

Applying ICN Recommended Practices on Predatory Pricing

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competition commission
south africa

INTRODUCTION

- Focus on two predation cases in South Africa
 - Media 24 [appropriateness of ATC test and AAC]
 - Airlines [duration and computation of cost measures, typical in predation cases in airlines]
- Changes to predatory pricing provisions in the Competition Act
- Some lessons and perspectives

PREREQUISITES FOR SUCCESSFUL PREDATION

Profit sacrifice

During this period consumers enjoy lower pricing as dominant firm is pricing aggressively

The predatory strategy will work if the dominant firm is also able to bear the profit sacrifice

Recoupment

Dominant firm will be able to increase prices following the exit, deterrence of entry or marginalization of its rival in order to recoup lost profits

Intervention by competition authorities need to balance between risk of **type I (over-enforcement)** and **type II (under-enforcement)** errors

ICN RECOMMENDED PRACTICES ON PREDATORY PRICING

- Determine whether predator is **dominant** within a defined relevant market
- Application of relevant **price-cost tests**
- Types of cost measures used in the analysis of predation include **marginal costs, variable costs, average avoidable cost (AAC) or long run incremental cost**
- **Potential challenges to application of price-cost tests:**
 - Identifying the appropriate measure of cost – case-specific
 - Identifying the dominant firm's costs is also difficult because accounting records do not typically correspond to the measure of cost deemed relevant by the legal rule or economic analysis in competition enforcement
 - Estimation of cost measures can depend on choice of time period – what is fixed/unavoidable in short term may be variable/avoidable in medium term
 - Whether decreased profits, rather than actual losses by predator are sufficient to intervene

Source: ICN Unilateral Conduct Workbook, Chapter IV: Predatory Pricing Analysis

TEST UNDER SOUTH AFRICAN LAW

Section 8(d)(iv) of the Competition Act - test for predatory pricing

“It is prohibited for a dominant firm to engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of its act [including] selling goods or services below their marginal or average variable cost”

Alternatively section 8(c) of the Competition Act - test for general exclusionary conduct

“It is prohibited for a dominant firm to engage in an exclusionary act...if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain”

New formulation under Competition Amendment Bill

“It is prohibited for a dominant firm to engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of its act [including] selling goods or services at predatory prices”

NEWSPAPERS: MEDIA 24 (1 of 3)

Competition Commission

1

Media 24 used one of its publications, Forum, as a **fighting brand** against competitor, Gold Net News (GNN), by pricing advertising in Forum below its AVC/AAC **(s8(d)(iv))** or alternatively pricing below ATC **(s8(c))**

2

Due to the conduct, GNN exited the market and Forum, which had not been profitable throughout the relevant period, was closed down after GNN exited

3

The **conduct signalled** to rivals (and potential rivals) that Media 24 would be a fierce competitor, which would deter potential competitors

4

The anticompetitive effect was that advertisers were forced to pay higher prices, deprived of their choice of newspapers and the benefits of greater competition in terms of quality and service. Readers were deprived of choice and the benefits of increased competition in terms of quality

5

Media 24 **sacrificed profits** which it would have made in another publication (Vista) by keeping Forum open i.e. the case evaluated opportunity cost associated with “**cannibalisation**”
= **AVERAGE INCREMENTAL COSTS/AAC**



Competition Tribunal

1

8(d)(iv)

- Taken to its logical conclusion, a dominant firm shown to have made a business decision that was not profit maximising, could find itself guilty of predation (**opportunity costs**)
- Calculation of opportunity costs is inherently uncertain
- Unlike historical costs, which have been incurred and can be ascertained from accounting records, opportunity costs rely on assumptions of “what might have been”
- Additional complications were:
 - Forum was not a fighting brand introduced in response to new entry, but existed for many years prior to the new entry by GNN. This made it more complex to calculate opportunity cost
 - The problem of common costs in multiproduct firms

Finding – Commission failed the test of s8(d)(iv)

2

8(c)

- Conduct considered under ATC standard, which may lead to over-enforcement because a firm pricing above AVC/AAC, but below ATC may have some legitimate pro-competitive purpose
- Therefore application of ATC will require additional evidence: **direct & indirect intent, recoupment & equally efficient competitor**
- **ATC standard** – appropriate in our economy which is characterised by high barriers to entry in many markets, unwillingness of capital markets to sponsor the entry of competitors against dominant incumbent firms
- ATC test is a more reliable standard when dealing with the problems associated with the vertically integrated or multi-product firm

Finding – Infringement found under 8(c)



Competition Appeal Court (CAC)

1

Decision of CAC

- Under 8(c) the wording of the Act does not encompass **INTENT**
- Relying on Motta (2004):
 - Price above ATC should be presumed lawful
 - Price below ATC but above AVC should be presumed lawful unless rebutted by either party
 - Price below AVC should be presumed unlawful unless the dominant firm can rebut
- Correct test is AAC/AVC and not ATC under section 8(c) and even on this cost benchmark the Commission failed
- Under **Section 8(d)(iv)**, the only appropriate cost measures are marginal cost or AVC and so the Commission's case fails

Finding – No Infringement found under 8(c) or 8(d)(iv)

2

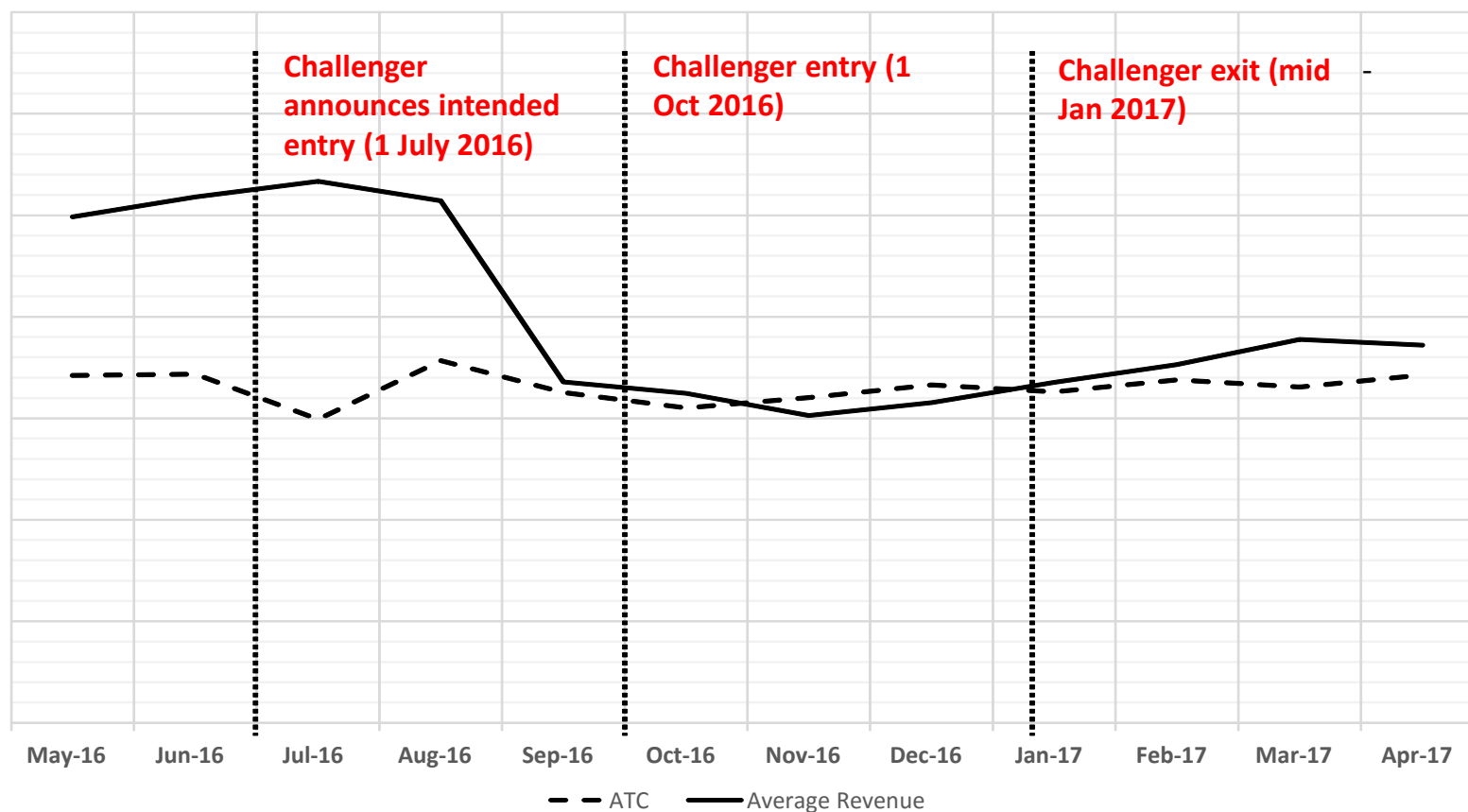
Appeal by Commission of decision of CAC (inter alia)

- Narrow interpretation of section 8(c) incorrect
- No legal basis for finding that the wording of section 8(c) prevents the Tribunal or a court from having regard to the intent of a dominant firm in carrying out the conduct in question
- Section 8(c) prevents a dominant firm from carrying out an exclusionary act which is an objective and effects-based assessment. It does not follow that the requisite exclusionary effect cannot be established by pricing below ATC where that is accompanied by evidence that the dominant firm intended, by means of such pricing, to force a competitor out of the market

Constitutional Court to hear the appeal in November 2018

AIRLINES

- Current airline case under litigation features interesting question of duration of conduct
 - How long is long enough for the conduct to be anti-competitive? [See e.g. Lufthansa/Germania (Bundeskartellamt)]
 - Is it enough if conduct provides a ‘final push’ to an already struggling firm?
- Average pricing below ATC for two months; Prices on two individual flights below AAC for 5 and 7 months [focus on a specific route and times]



WHAT LIES AHEAD IN SOUTH AFRICA

Competition Amendment Bill: current iteration of section 8(d)(iv)

*“It is prohibited for a dominant firm to engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of its act [including] selling goods or services at **predatory prices**”*

- The new test would do away with reference to particular cost measures under section 8(d)(iv) (marginal cost and average variable cost)
- However new definitions section refers to **predatory pricing** as “prices for goods or services below the firm’s average avoidable cost or average variable cost:
 - **Average Avoidable Cost** is defined as – the sum of all costs, including variable costs and product-specific fixed costs, that could have been avoided if the *firm* ceased producing an identified amount of additional output, divided by the quantity of the additional output
 - **Average Variable Cost** is defined as – the sum of all the costs that vary with an identified quantity of a particular product, divided by the total produced quantity of that product
- Section 8(c) catch all persists and pending the outcome of the appeal to the Con Court prices below ATC but above AVC with further evidence including intent could apply to exclusionary conduct – approach consistent with EU case law e.g. ECS/AKZO and Lufthansa/Germania

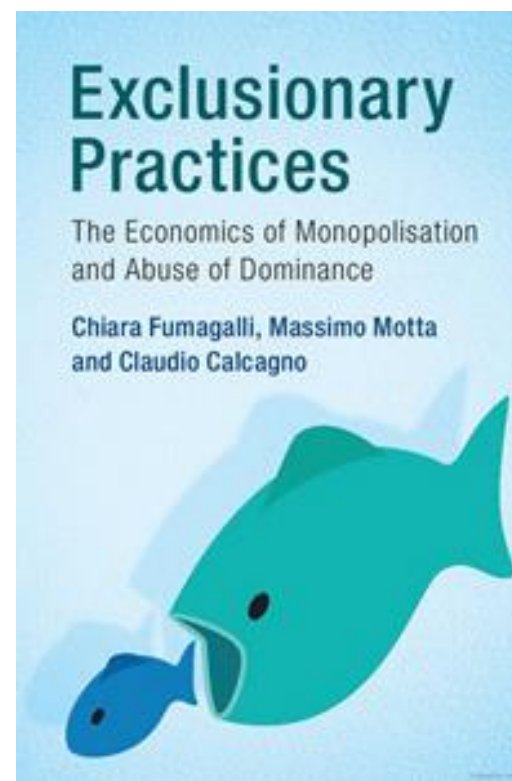
RECENT SCHOLARLY WORK

Meaning of exclusionary practices and challenges

"Exclusionary practices are contracts, pricing strategies and more generally actions taken by dominant firms to deter new competitors from entering an industry, to oblige rivals to exit, to confine them to market niches, or to prevent them from expanding, and which ultimately cause consumer harm. This is certainly the most controversial area in competition policy, and one in which economics has arguably not yet been able to guide policymakers in the design of sensible rules and enforcement practices"

C Fumagalli, M Motta & C Calcagno, 2018 [Exclusionary practices: The Economics of Monopolisation and Abuse of Dominance]

Effects: Big fish eat little fish



THANK YOU

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