A Brief Comparison of the European and the American Approach to Predatory Pricing*

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Summary: Predatory pricing might be called as „the trickiest antitrust problem“ due to the power of predatory pricing to lay bare the most controversial features and deepest contradictions of antitrust law – „using competition to destroy competition“ and „probihiting competition to foster competition“ – those are the callenging statements that pust to the extreme the law and economic of the predatory pricing, since those two statements really make sence only when it comes to the predatory pricing. This article aims to provide a brief explanation of divergent approaches to predatory pricing within the European jurisdiction and the American jurisdictions. The situation in the Czech Republic is mentioned as well although the Czech decisional practice is in line with the European decisional practice in the field of predatory pricing.

Keywords: predatory pricing – comparison – recoupment – cost level tests – profitability – case law – Student Agency versus Asiana Case

1. Introduction

Predatory pricing is an unlawful business behavio our within the broader category of unlawful exclusionary practices. It is a practice whereby an undertaking prices its products so low that competitors can not live with the price and are driven from the market. Once the competitors are excluded from the relevant market the undertaking hopes to increase prices to monopoly levels and recoup its losses.

The fact that a low price may not necessarily be a good price is the chief reason for taking predatory pricing law and economics as one of the most exiting vessel for saling the turbulent waters of antitrust law.[1] The controversy of this

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1 GIOCOLI, N. *Predatory pricing and antitrust law and economics: A historical Perspective.* 1st edition, Taylor & Francis Ltd, p. 5.

topic is based on a different approach to predatory prices, since competition authorities in the European Union and the United States have a very different approach in the assessment of predatory pricing.

The intractable problem for competition authorities is to identify where robust price competition ends and predatory pricing begins. As such, predatory pricing is one of the most dauting subject confronting nations with competition policies. Wrongfully identifying robust price competition as predatory pricing as well as failing to identify predatory pricing when it occurs are both prejudicial to customer welfare, but many competitors agrue that in respect of predatory pricing the avoidance of wrongfully identifying robust price competition as predatory pricing should be the priority.

There are also 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. The main stream view nowadays is that predatory pricing can be a rational strategy where certain conditions are met. As such, if it is accepted that predatory pricing does occur the problem is to identify it correctly and prove successfully.

Most predatory pricing theory centres around costs levels. The basic concept of predatory pricing is that a dominant undertaking prices below cost. The difficulty with this is that an undertaking's costs are usually difficult to compute and so is the relationship between its costs and prices. Particular problem arise where an undertaking uses the same production capacity to make different products. Discussion, which cost test is the best one has not yet reached a consensus, and even the courts have not yet strived to one approach within their decisional practice. The consensus is that the sale prices can not be automatically deduced only in accordance with price and cost comparison, since it is very important to analyze all other features of predatory behaviour, such as predatory intent, structure of the relevant market and market shares of other undertakings within the relevant market, etc.[2]

1.1. The profitability of predatory pricing

In general, there are different opinions about how often predatory pricing actually occurs. Since the predator strategy is to sacrifice profit and its maximalisation in the short term in order to get monopoly profits in the long term. Some economists are asrguing that predatory pricing is very hardly a rational business strategy and as such i tis very rare. The main stream view nowadays is that predatory

[2] JONES, A., SUFRIN, B. *EU Competition Law. Text, Cases and Materials*. Oxford: Oxford University Press, 2014, p. 403.

pricing can be a rational strategy where the conditions are right, for example in new economy markets.[3] When it comes to the profitiability of predatory pricing, several arguments can be founf, there are the most common:

- At least in some circumstances established firms will find it profitable to practice predation by reducing their prices to deter entry to the relevant market.
- Predatory pricing will rarely or never be profitable because the direct cost of predatory price cutting will always be prohibitive.
- Predatory pricing will rarely or never be practiced because it will almost always be less profitable then buying the rival out.
- Predatory pricing will never be profitable because the predatory threat will never be credible in a finite game of complete and perfect information.
- Predatory pricing will be profitable only for dominant firms with monopoly power and only when „conditions of entry" to the relevant market are difficult, i.e. barries to entry the relevant market are high.[4]

1.2. Comparison of approaches

Predatory pricing strategy can be found in both jurisdictions, but the approach to this issue differs in terms of historical development and even nowadays it is still characterized by considerable differences. Therefore, it is appropriate to find and evaluate the differences and similarities of these two major competition law jurisdictions, European and American. Since the main aim of my research is to compare the differences in the interaction, I will focus on following three basic aspects.

1.2.1. Generally different approach to competition

Primary EU law, ie. article 102 TFEU, applies only to undertakings in a dominant position. The fact that an undertaking has a dominant position on the relevant market is not in itself unlawful unless there is an abuse of a dominant position. This led to the evolution of the European concept of special responsibility of a dominant competitor. The aim is to prevent all abusive and exclusionary behaviour by dominant undertakings. It is not about protection of less efficient undertakings from dominant competitors, it is more about protection of the competition as such (and, as a result, a protection of customers and their welfare). On

[3] JONES, A., SUFRIN, B. *EU Competition Law. Text, Cases and Materials.* Oxford: Oxford University Press, 2014, p. 402.

[4] MARKOVITS, R. *Economics and the Interpretation and Application of U. S. and E. U. Antitrust Law Volume I Basic Concepts and Economics-Based Legal Analyses of Oligopolistic and Predatory Conduct*. Springer-Verlag Berlin and Heidelberg GmbH & Co. KG; year 2014, p. 517–530.

contrary, in the US a more aggressive competition in the business environment is acceptable and it is not desirable to suppress this feature.In the US, a monopoly position (obtained in accordance with law, coming from the competitor's ability to grow and its development) is desirable. A successful competitor can never be punished for his success. A high market shares (and thus a possible dominant possition on the relevant market) are not in itself illegal, but a monopolization and an effort to reach it are strictly prohibited.

For these reasons, following questions might be asked:

- Can a toleration of aggressive competition be positive?
- Or, is it better to rely on enforcement of strict competition standards?

The fundamental problem lies in situation when competition laws set its standards too strictly because the dominant undertaking will feel threatened and may also abandon competitive behavior, for example the undertaking may give up price reductions that could have a posittive effect on the relevant competiton as well as on customers. At the same time, less effective competitors may feel support on strict competition standards and these price reductions may be judicially challenged as a predatory behavior, which would, at the end of the day, force the dominant undertaking to raise prices, even if it did not commit any illegal act. The fact is, that most dominant undertakings will always prefer to avoid litigation (due to costs, long-lasting court proceedings). As such, bringing the lawsuit can be an effective tool against the dominant undertaking, even if the action does not have a chance to succeed. It can also be an opportunity to gain any important internal competition information, and so on.

2. From different historical perspective to current legal bases

The US is considered to be the cradle of competition law. The American concept is much older than the European one, since *the Sherman Act* was adopted already in 1890. In 1939 *the Robinson-Patman Act* was adopted, which specified the prohibition of price discrimination. In the US, there are four relevant Acts which, although adopted as independent, need to be seen in a comprehensive way. Besides, in case of common law system, due to a rule of precedents, the key case law doctrines have provided the ruling precedents for many decades. The US Supreme Court produced its 1967 *Utah Pie decision*, which was a true milestone and, later in 1994, *Brook Group decision* which is considered to be a leading case of the US predatory pricing approach.

While European competition law has developed since 1950's in the context of economic integration and requirements to remove barriers to trade between EU Member States and the beginning of free movement of goods. As such, the European concept is younger, as well as the competition legislation. The European judicial practice started to deal with predatory pricing in 1991 when the first case of predatory pricing appeared. In that time, the basic rules for assessing of the predatory behavior were defined. So called *AZKO rules* are based on assessing the alleged predatory pricing by comparing prices, average variable costs and total costs. One important element of predatory behavior was established as well, it is the intention of the dominant undertaking to eliminate the relevant competition. About five years later, the European Court of Justice (hereinafter the ECJ) dealt for the first time with the question of recoupment as a necessary condition of predatory pricing. The ECJ finally stated that the reimbursement of suffered losses (ie. recoupemnt) is not a necessary precondition for predatory pricing.

The importance of case law and secondary legislation remains a consistent feature of both compatition systems. Especially in the US, key case law doctrines have provided the ruling precedents for many decades. Concerning the secondary law in the EU, those are in particular EC Guidelines that are providing a guidance for the proper interpretation of primary law provisions. A kind of a secondary law dealing with predatory pricing could be found within the US legislation as well. For example, Guidelines of the US Ministry of Transport (dealing with an air industry) have also determined that predatory behavior is a dangerous anti-competitive practice.

3. Case study comparison in relation to recoupment

The US judicial practice requires the recoupment as a necessary precondition for predatory pricing. This strict rule on proof of recoupment was set by the Brook Group decision, since so called Two-Step test must be applied to any alleged predatory behaviour of the undertaking. Firtly, the price is set below the level of reasonable cost, and secondly, there is a high probability that an undertaking will replace the losses suffered in the first stage of predatory behaviour through a significant increase in prices after (all) other competitors have left the relevant market. This is a necessary condition that any plaintiff must prove and it appears to be highly problematic.

Thus, the US judicial practice recognizes recoupment as a prerequisite for qualifying a prohibited act as predatory, while in the EU within the reasoning in Tetra Pak II case, the ECJ declared that the condition of recoupment is not

considered as a necessary prerequisite proving price predation. To prove predatory pricing, it is sufficient to prove the probability that the undertaking will be able to compensate their losses in the future. As such, in the EU, it is sufficient to prove a real threat of damage to the relevant competition, which may be much easier for the plaintiff.

At this point a practical collision of both systems can be found. The relevant case law, *Tetra Pack II* case (*C-333/94 P*) and *Brook Group* case *(*509 U. S. *209*) are both dated in the first half of the 90's. Since that time, a practical collision of EU concept and US concept can be seen.It is almost certain, that a particular undertaking (competitor) would meet any actions brought against it for its predatory practices in the EU, while in the US, the same undertaking would not have met any actions for the same predatory practices behaviour.

It is a fact that due to the current conditions for assessing predatory pricing, it is extremely difficult to prove such an abusive behaviour, and therefore ultimately less and less abusive practices are considered as forbidden in the US. Since the Brook Group judgment (since 1994), no plaintiff has ever won a case of challenging predatory behavior, precisely due to the inability to prove all conditions of recoupment. Plaintiffs do not actually bring the actions because they are aware of the fact that a chance to win the case is very low. The US approach is likely motivated by the fear that an undertaking will be unfairly convicted of a predatory behaviour, which would negatively affect the relevant market. However, it is necessary to admit that certain skepticism of predatory pricing as a business strategy is a characteristic of the US approach.

Whereas in Europe, within the European development in the field of predatory pricing during the last two decades, an interesting shift in the European approach to the predatory prices can be seen. Already in 2010, in the *Compagnie Maritime Belge case* (C-395/96 P and C-396/96 P), the Advocate-General proposed that the recoupment should become one of the core components of the predatory pricing test, but the ECJ disagreed. The same situation happened again in 2009 within the *France Télécom case* (C-202/07 P). Inter alia, the ECJ had ruled again not having a strict recoupment requirement.

Arguments supporting the present ECJ position, are as follows:

- It is often difficult to prove what the dominant undertaking could do succesfully at an unspecified time in the future. It would be necessary to show that there would be no entry by more competitive or more determined rivals, and that when the dominant undertaking increased its price, it would not attract new entry. It would be also necessary to prove that although buyers were accustomed to low prices, they would be willing to pay significantly higher ones in the future. All of this suggest that the burden of proof is crucial.

- Predatory pricing by a dominant undertaking may have anti-competitive effects even if the dominant undertaking does not or could not recoup its looses The undertaking may discourage market entry, or causes exit, by signaling to actual or potential competitors that their profitability in the market will be low as long as the dominant undertaking is price leader in the relevant market.
- Predatory pricing may have anti-competitive effects even if the rival is not forced out of the relevant market, but instead decides to raise its prices to approximately the prices of the dominant company. In particular, in a concentrated market predatory pricing may demonstrate the dominant undertaking's ability and willingness to retaliate against aggressive pricing by a competitor, and so may give rise to oligopolistic pricing. In such circumstances it would be extremely difficult to prove that recoupment had occurred, even i fit had.

Generally speaking, opinions of Advocates-General are innovative and represent the development of the EU law, or, where it is appropriate, point to its defects. It is also a valuable source of information on EU law, since they often give a retrospective overview of development within the EU law and the ECJ's case law on the issue. Opinions of Advocates-General also often precede the ECJ's own decisional practice, since they are followed by the ECJ in approximately 80 percent of cases. And so, although in case of predatory pricing the ECJ has decided not to follow the Advocate-General opition, it is more and more than obvious that the EU approach to predatory pricing is developing and can not be expected to stay static in the future. In my opinion, in today's increasingly globalized world, the situation in which predatory behaviour is treated so differently is not sustainable for a long time.

Although it might be hard to predict a possible future development of predatory pricing in Europe these questions logically arise for everyone who is interested in the subject:

- What will be (most likely) the approach to predatory pricing in Europe within the coming decades? In which direction the European competition law should be moved in this area?
- Should the ECJ judges follow the Advocates-General Opinions or should they keep on holding a strict recoupment requirements? What is better for the European business environment, and why?

4. Predatory pricing situation in the Czech Republic

In the Czech Republic, there is a ban on applying predatory pricing regulated in the Competition Protection Act, section 11, subsection 1, letter e)[5]. Of course, it is clear that predatory pricing conduct must be interpreted in the same sense as the European Union's decision-making practice. It is necessary to meet the following conditions:

- firstly, there must be a long-term, or systematic, offering of low-priced products or services, and
- secondly, such conduct must be capable of distorting effective competition within the relevant market. The predatory competitor is later able to compensate its losses by increasing its own prices. Therefore, the predatory behavior is not in a long run perspective beneficial for consumers although at the beginning it may seems to be „consumer friendly" due to price reductions.

The legal prohibition of predatory pricing has initially caused a criticism in the Czech Republic, mainly due to its rather vague content, both in terms of the assessment of inappropriateness of the conduct as well as in terms of what the distortions of competition within the relevant market should be(means) in this case. The legal provision mentioned above also does not precisely define the concept of 'unreasonably low price'. And so, it was not clear according to which given the costs (variable, average or fixed) the value of the unreasonably low price should be judged. The explanatory approach of the Czech Office for Protection of Competition to this provision was not clear for a long time, since it took quite a while to dealt with predatory pricing case in practice.[6]

The first (and so far the only) Czech case dealing with predatory pricing is *the Student Agency versus Asiana Case* often described as "the combat between David and Goliath" in the press, in particular because of the unequal position of both competitors in the relevant market and their unequal market shares. It is a case of an abuse of a dominant position by the STUDENT AGENCY competitor which created barriers to entry the relevant market and was also selectively reducing its prices within the national bus line service market on the Prague – Brno route from December 2007 to March 2008. The competition was of a negative nature (with the intention of eliminating other competition from the relevant market) and consisted of applying selective price reductions (and therefore the long-term use of unreasonably low prices) for passenger tickets on bus connections which

[5] Law no. 143/2001 Sb., zákon o ochraně hospodářské soutěže a o změně některých zákonů (zákon o ochraně hospodářské soutěže).

[6] KINDL, J., MUNKOVÁ, J. *Zákon o ochraně hospodářské soutěže. Komentář.* 3. přepracované vydání. Praha: C. H. Beck, 2016, p. 215–216.

were coincided with the shedule of ASIANA's bus connections on the same route. The behavior described above was found to be capable of distorting competition on the relevant market. The selective reduction of prices to the sub-cost level occurred in response to prices of passenger transport set up by competing undertakings. STUDENT AGENCY also strengthened its transportation capacity of the connections in competitive shedule by deploying buses and the price on the route was set on a sub-standard basis to 50 CZK, later increased to 95 CZK for a one-way ticket.

While assessing this case, the Office for Protection of Competition had in most relevant aspects referred to the so-called more economic approach and had applied the cost level test, essentially in line with the European decision-making practice and in line with the concept of equally effective competitors.[7] This approach was subsequently confirmed by the Czech administrative courts.[8] It can be considered as an interesting fact, that according to the opinion of the Regional Court in Brno, the Office for the Protection of Competition failed to reliably prove that the train transportation service and the bus transportation service on the Prague – Brno are two separate relevant markets. Therefore, if it was not sufficiently proved that the market for public bus transport is in fact a separate relevant market in relation to the period under consideration, then the position of the competitor (STUDENT AGENCY undertaking) can not be considered as dominant and so it is not possible to impose so-called special responsibility of the undertaking for infringement of the dominant position on the relevant market.

However, the Supreme Administrative Court did not agree with the legal opinion of the Regional Court. The Supreme Administrative Court confirmed all conclusions of the Office for Protection of Competition, mainly the definition of the relevant product market. The relevant product market was finally defined by which the approach of the Office for Protection of Competition was confirmed. The relevant product market was defined as a single an separate passenger bus market, which also resulted in the dominant position of STUDENT AGENCY undertaking within the relevant market and thus the abuse of its dominant position by creating barriers to entry the relevant market in order to eliminate other competitors from the relevant market with the assumption of later compensation for the losses suffered (so called recoupment) was confirmed as well.

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[7] The First Instance Decision of the Office for Protection of Competition dated on 3rd November 2010, No. ÚOHS-S162/2008/DP-4490/2010/820/DBr and Decision of the Chairman of the Office for Protection of Competition dated on 18th February 2011, No. ÚHS-R169 / 2010 / HS-2676/2011/310-PGa.

[8] Judgment of the Regional Court in Brno dated on 9th November 2012, No. 62 Af 27/2011 and Judgment of the Supreme Administrative Court dated on 30th September 2013, No. 2 Afs 82/2012-134.

The fact is, that none of the Central European countries have a lot of experiences with predatory prices and its assessment. The Czech Republic, as a member state of the European Union, is required to apply its national competitive legislation in line with the EU primary law and case law, since the main purpose is to achieve the full compatibility and the euroconform interpretation of the national competition law. All of the above mentioned tendencies were clearly apparent when analyzing the case.

5. Conclusion

Concerning the current state of knowledge, there is a considerable amount of foreign (english) literature dealing with competition law, namely dealing with the phenomenon of predatory pricing, both from an economic and legal point of view. For this reason, the current state of knowledge can be considered as highly developed. The monographs focus on the analysis of the theoretical basis for assessing predatory prices, as well as on the relevant case law. There is also a sufficient number of expert papers and articles dealing separately with the American and the European approaches to predatory pricing. It is not exceptional to find a paper dealing with a specific national case law or a particular situation in the field of predatory pricing within a particular European state. To my best knowledge, a comprehensive analysis of the European and the American approach to predatory pricing, including a detailed case law comparison has not been so far published in English.

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