* [1991] ECR I-3359.

First, the language of the CJEU is seemingly absolute as regards prices below AVC[135] but all the commentators on the case find this uncomfortable and extreme and translate this into a rule that prices below AVC are *presumed* to be predatory, albeit taking the view that this is a very strong presumption, something which, as we shall see, has also been picked up by the GC and European Commission.[136] Secondly, when prices are between AVC and ATC what becomes crucial is the intent of the undertaking in the particular circumstances and this opens up a very difficult area because the intent of all profit-seeking undertakings is to beat, or outperform, their competitors. It may in practice prove very difficult to distinguish between the ordinary intentions of competition and those which are judged to be predatory, in particular as business people can engage in colourful phraseology. In one US case, the Chief Executive of a company accused of predatory pricing advised that, 'when you see the competition drowning . . . stick a water hose down their throats'. The Court responded that, 'The antitrust statutes do not condemn, without more, such colorful, vigorous hyperbole; there is nothing to gain by using the law to mandate "commercially correct" speech within corporate memoranda and business plans.'[137] In the EU context, what is important is the intention of the undertaking, not the effects of the behaviour; the fact that the hoped for result is not achieved is not relevant.[138] Thirdly, as we have seen above, for predatory pricing to be a rational strategy it must be possible for the undertaking engaging in it to recoup its losses – the *AKZO* case says nothing about the possibility of this. Finally, the case itself illustrates the difficulty of apportioning costs because the Commission and AKZO submitted very different cost estimates, with AKZO arguing that its labour costs were fixed, rather than variable, a point with which the CJEU agreed.

Nor is it obvious that the best explanation for this case was predatory pricing; it seems equally possible that the intervention of the European Commission simply brought to an end a competitive price war in a bilateral oligopoly.[139] ECS and AKZO had had previous commercial links before ECS entered into manufacturing, there are some doubts that AKZO could have maintained its pricing strategy given the market share of ECS, it is not clear that entry barriers into the market were high and there were a number of large buyers in the market which could have, if genuinely faced with a monopoly, kept ECS in business if they had felt threatened. The important point about this interpretation is that it shows that the main thrust of the case is in protecting smaller competitors against commercial harm visited on them by a larger undertaking. It certainly makes it very difficult for a dominant undertaking to decide how to respond to its competitors.

The next major case in front of the CJEU was *Tetra Pak*, where an undertaking had a dominant position in the aseptic carton market, with a market share of over 90%, but was fined for predatory pricing in a different market, for non-aseptic cartons, on which it was not

[135] And even stronger subsequently in Case C-333/94P *Tetra Pak International* v *Commission* [1996] ECR I-5951 at para. 41: 'prices below average variable costs must always be considered abusive'.

[136] For example, A. Jones and B. Sufrin, *EU Competition Law* (4th edn, Oxford University Press, 2011) at p. 396; Case T-340/03 *France Télécom SA* v *Commission* [2007] ECR II-107 at para. 227; Case C-202/07P *France Télécom SA* v *Commission* [2009] ECR I-2369 at para. 109 ('prima facie abusive'); European Commission (n. 7) at para. 64. In the UK, see *Aberdeen Journals* v *Director General of Fair Trading* [2003] CAT 11 at para. 357.

[137] *Advo, Inc.* v *Philadelphia Newspapers, Inc.* 854 F Supp 367 (3rd Cir. 1995).

[138] Case T-340/03 *France Télécom SA* v *Commission* [2007] ECR II-107 at para. 196. European Commission (n. 7) at para. 69.

[139] Van den Bergh and Camesasca (n. 122) at pp. 296–8.

dominant. One of the issues argued in the case was that, since the European Commission had not shown that Tetra Pak could recoup its losses, it was not guilty of predation. The CJEU firmly rejected this argument:

> . . . it would not be appropriate, in the circumstances of the present case, to require in addition proof that Tetra Pak had a realistic chance of recouping its losses. It must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated.[140]

This marks a significant difference between the EU approach to predatory pricing and that within the US, making it in principle easier to prove such a case in the EU. This has led to some debate within the academic literature, which has spilled over into the work of the CJEU. Broadly, there are two positions: there are those who feel that recoupment should be part of the test for predatory pricing under EU law because it is the essence of the practice;[141] and there are those who argue that, as the undertaking must be in a dominant position in order to bring the case, this means that the possibility of recoupment can be presumed.[142] The most authoritative supporter of the former position was Advocate General Fennelly, who thought that it was implicit in the *AKZO* test.[143] The problem with the latter position is that, although it may well be true in the cases with very high market shares, say over 75%, undertakings have been found to have a dominant position with market shares in the range of 40%–49% and the European Commission continues to argue that dominance is possible below the 40% mark. In addition, given that predatory pricing can be committed on a market where the undertaking is not dominant, as in *Tetra Pak*, the dominance found in one market does not imply recoupment on the other.

The recoupment issue was discussed in the co-called 'Wanadoo' case, where[144] Wanadoo, a subsidiary of France Télécom, was accused of predatory pricing by the European Commission in relation to the prices it charged for ADSL (i.e. broadband) internet for a period of around 18 months. For part of the period prices were below AVC; for the remaining part of the period they were below the full costs (ATC) of the service. The European Commission claimed that this was a deliberate policy, which was part of a company plan to pre-empt the market for high speed internet access. As a result of its policy, the undertaking's market share rose from 46% to 72% in the context of a rapidly growing market. By contrast, at the end of the period of the abuse no competitor had more than a 10% share of the market and one had gone out of business. A fine of €10.35 million was imposed. Wanadoo appealed to the GC on a number of grounds including that the European Commission had to provide evidence of recoupment of losses. The GC took the view that it was not necessary for proof of recoupment of losses to be found before taking a decision of predatory pricing.[145] This should perhaps be seen in the context of the GC's comment that case law established that if a dominant undertaking implemented a practice which intended to eliminate competitors, the fact that they were unsuccessful is irrelevant.[146] This was affirmed as the correct position

140 Case C-333/94P *Tetra Pak International* v *Commission* [1996] ECR I-5951 at para. 44.

141 See Bishop and Walker (n. 18) at para. 6.102; Van den Bergh and Camesasca (n. 122) at 294; L. Bravo and P. Siciliani, 'Exclusionary Pricing and Consumers Harm: The European Commission's Practice in the DSL Market' (2007) 3 *Journal of Competition Law and Economics* 243 at 254–5.

142 See European Commission (n. 11) at para. 122.

143 See Cases C-395 and 396/96 *Compagnie Maritime Belge* v *Commission* [2000] ECR I-1365 at para. 136 of the AG's opinion.

144 Case T-340/03 *France Télécom SA* v *Commission* [2007] ECR II-107.

145 Ibid., para. 228.

146 Ibid., para. 196.

by the CJEU on appeal in this case, contrary to the views expressed by Advocate General Mazák.[147]

To end this section it should be noted that the European Commission has experimented with different cost standards in its decisional practice and in guidance that it has issued in telecommunications and, most recently, in its guidance on exclusionary abuses. In its 'Notice on the application of competition rules to access agreements in the telecommunications sector', the European Commission suggested that it would be appropriate to apply a cost standard of long-run average incremental costs in telecommunications because in network industries there are much larger common and joint costs.[148] In a decision relating to Deutsche Post, it found predatory pricing on the grounds that the prices charged were below the long-run average incremental costs, that is the costs incurred in providing a specific service.[149] In its guidance on Article 102 TFEU, the Commission says that the appropriate cost benchmark is average avoidable costs, which means that the price it is charging for part of its output is not covering the costs that could have been avoided by not producing that output. This may be a stricter test because, in certain circumstances, such as where capacity is expanded in order to predate, the average avoidable costs will include this element of investment, which would not be included under the AVC test.[150]

UK case law on predatory pricing

Although accusations of predatory pricing are not uncommon in a UK context, there are only three examples of cases where a breach of the s. 18 prohibition has been found: *Napp Pharmaceuticals*, *Aberdeen Newspapers* and *English, Welsh and Scottish Railway (EWS)*.[151]

Napp was the first case before the CAT and involved a pharmaceutical firm which produced sustained release morphine tablets, which it sold into the community and hospital markets and had a market share, across the two markets, of around 95%. The hospital market was critical for Napp because, if a patient was prescribed its drug in hospital, the patient would continue to be prescribed the drug once he or she returned to the community. Although Napp accepted that it was pricing below cost in the hospital sector, it argued that the *AKZO* approach was inappropriate here because, although sales in the hospital segment were unprofitable, when these sales were combined with sales in the community segment, the business as a whole was profitable. For example, a patient in a hospital would be prescribed Napp's drug and then, on leaving hospital, would continue taking it. The combined revenue of sales to this patient in the hospital and community would be profitable. The CAT rejected this defence largely because Napp produced no evidence that this reasoning was part of its rationale at the time of sale (it was produced for the purposes of the tribunal hearing), although there were also some important conceptual weaknesses in the defence.[152] It confirmed the DGFT's finding of an abuse of a dominant position on the basis of predatory pricing.

[147] Case C-202/07P *France Télécom SA* v *Commission* [2009] ECR I-2369.
[148] [1998] OJ C265/2 at paras 113–14.
[149] Case COMP/35.141 *Deutsche Post*, OJ L125/27, 5.5.2001.
[150] European Commission (n. 7) at para. 64.
[151] *Aberdeen Journals* v *Director General of Fair Trading* [2003] CAT 11; *Napp Pharmaceuticals* v *Director General of Fair Trading* [2002] CAT 1; *English, Welsh and Scottish Railways Ltd* decision of the Office of Rail Regulation available at: *http://www.oft.gov.uk/OFTwork/competition-act-and-cartels/ca98/decisions/ews-rail* (accessed 02/09/12).
[152] *Napp* (n. 117) at paras 251 and 258–66.

Aberdeen Journals was a case which involved the owner of three papers in the Aberdeen area, two of which customers paid for, one of which was free, incurring losses on the free paper in relation to its prices for advertising in order to expel a new entrant on the market for free newspapers. Here, ultimately, after substantial argument,[153] the case came down to pricing below AVC for one month in 2000 (just after the Competition Act 1998 came into force) and the CAT upheld the DGFT's decision.

EWS was a decision of the Office of Rail Regulation (ORR) which found that EWS, which provided rail freight transport, had abused its dominant position by engaging in exclusive contracts, discriminatory behaviour and predatory pricing in order to protect its competitive position. A penalty of £4.1 million was imposed. Interestingly, the predatory pricing here was found to be between AVC and ATC, although closer to the former than the latter, and that, combined with the evidence of appropriate intention, convinced the ORR that predation had occurred.[154]

US case law on predatory pricing

Having looked at the EU and UK case law, it is worth briefly discussing the American experience because this offers an important contrast to the European approach as it is much more difficult to prove a case of predatory pricing under American law.[155] As a preliminary point, the Supreme Court has expressed some scepticism about the prevalence of predatory pricing: 'predatory pricing schemes are rarely tried, and even more rarely successful' and they are concerned that the costs of an erroneous finding of liability are high.[156] *Brooke Group* sets out two prerequisites for proving predatory pricing: first, the prices complained of must be below an appropriate measure of its rivals costs and, secondly, a demonstration that a competitor had a dangerous probability of recouping its investment in below-cost prices. The general consensus is that the combination of these two tests has made it very difficult or almost impossible for plaintiffs to prove predatory pricing cases.[157] The first hurdle will be proving that prices are below an appropriate measure of costs. Although the American federal courts do not appear to have adopted a common test, the Areeda–Turner test has been very influential and they began, it has been said, by embracing it.[158] One of the consequences of this was said to be that at high output levels the test was a paradise for defendants and virtually none lost a case.[159] In applying this test, the courts have faced a number of difficulties in applying the test but this has still provided the basic framework for their inquiry. The second hurdle,

[153] *Aberdeen Journals* v *Director General of Fair Trading* [2002] CAT 4; *Aberdeen Journals* v *Office of Fair Trading* [2003] CAT 11.

[154] *English, Welsh and Scottish Railways Ltd* decision of the Office of Rail Regulation available at: *http://www.oft.gov.uk/OFTwork/competition-act-and-cartels/ca98/decisions/ews-rail* (accessed 02/09/12) at 144 (all cost and price numbers are redacted).

[155] The focus is on the Sherman Act, not the Robinson-Patman Act, which has somewhat different conditions for liability.

[156] *Brooke Group Ltd* v *Brown & Williamson* 509 US 209 (1993) citing *Matsushita Electrical Industries Co Ltd* v *Zenith Radio Corp*, 475 US 574 at 589 (1986). Although compare *United States* v *AMR Corp*, 335 F 3rd 1109 (2003): 'Although this court approaches the matter with caution, we do not do so with the incredulity that once prevailed.' At para. 16.

[157] Although see D. Crane, 'The Paradox of Predatory Pricing' [2005] 91 *Cornell Law Review* 1 at 4–5, who suggests a more nuanced picture.

[158] See H. Hovenkamp (n. 37).

[159] Ibid., p. 388.