Abuse of Dominant Position Chapter on **Predatory Pricing**[1]

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I. Introduction

A dominant firm may abuse its position by engaging in practices aimed at deterring the entry or forcing the exit of potential and existing rivals out of the market that could lead to the impairment of competition and the competitive process. While such acts are prohibited under R.A. 10667, cases involving the abuse of dominant position are among the most difficult and challenging for competition and enforcement authorities to evaluate. This is largely because the observed acts can also be the outcome of fierce competition or an efficient production process which should not be discouraged.

This dilemma is acutely true of predatory pricing. Predatory pricing occurs when a dominant firm sets a price below cost with the object or effect of restricting entry or forcing exit of potential and existing rivals out of the market. While consumers benefit during the period of low prices, which looks similarly to robust competition, the overall result is a decrease in social welfare as the dominant incumbent firm raises prices following the decrease in competition.

This study aims to assist competition authorities in the country in distinguishing and evaluating cases of abuse of dominant position by outlining the economic theory of predation with the aim of translating them into practical and usable guidelines, taking into consideration the country's present institutional endowments. It will also examine the different tests of predation and evidentiary standards that have been applied in different jurisdictions, and their economic implications, as aided by a discussion of selected cases.

Part II provides a general account of the economic theory of predation. Part III discusses the different economic and legal tests and the evidentiary standards that have been developed in the EU and US anti-trust traditions. Part IV discusses the experiences of other countries, and Part V summarizes and concludes the paper with guidance for the Philippine context.

II. Economic theory

The earliest economic literature on predation were descriptive and lacked formalization (Bain (1956), Scherer (1980), Sylos-Labini (1962)). The earliest formal models based on straightforward applications of game theory, however, failed to demonstrate that rational incumbent would engage in predatory practices (Friedman (1979), Selten (1978)). In the US, this theoretical skepticism was associated with the adoption of more stringent standards of predation.

Subsequent economic models, however, pointed out that the paradoxical formal result was derived by assuming perfect observability of the incumbent and the entrant's payoffs, their respective cost functions, and market demand. When this stringent assumption is relaxed, the

models show that predation can be a rational strategy (Kreps and Wilson (1982), Milgrom and Roberts (1982)). Other more recent models have also shown that predation can arise from imperfections in the capital market and from the existence of economies of scale and scope (Fudenberg and Tirole (1986), Bolton and Scharfstein (1990)).

1. Predatory pricing: the workhorse model

The modern standard workhorse model of predation assumes the form provided in Ordover and Saloner (1989). An incumbent dominant firm wishes to maximize its present and future profits, $\pi^I = \pi^0 + \pi^f$, where π^I denotes the incumbent profits and the superscripts '0' and 'f' denote the incumbent's present and future profits, respectively. The incumbent's profits in both periods ,however, are not just determined by its own actions (a_0^I, a_1^I), but also on the actions of the entrants (a_0^E, a_1^E)[2]. These actions can also refer to the other business strategies such as the size of capital investment, expenditure on research and development, advertising or rent-seeking activities to earn favorable regulation.

Following Ordover and Saloner (1989), the incumbent's profit can then be represented by $\pi^I = \pi^0(a_0^I, a_0^E) + \pi^f(a_1^I\ (a_0^I, a_0^E), a_1^E(a_0^I, a_0^E); a_0^I, a_0^E)$. Differentiating with respect to a_0^I provides the following

$$\frac{d\pi^I}{da_0^I} = \frac{d\pi^0}{da_0^I} + \frac{\partial \pi^f}{\partial a_1^I} \cdot \frac{da_1^I}{da_0^I} + \frac{\partial \pi^f}{\partial a_1^E} \cdot \frac{da_1^E}{da_0^I} + \frac{\partial \pi^f}{\partial a_0^I} = 0.$$

The first term represents the short-term effect of the incumbent's present action on its profit. If there are intertemporal and strategic effects, the second and third term would be nonzero and capture the increase in profit from engaging in potentially anticompetitive behavior. The models discussed in the next sections can be expressed as variations of this model.

Ordover and Saloner (1989) further write out the specification needed for predatory pricing to be rational[3]. The $'\delta'$ terms indicate the duration of the periods of accommodation and monopolization respectively. The $'\pi'$ terms are profit terms during periods of predation, monopolization and accommodation. The left side of the inequality is the present discounted profits during the period of profit sacrifice, which must be less than the present discounted benefits of a successful predation.

$$\delta^{pred}\left(\pi^{accom} - \pi^{pred}\right) < \delta^{Monop}(\pi^{Monop} - \pi^{accom})$$

[2] Entry deterrence and predatory pricing to spur exit can be analyzed using similar economic concepts.
[3] The equation above is Kaplow (2018)'s interpretation of Ordover and Saloner (1989)'s discussion.

The challenge for competition authorities, therefore, is to set the standard for identifying what can be considered as predatory behavior based on the objective of consumer welfare maximization. Finding the optimal standard becomes more challenging when information is very hard to acquire. This increases the likelihood of committing erroneous regulatory decisions. Type 1 error happens when otherwise competitive pricing is judged as predatory and could have a chilling effect on competition. On the other hand, Type 2 error occurs when actual predation is allowed and considered competitive. While both harm social welfare, others argue that competition authorities should minimize the former (Jones and Suffrin (2016)).

2. Predation is irrational – The perfect information case and McGee critique

The first formalization based on a straightforward application of game theory with perfect information did not show that predatory pricing would be a rational strategy for the incumbent (Freidman 1979, Selten 1978).

Based on a finitely repeated game where payoffs and costs are perfectly observable, Selten (1978) showed that predatory pricing cannot rise in equilibrium. Suppose that the game is repeated *n* number of times. Predation would only be rational on the *k*th round if it can recoup its losses on the *n-k* remaining period. At the last stage, the monopolist will not choose to engage in predation since there is no longer any next period when it can recover its losses. However, in the period before the last stage, the entrant realizes this and decides to enter. By backward induction, the same line of reasoning can be repeated at each stage until at the beginning of the game. Thus, no predation occurs. This is popularly referred to as the Chain Store Paradox.

The more influential critique, however, came from Mcgee (1958, 1980), who identified several reasons as to why predation is a rare occurrence and irrational. First, dominant firms that have a large market share will lose more by selling quantities below cost. Second, during the period when the incumbent starts raising prices, the market will again attract new entrants, eroding whatever advantage the incumbent has artificially built. Third, the model also assumes that the incumbent has a 'deep pocket' which makes it possible to endure a period of losses. Finally, McGee argued that there are least costly alternatives to deter entry or force the exit of a rival in order to limit competition, such as through mergers and acquisitions.

McGee's arguments led to the adoption of a more stringent standard for catching and prosecuting predatory pricing. Aside from showing dominance and below cost pricing, it must also be shown that the firm can recoup its losses in the future. Since recoupment is very hard to prove, predatory cases have become a rarity in the US.

3. Predatory Pricing is rational

Subsequent models addressed the issues raised by McGee and identified conditions which could give rise to predation. First, if the incumbent firm can exercise price discrimination, then the incumbent may not necessarily lose in proportion to their market share (Fumagalli and Motta (2013); Fumagalli, Motta, and Calcagno (2018)). Further, when the incumbent faces multiple entrants in the future, then the stream of future benefits from building a reputation for being a tough predator also increases (Kreps and Wilson (1982)). Second, the prospect of new entrants acting as a check towards higher future prices will only occur when there are no significant barriers to entry (Fumagalli (2013), Fumagalli et al. (2018)). Third, when capital markets are imperfect, financial predation can occur (Fudenberg and Tirole (1986), Bolton and Scharfstein (1990)).

There are also reasons why an incumbent dominant firm may prefer predation over merger. As Posner pointed out, most jurisdictions have merger restrictions and those that involve a dominant firm are treated with a higher degree of regulatory scrutiny. Predation has the advantage of being harder to detect and prove. The acquisition of entrants to limit competition would also create the perverse incentives for other firms to enter the incumbent's market just to be acquired at a profit (Rasmusen (1985), cited by Ordover and Saloner (1989)). There is also evidence showing that predation and mergers are not necessarily mutually exclusive strategies.

a. Signaling model

Subsequent game theoretic models pointed out that the paradoxical result which failed to show the rationality of predatory pricing was based on the stringent assumption of perfect information. In reality, the payoffs and costs are private information and cannot be observed perfectly by the other firm. This arrangement also makes the pre-entry price set by the incumbent to be independent from the post-entry price, which leads to the result that predation is only a case of money burning.

Milgrom and Roberts (1982) took off from the model developed by Friedman and assumed imperfect information. The incumbent decides the quantity to produce based on its own cost and since it cannot observe the entrant's cost, it instead forms beliefs about it. The entrant observes the pre-entry price and tries to infer the actual cost of the incumbent as well as its post-entry pricing strategy. Hence, the pre-entry price serves as signal of the incumbent's cost that will eventually determine the post-entry price faced by the entrant and its profits.

This can lead to two possible results. In a separating equilibrium, the result is similar to the case when costs are perfectly observable. The incumbent's first period price is a perfect signal of its underlying costs. The more interesting example is the pooling equilibrium where the pre-entry price and quantity provide no information concerning the cost of the incumbent. Here, the high cost incumbent can pretend to be a low cost and deters entry.

Bolton, Brodley and Riordan (2010) describes what types of indirect evidence to note with predatory pricing due to information asymmetries. They emphasize that credible signals for low costs or low profits would help the predator establish its competitive advantage. Further, they note that a pure signaling model would also require high barriers to entry, or reputation building, to make their strategies credible

b. Reputation Model

The idea that an incumbent monopolist will engage in predatory pricing in order to build a reputation for being tough on rivals and make it unprofitable for them to enter and stay in the industry has long held an intuitive appeal. B.S. Yamey (1972) hypothesizes that reputational effects from predatory pricing can act as a barrier to entry by chilling entry of possible entrants who expect retaliation through predatory pricing. Predatory pricing thus acts as a behavioral or strategic barrier to entry, which may be valuable when traditional barriers to entry are low. Such constraints on pre-existing market power may be the incentive for firms to attempt predatory pricing in order to gain market power. Scherer notes that predatory pricing to build a reputation as a barrier to entry could occur with a firm operating in multiple markets.[4]

Kreps and Wilson (1982) provided a formalization by considering the case when an incumbent faces not just one potential entrant but a stream of multiple entrants in the future[5]. The model is similar to the signaling model and assumes imperfect information. Kreps and Wilson modified Selten's (**1978**) model and considers a finitely repeated game using sequential equilibria. However, entrants are uncertain about the actual payoffs of the monopolist, which is a more realistic assumption. The incumbent may be either weak (have high costs) or strong (low costs). In equilibrium, no matter how small the chance of the monopolist gain from predation, the entrants avoid challenging it for fear of predatory response even if there is a non-zero chance that the incumbent is actually weak and would accommodate entry.

Kreps and Wilson also considered the case when the incumbent monopolist does not observe the entrant's payoff. In this case, the entrant may also have the incentive to act tough and mimic an low cost firm and engage in a price battle. The result is that a strong entrant enters and the monopolist accommodates it.

While the reputation model is robust, it is very hard to prove cases of predation based on reputation building. Indeed, Elzinga and Mills (2000) argue that predatory reputation is not directly observable and would be too difficult to prove in court. Bolton, Brodley, and Riordan (2001) respond to say that reputational effects are relevant to substantiating facilitating market structure and address evaluations of market power. Reputational effects, if existing, may serve

[4]Cited in 'Organisation for Economic Co-operation and Development. 1989. "Predatory Pricing". *OECD Policy Roundtables.'*

[5] Or sells in multiple markets with one rival or entrant.

as barriers to entry when other traditional barriers are absent; lack of barriers to entry, and so a facilitating market structure, are current grounds for case dismissal.

c. Financial Predation

Predation can also be enabled by imperfections in the credit market (Telser (1966) , Fudenberg and Tirole (1986)). Bolton and Scharfstein (1990) examined the relationship between competition in the product market and how it is affected by conditions in the financial market. The model took cue from the empirical observation that big dominant firms can be financed from internal sources or internally generated funds. Internally financed firms are also in a better position to be more competitive in the product market. On the other hand, small entrants usually have "shallow pockets" and must rely on outside investors for financing. An example is an upstart firm relying on venture capital.

Bolton and Scharfstein (1990) assume that the incumbent and the entrant differ in their respective source of financing, as described above. The entrant enters a financial contract with an outside investor. However, due to asymmetric information and moral hazard problems, the contract is renewed periodically conditional on the firm's past profits or performance. The termination threat guarantees that only high performing firms will be funded while ensuring that the firm will not shirk, and that the investor gets its money back. Note that in making the contract, neither the entrant nor the investor consider the possibility of predation or the strategic behavior of the incumbent.

The incumbent on the other hand observes the contract between its rival and outside investor. This provides the incentive to make sure that the rival's profit is poor by engaging in predatory behavior during the first period and deprive the rival of sources of funding in the next period through the termination of the financial contract. A tradeoff therefore exists as contracts in the credit market that are designed to address the agency problems also increase the incentives of the incumbent to engage in predation.

Bolton, Bradley, and Riordan (2010) then offer types of indirect evidence for financial predation:

i) that the prey is dependent on external financing, and so faces agency and contractual issues that leave it exposed to predation;
ii) that the prey's financing depends on its initial market performance, such that damages to expected market performance metrics can endanger the contract;
iii) that the predator is aware of the prey's dependence on external financing, as demonstrable through predator conduct or internal documents;
iv) that the predator can finance predation internally or has access to more substantial credit than the prey, such that a predator faces smaller threats of leveraging or loss of funding

d. Scale Economies

A more recent model by Fumagalli and Motta (2013) have shown that predatory behavior can arise from the interaction between incumbency advantage and scale economies. In certain product and service markets where economies of scale and scope exist, an incumbent monopolist may take advantage of its captive customers in order to deter the entry or force the exit of a rival. Captive customer can be past customers with high switching costs, or where customers consuming the product is characterized by "learning by doing", or instances where customers are located in relatively isolated places with high transportation costs.

In the formal model (Fumagalli et al (2018)), there are two contestable buyers (B_1, B_2). The incumbent firm is more efficient in producing the first unit to the first buyer at cost $c_1 > 0$. On the other hand, the rival is more efficient with producing the two units for both buyers. It incurs a fixed cost but *f* but with marginal cost equal to zero, hence, $c_1 < f < 2c_1$. The specification of such cost structures captures the role of economies of scale such that two buyers are sufficient to achieve efficient scale but only one buyer is not.

Firms compete to sell to the first buyer in the first period and set prices simultaneously. In the second period, they compete for the second buyer. Even if the entrant is more efficient in serving both customers, it is not necessarily the case that it will get to sell to both buyers. The reason is that the total adjusted costs - defined as the total cost of producing both goods minus the extracted rent from selling to the 2nd customer - may be higher for the incumbent. Hence, the firm who gets to sell to the first buyer will also be able to sell to the second buyer. The exclusion of a more efficient rival allows the incumbent to extract more rents in the second period. Indirect economic evidence consistent with the scale-economies theory of harm are the existence of scale economies , and weak buyer power or captive consumers (of the dominant incumbent).

e. Behavioral Economics

Reeves and Stucke (2010) offer behavioral economics as a potential supplement to modern antitrust economics and legal practice. They demonstrate that in the absence of any primary economic theory to support decades of prior antitrust litigation and law, the Chicago School had positioned itself to be such a theory. It is their central tenets of actor rationality and firm profit-maximization that led a shift away from *per se* rules to rule-of-reason analysis, leading to more tolerant attitudes towards potentially anticompetitive behaviors assuming such actions otherwise 'do not make economic sense'. This shift is illustrated by the fear of false positives against false negatives in litigation; the belief that predation and monopolizing activity are irrational in the face of low barriers to entry and the presence of other rational firms to contest such activity; and the belief that quantitative measures of market power are insufficient to ground the likelihood of exercising market power.

Reeves and Stucke show how behavioral economics can be used to revise many assumptions of exercising market power and conditions of market entry. With regards to market entry, increased

rates of entry can be explained by different theories of overconfidence in own capabilities or possible events, while decreased rates of entry can be explained by high costs of acting on information or lacking confidence in one's own capabilities. With regards mergers attempted for efficiency, it could be that competitive conditions incite less-reasonable or more self-congratulatory perspectives from upper management, leading them to pursue the merger despite the uncertainty of efficiencies.

With regards to big buyers supposedly restraining market power, it could be that buyers overestimate their bargaining power, to the point that they focus more on punishing rival buyers instead of properly gauging the benefits that can be gained from their customers. With regards to deterrence arising from exacting financial costs, it could be that deterrence could also result from upper management abiding by social norms, while that under-deterrence could result from management being overconfident in their ability to avoid detection or some heuristic that prevents greater evaluation of detection and costs.

f. Plausible Efficiencies

Bolton, Bradley, and Riordan (2000) also argue that price cuts above Average Avoidable Cost but below Long Run Average Incremental Cost would have to be demonstrated as a 'unilateral best response', that is, a short-run profit maximizing price that allows the rival to remain in the market.

Market expanding efficiencies are for price cuts that aim to promote a new product or enter a new market. The three proposed elements of a market expanding efficiencies defense are:

i) That there are 'plausible efficiencies gains' such as cost reductions or increasing returns to scale that are achieved by the price cut
ii) That there are 'no less restrictive alternatives' that such efficiencies can be gained without restricting competition

They offer three types of market expanding efficiencies defenses. *Promotional pricing* is when prices below cost are able to induce favorable consumption of a new product that is likely to continue when future prices are increased. *Learning-by-doing* is when price cuts induce productions levels and experience that eventually lead to lower unit costs. And *network externalities* are when price cuts enable the expansion of a product or network expansion to increase efficiencies from use of the network.

g. Is Recoupment a necessary condition?

As detailed later, *Brooke Group (1993)* introduced a requirement for finding recoupment in predatory pricing in US antitrust law. On this issue, competition agencies appear divided. According to the ICN Report, 15 responding agencies stated that recoupment is a prerequisite to a finding of liability, whereas 18 agencies stated that recoupment is not a requirement for liability,

yet recoupment plays a role in the analysis for 13 of those agencies.[6] The impossibility of recoupment can serve as a defense for the dominant firm, as the UK experience suggests.[7]

In GlaxoSmithKline, which concerned sales of patent-protected drugs to hospitals, the French Competition Authority, employed a two-step test to show recoupment. The first concerned the estimation of the total loss incurred by the firm during the period of predatory pricing and the second step concerned the calculation of the profits due to the price rise in the two years following the exit of the main competitor.[8]

Kaplow (2018)[9] analyzes the capabilities of a recoupment probability test based on Ordover and Saloner (1990, equation reproduced below) as an assessment of market power to substitute for a finding of recoupment. We note that abuse of dominance cases require a finding of market power, and many analysts in the EU tradition consider a finding of likely recoupment unnecessary.[10]

$$\delta^{pred}\left(\pi^{accom} - \pi^{pred}\right) < \delta^{Monop}(\pi^{Monop} - \pi^{accom})$$

To examine the relationship between market power or dominance and recoupment, we consider the condition for successful recoupment above. Market power affects all the terms of the condition above, in particular the profit terms. If it were to do so uniformly, then market power cannot determine whether recoupment is possible. However, it would be reasonable that a proper finding of dominance would allow an analyst to assign relative values, in particular the size of π^{Monop} relative to π^{accom}. Suppose for example that if market power is caused by the barriers to entry effected by successful predatory pricing itself, then it is clear that market power is due to the success of the conduct. Thus, in this context, the difference between π^{accom} and π^{Monop} is large. Generally, if the finding of market power focuses on the gap between these two terms, then a separate investigation into recoupment is unnecessary.

Kaplow further discusses whether recoupment can aid in diagnosing predatory pricing, given possible incorrect or inconclusive results for profit sacrifice tests. We also note that profit sacrifice is included in the left-hand side of the recoupment expression. First, let us consider the case where profit sacrifice is known, but we do *not* know if predatory pricing occurred. Given profit maximizing behavior, recoupment is always needed for situations where the analyst needs to diagnose anti-competitive predatory pricing compared to legal predatory pricing (where there are efficiencies or objective justifications). Therefore, a separate recoupment condition is not necessary.[11]

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[6] ICN Report, 17.
[7] ICN Report, 18.
[8] ICN Report, 20.
[9] Louis Kaplow, *Recoupment and Predatory Pricing Analysis,* Journal of Legal Analysis (2017).
[10] *DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses (2005),* E. Rousseva "Rethinking Exclusionary Abuses in EU Competition Law" (2010)
[11] This is also noted by Reeves and Stucke (2010).

If it is clear that there is no profit sacrifice and that it was accommodation of rivals, then recoupment is also not needed. Recoupment without profit sacrifice is not predatory pricing For example: If we could show that long run profits recovery is lower, we would find it unlikely to be predatory pricing. Having noted that, if costs were truly uncertain, profits would be even more uncertain. Moreover, depending on the specific factor involved, and whether it is high or low, the size of the long run recoupment and the diagnosis for illegal predatory pricing would vary.[12] Hence, even in the case where the recoupment condition is diagnostic, its usefulness is limited.

Kaplow proposes that the probable recoupment test should instead be used in a triangulation framework, rather than a stand-alone fixture. This framework proposes a holistic appraisal of evidence the evaluation of competing probabilities to reach a conclusion on predation, instead of the currently linear approach of screening market power and barriers to entry before assessing recoupment. Notably, this is consistent with the EU approach where recoupment might be an important element of Predatory Pricing case, but is not central.

III. Predatory Pricing Jurisprudence

Diagnosing Predatory Pricing can be difficult because the price-cutting phase can be easily mistaken for strong competition. Using the economic models outlined so far as a guide, correctly diagnosing Predatory Pricing depends on a number of structural and indirect factors: the maturity of financial markets, the cost structure of firms, the particular characteristics of production of the good or the industry, conditions of distribution and consumption, as well as the beliefs of the firms concerning the strategy of their rivals.

However, competition authorities not only correct or discipline allegations of predatory pricing *ex post*, but also shape the incentives of firms *ex ante*. Their decision will serve as a guide for other firms to learn what is acceptable conduct and what is not. This requires that this particular rule-making channel should be also clear and predictable while at the same time adaptable to the fact of each case.

As apparent from the review of economic literature, there are two incontrovertible components to predatory pricing. The first is sacrifice, a period in which the monopolist is deliberately having lower profits. The second part is when the monopolist is reaping (or expects to reap) the benefits of its predatory policy, which we can call profit recovery[13]. As we will see, the jurisprudence of predatory pricing acknowledges these two facts, but the US and EU jurisprudences have settled on different appreciations.

[12] Kaplow uses the example of how changes in costs affect the use of recoupment. If costs were assumed to be on the higher end (as a reaction to uncertainty), then profit sacrifice is higher and long-run profit recovery is lower, which means that the recoupment is harder to meet. (pp. 35-36)

[13] We follow Kaplow (2018) to say that recoupment is that the profit sacrifice is smaller than the profit recovery.

1. Legal tests: EU experience

In this section, the relevant EU cases will be discussed to show how the economic theory guided the decision making of competition authorities and courts.

a. Case C-62/86 AKZO (EU)

AKZO applied for the annulment of the Commission decision (IV/30698 — ECS/AKZO Chemie, Official Journal 1985 L 374, p. 1), which found that AKZO abused its dominant position in the organic peroxides market by engaging in predatory pricing in order to eliminate a competitor, ECS. ECS was a small UK firm, selling its benzoyl peroxide to customers in the UK and Eire, which used it as a bleach in the treatment of flour. ECS then started selling its benzoyl peroxide to customers in the polymer industry. AKZO, a Dutch company, threatened ECS that it would drop its prices in the flour market, in case ECS did not withdraw from the polymer market.

The European Court of Justice agreed that AKZO engaged in predatory pricing, and introduced a more structured cost-based test:

> [70] It follows that [Article 102] prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality. From that point of view, however, not all competition by means of price can be regarded as legitimate.
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> [71] 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 the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced.
>
> [72] Moreover, prices below average total costs, 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.

AKZO and the Areeda-Turner Test

The Areeda-Turner rule which considers pricing below short run marginal cost (SRMC) as predatory, while if the price equals or exceeds the reasonable anticipated marginal cost is not predatory.[14] Given the difficulties in operationalizing SRMC, average variable cost (AVC) is used as a proxy for the former. According to the Areeda-Turner rule, price at or above the reasonably expected AVC is presumed to be lawful. On the contrary, price below the anticipated AVC is presumed to be unlawful. The Areeda and Turner rule is commonly applied in US jurisprudence,[15] and has also influenced the EU test in *AKZO*.[16]

In *AKZO*, The European Court of Justice added to the Areeda-Turner test that prices above AVC can also be abusive, if eliminatory intent can be proven. In this case, eliminatory intent was found as AKZO directly threatened to attack the competitor's business by undercutting its prices.

- Prices below AVC are presumed to be predatory
- Prices below ATC but above AVC can be predatory, if coupled with an intent to eliminate a competitor, supported by sound and consistent evidence. Such practice may eliminate an 'as efficient competitor', that due to lesser financial resources cannot stand the predatory pricing targeted against them.

b. Case C-333/94P Tetra Pak (EU)

Possibility of recoupment

The Commission found Tetra Pak, a company specializing in packaging equipment for liquid or semi-liquid food products in cartons, to have abused its dominant position by engaging in abusive tying and predatory pricing practices. Tetra Pak appealed the decision. With respect to predatory pricing, Tetra Pak argued that the Commission should have considered the possibility of recoupment. This Court rejected this argument and stated that:

> [44] [I]t 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

[14] P. Areeda and D. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act" (1975) 88 Harvard LR 697.
[15] See J. Brodley and D. Hay, "Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards" (1981) 66 Cornell LR 738; J. Hurwitz and W. Kovacic, "Judicial Analysis of Predation: The Emerging Trends" (1982) Vand LR 63; E. Elhauge and D. Geradin, Global Competition Law and Economics (2nd ed, Hart, 2011); H. Hovenkamp, Federal Antitrust Policy (4th ed, West 2011) 372-379.
[16] ECS/AKZO [1985] OJ L374/1; Case C-62/86 AKZO Chemie BV v Commission [1991] ECR I-3359.

predatory pricing whenever there is a risk that competitors will be eliminated. The Court of First Instance found, at paragraphs 151 and 191 of its judgment , that there was such a risk in this case. The aim pursued , which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors .

Predation in an adjacent market

This case is also important as the Court assessed predatory pricing in the market where Tetra Pak was non – dominant (non-aseptic carton market). Nonetheless the market had close associative links with the aseptic market, where Tetra Pak was found dominant. Tetra Pak was able to sustain losses in the non-aseptic cartons market, given its substantial profits in the aseptic cartons market. The Court stated that:

[31] Accordingly, the Court of First Instance was right to accept the application of Article [102] of the Treaty in this case, given that the quasi-monopoly enjoyed by Tetra Pak on the aseptic markets and its leading position on the distinct, though closely associated, non-aseptic markets placed it in a situation comparable to that of holding a dominant position on the markets in question as a whole.

c. Case C-202/07P, France Telecom (EU)

The Commission (Commission Decision of 16 July 2003) found that Wanadoo Interactive (part of the France Telecom group – and merged with France Telecom since 2004) infringed Article [102 TFEU] by charging for its eXtense and Wanadoo ADSL services predatory prices that did not enable it to cover its variable costs until August 2001 or to cover its full costs from August 2001 onwards, as part of a plan to pre-empt the market in high-speed internet access during a key phase in its development.[17] development' (Article 1). The Commission ordered it to bring the infringement to an end (Article 2) and imposed a fine on it of EUR 10.35 million (Article 4).

Meeting Competition Defense

[45] Lastly, the Court determined whether limiting WIN's right to align its prices on those of its competitors, inasmuch as it 'would result in its not recovering the costs of the service in question', was compatible with Community law.

[17] Case T-340/03, France Telecom SA v Commission [2007] ECR II-107, para 5.

[46] To that end, the Court refers in paragraphs 185 and 186 of the judgment under appeal to the Community case-law according to which Article 82 EC imposes specific obligations on undertakings in a dominant position. In particular, the Court recalled that, although the fact that an undertaking is in a dominant position cannot deprive it of the right to protect its own commercial interests if they are attacked and such an undertaking must be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, it is not possible, however, to countenance such behaviour if its actual purpose is to strengthen that dominant position and abuse it.

[47] It was on the basis of that case-law that the Court of First Instance thus found, in paragraph 187 of the judgment under appeal, that WIN cannot rely on any absolute right to align its prices on those of its competitors in order to justify its conduct where that conduct constitutes an abuse of its dominant position.

Possibility of recoupment

[110] Accordingly, contrary to what the appellant claims, it does not follow from the case-law of the Court that proof of the possibility of recoupment of losses suffered by the application, by an undertaking in a dominant position, of prices lower than a certain level of costs constitutes a necessary precondition to establishing that such a pricing policy is abusive. In particular, the Court has taken the opportunity to dispense with such proof in circumstances where the eliminatory intent of the undertaking at issue could be presumed in view of that undertaking's application of prices lower than average variable costs (see, to that effect, Tetra Pak v Commission, paragraph 44).

[111] That interpretation does not, of course, preclude the Commission from finding such a possibility of recoupment of losses to be a relevant factor in assessing whether or not the practice concerned is abusive, in that it may, for example where prices lower than average variable costs are applied, assist in excluding economic justifications other than the elimination of a competitor, or, where prices below average total costs but above average variable costs are applied, assist in establishing that a plan to eliminate a competitor exists.

[112] Moreover, the lack of any possibility of recoupment of losses is not sufficient to prevent the undertaking concerned reinforcing its dominant position, in particular, following the withdrawal from the market of one or a number of its competitors, so that the degree of competition existing on the market, already weakened precisely because of the presence of the undertaking concerned, is further reduced and customers suffer loss as a result of the limitation of the choices available to them.

Analysis of costs – new product in an expanding market

> [134] […] [T]he application of the accounting method used in AKZO v Commission, … , and the Tetra Pak cases, … , which takes into account the costs simply as they appear in the undertakings accounts, in the present case leads to very low rates of recovery […]
>
> [135] However, the Commission considered, … , that in an expanding market, since the cost of acquiring customers forms a substantial portion of expenditure 'the rates of recovery … [did] not by themselves prove that prices were predatory'.

In this case, the Commission adjusted the AKZO test and did not limit its analysis in examining costs and revenues. Instead, the Commission spread the costs of customer acquisition over 48 months and in assessing the revenue from subscriptions, it took into account a nominal subscription. These two adjustments improved the cost recovery rates rather than simply relying on unadjusted accounting data as per the AKZO test. This decision shows that the cost benchmark can and should be changed when it is required by the specific features of the industry. This also shows that in quickly expanding markets where products are new, the Commission has applied a price-cost test, and then supplied evidence of intent to foreclose as element.[18]

d. Case C-209/10 Post Danmark (EU)

Different cost benchmarks

This case concerns the pricing practices of Post Danmark on the liberalized market for unaddressed mail in Denmark. Post Danmark was a statutory monopoly charged with a universal service obligation (USO) in the market for normal addressed mail under a certain weight. It had an infrastructure and a nationwide network, which it also used for its unaddressed mail business. Post Danmark has allegedly engaged in selective price reductions to drive away its competitors' three biggest customers.

The Danish Competition Authority examined the complaint and could not establish eliminatory intent. The Danish Competition Authority examined the Average Incremental Cost (AIC) in order account for the shared infrastructure. It found that Post Danmark's prices with respect to two customers were above ATC. With respect to the third customer, Post Danmark''s prices were

[18] Adding in additional evidence for intent (or effect) is needed, as many firms would offer low pricers in situations where the market is new and growing.(Fumagalli et al 2018) pg 108

below ATC but above AIC. Hence, by applying the AKZO test, it found that PD did not engage in predation, as it had no eliminatory intent.

However, the Danish Competition Authority found that Post Danmark has abused its dominant position in the market for unaddressed mail by engaging in price discrimination between existing and new customers to induce switching by competitors' customers. Such discrimination could not be objectively justified on cost related grounds.

This case reached the EU Court of Justice through a preliminary reference procedure, which held that "Article [102 TFEU] must be interpreted as meaning that a policy by which a dominant undertaking charges low prices to certain major customers of a competitor may not be considered to amount to an exclusionary abuse merely because the price that undertaking charges one of those customers is lower than the average total costs attributed to the activity concerned, but higher than the average incremental costs pertaining to that activity, as estimated in the procedure giving rise to the case in the main proceedings. In order to assess the **existence of anti-competitive effects** in circumstances such as those of that case, it is necessary to consider whether that pricing policy, without objective justification, produces an **actual or likely exclusionary effect**, to the detriment of competition and, thereby, of consumers' interests".[19]

Post Danmark develops the AKZO test by using different cost benchmarks. In addition, it clarifies the situation where the dominant company prices above AVC (AIC) and below ATC and no eliminatory intent can be proven. In that case, such pricing may be abusive, if anticompetitive effects can be proven.

e. Intention to eliminate a competitor

We can summarize from the discussion above that the legal tests on Predatory Pricing tests were maintained until the Guidance Paper as, broadly speaking, a two-part test:

a) Price-Cost Test – If price were below an appropriate measure of ATC but above AVC, then a second test would apply:
b) There would need to be proof of intent to harm competitors, or effects on the market.

We point out that , in practice, the Community courts used elements of evidence which could have reflected business objectives other than the intent to eliminate. Furthermore, the (subjective) intent leg of the test sits uncomfortably with the notion of the objective nature of abuse. The other issue is that in the CFI's decision, it says that below cost pricing and intent together is sufficient for an object case, even when its effects evidence is not clear in its favor. We

[19] Case C-209/10 Post Danmark, para 45.

shall see that the move to the Guidance Paper makes encourages effects-based analysis as the norm, yet allowing object cases increasingly as reserved for exceptional circumstances.

The intention to eliminate must be based "on the basis of sound and consistent evidence"[20] which may be "direct or indirect". The table below list down the various evidences used to prove intent in these landmark cases:

Table 1: Evidence used for Intent

	Evidence for Intent
AKZO	a) Prolonged below cost price cutting b) P<ATC without business justification c) Selective Price Cutting d) Bait Pricing e) Acquisition of information regarding rivals (from poached customers) f) Company Documentary evidence
Tetra Pak (II)	a) Continuity, duration, scale of the incurred losses b) Import of Tetra Rex selling at price of 10-30% below purchase price. c) Prices for Tetra Rex cartons which were 20 to 50% lower than the prices applied in other member states. d) Reports from Company Board of directors referring to the need to make financial sacrifices to fight competition e) Tetra Pak was not following the prices of its competitor Elopak, but was increasing the price difference by further reducing its prices f) Increase in Tetra Pak sales and the reduction of Elopak sales
France Telecom / WIN	a) Company Documentation. The CFI's decision reads: [205] "It is therefore appropriate to reject WIN's complaint that supposedly inculpatory documents were taken into account out of context and that a number of exculpatory statements were not taken into account" [206] "For the sake of completeness, it should be pointed out that, even by placing the phrase we will have difficulty in pre-empting this market if our prices are too high' in context, that is, by preceding it with the words we have gone in too high on the price' and following it with the words 'our competitors will price below us', the notion of an intention to eliminate competition is still present" […] [209] "In any event, those statements, which are contained in internal company documents, are an indication of the existence of a plan of predation and reinforced by other evidence" b) The commission had different notion than the CFI. In addition, the Commission wrote that "the expression of the pre-emption intention is conveyed and corroborated by

[20] Case T-340/03, France Telecom SA v Commission [2007] ECR II-107, para 197; Case T-83/91 Tetra Pak v Commission. Para 151.

	indisputable economic factors and by the translating of the intention into commercial policy". c) The Commission listed the following "indisputable economic factors": 1. Competitors have no access to external financing 2. Choice of prices and sales which it knows that competitors cannot match 3. Its awareness of having structural advantages and advantages deriving from a wide customer basis

2. Commission Guidance Paper

The Commission Guidance Paper,[21] follows and is a reaction to the case law outlined above. With respect to cost benchmarks, the Commission uses the AAC instead of AVC[22] and LRAIC[23] instead of ATC. Following the Guidance Paper, the EU Court of Justice used the LRAIC in *Post Danmark*.

If price were below AAC, then that would satisfy the sacrifice test, and would be lead to a presumption of a foreclosure effect on an as efficient competitor. More interestingly, a "sacrifice" may be established even if unit prices are above AAC, but the *net revenue is lower* that it could have been had an alternative price strategy been taken. Part of the logic here of the Commission here would be to apply a "no economic sense" test to the company's recent pricing activity.

In this later case, the interpretation of the Guidance Paper would be that an "as efficient" competitor *could* be foreclosed from the market, but the Commission would also have to examine other factors to prove anti-competitive foreclosure. These factors, generally, are:[24]

- Market Position of the dominant undertaking and its competitors
- Conditions on the Relevant Market
- Position of Customers or Input Suppliers
- Extent of the Alleged Conduct

[21] Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 45/7.

[22] The Commission in the Guidance Paper accepts that "[i]n most cases the average variable cost (AVC) and AAC will be the same, as often only variable costs can be avoided. However, in circumstances where AVC and AAC differ, the latter better reflects possible sacrifice: for example, if the dominant undertaking had to expand capacity in order to be able to predate, then the sunk costs of that extra capacity should be taken into account in looking at the dominant undertaking's losses. Those costs would be reflected in the AAC, but not the AVC". See Guidance Paper, para 64, n3.

[23] LRAIC was employed in Deutsche Post AG, [2001] OJ L125/27.

[24]

- Evidence of Actual Foreclosure or Exclusionary Strategy

More specifically for Predatory Pricing, the Commission will consider factors outlined in paragraphs 67-73, copied below:

(a) Sacrifice

64. Conduct will be viewed by the Commission as entailing a sacrifice if, by charging a lower price for all or a particular part of its output over the relevant time period, or by expanding its output over the relevant time period, the dominant undertaking incurred or is incurring losses that could have been avoided. The Commission will take AAC as the appropriate starting point for assessing whether the dominant undertaking incurred or is incurring avoidable losses. If a dominant undertaking charges a price below AAC for all or part of its output, it is not recovering the costs that could have been avoided by not producing that output: it is incurring a loss that could have been avoided. Pricing below AAC will thus in most cases be viewed by the Commission as a clear indication of sacrifice.

65. However, the concept of sacrifice does not only include pricing below AAC. In order to show a predatory strategy, the Commission may also investigate whether the allegedly predatory conduct led in the short term to net revenues lower than could have been expected from a reasonable alternative conduct, that is to say, whether the dominant undertaking incurred a loss that it could have avoided. The Commission will not compare the actual conduct with hypothetical or theoretical alternatives that might have been more profitable. Only economically rational and practicable alternatives will be considered which, taking into account the market conditions and business realities facing the dominant undertaking, can realistically be expected to be more profitable.

66. In some cases it will be possible to rely upon direct evidence consisting of documents from the dominant undertaking which clearly show a predatory strategy, such as a detailed plan to sacrifice in order to exclude a competitor, to prevent entry or to pre-empt the emergence of a market, or evidence of concrete threats of predatory action.

(b) Anti-competitive foreclosure

67. If sufficient reliable data are available, the Commission will apply the equally efficient competitor analysis, described in paragraphs 25 to 27, to determine whether the conduct is capable of harming consumers. Normally only pricing below LRAIC is capable of foreclosing as efficient competitors from the market.

68. In addition to the factors already mentioned in paragraph 20, the Commission will generally investigate whether and how the suspected conduct reduces the likelihood that competitors will compete. For instance, if the dominant undertaking is better informed about cost or other market conditions, or can distort market signals about profitability, it may engage in predatory conduct so as to influence the expectations of potential entrants and thereby deter entry. If the conduct and its likely effects are felt on multiple markets and/or in successive periods of possible entry, the dominant undertaking may be shown to be seeking a reputation for predatory conduct. If the targeted competitor is dependent on external financing, substantial price decreases or other predatory conduct by the dominant undertaking could adversely affect the competitor's performance so that its access to further financing may be seriously undermined.

69. The Commission does not consider that it is necessary to show that competitors have exited the market in order to show that there has been anti-competitive foreclosure. The possibility cannot be excluded that the dominant undertaking may prefer to prevent the competitor from competing vigorously and have it follow the dominant undertaking's pricing, rather than eliminate it from the market altogether. Such disciplining avoids the risk inherent in eliminating competitors, in particular the risk that the assets of the competitor are sold at a low price and stay in the market, creating a new low cost entrant.

70. Generally speaking, consumers are likely to be harmed if the dominant undertaking can reasonably expect its market power after the predatory conduct comes to an end to be greater than it would have been had the undertaking not engaged in that conduct in the first place, that is to say, if the undertaking is likely to be in a position to benefit from the sacrifice.

71. This does not mean that the Commission will only intervene if the dominant undertaking would be likely to be able to increase its prices above the level persisting in the market before the conduct. It is sufficient, for instance, that the conduct would be likely to prevent or delay a decline in prices that would otherwise have occurred. Identifying consumer harm is not a mechanical calculation of profits and losses, and proof of overall profits is not required. Likely consumer harm may be demonstrated by assessing the likely foreclosure effect of the conduct, combined with consideration of other factors, such as entry barriers. In this context, the Commission will also consider possibilities of re-entry.

72. It may be easier for the dominant undertaking to engage in predatory conduct if it selectively targets specific customers with low prices, as this will limit the losses incurred by the dominant undertaking.

73. It is less likely that the dominant undertaking engages in predatory conduct if the conduct concerns a low price applied generally for a long period of time.

(c) Efficiencies

74. In general it is considered unlikely that predatory conduct will create efficiencies. However, [provided that the conditions set out in Section III D are fulfilled], the Commission will consider claims by a dominant undertaking that the low pricing enables it to achieve economies of scale or efficiencies related to expanding the market.

Finally, it is important to note that the Commission "may also pursue predatory practices by dominant undertakings on secondary markets on which they are not yet dominant. In particular, the Commission will be more likely to find such an abuse in sectors where activities are protected by a legal monopoly. While the dominant undertaking does not need to engage in predatory conduct to protect its dominant position in the market protected by legal monopoly, it may use the profits gained in the monopoly market to cross-subsidize its activities in another market and thereby threaten to eliminate effective competition in that other market".[25]

Contrasting the Guidance Paper to the approach prior to it, we find that while the sacrifice aspect of the test remains intact, the intent element has been demoted. The goal ought to be whether the conduct may be described as anti-competitive foreclosure, either through object or (usually) effect. Intent may still play a role in this, but it is only one element out of several.

Pre-Guidance Paper, the meeting competition defense was discarded once intent to foreclose was determined. Furthermore, in practice is was never used successfully as a defense. Post-Guidance Paper, the Commission dispensed with the "meeting competition" defense entirely. This is a defense against intent, which the dominant firm will argue is a denial of intent. As intent is no longer a central leg in predatory pricing cases, the defense is also no longer front and center[26]. The Guidance Paper also has a somewhat different definition of recoupment than the recoupment in US jurisprudence. In the Guidance Paper, it is enough that the conduct would delay or prevent a decline in prices that would have otherwise occurred. Further, the Commission acknowledges that predation is unlikely to lead to efficiencies, yet it is open for dominant firms to argue that low pricing may result in economies of scale as a defense[27].

Box 1: Cost Benchmarks Definitions
MC: The increase in total cost for producing the last unit of output

[25] Commission Guidance, para 63 n2.
[26] E. Rousseva (2010) pg 380
[27] Which would be relevant in a new and emerging markets or products situation.

AVC: The variable cost of production of one unit of output. It is calculated by dividing variable costs by the total number of units of output and can include, for example, fuel and labor costs, repair and maintenance costs, materials, per unit royalties and license fees.

ATC: The total cost of production of one unit of output. It is calculated by dividing fixed and variable costs by the total number of units of output.

AAC: The cost, which is avoided by refraining from producing a unit of output. According to the Commission Guidance, "[i]n most cases the average variable cost (AVC) and AAC will be the same, as often only variable costs can be avoided. However, in circumstances where AVC and AAC differ, the latter better reflects possible sacrifice: for example, if the dominant undertaking had to expand capacity in order to be able to predate, then the sunk costs of that extra capacity should be taken into account in looking at the dominant undertaking's losses. Those costs would be reflected in the AAC, but not the AVC".[28]

LRAIC: The total costs the company incurs, when producing a product. The Commission in its Guidance states that "LRAIC is usually above AAC because, in contrast to AAC (which only includes fixed costs if incurred during the period under examination), LRAIC includes product specific fixed costs made before the period in which allegedly abusive conduct took place. Failure to cover LRAIC indicates that the dominant undertaking is not recovering all the (attributable) fixed costs of producing the good or service in question and that an equally efficient competitor could be foreclosed from the market".[29]

The Commission also states that "Long-run average incremental cost is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC and average total cost (ATC) are good proxies for each other, and are the same in the case of single product undertakings. If multi-product undertakings have economies of scope, LRAIC would be below ATC for each individual product, as true common costs are not taken into account in LRAIC. In the case of multiple products, any costs that could have been avoided by not producing a particular product or range are not considered to be common costs. In situations where common costs are significant, they may have to be taken into account when assessing the ability to foreclose equally efficient competitors".[30]

[28] Commission Guidance, para 64, n3.
[29] Commission Guidance, para 26.
[30] Commission Guidance, para 26 n2.

3. Legal tests: US experience

a. Case 475 U.S. 574 (1986) Matsushita Electric Industrial Co. Ltd. v. Zenith Radio Corp.

This case concerns a predatory pricing scheme as allegedly executed by foreign conspiracy among dominant firms to enter and challenge an incumbent's local market. The respondent Zenith Radio Corporation ('Zenith') was a U.S. "consumer electronic products" (CEPs) manufacturer which accused petitioners Matsushita Electrical Industrial Co. Ltd. ('Matsushita') and multiple Japanese corporations or Japanese-controlled American corporations of conspiring to maintain high prices on TV sets in Japan so that low prices could be fix on TV set exports to the United States.

The Court reversed the Court of Appeals decision, finding it had not applied proper standards to petitioners' motion for summary judgement. Namely, it found that the respondent's claims of conspiracy were not plausible given the economic context; [31] that claims of predatory pricing were implausible given the respondent's survival after the suspected activity; [32] and that the "direct evidence" of conspiracy in Japan offered by respondent was not material enough to allege antitrust damages sustained in the United States.[33]

> *"…predatory pricing schemes are rarely tried, and even more successful."*

The majority decision cited a "consensus" of economic literature at the time to illustrate the improbability of a predatory pricing scheme's success. The critiques of Bork and McGee formed the bedrock of this supposed consensus, explaining that the losses sustained by predatory pricing schemes needed future prices to be held at unrealistic levels and durations (prolonged high pricing attracted competitors) to be profitable. As the Court understood the literature: "The success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain."[34]

Compounding the implausibility of predatory pricing done by a single firm was the fact that *Matsushita* concerned alleged predatory pricing done by multiple firms seeking to conspire. That is, the Court argued that petitioners would have had to face numerous other difficulties in sustaining tacit or explicit coordination and properly allocating losses or profits from the predatory activity. That respondents had offered documentary evidence of agreements for

[31] 475 U.S. 587, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[32] 475 U.S. 591, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[33] 475 U.S. 595, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[34] 475 U.S. 589, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)

fixing minimum prices and setting a five-company distributor limit in the US market was held in favor of petitioners, as such activities would have kept prices up, not undercut them.[35]

The Court has been criticized for citing as the consensus "conservative scholars" who had ignored the literature which had responded to the McGee and Bork critiques by the time of *Matsushita*.[36] The decision appeared to have ignored the ample evidence of conspiracy which had been presented during the trial.[37]

Mistaken inferences

Believing that predatory pricing is unlikely, and believing that conspiracies tended to raise prices anyway, the Court argued that mistaken inferences would be costly to competition. That is, "they chill the very conduct the antitrust laws are designed to protect."[38] To survive summary judgement, Zenith needed to present evidence that conspiracy was a reasonable claim amidst competing explanations of independent action. Instead, the Court found that petitioners had no ability nor motive to conspire against Zenith, who was the incumbent in the US televisions market at the time.[39]

b. Case 509 U.S. 209 (1986) Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.

This case concerns a predatory pricing scheme as allegedly executed by one competitor against another competitor in an oligopoly where neither were the overall leader. Petitioner Brooke Group (also known as 'Liggett') accused Brown & Williamson of predatory pricing against Liggett's own line of generic cigarettes, using price discrimination between Brown & Williamson's branded cigarettes and generics cigarettes as well as volume rebates on generics.

The Supreme Court affirmed the Court of Appeals decision, finding that the alleged predatory pricing reliant on an oligopoly structure was unlikely given that the predator was not dominant. Finding that growth in the generics market expanded during the alleged predatory period,[40] and that market leaders did not follow respondent's pricing schemes,[41] the Court did not consider

[35] 475 U.S. 595-596, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[36] Page 97, "Reconsidering Brooke Group: Predatory Pricing In Light of the Empirical Learning", Sandeep Vaheesan, *Berkeley Business Law Journal* Vol. 12 Issue 1 (2015)
[37] Page 137, *Competition Law in the United States*, Howard Langer
[38] 475 U.S. 594, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[39] 475 U.S. 588, *Matsushita Electric Industrial Co. Ltd.* v. *Zenith Radio Corp.* (1986)
[40] 509 U.S. 234, *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[41] 509 U.S. 240, *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)

that the tacit coordination or low pricing levels necessary to substantiate a predatory pricing claim were present.

Two-pronged test for predation

Brooke Group established the two prongs used to assess predatory pricing claims: the first being the establishment of a price below an appropriate measure of the defendant's cost, and the second being the establishment of an appropriate measure of probability of monopolizing from the predatory behavior.

The court expounds on the first such that exclusionary effects above some appropriate cost measure still reflects a firm's competitive ability, even going so far as to defend price cuts that ultimately lead to supra-competitive pricing.[42] The court expounds on the second by holding the Sherman Act's "dangerous probability to monopolize" and the Robinson-Patman Act's "reasonable possibility" standards. Such standards are fulfilled in a predatory pricing case by showing the likeliness of "the ultimate object of an unlawful predatory pricing scheme":[43] recoupment after predation, i.e. the ability to sustain supra-competitive prices.[44]

The Court accepted that evidence of predation existed such that for the alleged predatory period, Brown & Williamson's prices for generics were below their cost. However, the Court believed that such evidence was inadequate to demonstrate an ability to recover the losses from said pricing. Even after Brown & Williamson's entry and predation, the generics segment had grown and cigarettes were available at heavily-discounted prices;[45] neither R.J. Reynolds, nor Philip Morris, nor Liggett officers admitted to recognizing signals for oligopoly pricing.[46]

On cost tests: the US Supreme Court declined to define the measure of variable cost upon which predatory pricing can be defined. In practice, it has been held that average variable cost is the crucial cost concept, while others like US SC Justice Bryer would advocate for "avoidable" or "incremental" cost[47]. While *Brooke* established that pricing below some measure of variable cost is predatory, it became unclear in US appellate courts whether is could be predatory when price is above a measure of variable cost.[48]

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[42] 509 U.S. 223-224, *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[43] 509 U.S. 224*, Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[44] 509 U.S. 225*, Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[45] 509 U.S. 239, *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[46] 509 U.S. 239, *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[47] Elhauge (2018) pg 292
[48] Elhauge (2018) pg 291 argues that prior to *Brooke* appellate courts would consider pricing above average variable costs but below average total costs might still be predatory given other evidence.

In the US, the plaintiff needs to show that the alleged perpetrator has a dangerous possibility to recoup its losses due to below cost pricing.[49] According to the US Supreme Court in *Brooke Group*, proving recoupment "requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market".[50]

Meeting Competition and other Defenses

Another effect of the *Brooke* decision was that the Supreme Court linked the Robinson-Patman Act and Sherman Act Section 2, and that both should be interpreted as protecting competition and not competitors. The alignment of these laws mean that the meeting competition defense under RPA Section 2(b) can be used as a defense in predatory pricing cases, where the seller can prove that it has cut its prices below cost in order to meet competitive offers which it believed in *good faith* its competitors were offering. Establishing good faith in its actions means that the seller's price cutting must be in response to sufficient information about the behavior of its competitors. The sources of such information could be reports from customers, coming from independent attempts to verify information coming from that sellers brokers or salesmen.[51] "Good faith" can also be established if price cuts are selective or if it is area wide[52], whether it is involves retaining existing customers or gaining new ones.[53] Generally, the meeting competition defense is widely invoked.[54]

In 2018, the DOJ convened a roundtable on the enforcement of the Sherman Act's Section 2. It developed a document summarizing what the DOJ gleaned from the proceedings.[55] The document affirmed the notion that they would consider efficiency defenses supported by evidence. Such defenses include promotional pricing, learning by doing and network externalities. This report is not without some controversy. FTC Commissioners Pamela Jones Harbour, Jon Leibowitz, and J. Thomas Rosch jointly issued a statement criticizing some aspects of the DOJ Report, and writing that if adopted by courts "would be a blueprint for radically weakened enforcement of Section 2 of the Sherman Act". Specifically regarding efficiency

[49] Brooke Group Ltd v Brown & Williamson Tobacco Corp, 509 US 209 (1993). See also Matsushita Elec. Indust. Co Ltd v Zenith Radio Corp, 475 US 574 (1986); Weyerhaeuser Co v Ross-Simmons Hardwood Lumber Co Inc 127 SCt 1069 (2007) (predatory bidding). Scott Hemphill, "The Role of Recoupment in Predatory Pricing Analyses" (2001) StanLR1581.
[50] Brooke Group, 509 US 209, 225.
[51] See for example, 324 US 746, 759 (1945)
[52] In contrast with EU law where targeted price cuts are evidence of intent to predate.
[53] E. Rousseva (2010), page 271.
[54] Antitrust Law Developments (Eigth) Volume I (2017), pg 297
[55] DOJ (2018).

defenses, they write that the Supreme Court has never embraced efficiency arguments as defenses to foreclosure.[56]

Chilling competition

Brooke Group affirmed many of the reservations raised in *Matsushita.* Due to the supposed rarity of attempted and successful predatory pricing schemes, the Court believed there would be high costs associated with litigating firms who would otherwise be engaged in competitive pricing. The Court emphasized the antitrust goal of defending competition over specific competitors; injury to a competitor due to below-cost pricing does not necessarily indicate injury to the market.[57] Quoting *Cargill* v. *Monfort:*

> "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result."[58]

Brooke Group also shared Matsushita's call to apply antitrust law beyond a single-firm setting, noting the oligopolistic structure of the U.S cigarette market. Once more noting the difficulties of engaging in tacit coordination to discipline a target, especially considering that Brown & Williamson was not the leader in the oligopoly, the Court believed there was no sufficient evidence to prove that Brown & Williamson could have engaged in predation.

c. Case 429 F.3d 190 (2005) Spirit Airlines, Inc., Plaintiff-appellant v. Northwest Airlines, Inc., Defendant-appellee

This case concerns a predatory pricing scheme as allegedly executed by a dominant firm by lowering its product price and increasing its product capacity against a new entrant. The plaintiff Spirit Airlines, Inc. ('Spirit') was a U.S. low-cost carrier which accused defendant Northwest Airlines, Inc., ('Northwest') of engaging in predatory pricing for the Detroit-Boston and Detroit-

[56] "STATEMENT OF COMMISSIONERS HARBOUR, LEIBOWITZ AND ROSCH ON THE ISSUANCE OF THE SECTION 2 REPORT BY THE DEPARTMENT OF JUSTICE" (https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-commissioners-react-department-justice-report-competition-monopoly-single-firm-conduct-under/080908section2stmt.pdf)
[57] 509 U.S. 225*, Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)
[58] *Cargill* v. *Monfort* (1986), as quoted in 509 U.S. 223 *Brooke Group Ltd.* v. *Brown & Williamson Corp (1993*)

Philadelphia airplane routes. Northwest accomplished this by adding aircraft and lowering ticket prices on those routes so that Spirit would be pressured to exit, which it did.

While trial court had found in summary judgement that Spirit's claims were implausible, the Court of Appeals reversed and sent back the case to be decided again. The Court of Appeals found Spirit had established sufficient evidence for a reasonable trier of fact to conclude that Spirit's definition and measurements of the relevant markets (leisure or low price customers travelling specifically between DTW-BOS and DTW-PHL) was appropriate;[59] that the relevant markets were highly concentrated and that Northwest was dominant;[60] that Northwest's additions to the DTW-BOS and DTW-PHL routes earned revenues below average variable cost;[61] and that Northwest was likely able to recoup losses once Spirit exited.[62]

Predation by added capacity; barriers to entry

Spirit v. Northwest demonstrated how a predatory pricing scheme could be rational in an industry with large barriers to entry. The airline industry poses barriers to entry which are uniquely difficult to overcome. Gate access for aircraft is not determined by open competition, and entrants often must lease at higher rates than incumbents.[63] The hub-and-spoke system (where a central airport 'hub' connects cities of different 'spokes') allows incumbents such control over route capacities and prices that competition is minimized.[64] Northwest had control over majority of passengers flying the DTW-BOS and DTW-PHL routes, as well as the Minneapolis and Memphis hubs from which Northwest connected other passengers to the routes.[65]

But in such an environment, predatory prices must be augmented with added capacity to discipline or remove entrants. While the marginal cost of adding more passengers is low, the resulting fare decreases are not enough to divert enough passengers away from an entrant

[59] Page 2, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[60] Page 11, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[61] Page 24, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[62] Page 29, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[63] Page 8, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[64] Page 26, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*
[65] Page 9, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*

unless there is enough added capacity to carry the diverted passengers. This added capacity is a variable cost that the incumbent incurs specifically against the entrant (otherwise it would have added capacity before), and so is inputted in the below-cost threshold for predation. This consideration would not likely have been detected in standard cost thresholds.[66]

Conflict over the Proper Cost

The *Spirit Airlines* and *American Airlines* attempted to challenge *Brooke*'s cost test in a particularly contradictory manner. First, in *American Airlines*, the DOJ proposed an incremental version of the price test, whether *American*'s incremental cost exceeded incremental revenue before and after the expansion of capacity. It also tested whether American's incremental cost of capacity expansion exceeded its price. [67]

The District and 10th District Appeals Court in this case rejected the notion of "incremental" profits. It noted that a standard price cost test in Brooke comparing AVC over the whole of its operations to price would vindicate American Airlines. The courts also claimed that these tests used the internal accounting system of American where the resulting cost measures did not correctly measure and allocate "avoidable" costs.

The result for *Spirit Airlines* was different. In this case, the 6th Circuit held that the same incremental profits test as an acceptable form of the price-cost test, because it deemed that capacity expansion is a non-price conduct, which allowed the courts to departure from the "standard" Brooke price cost test.

d. Case 549 U.S. 312 (2007) Weyerhaeuser Company v. Ross-Simons Hardwood Lumber Company

This case concerns a predatory buying scheme as allegedly executed by an incumbent against a competitor for shared inputs. Plaintiff Weyerhaeuser Co. ("Weyerhaeuser) and defendant Ross-Simons Hardwood Lumber Company ("Ross-Simons") were hardwood-lumber saw-mill operators in the Pacific Northwest. Ross-Simmons alleged that Weyerhaeuser was attempting to monopolize the alder sawmill competition by bidding for alder sawlogs at higher-than-competitive prices to deprive Ross-Simons of the input, thus forcing Ross-Simons from the market (Ross-Simons had shut down the mill by time of trial) and to exercise resulting monopsony power by offering lower-than-competitive bids for alder sawlogs in the future.[68]

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[66] Page 30-31, 429 F.3d 190 (2005), *Spirit Airlines, Inc., Plaintiff-appellant* v. *Northwest Airlines, Inc., Defendant-appellee*

[67] These were the DOJ's Test 1 and Test 4. The DOJ also had a Test 2: Whether American's LR AVC exceeded price and Test 3, whether price was persistently below AA's internal cost measure which it uses to calculate profitability.

[68] 549 U.S. 316 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*

The trial court sided with Ross-Simons, denying Weyerhaeuser's argument that the predatory pricing standards established in *Brooke Group* were of pertinence to Ross-Simons burden of proof.[69] The appeals court affirmed the decision, reasoning that predatory selling and predatory bidding were not materially similar, with predatory bidding not potentially beneficial to consumers compared to the low pricing of predatory selling.[70] However, the Supreme Court on a unanimous decision reversed the appeals court and remanded the trial. It found that predatory bidding and predatory pricing were analytically similar, and so the standards of *Brooke Group* needed to be applied Ross-Simons' claims; such claims did not appear to fulfill the standards.

Predatory bidding and predatory pricing

As both predatory bidding and predatory pricing employ unilateral pricing measures for anticompetitive purposes and both require firms to take short-run losses on the prospect of future supra-competitive profits,[71] the Court considered the two practices to be analytically similar and so subject to similar legal standards. As a result, the Court reiterated the below-cost and 'dangerous probability to recoup' standards from *Brooke Group*; in similar fashion, it considered predatory buying to be rarely tried and even more rarely successful.

The Court noted possible pro-competitive explanations for alleged predatory buying, such as responding to increased consumer demand; aiming to gain greater market share in the output market; focusing on an input-intensive production process; or simply making a mistake in bidding.[72] Consequently, such pro-competitive buying or even a failed predatory buying scheme could be a boon to the market, with higher input prices inducing new firms to enter the input market, and more outputs leading to lower prices for consumers; as predatory buying does not seek recoupment on the output side, consumers are not likely to be harmed directly, if at all.[73]

IV. Predation in a comparative perspective: International organizations' studies

The detailed exposition of the EU decisional practices serves to expose the salient issues, which every agency would focus in a predatory pricing case. Helpful in that regard, are also empirical studies undertaken by international organizations. In 2008, the ICN published a detailed study on predatory practices based on the responses of agencies and non-governmental advisors (NGAs)

[69] 549 U.S. 317 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*
[70] 549 U.S. 317 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*
[71] 549 U.S. 322 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*
[72] 549 U.S. 323 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*
[73] 549 U.S. 324 (2007), *Weyerhaeuser Company* v. *Ross-Simons Hardwood Lumber Company*

covering thirty-five jurisdictions.[74] While there were divergences in the response, the Report points to certain common principles to the treatment of predatory pricing across a range of jurisdictions. Below, we deal with some of the most pertinent questions on predatory pricing, which pose challenges for many competition authorities and courts in various jurisdictions.

a. What is the appropriate cost-benchmark?

According to the ICN Report, seven jurisdictions (Australia, Brazil, Canada, Mexico, Kenya, Russia, and South Africa) prohibit firms to sell at 'a price unreasonably below cost'.[75] The laws in three countries – Kenya, Mexico, South Africa - provide for specific cost benchmarks for predatory pricing: average variable cost, average variable cost and average total cost, and marginal cost and average variable cost, respectively.

It is important to remember, that competition agencies may use a combination of cost benchmarks depending on the case, as the EU experience suggests.[76] Experience in the EU, as well as other agencies,[77] suggests that pricing below AVC gives rise to a presumption of predation. The challenge here is to perform an accurate calculation and identify what constitutes a variable cost.

Cost benchmarks are used by virtually all agencies to assessed whether the alleged perpetrator is selling at a loss or sacrifice. There is no consensus as to a single cost benchmark, and often agencies use more than one benchmark (see EU approach above). A presumption that pricing below AVC is predatory is employed by some agencies, though this presumption is generally rebuttable. Pricing above ATC will not give rise to predation, and is generally considered to be a safe harbor. It is only in the EU where it might be abusive, depending on the market conditions as *Compagnie Maritime Belge* suggests.

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[74] International Competition Network – Unilateral Conduct Working Group, "Report on Predatory Pricing" (2008) http://www.internationalcompetitionnetwork.org/uploads/library/doc354.pdf (accessed 8 November 2018). Presented at the 7th Annual Conference of the ICN. Kyoto, April 2008.

Responses were provided by Brazil, Bulgaria, Canada, Chile, Czech Republic, Denmark, European Commission, France, Germany, Hungary, Ireland, Israel, Italy, Jamaica, Japan, Jersey, Kenya, Korea, Latvia, Lithuania, Mexico, New Zealand, Norway, Peru, Russia, Serbia, Singapore, Slovak Republic, South Africa, Switzerland, Taiwan, Turkey, United Kingdom, and the United States. A submission by a NGA concerned Australia. For the submissions see http://www.internationalcompetitionnetwork.org/working-groups/current/unilateral/questionnaires-responses/predatory-pricing.aspx (accessed 8 November 2018).

[75] ICN Report, 5.

[76] ICN Report, 12.

[77] ICN Report, 13.

b. Challenges with Cost and Price Data

Cost data from parties is almost always in a form not directly amenable to the price-costs/sacrifice tests involved[78]. Assembling the price and cost data that is usable by an agency is costly. Moreover, the agencies demands must not be excessive relative to what is needed. Usually, the cost and price data of the alleged predator is used. Cost data from competitors are normally used for competitive effects, except when cost data is not available from the dominant firm. Lacking either, the agency could use market research survey data.

Even after accounting data is extracted from the dominant firm, its interpretation is not straightforward. As indicated in the jurisprudence, the information used in the cost benchmarks can be different depending on its application/industry. Knowledge of cost management, as a subfield of accounting is essential. A few important points are highlighted here. The first is the notion of cost used in production requires carefully selecting accounting expenses that are properly understood to be part of average variable (incremental, avoidable) costs.

The second is the notion of allocating certain fixed costs which are necessary to spend in increasing output, which is part of average incremental costs. The notion of "cost allocation" from cost management is necessary. While many firms might use these concepts, the dominant firm's accounting system might not allocate costs similarly to an antitrust agency investigating exclusionary conduct.

Price data can also be complicated matter. Transaction prices may not be enough to measure marginal revenue if the analyst is analyzing complementary goods, or a loss-leader pricing strategy. Theoretically, one should estmate marginal revenue, and as a possible empirical alternative, compute average (marginal) revenue as well.

Finally, the price-cost test exists in a specific time period. Usually, the time period is the duration of time when the predatory conduct allegedly occurred. However, too short a period raises questions of whether it is consistent conduct, or capable to successfully excluding competitors.

c. Other possible Justifications and defenses?

Pro-competitive justifications (such as introductory offers or getting rid of stock) are possible, yet some jurisdictions – as the analysis on the EU above demonstrates – adopt a rather strict approach.

Possible defenses in various jurisdictions include:[79]

[78] ICN Report (2012), par 73-75.
[79] ICN Report, 28. See also ICN Report 2012, para 145.

- Promotional pricing (Singapore)
- Below cost pricing is necessary to enter a new market (France)
- Launching a new product (South Africa)
- Economies of scale (United Kingdom)
- Boost demand for a complementary product or service (New Zealand)
- Adjusting in a situation of price war (France and Switzerland)
- Sudden change in market conditions (excess, obsolete or perishable products) (Canada, Japan)
- Sudden change in demand making below cost necessary to stay in the market (Singapore)

V. Suggestions for the Philippines

The relevant PCA section is Section 15 (a) which states:

> "Selling goods or services below cost with the object of driving competition out of the relevant market: Provided, That in the Commission's evaluation of this fact, it shall consider whether the entity or entities have not such object and the price established was in good faith to meet or compete with the lower price of a competitor in the same market selling the same or comparable product or service of like quality."

The elements found in EU or US jurisprudence are also present in our law. However, the literature suggests that there are substantial differences in the interpretation between the two traditions.

Price-cost Test

The cost test mentioned in 15(a) is not yet formally defined in the law. Based on the literature on predatory pricing jurisprudence, it is recommended to model our price-cost test after the EU, and most countries enforcement practice.

Specifically, we should have a rebuttable presumption of predatory pricing if prices are below AIC, appropriately defined in each specific industry or instance. If prices are above AIC, a finding of anticompetitive predatory pricing may be found as long as there is evidence of intent or anticompetitive foreclosure. A broader set of circumstances to consider when proving whether or not predatory pricing occurred would lead to fewer erroneous conclusions.

This price cost test would be appropriate in the Philippines context as cost data may be elusive or unreliable and acknowledges that such data may give a weak signal if price is above AIC. When price is less than AIC, the test gives the strongest information, and is most reliable.

Recoupment

Although the PCA mentions cost, it makes no mention of recoupment in any way. As to whether or not to require any further additional evidence of recoupment, it is recommended to pattern our approach with that of the EU, where recoupment may be used to prove predatory pricing, but ultimately is not a necessary condition.

Recoupment is not only very hard to prove but also very limited in its usefulness in divining predatory pricing. Given this, the necessary resources required to prove recoupment may be too high, to the point of discouraging taking up of predatory pricing cases at all. This would make it difficult to achieve our mandate as the competition authority in the country.

A broader definition of recoupment in important, in that it is not necessary to prove likely exit, only that the conduct disciplines competitors to reinforce its dominant position. The EU's approach to recoupment zeroes in on any likely effect of the abusive conduct that increases and preserves the market power of the dominant firm.

Intent and Foreclosure

"*Object*" is mentioned in the PCA as one of the elements in proving predatory pricing. We find that proving intent can be useful in disambiguating the conduct of the dominant firm and may be one of the decisive factors in a case, especially when the alleged predtor prices above AVC or AIC but below ATC. To prove predatory pricing, we welcome including "likely effects" as the key part of intent evidence, consistent with modern practice.

To help in this, we should include in our investigation indirect economic evidence, similar to that of the EU Guidance Document, to show that the predator is capable of successfully implementing predatory pricing.[80] In addition, the review of economic theories in Part II would also give the ingredients the PCC would look for in a predatory pricing case. Most indirect evidence is similar to the evidence for dominance (such as high barriers to entry), and others are particular to exclusionary conduct generally, such as multimarket presence and reputation building.

Defenses

It is recommended that we follow the EU's approach to the meeting competition defense. The literature review shows that meeting competition is often not considered a valid defense, given

[80] See Page 21 for a list of factors.

the price cost test and intent evidence is strong. A defense based on economies of scale, as mentioned in the EU guidance document, makes the most economic sense, and the list of defenses in Part IV-c are special cases of economies of scale/externalities.

The phrase "good faith" likely comes from US jurisprudence, where it has been given wide latitude as a defense (See page 28 on *Brooke Group*) . There is no corresponding principle in the Philippines in antitrust law, and thus we are not bound to it. Further legal research must be conducted to confirm what the PCC's position on it should be. An interpretation of good faith in the PCA, based on the economics of predatory pricing, involves debunking the dominant firm's intent/object to exclude . This is a reasonable interpretation, which puts the issue squarely in terms of evidence of intent or likely effects.

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