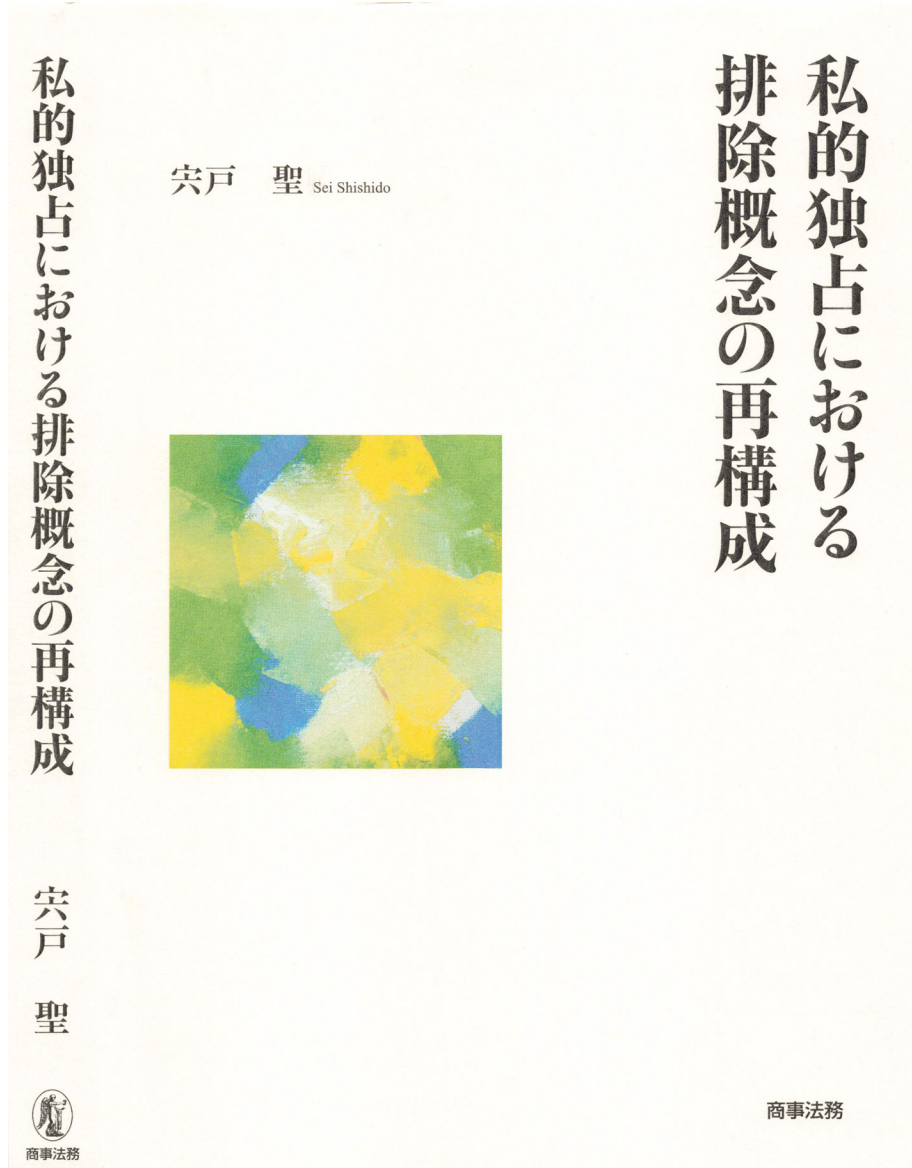


Above Cost Predatory Pricing and Private Monopolization

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About my paper



Intro

I will talk about predatory pricing that are not below AVC or AAC.

In Japan...

- Article 2.5 of the Japanese “Anti Monopoly Act (AMA or JAMA)” defines “Private monopolization”
- Private monopolization is prohibited by Article 3
- Private monopolization is the Similar concept to Monopolization under Section 2 of Sherman act or Abuse of dominance under Article 102 of TFEU

Private Monopolization : requirement

- Exclusion or Control
- Whether it is exclusion or not will be decided by “Artificiality” + “Exclusionary Effect”
- the formation, maintenance, and strengthening of market power

In typical predatory pricing case...

- The price in question can be artificial and has exclusionary effect if it is below AAC or AVC

Intro 2

The USEN case

- The court did not perform price-cost analysis
- Conduct in question: Dominant incumbent (USEN) stole its competitor's customer by setting low price only for those customers that have dealt with its competitor. It also stole its competitor's employee.
- The price: it was above AAC or AVC, probably even above ATC.

Criticisms

- The exclusionary strategy involved pricing conduct
- Strategy was typical predation
- It must be analyzed with price cost test

Question

- was price cost test necessary for USEN case?
- How can we analyze pricing conduct with prices above AVC or AAC?

Two types of above cost pricing

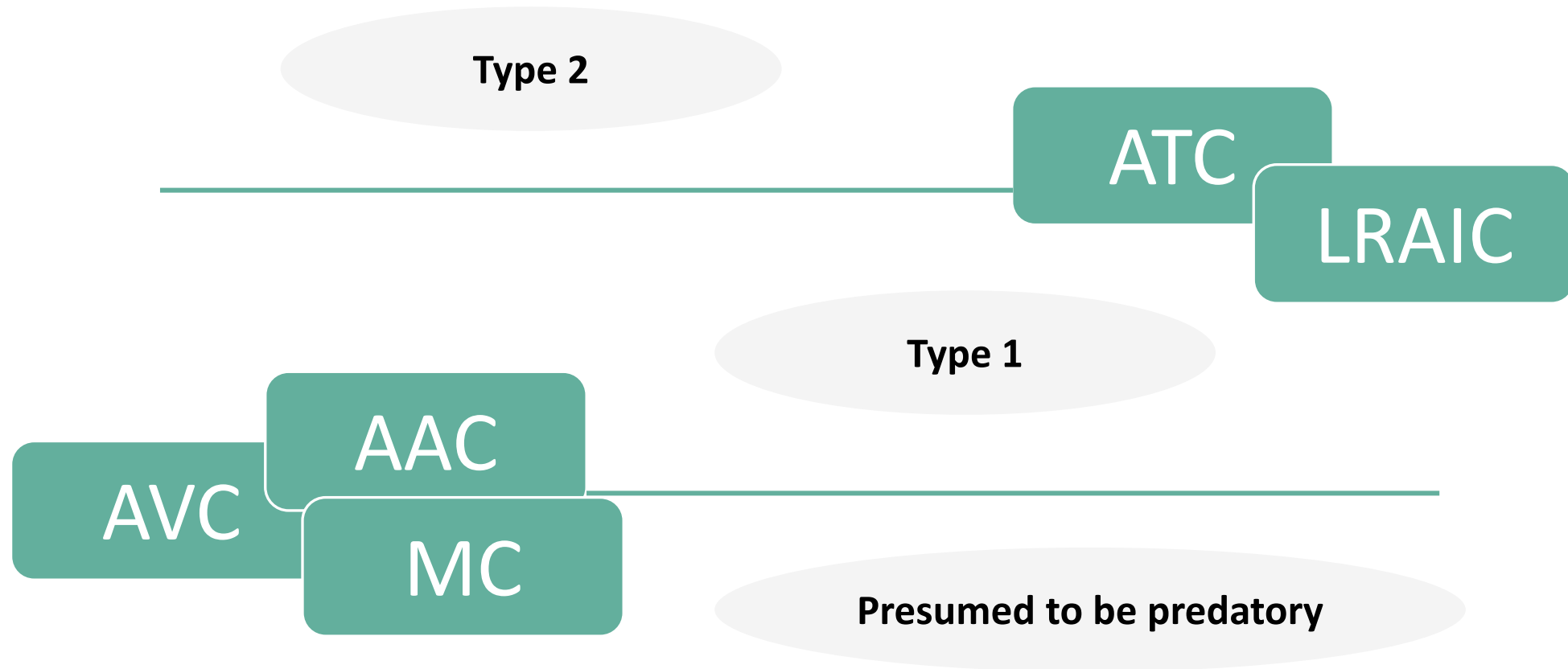


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Provisions of Japanese “AMA”

Article 2.9.3:

- unjust low pricing which is below Average Avoidable Cost or Average Variable Cost

Section 6 of General Designation by JFTC

- other types of unjust low pricing
- In addition to any act falling under the provisions of Article 2(9)(iii) of the AMA, unjustly supplying goods or services for a low consideration, thereby tending to cause difficulties to the business activities of other enterprises.

Article 2.5: A private monopolization

- “Such business activities, by which any enterprise, individually or by combination or conspiracy with other enterprises, or by any other manner, excludes or controls the business activities of other enterprises, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade”.
- According to the Japanese supreme court, “excludes” means “to make its competitor’s entry significantly difficult through an artificial method in the sense that such method is beyond the normal method of competition”.
 - *NTT east* and *JASRAC*.

Japanese courts (Type 1 cases)

Supreme court (Shibaura Slaughterhouse)

- Price competition is the essential factor of the competition on the merits which competition policy try to induce.
- Price above ATC is mere competition and therefore it cannot be harmful to the competition.

Exceptional cases

- Hamaguchi Oil
- Zenrin Map
 - Prohibited prices above AVC but below ATC.
 - JFTC found that the defendant had intent to exclude rival from the market.

Guidelines by JFTC

Unjust low pricing guideline

- Since above cost pricing never exclude as efficient competitors, JFTC never prohibits pricing above ATC as an unjust low pricing.
- When the price in question is above AVC but below ATC, JFTC considers various factors such as actual circumstances of competitors, size of the price cutter, duration of the price cut, and purpose or intent of price cut etc.

Private monopolization guideline

- Setting the price below AAC, which is not the result of business effort or normal competitive process, might exclude as efficient competitors or more efficient competitors. Therefore, such pricing might cause anticompetitive effect.
- Unless there are special circumstances, setting the price between ATC and AAC unlikely excluded as efficient or more efficient competitors.

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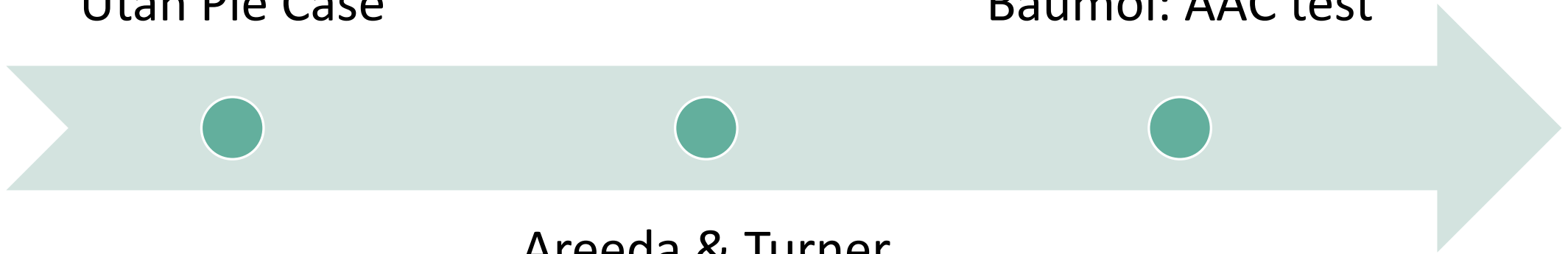
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Development of Price-cost analysis

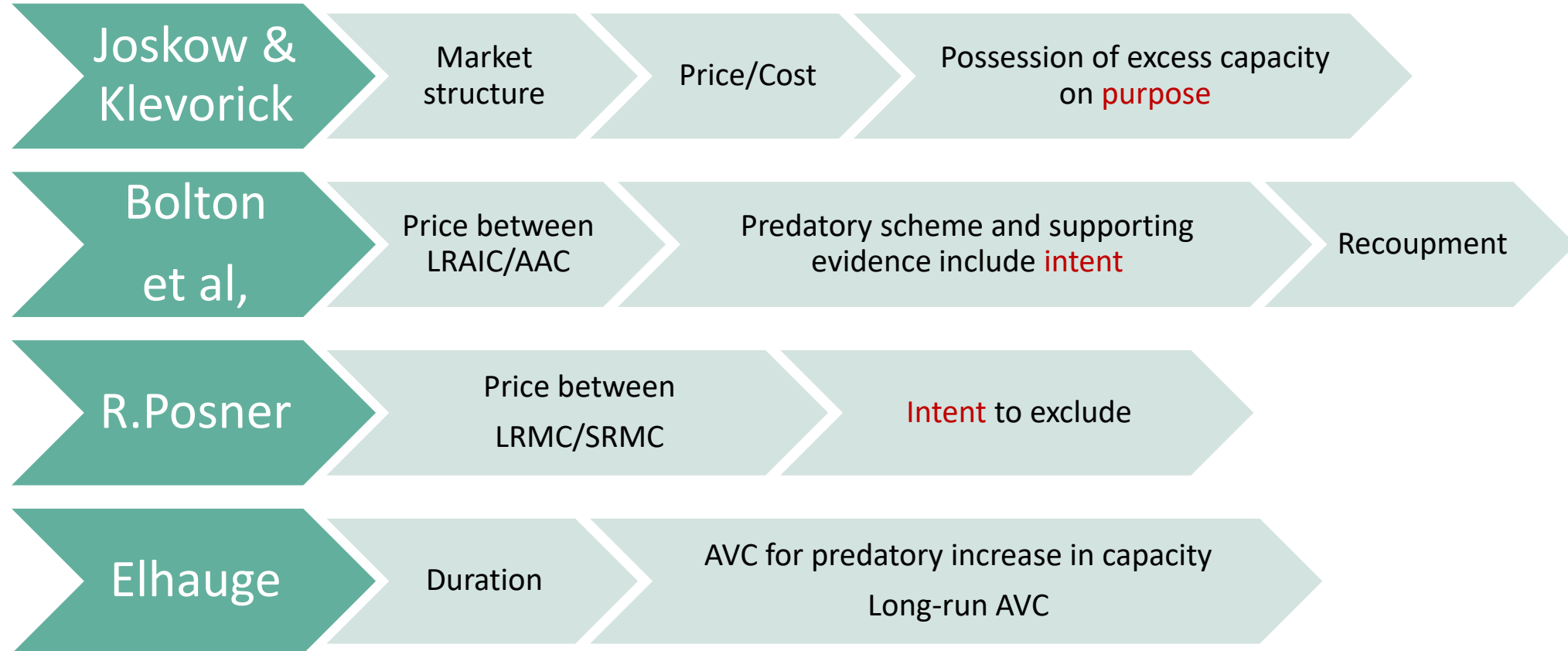
Before 1975 :
Utah Pie Case

Baumol: AAC test

Areeda & Turner
test: AVC (MC)
test



Overview of Academic debate over type 1 pricing in US



Academic Debate on above-cost pricing 1

Joskow & Klevorick (1979)

- On the first step of the test, plaintiff must show the structural characteristics that suggest that there is a reasonable probability that monopoly power has been or could be sustained by the use of price reductions.
- Price-cost analysis can be applied only when plaintiff satisfy the necessary conditions of the first test.
 - See Paul L. Joskow & Alvin K. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 Yale L.J. 213, 245-249.
- The evidence which shows that the price is below AVC is a conclusive evidence of predation.
- The evidence of below ATC but above AVC price is presumptive evidence of predation.
 - Defendant can claim justification if it has excess capacity. Defendant cannot rebut if such possession of excess capacity was on purpose.

Academic Debate on above-cost pricing 2

Bolton et al. (2000)

- Use modern economic theories and price cost analysis.
- Pricing between LRAIC and AAC might cause anticompetitive effect.
- “Advances in economic theory over the last twenty years provide the tools to conduct the close analysis that Brooke and other recent Supreme Court decisions have called for.”
- “Toward this goal, this article has proposed a structured rule of reason that would focus enforcement on cases where economic conditions make predation strongly plausible and where market conduct makes anticompetitive effects dangerously probable”. *See id.*, at 2238-2239.

As a necessary element in the prima facie proof of predatory pricing, Bolton and others suggest that, the courts need to consider followings.

- The market structure must make predation a feasible strategy.
- Ex ante plausibility of predation which is shown by proof of a predatory scheme and supporting evidence.
- Probable recoupment and price below cost.

Academic Debate on above-cost pricing 3

Posner (2001)

- Rely heavily on equally-efficient competitor test.
- Price below SRMC is predatory.
- Price below long-run marginal cost (LRMC: can be replaced by ATC) is predatory if it is engaged with exclusionary intent.

Academic Debate on above-cost pricing 4

Elhauge

- “The current debate is framed as being about which costs to include, when in fact the real debate is about which time period, output, and firm to consider in deciding how to categorize a cost”.
- “the question of whether (and what) costs to consider should depend solely on whether they could be varied during the time period of the alleged predation”.
- Appropriate measure of cost should be AVC for predatory increase in capacity (almost same as “long-run” AVC or AAC for predation).

Elhauge explains that it is easy to calculate such AVC once predation is completed, but it is not actually.

- You need to know the actual total cost function which is hard to calculate.
- Also, there is no reason to just wait until predation is done. Exclusion of competitors can be happened in initial period of predation.

Summary

Role of the intent evidence

- Posner proposed a test includes the consideration of “intent to exclude”, because he believes that exchange of some private information (such as cost structure or nature of management) can be a key, as Bolton et al. (2000) suggested.

The importance of the “Strategy”

- In sum, in a case of both type of of above-cost pricing, the most important thing is a consideration of the objective aspect of pricing strategy, not the price-cost relationship.
- Because the nature of the pricing strategy cannot be determined by the price-cost test itself, we need to analyze the intent of the pricing the communication of such information.

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 - d. Possible analytical framework suggested by EU case law
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Economic theory of predation

McGee (1958)

- argued that predatory pricing is not rational--and therefore does not occur--because the predator presumably has a greater market share; thus, when the price of the product falls below cost, the predator will suffer proportionately greater losses than the prey.
- John S. McGee, *Predatory Price Cutting: The Standard Oil (N. J.) Case*, 1 *Journal of Law and Economics* 137, 168 (1958).
- *See id*; see also John S. McGee, *Predatory Pricing Revisited*, 23 *J. L. & Econ.* 289 (1980).

Economic theory of predation

Game theory

- In 1980s, however, some economic scholars presented counter argument to Chicago school approach. These economists proposes numerous models which presuppose imperfect information or incomplete information.

Financial predation

Signaling & Reputation effect

- “In reputation effect and other signaling predation, the predator lowers prices to mislead the prey and any potential entrants into believing that market conditions are unfavorable. Signaling is a plausible predatory strategy because a firm's decision to enter or leave a market is based on its evaluation of expected future revenues and costs”. See Bolton et al., (2000).

None of those models requires exclusion of as efficient competitor or the below-cost pricing.

The legal theory of predation

“No Economic Sense” or “Profit Sacrifice” test


No Economic Sense Test or Profit Sacrifice test

- Predation(Bork, Ordoover & Willig)
 - “the predatory behavior is a response to a rival that sacrifices part of the profit that could be earned under competitive circumstances, were the rival to remain viable, in order to induce exit and gain consequent additional monopoly profit.”
- Aspen
 - The defendant “was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival.” (cited Bork) *Id.*, at 610-11; *see also Trinko*, 540 U.S. at 399-400.

Both tests are not assuming the below cost pricing.



Predation occurs even when the price is above ATC.



Both tests focus on initial profit of the conduct.

The legal theory of predation

Equally efficient competitor test

This test is the ground of AAC test and ATC test.

- Areeda & Turner (1975) explains that “the low price at or above average [total] cost is competition on the merits and excludes only less efficient rivals.”
- Posner (1974) proposes two-folded AVC and ATC test by focusing on an exclusion of “an equally or more efficient rival”.
- Baumol (1996) proposes AAC test on “the premise that a proper Areeda-Turner price is one that does not threaten the existence (or at least the presence) of any equally efficient or more efficient supplier”

However,

- The anticompetitive effect can be brought by above ATC pricing.

Criticisms

Mano & Durand (2010)

- “Even the elimination of a less efficient firm, when comparisons are possible, may reduce welfare and benefit consumers”.
- Miguel de la Mano and Benoît Durand, *A Three-Step Structured Rule of Reason to Assess Predation under Article 102*, DG Competition, European Commission Office of the Chief Economist Discussion Paper (2010; first version was published in 2005).

Edlin (2002) and Williamson (1977)

- New entrant might be less efficient at the initial period, but it might become equally or more efficient as an incumbents if it exists in the market long enough.
- See Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 Yale L.J. 941, 975, 978 n.95, 977 (2002); Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L. J. 284, 296, 298 n.43.

EU cases prohibited pricing Above ATC

CMBT (Compagne Maritime Belge Transport)

- “It is sufficient to recall that the conduct at issue here is that of a conference having a share of over 90% of the market in question and only one competitor. The appellants have, moreover, never seriously disputed, and indeed admitted at the hearing, that the purpose of the conduct complained of was to eliminate [a competitor] from the market”. Para 119.

Irish Sugar

- Irish Sugar “carried out more than 88% of sales registered on that market for the entire duration of the infringement period”. Para 44.
- “The purpose of this rebate was to reduce the imports of cheaper retail packets from Northern Ireland into Ireland”. Para 173.
- “Such a practice of selective or discriminatory pricing has been condemned by the Commission and the Court of Justice in earlier cases”. Para 173.

Interpretation of JAMA: JAMA covers above cost pricing

Requirement for Exclusionary Private Monopolization

- The Exclusion (Artificiality + Exclusionary effect)
- Establishing, maintaining or strengthening of the market power



Article 2.5 itself
and case laws
never expressly
required below-
cost pricing

The USEN case (JFTC decision)

Facts

- The defendant was USEN, the biggest broadcasting company in JP.
- There was only one viable competitor in the market.
- Market share (Next slide)
- USEN tried to buy its competitor but failed...

Conduct

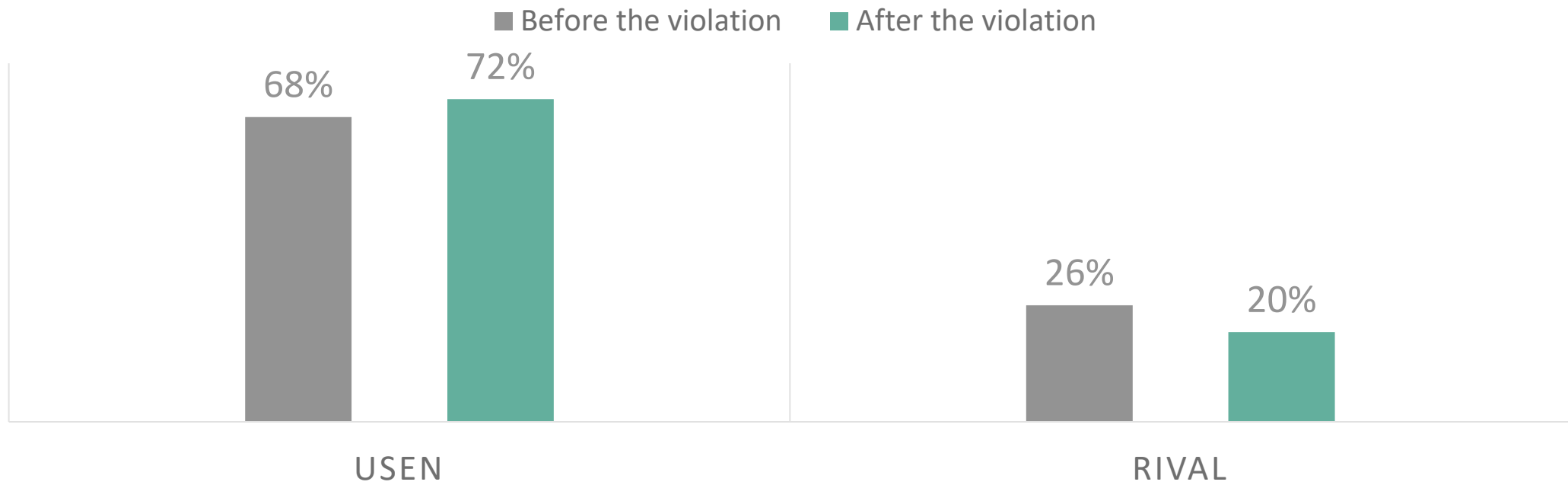
- low pricing by USEN to deprive the only competitor's customers.
- a price discrimination strategy that relies on customer business relationships.

Low Pricing (for monthly subscription service)

- 2003: less than 3675 yen with 3 month free trial, only for competitor's customer
- 2004: 3,150 yen with 6 month free trial, only for competitor's customer

The USEN case (Market Share)

MARKET SHARE OF THE PARTIES



The USEN case

JFTC considered the following elements...

- Dominant share of defendants
- Intent to integrate its only competitor in the market
- Discriminatory nature of its price

Civil case (the Tokyo High Court)

- The court found that the defendants engaged in the campaign to solicit its competitor's customers.
- They hired its competitor's employees just to pursue that campaign.

The USEN case

Did the court need price-cost analysis?

- Some argues that the pricing in question was below AAC
- But it doesn't matter even if it is true

Because the evidences showed that

- the market share of the USEN was significantly high
- the only competitor in the market was the single target of the predatory strategy
- the conduct in question was directed solely to deprive the customers from competitor.
- the only result of the strategy was the fact that the competitor's market share was taken by USEN



It can be inferred that a significant market foreclosure was caused by the strategy, whether or not the price was below cost.

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Proposed approach

market share of the defendant

- It is desirable to decrease the risk of type 1 error as possible as we can.

market conditions and structure

- Some industries have bigger concern of anti-competitive effects due to the formation of reputation effects and strategies to prevent entry by low pricing

Intent evidence

- I will explain about it on next slide

Price discrimination

- Discriminatory nature of the price can be a fact to help understanding the anticompetitive nature of the strategy

Why does the intent matter?

Bolton et al., (2000) required a consideration of predatory scheme; Posner cited this article before he suggested LRMCM+ intent test.

There are some circumstances that predation occurs by the communication of private information.

if we cannot rely solely on the price-cost analysis, we need to consider other elements to understand the nature of the pricing strategy.

Such nature cannot be understood by price-cost analysis itself in above-cost pricing cases. Probably this is why Posner or competition authorities suggested considering exclusionary intent in such cases.

In the case of above-cost predatory pricing, the relationship between price and cost is not important. The most important thing is the strategic nature of the pricing conduct.

Criticisms

Areeda & Hovenkamp IIIA:

- “But the problem of relying on judgments about intent when prices are above cost is even more severe than the problems of relying on intent evidence to condemn prices below cost”.
- “it is impossible to base conclusions of anticompetitive behavior on intent when prices are above cost without chilling normal aggressive competition”.

Comanor & Frech (1993):

- “Evidence on intent is relevant to the extent that it permits one to evaluate the essential purpose of the price cut”.
- “Where there is evidence of intent to communicate a predatory commitment (or portray a particular reaction function) to current or potential rivals, predation is particularly likely to have occurred”.

Long run marginal cost is the cost you need to cover to keep operating in a future (you need to cover this for future investments). If this cost exceeds total revenue of rivals for long enough, then such rivals should be excluded by price below LRMC.

The incumbent can exclude equally efficient rivals by setting a price below LRMC.

However, if it is a case of dying industry, such pricing might be justified because, in such industry, you don't need any capital investment in a future.

So We need to identify the anticompetitive nature of the pricing strategy if the price is above AVC.

Harm to the consumer welfare

Consumer Welfare Standard in Japan

- It is just one of the explanations of the goal of the law
- No need to prove it, courts can infer it from the formation, maintenance, and strengthening of market power.



That is why and how the USEN case prohibited type 2 of above-cost pricing.



Thank you!
