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Predatory Price Cutting: Notes and Comments

B. S. Yamey

In this article, Professor Yamey reviews the post-war contributions to the literature and analysis of predatory price cutting. While the point has been made frequently in the literature on predatory pricing that the practice makes little sense where entry into the industry in question is easy, the author gives several examples that illustrate how temporary price cutting may operate as an effective hindrance to new entry. The author suggests that the predatory nature of temporary price cutting, where it is present, is a reflection of the aggressor's intentions and whether those are to eliminate independent rivals. The author argues that, given this definition, predatory pricing should be considered not as constituting a distinct analytical category but rather as being an extreme variant of a broader class of temporary price cutting practices that allow the aggressor to achieve or restore a monopoly position.

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I.

In various post-war contributions to the analysis and empirical study of predatory price cutting, the practice has been defined as temporary selling, at prices below its costs, by a firm (or concerned group of firms) to drive out or crush a competitor. For convenience, the two firms will be called aggressor and rival, or predator and victim.

An early contribution, by John S. McGee, broke new ground by arguing that price cutting of this kind is not a sensible or profitable strategy for an aggressor to adopt since a better alternative is at hand.[1] He concluded: "Whereas it is *conceivable* that some one might embark on a predatory program, I cannot see that it would pay him to do so, since outright purchase [of the rival firm] is both cheaper and more reliable."[2] McGee did not consider specifically a close substitute for acquisition, namely the formation of a cartel between the two firms jointly to exploit the monopoly. In the earlier of two papers on predatory pricing Lester Telser noted this alternative, and concluded on lines similar to McGee's: "Either some form of collusion or a merger of the competitors would seem preferable to any possible outcome of economic predation."[3]

The key element in McGee's analysis is that predatory price cutting involves both firms, the predator and its victim, in unnecessary and avoidable loss of profits. In McGee's words: "Since the revenues to be gotten during the predatory price war will always be less than those that could be gotten immediately through purchase, and will not be higher after the war is concluded [as compared with the revenues after the merger], present worth [of the aggressor] will be higher in the purchase case."[4] Telser's more striking formulation is similar: "Price warfare between the two [firms] is equivalent to forming a coalition between each firm and the consumers, such that the consumers gain from the conflict between the firms. Since both firms can benefit by agreeing on a merger price, and both stand to lose by sales below cost, one would think that rational men would prefer merger."[5]

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1 John S. McGee, Predatory Price Cutting: The Standard Oil (N.J.) Case, 1 J. Law & Econ. 137, 138–43 (1958). See also Lester G. Telser, Abusive Trade Practices: An Economic Analysis, 30 Law & Contemp. Prob. 488, 494–96 (1965).

2 John S. McGee, *supra* note 1, at 143; see also 168. The inclusion of the word "conceivable" seems to have been made to cover cases of error. The word "reliable" refers to the advantage of purchase of assets over their competitive elimination, since the latter course does not sterilise them from further use.

3 Lester G. Telser, *supra* note 1, at 495.

4 John S. McGee, *supra* note 1, at 140.

5 Lester G. Telser, Cutthroat Competition and the Long Purse, 9 J. Law & Econ. 259, 265 (1966).

McGee's strong conclusion that monopoly achieved by the acquisition of the rival is cheaper than monopoly achieved by the elimination of the rival in economic war was modified by later contributors, including Telser.[6] Considerations omitted or dismissed in McGee's study have been brought into the analysis; and their inclusion serves to mitigate the conclusion that predatory pricing necessarily is economic folly. These considerations concern, *inter alia*, the elements of strategical and tactical manoeuvre which may affect the outcomes, including the long-term implications, of the alternative courses of action open to the aggressor. Some elaboration of these considerations follows.

The price to be agreed upon in the purchase of the rival is not a matter of indifference to the aggressor, can affect its choice of a strategy for dealing with the problem created by the presence of the rival, and may itself be capable of being affected by predatory pricing. Initially it is unlikely that the aggressor and its rival will make the same assessment and valuation of the latter's prospects of profits in the given situation. Two possibilities can be distinguished. First, initially the rival's minimum asking price may exceed the aggressor's maximum offer price (and, *mutatis mutandis*, a similar deadlock may exist when the formation of a cartel is at issue). A bout of price welfare initiated by the aggressor, or a threat of such activity, might serve to cause the rival to revise its expectations, and hence to alter its terms of sale to an acceptable level.[7] Second, initially the minimum asking price of the rival may be less than the maximum price the aggressor is willing to pay, so that a mutually satisfactory transaction would be possible. Nevertheless, the use, or the threat, of predatory pricing may be a useful component in the course of bargaining in which the aggressor tries to beat down the actual price to be paid towards the minimum asking price, as well as to induce the rival to reduce the minimum price.[8]

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6 For the relevant contributors, see Lester G. Telser, *supra* note 5, at 259–70; Richard Zerbe, The American Sugar Refinery Company, 1887–1914: The Story of a Monopoly, 12 J. Law & Econ. 339, 363 n.120 (1969); Donald Dewey, The Theory of Imperfect Competition: A Radical Reconstruction, ch. 7 (1969); Kenneth G. Elzinga, Predatory Pricing: The Cost of the Gunpowder Trust, 13 J. Law & Econ. 223 (1970).

7 It is conceivable that even where both the aggressor and the rival have identical expectations about the future profits of the latter, no acquisition price may be acceptable to both parties. This could be the case, for example, where the owners of the independent firm place a high value on their independence and on the ownership and control of their own enterprise. A period of losses induced by predatory pricing may change their attitude.

8 It is not only the dominant firm or group which can initiate temporary price cutting in an attempt to achieve its anti-competitive ends. The analysis applies symmetrically to a dominant firm and to the independent rival. Provided that the rival has, or can expand its output to secure, a sufficient share of business in that sector of the market in which it wishes to concentrate its pressure—the sector could be a separate region, a particular class of customer, or selected qualities or varieties of the product—it can initiate price cutting with the intention of inducing the dominant firm to agree to a more favourable settlement (that is, a bigger share of the cartel or a higher acquisition price) than it otherwise would have been prepared to grant.

The aggressor will, moreover, be looking beyond the immediate problem of dealing with its present rival. Alternative strategies for dealing with that rival may have different effects on the flow of future rivals. A policy of preserving monopoly by buying-up rivals may possibly be inferred from the purchase of a particular rival; and the purchase may then have the unfortunate effect of encouraging potential entrants to enter and to offer themselves as willing sellers, thereby progressively diluting the original owners' share of the monopoly profits. A policy of using predatory pricing, either regularly or occasionally, is likely to have a more discouraging effect.[9] It may be noted, in passing, that the effect of predatory pricing on the calculations of potential entrants makes it yet more difficult for the empirical investigator to determine whether or not a particular attempt at predation succeeded in achieving its purpose.

The preceding considerations apply independently of any assumption that the rival has less easy access to capital than the aggressor. Where access is more restricted for the former, perhaps because it is the smaller firm in the relevant market, the relative advantages of predatory pricing may be increased. However, in assessing the impact of the relative ease of access to capital, it should be recognised that the drain on resources would be larger for the firm with the larger share of the affected market (assuming the costs of the two firms to be the same). The aggressor may ordinarily be expected to be the larger of the two firms.

The modification of McGee's strong proposition about the folly of predatory pricing makes it difficult to predict the frequency with which the practice is likely to be used and the types of circumstances in which it may be expected to be relatively more or less common. Nevertheless, the opinion has been expressed that predatory pricing will be rare. Thus Telser has written: "Although it does not seem possible a priori to predict the frequency of price welfare, these will be rare if entrepreneurs are reasonable and intelligent."[10] Zerbe's view is "that predatory price wars might occur but would be unlikely."[11] One imagines that these views are not only influenced by the appeal of McGee's analysis but also that they are coloured to some extent by the fact that systematic and searching examinations of the historical record have shown, in a number of cases, that supposed

9 Elzinga has suggested that the response of potential entrants to the driving-out of established independents by predatory pricing "is not easily predicted." The "demonstration effect" may deter some. On the other hand, others "may realize the inability of the dominant firm to continue such a costly practice and promptly enter." Kenneth G. Elzinga, supra note 6, at 240. The latter possibility cannot be denied. But a policy of buying up new entrants without a fight is bound to attract new entrants.

10 Lester G. Telser, *supra* note 5, at 268.

11 Richard Zerbe, *supra* note 6, at 363 n.120. See also Kenneth G. Elzinga, *supra* note 6, at 240.

instances of price predation were nothing of the kind, or that the available evidence is incomplete or consistent with different explanations.[12]

It is not suggested in this paper that predatory pricing in the McGee sense has been frequent or is likely to be frequent even in the absence of hostile legislation. Indeed, because reasonably documented examples of the use of the practice are rare—a dearth intensified by the results of the thorough researches of McGee and others—there is some interest in presenting, in section III, a short account of one reasonably clear-cut example of predatory pricing, to augment by one the exiguous stock of recorded cases. Before coming to that section, however, the argument in the next section will suggest that predatory pricing, as it is currently defined, should be considered not as constituting a distinct analytical category but rather as being an extreme variant of a broader class of temporary price cutting practices designed to drive out or crush an independent competitor so that the aggressor can achieve or restore a monopoly position. Although their identification is beset with difficulties, examples of this broader class may not be so hard to find as are examples of predatory pricing in the strict McGee sense.

II.

The crucial point in McGee's analysis of predatory pricing is that the practice involves predator and victim in unnecessary loss of profits. Such loss or sacrifice of profits is independent, however, of whether the deliberate price cutting by the predator takes the price below cost (say, below its long-run marginal cost or average cost): all that is necessary is that the price is taken to a level lower than that which would otherwise prevail. Any deliberate price cut to achieve some ulterior aim involves a sacrifice of profits of this kind. The only special feature of price cutting below cost is that the loss of profits includes some loss in the absolute sense, that is, that the firm is "losing money." But nothing either in McGee's original analysis or in subsequent elaborations depends upon this feature, which cannot have any distinctive analytical significance.

It is true that in their expositions both McGee and Telser seem to assume that the price ruling before predatory pricing is instigated (or the merger concluded) is at the competitive level,[13] so that any deliberate price cut must be a cut below

12 For studies of real or alleged instances of predation, see John S. McGee, *supra* note 1; Richard Zerbe, *supra* note 6; Kenneth G. Elzinga, *supra* note 6; P. T. Bauer, West African Trade 121–24 (1954); M. A. Adelman, A & P: A Study in Price-Cost Behavior and Public Policy 372–79 (1959); and Gt. Brit., Monopolies Comm'n, Electrical Wiring, Harnesses for Motor Vehicles: A Report on Whether Uneconomic Prices are Quoted (1966). See also F. M. Scherer, Industrial Market Structure and Economic Performance 273–78 (1970).

13 John S. McGee, *supra* note 1, at 140; Lester G. Telser, *supra* note 5, at 263.

cost. But this restrictive assumption is not required for their analyses. In the duopolistic market situation which is postulated the initial price could be at any level, from the competitive price at one extreme to the monopoly price at the other. The considerations included in McGee's analysis would be relevant regardless of the level of the initial price,[14] and of the extent of the reduction from the price.

Again, the considerations which have led to the withdrawal from McGee's strong proposition do not depend for their relevance on the fact that sales are being made at price below cost during the period of predatory pricing. The aggressor may be able to achieve its objective of eliminating or disciplining the rival and of discouraging potential entrants by means of price cutting falling short of predatory pricing as this is defined currently. The aggressor has an obvious interest in minimising the extent of its price cutting to achieve a particular result, and has a choice of tactics. A smaller cut may in some circumstances be as effective as a larger cut, especially where the rival has reason to suppose that the aggressor will go further if necessary. On the other hand, a sharp initial cut may sometimes convey the intended message more emphatically and achieve the intended result more quickly.[15]

In so far as the aggressor's pricing behaviour may have the desired effect, this will stem from the rival's assessment of the aggressor's determination to frustrate its expectations, for example, as to the rate of growth of its sales and its attainable profit margins. It is improbable that the fact that the aggressor has taken the price below its own cost rather than, say, to a level somewhat above it, would make any difference. It should be remembered, furthermore, that the rival at which the price cutting is being directed cannot know, save in extreme cases, whether prices are in fact being cut below the aggressor's costs, of which it cannot be fully informed. Moreover, in so far as it is the fact that sales are being made at prices below the cutter's costs that is considered to be the crucial element in predatory pricing, the message of the strategy may fail to get through to the victim who may not know which of the various possible concepts of cost—

14 This is seen to be so even where the initial price is the monopoly price. The aggressor has an incentive to remove or neutralise the rival if the prevailing situation does not maximise joint profits because costs are higher than they need be.

15 Thus one member of a shipping conference expressed the following view in the course of a rate-cutting war with outsiders in the 1890's: "We still think here . . . that it would be better to go at once to an irreducible minimum to show Hendersons [one of the outsiders] that we are really in earnest. The extra cost would not matter if it shortened the struggle". Quoted in Francis E. Hyde, Shipping Enterprise and Management 1830–1939: Harrisons of Liverpool 76 (1967).

marginal or average, short-run or long-run—it should apply when trying to interpret what course the aggressor is following.[16]

It follows from the foregoing that there can be predatory intent in price cutting whether or not the aggressor sets its prices above or below its costs (in one or other meaning of the latter term). Apart from intent, the common characteristic of predatory price cutting in the broad sense is that it is temporary and that it is in the predator's interest to confine, where possible, the temporary sacrifice of profits to those parts of the market (regions, product varieties, classes of customer) in which the victim is trading.

It follows, further, that an outside observer may also have considerable difficulty in deciding whether predatory pricing has been practised, even when the category is widened by the removal of the condition that the price must be below cost for the action to qualify as predatory. This is so because a firm may reduce its prices for a variety of reasons and need not change them equally in all sub-markets or for all products. It may reduce prices because a new firm has entered the market or an established firm has increased its output, so adding to total supply. It may reduce its prices because of an actual or expected change in costs or in demand, or in an attempt to induce non-users of its products to become users. The predatory nature of temporary price cutting, where it is present, is a reflection of the aggressor's intention, which is to eliminate its rival as an independent competitor, not through the exercise of greater efficiency in the usual sense but through a pricing manoeuvre containing an undertone of threat. Such an intention is obviously difficult to establish conclusively, and can be inferred with reasonable confidence only when the observer, be he judge or academic, has been able to gain a

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16 It might seem more relevant to define predatory pricing as pricing below the costs of the rival to be eliminated rather than to regard the predator's costs as the standard by which to appraise the character of the price cutting. But this alternative definition would carry no greater analytical significance. And, save in extreme cases, the predator would not know for certain whether the price he set was below the level of his rival's costs in their relevant specification.

In the recent Bolton Committee Report on Small Firms it is noted that the published accounts of small, typically specialised, companies "may give a complete picture of the company's turnover and therefore the profitability of its limited range of products." (The disclosure provisions of companies legislation do not require diversified companies to give comparable information for each of their activities.) Fears were frequently expressed to the Committee that the large diversified company "having learned the profit margins of a competitor from his accounts," "could undercut his prices for a period and thus force his closure." The Committee reported that while this practice was "certainly conceivable," "no single case of this kind has been brought to our notice." Small Firms: Report of the Committee of Inquiry on Small Firms, Cmnd. No. 4811, at 307 (1971).

detailed and thorough understanding of the surrounding circumstances in all their complexity. It would certainly be incorrect to describe an established firm as a predator simply on the basis of a record that it had reduced the price of its product and then raised it when a rival withdrew or came to terms with it. Any attempt to define predation in this or way and to brand it as illegal would make it virtually impossible for an established firm with a large share of the market to compete effectively with smaller firms or new entrants. (One may note, parenthetically, that, according to McGee's analysis it would be economic folly for such a firm to compete on prices either in a predatory or non-predatory way—unless mergers by such firms were ruled out by law.) On the other hand, any attempt to narrow the definition by inserting in it the requirement that the reduced price be lower than cost (in some sense) would be inappropriate, since it has been shown here that selling at reduced prices above cost can serve the same purpose in the context of predatory intent. Moreover, the difficulties of identifying predatory pricing in the McGee sense are certainly no smaller than those noted above.

It is perhaps not surprising that it has been hard to find clear-cut historical examples of the extreme McGee variant of predatory price cutting, even when one is not unduly fussy about the appropriate definition of cost which should be used. But if it is correct to infer from the McGee analysis and its elaboration that predatory pricing (involving sales below cost) is likely to be rare or exceptional, it would also be correct to infer that predatory price cutting activities of a less extreme kind should also be rare or exceptional.

Temporary price cutting by dominant firms or groups has, of course, been practised quite frequently. And although, as has been suggested above, there are severe difficulties in distinguishing between temporary price cutting which is predatory in intent and that which is not, it appears that the predatory variety may not have been uncommon. If this were the case, it would seem to follow that the weight to be given to the factors which weaken McGee's strong conclusion concerning the folly of economic warfare should be greater than that suggested in several of the contributions on the subject which have appeared since McGee's paper was published.

On the information available several of the bouts of price cutting rejected in the recent literature as instances of predatory pricing seem to be eligible as instances of temporary, localised price cutting designed to deal predatorily with an independent competitor. Further examples can be suggested. The use of "fighting ships" by shipping cartels (conferences) is well documented, the Mogul case discussed in the next section being one example. The essence of the practice is for ships belonging to the conference to be used to cut freight rates when and where independent rivals are active so as to deny them business and profits. The special rates are not offered at other times and places. Both the majority and the minority groups of the Royal Commission on Shipping Rings reported in 1909 in terms suggesting that such temporary price cutting was a standard

weapon in the armoury of shipping conferences for dealing with interlopers. The majority reported that the practice (together with other practices) was used "until the opposition line is either driven off or admitted to the Conference," and the minority that "under-cutting their competitors" continued "until they have driven them away."[17]

Other examples of temporary price cutting which may be predatory are provided by the use of "fighting brands" by a monopolist to meet the competition of a new entrant in those parts of the market where it is trying to become established or to extend its operations. A special brand is introduced for the purpose. Its sale is confined to the affected areas; the quantities offered are controlled so as not to make unnecessary sacrifices of profit; and it is withdrawn as soon as the objective has been attained, namely the acquisition of the independent by the monopolist, or the withdrawal of the independent, or its abandonment of plans for enlarging its share of the market. Good examples of the use of fighting brands are provided by the activities of the match monopoly in Canada from its creation, by merger, in 1927 to the outbreak of the Second World War. The dominant firm used the device at various times, and this suggests that the firm was convinced of its efficacy.[18]

The use of temporary localised price cuts probably with predatory intent can also be illustrated from the workings of the basing point system in some industries. The normal operation of the system itself discouraged independent pricing because other sellers, regardless of their location, would match a reduction in a base price initiated by one of their number. The use of punitive basing points and punitive base prices went further. A small seller who was not adhering strictly to the rules of the system could be punished, and brought back into line, by the expedient of the cartel introducing a deliberately low base price in his principal production centre: all (or most of) his sales would have to be made at this low price because of his competitors' willingness to supply at that price in the affect-

17 Report of the Royal Comm'n on Shipping Rings, Cd. No. 4668, at 35, 96 (1909).

"Perhaps the most spectacular instance of this practice [the use of fighting ships] was the Syndikats-Rhederi, a 'fighting corporation' established in 1905 by six important German lines trading out of Hamburg. The corporation purchased four small and comparatively inexpensive vessels which, with others chartered from time to time, were hired out to the six owners of the syndicate to throttle competition. In time of 'peace' the syndicate's ships engaged in regular trade on time charters". Daniel Marx, Jr. International Shipping Cartels, A Study of Industrial Self-Regulation by Shipping Conferences 55 (1953). See also Alfred Marshall, Industry and Trade 434 n.2, 533 (1919: references to 1932 ed.).

18 Can., Dep't of Justice, Combines Investigation Comm'r, Matches, Investigation into an Alleged Combine in the Manufacture, Distribution & Sales of Matches, *passim* (1949). For description and discussion of the use of fighting brands in the match industry in the United Kingdom, see Gt. Brit., Monopolies & Restrictive Practices Comm'n, Report on the Supply and Export of Matches and the Supply of Match-making Machinery, 59, 62, 85 (1953). For fighting companies, successful and unsuccessful, see Gt. Brit., Monopolies & Restrictive Practices Comm'n, Report on the Supply of Cast Iron Rainwater Goods, 23 26–28 (1951); Report on the Supply of Electric Lamps, 43, 44, 90 (1951); Report on the Supply of Certain Industrial and Medical Gases, 21, 92 (1965).

ed area. This practice of localised price cutting was used, for example, with some effect in the United States cement industry in the inter-war years.[19]

It has sometimes been suggested that alleged examples of predatory pricing in a particular sub-market may be nothing other than manifestations of profit-maximising price discrimination. However, the various examples touched upon here cannot reasonably be regarded as instances of the exploitation by a monopolist of a perceived opportunity to discriminate in his prices between sub-markets in which demand intrinsically is of materially different price elasticities. The price differentiation is removed as soon as the rival comes to heel. The long arm of coincidence would have had to be in frequent operation for the successful neutralisation of the rival in such cases to have been coincident with changes in underlying demand elasticities.

However, while the explanation of the phenomena as instances of price discrimination may be rejected, it must be stressed that it is not possible, on the information available, to decide unambiguously whether all our examples of temporary price cutting should be classified as predatory or not. The distinction turns not on form but on intent; and on the latter the available information is incomplete.

III.

This section presents an account of what seems to be as clear-cut an example of predatory pricing in the McGee sense (that is, involving selling deliberately below cost) as one is likely to find, bearing in mind the difficulties of tracking down all the relevant information, including data on the predator's costs.

In December 1891 the law lords in the House of Lords pronounced upon the activities of a conference of shipowners in the China-England trade designed to exclude competitors so as to maintain a monopoly. This important decision, *Mogul Steamship Co. v. McGregor, Gow and Co. et al.*, terminated litigation which had been started in 1885 and concerned events of that year.[20]

Shipowners regularly engaged in the China trade had formed a conference in 1879 to regulate freight rates and the sailings of the ships of each member. The

19 Samuel M. Loescher, Imperfect Collusion in the Cement Industry, esp. 22–25, 125–29 (1959).

20 Mogul Steamship Co. v. McGregor, Gow & Co., *et al.*, 54 L.J.Q.B. 540 (1884/5); 57 L.J.Q.B. 541 (1887/8); 23 Q.B.D. 598 (C.A.) (1889); [1892] A.C. 25. For contemporary views on the importance of the decision, see Notes, 8 Law Q. Rev. 101 (1892); and Leading Article, The (London) Times, Dec. 25, 1891, at 7. For recent comment on the decision and its influence on the development of the law in the United States, see William Letwin, Law and Economic Policy in America: the Evolution of the Sherman Antitrust Act 49–51, 148, 149, 176 (1965). The various successive judgments in the case were each the subject of a leading article in The (London) Times, Aug. 14, 1888; July 15, 1889; and Dec. 19, 1891. Some account of the background and course of the dispute is to be found in Francis E. Hyde & J. R. Harris, Blue Funnel: A History of Alfred Holt & Co. of Liverpool from 1865 to 1914, at chs 3 & 4 (1956); and Sheila Marriner & Francis E. Hyde, The Senior, John Samuel Swire 1825–98, chs 8 & 9 (1967).

object was to improve the profitability of the trade by removing competition among members, especially at the height of the tea harvest (May and June) when large quantities of tea were shipped from Hankow and elsewhere down the Yang-tse-Kiang river to Shanghai, and thence to London. At some time before 1884 the conference introduced a 5 per cent rebate payable to such shippers as gave all their business to conference companies during that particular year. This was designed to discourage shippers from giving business to interlopers who might be attracted into the trade, particularly at the height of the tea season when demand for shipping space was high and, presumably, also relatively inelastic.

IT MUST BE STRESSED THAT IT IS NOT POSSIBLE, ON THE INFORMATION AVAILABLE, TO DECIDE UNAMBIGUOUSLY WHETHER ALL OUR EXAMPLES OF TEMPORARY PRICE CUTTING SHOULD BE CLASSIFIED AS PREDATORY OR NOT. THE DISTINCTION TURNS NOT ON FORM BUT ON INTENT.

The plaintiff company, Mogul, was formed in 1883, with ships engaged primarily in the Australia trade. It had an interest in picking up freights in China at the time of the year when homeward freight was plentiful in China but hard to come by in Australia. In the 1884 season the conference allowed two sailings to Mogul ships,[21] although the company was not admitted as a full member. In the next year Mogul asked to be admitted as a full member of the conference, and threatened to cut rates if its request was not granted.[22] The conference refused the request, and decided to treat Mogul as an outsider which had to be excluded from the trade.[23] The reason for the refusal is not clear. There is a contemporary reference to a "dispute";[24] and The Times (London) believed that the exclusion of Mogul was decided upon "probably because the shipowners . . . believed that their own vessels and resources were sufficient to supply all the demands of the trade."[25] Presumably Mogul had asked for an unacceptably large share of the trade, and the conference thought it more profitable to adopt tactics to exclude Mogul and to discourage others.

The methods of exclusion were the application of the loyalty rebate system to the disadvantage of Mogul and others, inducement of shipping agents in China

21 Sheila Marriner & Francis E. Hyde, *supra* note 20, at 148.

22 *Id*. at 148.

23 According to a trade paper, Mogul was "amongst the most inveterate ring men in London," and they instituted the action "because they were unable to participate in that which they subsequently denounced as wrong and an evil." 17 Fairplay 1372 (London, 1891). See also 13 Fairplay 110–11 (London, 1889).

24 The (London) Times, Aug. 14, 1888, at 9.

25 The (London) Times, Dec. 19, 1891, at 9.

to shun dealings with non-conference shipping lines, and the undercutting of freight rates when and where interloping vessels were active. In the first phase of the litigation only the rebate system was complained of; in the second phase, the other two methods were also at issue.

It is not necessary to give here an analysis of the reasons for the decision of the House of Lords adverse to Mogul—a decision which was unanimous, which confirmed a 2–1 decision in the Court of Appeal and which in turn had confirmed the decision in the Queen's Bench. It is sufficient to note, in broad terms, that the attempts of the conference to exclude competitors and to monopolize the trade were held not to be in unlawful restraint of trade; that the methods used by the conference were not unlawful *per se* (in that, for example, they did not involve violence, molestation or intimidation); and that the methods used did not become unlawful by virtue of the fact that they were used by a concerted group of firms rather than by a single firm. Present concern is to see whether the price cutting component in the conference strategy should qualify as an example of successful predatory pricing in the strict McGee sense.

The facts referred to in the law reports do not appear to have been in dispute. In 1885 the conference decided

> "that if any non-Conference steamer should proceed to Hankow to load independently any necessary number of Conference steamers should be sent at the same time to Hankow, in order to underbid the freight which the independent shipowners might offer, without any regard to whether the freight they should bid would be remunerative or not."[26]

Three independent ships were sent to Hankow, two of them being Mogul ships; and the agents for the conference lines responded by sending such ships as they thought necessary. Freight rates fell dramatically. It was accepted in the Court of Appeal and in the House of Lords that they fell to a level unremunerative alike to independent and to conference shipowners. According to Lord Esher, Master of the Rolls, rates were "so low that if they [defendants] continued it they themselves could not carry on trade."[27] Several of the law lords made similar statements. Thus Lord Halsbury, L.C.: "The sending up of ships to Hankow, which in itself and to the knowledge of the associated traders, would be unprofitable, but was done for

26 Mogul Steamship Co. v. McGregor, Gow & Co. *et al.*, 23 Q.B.D. 598 (C.A.) (1889), at 602.

27 *Id.* at 610. Bowen, L. J., expressed the view that "All commercial men with capital are acquainted with the ordinary expedient of sowing one year a crop of apparently unfruitful prices, in order by driving competition away to reap a fuller harvest of profit in future . . ." *Id.* at 615.

the purpose of influencing other traders against coming there . . . "[28] Apparently in the event the losses of the conference were larger than those of the outsiders, since some conference ships sailed empty from Hankow, while all the outsiders' vessels were able to load up with some cargo and did not have to sail in ballast.[29]

It is reasonably clear that the intentions of the conference were those of predatory pricing, that the conference contemplated pricing below cost, and that in the event its members did cut prices below their costs (in the sense that the voyages in question were unremunerative at the prices charged).

It is more difficult to establish the eventual outcome of the predatory pricing practised in conjunction with the other restrictive arrangements of the conference. The more immediate consequences of the events of 1885 are blurred by the occurrence of other developments. In 1882 a shipping company, The China Shippers Mutual Steam Navigation Company, financed largely by shippers, had been formed primarily so that the co-operating firms could avoid the terms and restrictions imposed by the shipping conferences.[30] Quite soon, however, the Mutual was working with the China conferences.[31] But in 1887 it withdrew from the conference arrangements and entered into an alliance with Mogul in terms of which the ships were to run under the Mutual flag as one line both outwards to China and homewards.[32] (It was this step which probably emboldened Mogul to continue with its expensive litigation.[33]) By 1891 the situation had changed once more. The rate war which had begun in 1887 had "continued with unabated ferocity," and Mutual "was finally forced to agree to Conference terms and became a member of a new Homeward Conference in 1891."[34]

28 Mogul Steamship Co. v. McGregor, Gow & Co., *et al*., [1892] A.C. 25, at 37. See also *id*. at 43 (Lord Watson); at 44 (Lord Bramwell); and at 56 (Lord Field).

29 *Id.* at 56.

30 Sheila Marriner & Francis E. Hyde, *supra* note 20, at 154–56. The formation of the first shipping conferences in the Chine trade naturally aroused the suspicions and opposition of some shippers. As early as December 1879 several shippers "decided on united action against the shipowners," and formed the China and Japan Shippers Association. The main bones of contention were the alleged elimination of competition in the supply of shipping services, the deferment of the payment to shippers of the loyalty rebates, and the treatment for rebate purposes of forwarding charges. The Association chartered some ships so as to become independent of the conferences. There were difficulties in securing such charters. In 1882 shippers took a more positive step in forming the Mutual to continue the fight against the conferences on a better organised basis. *Id*. at 150–56.

31 *Id*. at 138–39, 156. But see Francis E. Hyde & J. R. Harris, *supra* note 20, at 71, where it is said that because of the hostile reactions and concerted actions of the conference companies "the China Mutual could do nothing but comply and between 1884 and 1887 the Company was forced to instruct its agents to agree to the Conference terms."

32 Francis E. Hyde & J. R. Harris, *supra* note 20, at 72–73.

33 Sheila Marriner & Francis E. Hyde, *supra* note 20, at 149.

34 Francis E. Hyde & J. R. Harris, *supra* note 20, at 73. According to Sheila Marriner & Francis E. Hyde, *supra* note 20, at 166, the first new homeward agreement after the completion of the Mogul litigation took effect in January 1893.

Mogul was not admitted to membership of this conference then or later.[35] It is not included among the members of the Far East Homeward Conference listed in the Report of the Royal Commission on Shipping Rings of 1909.[36] The exclusion of Mogul from the homeward conference after 1885 is all the more noticeable and remarkable in that, after the events of the 1880s, the company was included as a member of other shipping conferences, including the conference on the outward trade to China and the Far East in which its main adversaries were engaged. In this capacity Mogul is listed in the Report of 1909 referred to above.

Thus the actions, including predatory pricing, taken against Mogul in the 1880s appear to have succeeded in achieving the intended goal of excluding Mogul. The only minor qualification to be made is that Mogul, after negotiations, was given "certain rights of loading on its own berth" in a Yang-tse port.[37]

It is obviously not possible to determine whether the predatory pricing was unprofitable in the sense that the conference might have achieved its objective at lower cost to itself without involving itself in selling its services below cost. The fact that shipping companies continued to use fighting ships after the Mogul affair suggests that predatory pricing and the standing threat of such action were considered efficacious. Price cutting by fighting ships did not, of course, necessarily involve prices below cost, but only temporary low prices. But it is the burden of the argument in section II that the *size* of the temporary price reductions is not to be regarded as the determining characteristic of predatory pricing.

THE MOGUL STORY SERVES TO ILLUSTRATE A GENERAL POINT, NAMELY, THAT PREDATORY PRICING, OR THE THREAT OF ITS USE, MAY ITSELF OPERATE AS AN EFFECTIVE HINDRANCE TO NEW ENTRY EVEN IN SITUATIONS WHERE THE CONVENTIONAL BARRIERS TO ENTRY ARE WEAK OR ABSENT.

The point is frequently made in the literature on predatory pricing that the practice makes little sense where entry into the industry or trade in question is easy. However, the Mogul story serves to illustrate a general point, namely, that predatory pricing, or the threat of its use, *may* itself operate as an effective hindrance to new entry even in situations where the conventional barriers to entry are weak or absent. In this respect predatory pricing, like certain other pricing practices, should be given a place in the analysis of barriers to entry.

35 For the revision of the agreement in 1894, see Francis E. Hyde & J. R. Harris, *supra* note 20, at 82.

36 Report of the Royal Comm'n on Shipping Rings, *supra* note 17.

37 George Blake, Gellatly's 1862–1962: A Short History of the Firm 78 (1962).