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In the EU, predatory pricing analysis traditionally has stood somewhat apart from the assessment of other types of unilateral conduct under Article 82 EC Treaty. In its *AKZO* judgment of 1991, the European Court of Justice ("ECJ") relied on cost and sales price data, by adopting the "Areeda-Turner" test for predation, long before an economic approach to abuse of dominance analysis became pervasive.[1] But, the *AKZO* test also, to some degree, disregarded economic effects, in so far as it established a *per se* rule (for pricing below average variable costs, ("AVC")) and emphasized the importance of exclusionary intent (for pricing below average total costs, ("ATC")).

In its *Wanadoo* decision of 2003, the European Commission ("Commission") applied the *AKZO* test and explicitly rejected the notion that recoupment of losses should be part of the test for predation.[2] The Commission's approach was upheld by the Court of First Instance ("CFI").[3] Although many commentators considered this was inconsistent with contemporary economic theory and unnecessarily diverged from the analysis under

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

[2] Commission Decision of 16 July 2003 COMP/38.233 – *Wanadoo Interactive*. In this decision, the Commission imposed €10.4 million in fines on Wanadoo Interactive for practicing predatory prices in the area of high-speed (ADSL) Internet access, in the period from 2001 to 2002.

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

U.S. antitrust law, the Commission's Staff Discussion Paper of 2005 maintained that separate proof of (the possibility of) recoupment was not required to find an abuse.[4]

Against this background, the Commission's 2008 Guidance appears to propose a blend of old and new theories. The Commission indicates it will generally intervene where a dominant firm engages in predatory conduct

> by deliberately incurring losses or foregoing profits in the short term … so as to foreclose, or be likely to foreclose, one or more of its actual or potential competitors with a view to strengthening or maintaining its market power, thereby causing consumer harm.[5]

The Commission's predation analysis thus focuses on economic sacrifice and anticompetitive foreclosure. While the dominant company's ability to benefit from its sacrifice is mentioned as key to establishing consumer harm, the Guidance stops short of recognizing the possibility to recoup losses as part of the test for predation. The ECJ may resolve this issue later this year, when it rules on the *Wanadoo* appeal.[6]

I. THE COMMISSION'S GUIDANCE—PROVING SACRIFICE AND FORECLOSURE

The Guidance defines sacrifice as conduct whereby a dominant firm incurs avoidable losses by charging low prices or increasing the output of a particular product, over a specified period of time.[7] Sacrifice may exist if (i) the dominant firm's prices are

[4]DG Competition Staff Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses [hereinafter *Discussion Paper*].

[5]GUIDANCE ON THE COMMISSION'S ENFORCEMENT PRIORITIES IN APPLYING ARTICLE 82 EC TREATY TO ABUSIVE EXCLUSIONARY CONDUCT BY DOMINANT UNDERTAKINGS [hereinafter *Guidance*], para. 62. The Commission mentions it will pursue predatory conduct not only in the market where the firm enjoys dominance but also in any secondary market where the firm, albeit not dominant, can use its profits to cross-subsidize its activities. Guidance, footnote 39.

[6]Case C-202/07 P, *France Télécom v. Commission*.

[7]Guidance, paras 63 to 65.

below average avoidable cost ("AAC") or (ii) its pricing, while above AAC, led to a loss that could be avoided, as part of a predatory strategy. This two-fold approach is reminiscent of the *AKZO* test, but also departs from it in a number of ways.

First, referring to the presumption created by *AKZO*, the Commission states that it will view pricing below AAC in most cases as a clear indication of sacrifice. AAC will normally be the same as AVC, although the Commission acknowledges that they may differ. AAC arguably is a more appropriate benchmark, as it captures the sunk costs a dominant firm may incur from predatory expansion of capacity. In practice, the circumstances where the difference matters will most likely be limited, as the Commission is unlikely to bring a case that hinges on the difference between coverage of AVC or AAC.

In addition, in order to show a predatory strategy, the Commission may also investigate whether the short-term net revenues were lower than what could be expected from reasonable alternative conduct. This appears to be a variation of the *AKZO* scenario of pricing below ATC, with predatory intent. According to the Guidance, alternative conduct should be defined on the basis of economically rational and realistic alternatives, not mere hypotheses or theoretical examples of profitability. The Commission specifies that a dominant firm can defend itself by offering conclusive evidence showing that, while ultimately unprofitable, its pricing decision was made in good faith. But, where there is documentary evidence of a predatory strategy, the Commission will conclude the dominant firm's conduct entails a sacrifice.

The emphasis on anticompetitive foreclosure represents a positive change in the Commission's enforcement policy.[8] If sufficient reliable data is available, the Commission will apply its "equally efficient competitor test" in order to determine whether conduct is capable of harming competitors, and thus constitutes anticompetitive foreclosure. The Guidance states that, normally, only pricing below long-run average incremental cost ("LRAIC") is capable of foreclosing equally efficient competitors from the market. The Commission will investigate whether and how the below-cost pricing reduces the likelihood that rivals will compete. Proof that competitors have actually exited the market is not considered necessary to show anticompetitive foreclosure.

Perhaps the most important development in the Commission's predation analysis is that consumer harm is considered to be likely to occur if the dominant firm is likely to be in a position to benefit from the sacrifice (although this does not necessarily mean increasing prices above pre-predation levels). The Guidance thus introduces a focus on the shape of the market in the period following the alleged predatory conduct, which had been largely absent from predatory pricing enforcement under Article 82 EC Treaty in the past. However, stopping short of requiring evidence that the dominant firm has a realistic chance of recouping its losses, the Guidance states in very general terms that 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*.[9]

[8]Guidance, paras 66 to 72.

[9]Guidance, para 70.

In support of this approach, the Commission invokes (in a footnote) the *Tetra Pak II* judgment's statement that proof of actual recoupment of losses is not required.[10]

II. RECOUPMENT—ARE WE ALMOST THERE?

The move away in the Guidance from a *per se* application of the *AKZO* test and the introduction of a forward-looking element in the Commission's predation analysis constitute a step in the right direction. However, it is regrettable that the Commission did not resolutely endorse separate proof of (the possibility of) recoupment as part of this analysis.

The Discussion Paper could have been interpreted as an indication that the Commission was preparing a U-turn in this respect. As a general matter, the Discussion Paper acknowledged that low prices incurring losses—in the short run—need not always be tantamount to predation but, in fact, may be necessary to enter a market or to familiarize customers with a product.[11] It also stated that, in a competitive market with plenty of competitors, the exclusion of some of them will in general not lead to a sufficient weakening of competition so as to allow the predator to recoup its investment, suggesting the possibility of recoupment should be a prerequisite to a predation finding.[12] However, although attaching significant importance to showing the likelihood of recoupment as part of a predation analysis (by "investigating the entry barriers to the market, the (strengthened) position of the company and foreseeable changes to the future structure of the market"), the Commission ultimately rejected recoupment as a constituent

[10]Case T-83/91, *Tetra Pak International SA v. Commission*, [1994] ECR II-755, upheld by the ECJ in Case C-333/94, [1996] ECR I-5951.

[11]Discussion Paper, para. 95.

[12]Discussion Paper, para. 97.

part of the test for predation.[13] This was based on the argument that, under EC competition law, the finding of dominance (which is a precondition to any Article 82 infringement finding) normally means that entry barriers are sufficiently high to presume the possibility to recoup.

The Commission's stance, first in the Discussion Paper and then in its Guidance, may be explained in part by its desire to avoid undermining its position in the *Wanadoo* litigation, where the CFI upheld the Commission's decision *inter alia* on the issue of recoupment. When the ECJ rules on France Télécom's appeal, presumably later this year, it will have a unique opportunity to clarify the role of recoupment as part of test for predation under Article 82 EC Treaty. In his opinion of September 25, 2008, Advocate General Mazák resolutely urges the ECJ to conclude that proof of the possibility of recoupment (but not of actual recoupment) "is required in order to find predation."[14] In unusually severe terms, the Advocate General rejects the approach of the Commission and the CFI in relation to recoupment on several grounds.

First, the Advocate General criticizes the CFI's reliance on *Tetra Pak II*, now echoed in the Commission's Guidance, as a precedent that proof of recoupment is not required in the context of a predation case under Article 82 EC Treaty. He considers that the *Tetra Pak II* judgment unambiguously stated that it was not appropriate to require proof that a dominant company had a realistic chance of recouping its losses "in the

[13]Discussion Paper, para. 122.

[14]Opinion of AG Mazák of 25 September 2008 in Case C-202/07 P *France Télécom v. Commission*, not yet reported, para. 73.

circumstances of that particular case."[15] Accordingly, the CFI committed a double error, as it incorrectly applied *Tetra Pak II* as a general rule and also failed to explain why proof of the possibility of recoupment of losses was not necessary in the light of the specific facts of the *Wanadoo* case.

More fundamentally, the Advocate General considers that both the Commission and the CFI erred in law by not treating the possibility of recoupment as a precondition to a finding of predatory pricing. In his view, the analysis of the possibility of recoupment of losses requires a forward-looking appraisal of the market structure, similar to the analysis undertaken by the Commission in the area of merger control. The *ex ante* nature of this assessment also explains why the Advocate General rejects the argument that recoupment is implied by dominance, as "the determination of dominance is often based on historical market conditions."[16]

In conclusion, the Advocate General submits that, if there is no possibility of recouping losses, consumers should in principle not be harmed, pointing out that this is also the prevailing view of economists and citing U.S. case law in support of his opinion.

III. RECOUPMENT—TOWARDS CONVERGENCE WITH THE US?

In *Brooke Group*, the U.S. Supreme Court held that predatory pricing required proof (i) that the prices complained of are below an appropriate measure of its rival's costs and (ii) that the competitor had a reasonable prospect of recouping its investment in below-cost prices. Without recoupment, "even if predatory pricing causes the target

[15]Opinion of AG Mazák, para. 59.

[16]Opinion of AG Mazák, para. 76, citing R. O'DONOGHUE & A.J. PADILLA, THE LAW AND ECONOMICS OF ARTICLE 82 EC (2006).

painful losses, it produces lower aggregate prices in the market, and consumer welfare is enhanced."[17]

Some commentators claim that in the wake of *Brooke Group*, fewer predatory pricing cases have been brought in the United States, and even fewer have succeeded. However, others point out that the Supreme Court has not completely slammed the door on predation, as evidenced by a significant number of U.S. antitrust suits based on predation.[18]

In its recent Report on Single Firm Conduct, the U.S. Department of Justice ("DOJ") states that requirement of a dangerous probability of recoupment is an important reality check in assessing predatory-pricing allegations.[19] As such, the recoupment requirement is seen as a valuable screening device to identify implausible predatory pricing claims.

In his *Wanadoo* opinion, Advocate General Mazák agrees that requiring *ex ante* proof of the possibility of recoupment would function as a useful and administrable screen, as it is "much easier to determine from the structure of the market that recoupment is improbable than it is to find the cost a particular producer experiences."[20] Since the cost/price analysis required in predatory pricing cases is bound to be difficult,

[17]Brooke Group Ltd. V. Brown & Williamson Tobacco Corp., 509 U.S. 209, 113 S.Ct. 2578 at 222-224.

[18]D. Crane, *The Paradox of Predatory Pricing,* 91 CORNELL L. REV. 1 (2005) at para 6, reporting at least fifty-seven federal antitrust law suits alleging predatory pricing in the period 1993-2005.

[19]U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 67-68 (2008) [hereinafter *DOJ Report*].

[20]Opinion of AG Mazák, footnote 52, citing the US case A. A. Poulty Farms v Rose Acre Farms 881 F.2d 1396, (7th Circ. 1989).

controversial, and contentious, the recoupment requirement should alleviate the cost of errors (especially false positives).

Recoupment analysis has also been considered by a number of national competition authorities and courts in the EU Member States. For example, in its *AOL* decision, the French Competition Council stated that predation can be characterized only by recoupment of losses over time, and that such recoupment can take any form.[21] The Competition Council also examined the importance of recoupment at length in *GlaxoSmithKline*, where it held that the sacrifice incurred by a dominant firm does not, in effect, make sense unless that firm considers it will be able to recoup its losses in the long run.[22] According to the Competition Council, the possibility of recoupment is the very reason why competition authorities, whose duty it is to protect consumers, prohibit predation. Similarly, the Swedish Market Court held in *Statens Järnväger* that losses resulting from below-cost pricing should be able to be recouped at a later stage.[23] In the *Welsh Buses* case, on the other hand, the U.K. Office of Fair Trading examined the possibility of recoupment, but also referred inter alia to *Tetra Pak II* in support of the view that proof of actual recoupment should not be required.[24]

[21]Conseil de la Concurrence, Decision No. 04-D-17 of 11 May 2004, *AOL France and AOL Europe SA*, para. 66.

[22]Conseil de la Concurrence, Decision No. 07-D-09 of 14 March 2007, *GlaxoSmithKline France*, para 166.

[23]Marknadsdomstolen, Decision No. 2000:2 of 1 February 2000, *Statens Järnvägar v. Kokurrensverket & BK Tåg AB*, p. 28.

[24]Decision of the Office of Fair Trading of 18 November 2008, *Cardiff Bus*, Case CE/5281/04.

IV. LIMITED SCOPE FOR DEFENSES?

The Guidance provides dominant firms with little room to justify below-cost pricing. While low pricing can be justified by economies of scale or efficiencies generated by expansion in the market, in general the Commission considers it unlikely that predation will create efficiencies.[25] In its *Report on Unilateral Conduct*, the DOJ appeared more receptive to possible efficiency defenses to below-cost pricing[26], which was one of the DOJ's viewpoints that provoked criticism from a number of FTC Commissioners.[27]

Further, the Guidance remains entirely silent on the "meeting competition" defense. That is unfortunate, as dominant firms need to know whether they are entitled to match their competitors' prices, even if this means pricing below costs. Again, the ECJ may provide answer this question when it rules on the *Wanadoo* appeal.

In *Wanadoo*, both the Commission and the CFI rejected the notion that a dominant firm has an absolute right to align its prices on those of its competitors. However, while the Commission argued that a dominant firm should never be permitted to align its prices where this would result in pricing below costs, Advocate General Mazák remarked that the CFI's position was more subtle. In particular, the CFI left the door open for a "meeting competition" defense in predatory pricing cases, by stating that

> [e]ven if alignment of prices by a dominant undertaking on those of its competitors is not in itself abusive or objectionable, it might become so where it

[25]Guidance, para 73.

[26]DOJ Report, p. 71.

[27]Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice at 6 (Sept. 8, 2008) *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf.

> is aimed not only at protecting its interests but also at strengthening and abusing its dominant position.[28]

However, the Advocate General considered that the CFI failed to assess concretely whether or not that test was met in the *Wanadoo* case. The Advocate General considered that "one should allow for circumstances where a dominant undertaking is exceptionally permitted to show that its pricing below average variable cost is objectively justified."[29]

V. TOO MUCH EMPHASIS ON SUBJECTIVE INTENT?

Finally, the Guidance's reliance on direct evidence showing predatory intent as sufficient proof of sacrifice seems out of tune with an effects-based enforcement policy. As examples of documents that may evidence a predatory strategy, the Guidance cites detailed plans to sacrifice profits in order to exclude a rival, to prevent entry, or to pre-empt the emergence of a market, or evidence of concrete threats of predatory action.[30]

However, evidence of a dominant firm's subjective intent, reflected in its internal documents, should never substitute for a thorough analysis of the effects of its conduct on the market. In this respect, there has arguably always been a degree of tension between the second part of the *AKZO* test (which focuses on predatory intent, where prices are above AVC but below ATC) and the notion that abuse, within the meaning of Article 82 EC Treaty, is an objective concept. It is therefore regrettable that, beyond the area of predation, the Guidance also cites "internal documents which contain direct evidence of a

[28]Case T-340/03, *France Télécom v. Commission*, para. 187.

[29]Opinion of AG Mazák, para. 95. U.S. case law is divided on this issue, and the DOJ Report suggests that the "meeting competition" defense should not apply in predatory pricing cases (DOJ Report, p.71).

[30]Guidance, para 65.

strategy to exclude competitors" as a factor that is generally relevant to the Commission's foreclosure analysis and helpful to interpret a dominant firm's conduct.[31]

In the United States, antitrust law considers that such documents "provide no help in deciding whether a defendant has crossed the elusive line separating aggressive competition from unfair competition."[32] Perhaps this is best summed up as follows:

> the antitrust statutes do not condemn, without more, such colorful, vigorous hyperbole as '[w]hen [you] see the competition drowning ... stick a water hose down their throats'.[33]

VI. CONCLUSION

In the area of predation, the Commission's Guidance represents a cautious step in the right direction. The emphasis on anticompetitive foreclosure, in particular the focus on market circumstances in the period after predation, should result in a move away from a mechanistic application of the *AKZO* test towards a more effects-based predation analysis. However, regardless of whether the ECJ will ultimately rule that Article 82 EC Treaty requires the possibility of recoupment (not proof of actual recoupment) as part of the legal test for predation, it is unfortunate that, in setting out its Guidance, the Commission did not propose to apply a recoupment analysis at least as an initial screen in order to focus its enforcement actions. In any event, it cannot be excluded that the Commission might have to adjust its approach to recoupment and/or the "meeting competition" defense, once the ECJ (or the CFI, if the case is referred back to it) has ruled on the *Wanadoo* appeal.

[31]Guidance, para 20.

[32]Morgan v. Ponder, 892 F.2d 1355, 1359 (8th Cir.1989).

[33]Advo, Inc. v. Philadelphia Newspapers, Inc. 51 F.3d 1191, 1199 (3d Cir. 1995).