

THE EUROPEAN COMMISSION'S ECS/AKZO STANDARD FOR PREDATORY PRICING IN THE E.E.C.: DETERRENCE OR DISORDER?

I. INTRODUCTION

In June 1983 the Commission of the European Communities (Commission),¹ acting on a complaint² made in June of 1982 by Engineering

¹ The Commission of the European Communities is one of four institutions of the European Economic Community (EEC). The Treaty Establishing the European Communities, done at Rome, Mar. 25, 1957, 298 U.N.T.S. 3 [hereinafter Treaty of Rome], established the EEC, which currently includes: Belgium, Denmark, France, the Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. Article 4 of the Treaty of Rome delineates the EEC power structure into four separate institutions: the Assembly (European Parliament), the Council, the Commission, and the Court of Justice. Article 155 of the Treaty specifies the purpose and duties of the Commission:

In order to ensure the proper functioning and development of the Common Market the Commission shall: ensure that the provisions of this Treaty and the measures taken by the institutions pursuant thereto are applied . . . [and] exercise the powers conferred on it by the Council for the implementation of the rules laid down by the latter.

Id. at art. 155.

The Commission's broad powers in the area of antitrust law, known as competition law in Europe, make it the primary source of that law in the EEC. Through its powers of investigation, powers to order termination of infringement, and powers to impose fines, the Commission essentially determines the competition policy of the EEC. For further discussion on the Commission's role in competition law, see Schrans, *The Community and its Institutions*, in COMMISSION OF THE EUROPEAN COMMUNITIES, THIRTY YEARS OF COMMUNITY LAW 24-27 (1983). See also C. BELLAMY & G. CHILD, COMMON MARKET LAW OF COMPETITION 4-6 (1978).

² Plaintiff corporation made its complaint to the Commission pursuant to article 3 of Regulation No. 17 of the European Council. The Council designed Regulation No. 17 to empower the Commission in competition matters to undertake necessary investigations, to impose fines, and to end infringements. Article 3 states:

1. Where the Commission, upon application or upon its own initiative, finds that there is infringement of Article 85 or Article 86 of the Treaty, it may by decision require the undertakings or associations of undertakings concerned to bring such infringement to an end.

2. Those entitled to make application are:

(a) Member States

(b) natural or legal persons who claim a legitimate interest

3. Without prejudice to the other provisions of this Regulation the Commission may, before taking a decision under paragraph 1, address to the undertakings or associations of undertakings concerned recommendations for termination of the infringement.

Council Regulation (EEC) No. 17, 5 J.O. COMM. EUR. 204 (1962) (regulation of the Council of Europe) [hereinafter Regulation No. 17].

and Chemical Supplies (Epsom and Gloucester) Ltd., United Kingdom (ECS),³ initiated proceedings against AKZO Chemie BV, the Netherlands (AKZO).⁴ The complaint lodged by ECS alleged that AKZO had, contrary to article 86 of the European Economic Community Treaty (Treaty of Rome),⁵ abused its dominant position⁶ in the Eu-

³ Eng'g and Chem. Supplies (Epsom and Gloucester) Ltd. v. AKZO Chemie BV, 28 O.J. EUR. COMM. (No. L 374) 1 (1985). [hereinafter ECS/AKZO Final Decision]. ECS was at the time of the complaint a small, privately owned producer of benzoyl peroxide in the United Kingdom. ECS mainly manufactured and marketed flour additives, including benzoyl peroxide-based bleaching agents, but in 1975 ECS also began producing benzoyl peroxide for use as a catalyst in the polymer industry. *Id.* at 5.

⁴ *Id.* at 2. AKZO Chemie BV [hereinafter AKZO Chemie] and its subsidiaries comprise the specialty chemicals division of AKZO NV, a large multinational producer of chemicals and fibers. AKZO Chemie, at the time of the complaint, produced organic peroxides including benzoyl peroxide. *Id.*

⁵ Treaty of Rome, *supra* note 1, art. 86. Article 86 of the Treaty of Rome addresses the common rules concerning the Community's competition policy. Article 86 states:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between member states.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Id. The Court of Justice in *Europemballage Corp. and Continental Can Co. v. Comm'n of the European Communities*, 1973 E. Comm. Ct. J. Rep. 215, 12 Comm. Mkt L.R. 199 (1973), declared that the abusive practices listed in article 86 do not comprise an exhaustive enumeration of abuses, but are simply examples. *Id.* at 245, 12 Comm. Mkt. L.R. at 224.

The Commission bases its competition policy primarily on article 3(f) of the Treaty, which posits that "the activities of the Community shall include . . . (f) the institution of a system ensuring that competition in the common market is not distorted." Treaty of Rome, *supra* note 1, art. 3.

⁶ The Treaty of Rome does not define the term "dominant." However, several general criteria are customarily applied in determining whether a business enterprise might hold a dominant position. One major factor is the size of the undertaking in relation to whether it is large enough to be able to conduct its business without regard for the effect that its conduct has on its competitors, suppliers, or customers. The Court of Justice has held that such an undertaking enjoys a dominant position. *United Brands Co. and United Brands Continental BV v. Comm'n of the European*

ropean Economic Community (EEC) organic peroxides market.⁷ This alleged abusive conduct consisted of systematic predatory and discriminatory pricing⁸ by AKZO, executed through its subsidiary AKZO UK Ltd. (AKZO UK).⁹ ECS complained that AKZO implemented its pricing policy in response to ECS' expansion into the plastics sector of the organic peroxides market in the United Kingdom and Germany.¹⁰ ECS also claimed that AKZO UK intended that its low prices eliminate ECS as a competitor in the EEC organic peroxide market.¹¹

Communities, 1978 E. Comm. Ct. J. Rep. 207, 21 Comm. Mkt. L.R. 429 (1978). Also, the firm must possess a large share of the relevant market; a market share several times greater than that of its nearest competitor could be a strong indication of dominance. Metro SB - Grossmarket GmbH & Co., KG v. Comm'n of the European Communities, 1976 E. Comm. Ct. J. Rep. 1353, 22 Comm. Mkt. L.R. 1 (1978). In addition, geographic size of the relevant market, substitutability of the product in question, and existing barriers to entry into the field all may help determine whether an enterprise commands a dominant position in the market. For a more thorough discussion of dominance, see R. GRAUPNER, *THE RULES OF COMPETITION IN THE EUROPEAN COMMUNITY* 11 (1965).

⁷ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 1. Organic peroxides are specialty chemicals used mainly in the polymer industry. Benzoyl peroxide, the major organic peroxide in terms of production and variety of uses, is widely utilized in the polymer sector. In the instant matter, benzoyl peroxide is important in its specialized use as a bleaching agent for flour. *Id.* at 3.

⁸ See *infra* notes 31, 75 and accompanying text.

⁹ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 1. AKZO UK is a wholly-owned subsidiary of AKZO Chemie. AKZO UK manufactures and markets specialty chemicals for AKZO Chemie in the United Kingdom. These chemicals include organic peroxides for the polymer industry and benzoyl peroxide for use as a bleaching agent in the commercial baking of bread. *Id.* at 2. This Note hereinafter adopts the Commission's clarification of AKZO's various entities, which explains that "the term AKZO is used to indicate the single economic unit formed by AKZO Chemie BV and its subsidiary companies. When the context requires a distinction to be made between parent and subsidiary, AKZO Chemie BV is referred to as 'AKZO Chemie' and AKZO Chemie UK Ltd. as 'AKZO UK.'" *Id.* at 2, n.1.

¹⁰ *Id.* at 2. ECS originally purchased its benzoyl peroxide in bulk from AKZO UK but began, in 1977, to develop its own production capabilities for flour additives. *Id.* at 6. In 1979 ECS decided to expand from producing solely for the flour additives sector, and thus began to produce benzoyl peroxide in forms suitable for sale in the more lucrative bulk polymer industry. ECS at first sold benzoyl peroxide in this form to United Kingdom clients only; in September 1979, however, ECS sold its first consignment of bulk benzoyl peroxide to BASF of Ludwigshafen, a major AKZO customer, at a price 15-20% lower than that charged by AKZO at the time. *Id.* at 7.

¹¹ *Id.* at 6-7. ECS was at the time of the dispute AKZO UK's closest competitor in the United Kingdom and Ireland flour bleaching agents market. According to AKZO figures, AKZO UK held a 1982 market share of 52%, while ECS' share of the same market in 1982 was 35%. *Id.* at 5.

The Commission investigated the complaint during 1982,¹² and in July of 1983, issued an interim measures decision¹³ ordering AKZO UK to raise its profits to the levels realized before it began the alleged predatory and discriminatory pricing.¹⁴ On December 14, 1985, the Commission issued its final decision on the matter, holding that AKZO had abused its dominant position in the EEC organic peroxide market by pursuing a strategy of predatory pricing in the United Kingdom flour additives sector.¹⁵ The Commission determined that

¹² *Id.* at 8. The Commission conducted surprise investigations at AKZO Chemie and AKZO UK offices in December 1982, pursuant to article 14(1) of Regulation No. 17, which states in pertinent part:

[T]he Commission may undertake all necessary investigation into undertakings and associations of undertakings. To this end the officials authorized by the Commission are empowered:

- a. to examine the books and other business records;
- b. to take copies of or extracts from the books and business records;
- c. to ask for oral examinations on the spot;
- d. to enter any premises, land and means of transport of undertakings.

Regulation No. 17, *supra* note 2, art. 14(1). Through these investigations the Commission obtained a number of important internal documents implicating AKZO UK in a concerted effort to initiate a policy of predatory and discriminatory pricing. ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 8. *See infra* notes 86-90 and accompanying text. For a case analysis concerning the Commission's investigatory powers under Regulation No. 17, see Recent Development, *National Panasonic (U.K.) Ltd. v. E.C. Commission: Antitrust Investigations in the European Economic Community*, 11 GA. J. INT'L & COMP. L. 177 (1981).

¹³ *Eng'g and Chem. Supplies (Epsom and Gloucester) Ltd. v. AKZO Chemie UK Ltd.*, 26 O.J. EUR. COMM. (No. L 252) 13 [hereinafter ECS/AKZO Interim Measures Decision]. In *Camera Care Ltd. v. Comm'n of the European Communities*, 1980 E. Comm. Ct. J. Rep. 119, 27 Comm. Mkt. L.R. 334 (1980), the Court of Justice bestowed upon the Commission the power to adopt "any preliminary measures which . . . appear necessary [to the Commission] at any given moment," within the context of a decision requiring termination of an infringement of EEC competition rules. *Id.* at 131, 27 Comm. Mkt. L.R. at 347. The Commission noted the conditions necessary for the granting of interim measures: the establishment by sufficiently clear evidence of a likelihood of infringement under article 85 or article 86; the likelihood of serious and irreparable harm to the applicant unless measures are ordered; and proven urgency. ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 17. The Commission determined that the circumstances of the case fulfilled these requirements, and in its annex to the decision, detailed allowable prices which AKZO UK could thereafter charge its customers. The Commission declared that AKZO UK could only lower those prices to meet, but not undercut, another supplier's lower price offer. *Id.* at 20.

¹⁴ *See supra* note 13.

¹⁵ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 25. The Commission concluded:

- (ii) AKZO abused its dominant position in the EEC organic peroxides market by the making of threats to ECS in late 1979 and then systematic

AKZO's strategy was designed to eliminate ECS from the larger, more lucrative plastics sector of the EEC organic peroxides market, and was therefore abusive conduct within the prohibition of article 86 of the Treaty of Rome.¹⁶ The Commission imposed an exemplary fine of 10 million ECU¹⁷ upon AKZO and later referred to AKZO's behavior as "one of the worst forms of infringement under article 86."¹⁸ AKZO subsequently lodged an action for annulment, now pending, with the European Court of Justice.¹⁹

implementation since the end of 1980 of a course of commercial behavior in the flour additives sector designed to damage the business of ECS and in the long term secure its withdrawal as a competitor from the organic peroxides market thereby reinforcing by unfair means the dominant position of AKZO.

¹⁶ *Id.*

¹⁷ *Id.* at 27. The European currency unit, or ECU, is integral to the monetary system of the EEC. According to the Commission, the ECU serves four different functions:

- (i) it acts as a *numeraire* in that each currency has a central rate expressed in this unit; (ii) as a central point of reference it indicates when currencies are spreading apart from each other ('divergence indicator'); (iii) it acts as a denomination through which intervention and credit is extended by the authorities; and (iv) it acts as a means of settlement between the Community's monetary authorities.

McMahon, *Progress Toward Economic and Monetary Union*, in COMMISSION OF THE EUROPEAN COMMUNITIES, THIRTY YEARS OF COMMUNITY LAW 409 (1983).

At the time of the decision, 10 million ECU equalled 24,696,000 Dutch florins (\$U.S. 8,689,655), the highest fine the Commission has ever imposed on any firm. The Commission sanctioned the fine according to article 15 of Regulation No. 17, which allows for fines of up to 1 million ECU or 10% of the turnover of the guilty undertaking in the preceding business year, whichever is greater. ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 25. The Commission also ordered AKZO to offer the same terms and conditions to all its current and prospective customers, and to report its compliance to the Commission for the following five years. *Id.* at 27.

¹⁸ COMMISSION OF THE EUROPEAN COMMUNITIES, FIFTEENTH REPORT ON COMPETITION POLICY 85 (1986).

¹⁹ The European Court of Justice, located in Luxembourg, consists of twelve judges unanimously elected by the governments of the EEC member states. According to the Treaty of Rome, the role of the Court of Justice is to "ensure that the law is observed in the interpretation and implementation of the Treaty." Treaty of Rome, *supra* note 1, art. 164.

The judges are assisted by several advocates-general, who are required by the Treaty to "make reasoned submissions in open court, with complete impartiality and independence" on cases before the Court of Justice. *Id.* at art. 166. The opinions of the advocates-general are in no way binding upon the Court, but are invariably published with the judgment of the Court and often relied upon by the Court in its decision. See D. LASOK & J. BRIDGE, LAW AND INSTITUTIONS OF THE EUROPEAN

The ECS/AKZO decision marked the first time the Commission has addressed the issue of predatory pricing. Although the Commission unequivocally condemned AKZO's conduct, it failed to either adopt or devise any concrete method for determining what prices are predatory. Instead, the Commission relied heavily on an abundance of subjective evidence, consisting mainly of internal AKZO memoranda and documents, which substantiated AKZO's predatory intent. In using this evidence to support its finding the Commission neglected to properly stress the objective evidence present - the relationship between AKZO UK's prices and its costs of doing business. Due to its failure to apply a more comprehensive standard of analysis, the Commission may encounter substantial difficulty in determining predation in future matters where subjective evidence is not present.

COMMUNITIES 146-48.

Article 173 provides for the right to appeal Commission decisions:

Supervision of the legality of acts taken by the Council and the Commission other than recommendations or opinions shall be a matter for the Court of Justice. It shall for this purpose have jurisdiction in proceedings instituted by a member state, the Council or the Commission, on the grounds of lack of jurisdiction, infringement of important procedural rules, infringement of this Treaty or of any rule of law relating to its application, or misuse of powers.

Any natural or legal person may, subject to the same conditions, have recourse against a decision directed to him or it or against a decision which, although in the form of a regulation or a decision directed to another person, is of direct and individual concern to him or to it.

Treaty of Rome, *supra* note 1, art. 173.

Regulation No. 17 delineates the Court's power to review Commission competition decisions, specifying that "[t]he Court of Justice shall have unlimited jurisdiction within the meaning of article 172 of the Treaty to review decisions whereby the Commission has fixed a fine or periodic penalty payment; it may cancel, reduce or increase the fine or periodic penalty payment imposed." Regulation No. 17, *supra* note 2, art. 17. Article 172 of the Treaty states that "[r]egulations made by the Council pursuant to the provisions of this Treaty may confer on the Court of Justice plenary jurisdiction in regard to the penalties provided for in such regulations." Treaty of Rome, *supra* note 1, art. 172.

Proceedings in a direct action such as AKZO's appeal advance in four distinct phases: the written procedure stage, the directions and inquiries stage, the oral procedure, and the judgment. In the first phase, the parties to the dispute (in this case, AKZO and the Commission) submit their written arguments to the Court. At the directions and inquiries stage, the Court decides what further steps need to be taken and makes inquiries into issues of fact. The oral procedure includes a hearing and delivery of the advocate-general's opinion. Finally, the Court releases its judgment in the matter. At the time of publication, the Court had recently completed the written stage of the AKZO appeal process. For a detailed discussion of European Court of Justice procedure, see LASOK, *THE EUROPEAN COURT OF JUSTICE: PRACTICE AND PROCEDURE* 29-46 (1984).

This Note proposes that the Commission could more effectively detect and deter predatory pricing in the EEC by adopting a test for predation which sufficiently examines both objective and subjective evidence. This Note further posits that the Commission's future application of such an analysis would ensure effective prosecution of predatory firms when little or no subjective evidence is available, while giving proper emphasis to such evidence when it is present. This Note also proposes that adoption of a comprehensive test for predation would afford EEC firms more guidance and a greater degree of predictability concerning the fairness of the prices they set. Finally, this Note suggests that the European Court of Justice, upon consideration of AKZO's action for annulment, urge the Commission to apply a comprehensive standard in future EEC predation cases.

II. STANDARDS FOR UNFAIR PRICING IN THE EEC

The drafters of the Treaty of Rome²⁰ intended article 86, through its prohibition of abusive conduct by a dominant "undertaking"²¹ to act as a device for the maintenance of free competition in the European common market.²² Subsection (a) of article 86 denotes as abusive conduct the practice of a dominant undertaking "directly or indirectly imposing unfair purchase or selling prices or other unfair

²⁰ Representatives of six European governments—Belgium, the Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands—signed the Treaty of Rome on March 27, 1957. By signing this Treaty, the contracting parties agreed to "establish among themselves a European Economic Community." Treaty of Rome, *supra* note 1, art. 1. Article 2 presents the lofty goals of the original parties to the Treaty:

The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of member states, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

Id. at art. 2. The remainder of the Treaty sets out the methods for accomplishing these goals, including the formation of the Assembly, the Council, the Commission, and the Court of Justice. For a comprehensive introduction to the EEC, see LASOK & BRIDGE, *supra* note 19.

²¹ The Treaty of Rome does not define the term "undertaking." However, its common understanding "is recognized as referring to any economic unit—either a single individual or several individuals combined in a partnership or corporation—which is concerned with the production or distribution of goods or the provision of services." GRAUPNER, *supra* note 6, at 11.

²² See *supra* note 5.

trading conditions.”²³ Article 86 does not, however, indicate exactly what constitutes an unfair price. This lack of definition requires the Commission and the Court of Justice to examine the price that an undertaking imposes and its relationship to the costs of doing business to determine the fairness of that imposed price.²⁴

Article 3(f) of the Treaty of Rome, which restricts virtually any anti-competitive conduct, lends essential guidance to the interpretation of article 86. Article 3(f) states that “the activities of the Community shall include . . . (g) the institution of a system ensuring that competition in the common market is not distorted.”²⁵ In *Europemballage Corp. and Continental Can Co. v. Commission of the European Communities*,²⁶ the Court of Justice declared that “[a]rticle 3 considers the pursuit of the objectives which it lays down to be indispensable for the achievement of the Community’s tasks.”²⁷ The Court then found articles 85 through 90 to be the proper legal means by which to accomplish the protection of free competition in the EEC.²⁸ Additionally, in *Instituto Chemioterapico Italiano SpA and Commercial Solvents Corp. v. Commission of the European Communities*,²⁹ the Court held that the expanse of article 86 covers not only abuses which may directly prejudice consumers, but also abuses which harm consumers indirectly by distorting the competitive structure outlined in article 3(f).³⁰

²³ Treaty of Rome, *supra* note 1, at art. 86.

²⁴ Article 164 of the Treaty of Rome empowers the Court of Justice to “ensure that the law is observed in the interpretation . . . of this Treaty.” Treaty of Rome, *supra* note 1, at art. 164. As stated by Advocate General Mayras in *BRT v. Sabam and NV Fonior*, 1974 E. Comm. Ct. J. Rep. 313, 14 Comm. Mkt. L.R. 238 (1974), “the concept of abuse . . . is not defined by article 86, which only goes so far as to give some examples of abuse. It must thus be determined according to the individual case.” Opinion of Advocate General Mayras, *id.* at 324, 14 Comm. Mkt. L.R. at 277. Both the Commission and the Court of Justice in several cases have considered the definition of unfair trading prices, listed as an abuse under article 86. *See infra* notes 40-47 and accompanying text.

²⁵ Treaty of Rome, *supra* note 1, at art. 3(f). The Commission emphasized the importance of implementing a competition policy in its First Report on Competition Policy, stating that “[c]ompetition is the best stimulant of economic activity since it guarantees the widest possible freedom of action to all Competition policy is an essential means for satisfying to a great extent the individual and collective needs of our society.” COMMISSION OF THE EUROPEAN COMMUNITIES, FIRST REPORT ON COMPETITION POLICY 11 (1972).

²⁶ 1973 E. Comm. Ct. J. Rep. 215, 12 Comm. Mkt. L.R. 199 (1973).

²⁷ *Id.* at 244, 12 Comm. Mkt. L.R. at 223.

²⁸ *Id.* at 245, 12 Comm. Mkt. L.R. at 224.

²⁹ 1974 E. Comm. Ct. J. Rep. 223, 13 Comm. Mkt. L.R. 309 (1974).

³⁰ *Id.* at 246, 13 Comm. Mkt. L.R. at 342.

Predatory pricing is one example of abusive conduct that not only may cause consumers direct harm, but also may distort the EEC's competitive structure. Predatory pricing generally refers to an undertaking's offense of charging nonenumerative, or below cost, prices with the intent of restricting competition. The predator then raises its prices above its costs as it gains market power, ultimately charging excessively high prices and reaping monopoly profits.³¹ To achieve such market power, the predator usually must eliminate viable competitors. The capacity to eliminate competitors exists when a firm possesses a dominant, or monopolistic, position.³² The Court of Justice has not yet considered whether predatory pricing by a dominant firm distorts the pro-competitive structure envisaged in article 3(f).³³ The Court in *Continental Can*, however, reasoned that, because article 3(f) provides for the institution of a system ensuring that competition in the EEC remain undistorted, that article requires *a fortiori* that competition not be eliminated.³⁴

Although the Court and Commission lack experience in examining the imposition of excessively low prices, both have declared the

³¹ The standard definition of predatory pricing is that posited by Joskow and Klevorick:

Predatory pricing behavior involves a reduction of price in the short run so as to drive competing firms out of the market or to discourage entry of new firms in an effort to gain larger profits via higher prices in the long run than would have been earned if the price reduction had not occurred.

Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213, 219-20 (1979).

³² See *supra* note 6.

³³ Though the Court of Justice has not addressed the substantive matters involved in ECS/AKZO, it already has decided two procedural issues presented by AKZO. In *AKZO Chemie v. Commission*, 48 Comm. Mkt. L.R. 231 (1987), AKZO appealed a decision by the Commission dated December 18, 1984 instructing AKZO to communicate to ECS documents of a confidential nature. The Court held that the Commission, by delivering the documents to ECS before informing AKZO of its actions, "made it impossible for [AKZO] to avail itself of the remedies afforded by the combined provisions of articles 173 and 185 of the Treaty to prevent the contested decision from being carried out." *Id.* at 260. The Court voided the Commission's decision and ordered it to pay costs. *Id.*

The second matter, *AKZO Chemie v. Commission*, 48 Comm. Mkt. L. R. 225 (1987), concerned a Commission decision dated November 6, 1984 requiring AKZO to submit to Commission investigations. The Court rejected AKZO's appeal and ordered AKZO to pay costs. *Id.* at 230.

³⁴ *Europemballage Corp. and Continental Can v. Commission of the European Communities*, 1973 E. Comm. Ct. J. Rep. 215, 244, 12 Comm. Mkt. L.R. 199, 223 (1973).

charging of certain high prices to be "unfair" and, therefore, abusive conduct under article 86. In *General Motors Continentaal NV. v. Commission of the European Communities*,³⁵ the Court of Justice upheld the Commission's ruling that high prices charged by General Motors for automobile inspections were prohibited under article 86(a).³⁶ Similarly, when the defendant in *United Brands Co. and United Brands Continental BV. v. Commission of the European Communities*³⁷ charged a higher price for bananas in one market as compared to others, the Court determined that imposing a high price which bore no reasonable relation to the economic value of the product supplied constituted abusive conduct.³⁸

Thus, a dominant undertaking's charging of excessively high prices may indicate an infringement of article 3(f) of the Treaty of Rome and, therefore, may be prohibited under article 86(a). Though neither *General Motors* nor *United Brands* addressed low prices, the Commission attempted to formulate a standard for an "unfair" price. Choosing to follow its historical pattern of avoiding traditional cost analysis,³⁹ the Commission employed a nebulous concept labelled "economic value." In *General Motors* the Commission compared the prices charged by General Motors for the inspection of automobiles imported within General Motor's system with the prices imposed for the same inspection by private dealers outside of General Motors. Upon finding that the General Motors prices were significantly higher, the Commission declared them in excess of their economic value and

³⁵ 1975 E. Comm. Ct. J. Rep. 1367, 17 Comm. Mkt. L.R. 95 (1976). This was a review of the Commission's decision in *Re General Motors Continental NV*, 18 O.J. EUR. COMM. (No. L 29) 14 (1975).

³⁶ 1975 E. Comm. Ct. J. Rep. at 1379, 17 Comm. Mkt. L.R. at 110.

³⁷ 1978 E. Comm. Ct. J. Rep. 207, 21 Comm. Mkt. L.R. 429 (1978). This was a review of the Commission's decision in *Re the United Brands Co.*, 19 O.J. EUR. COMM. (No. L 95) 1 (1976).

³⁸ *United Brands*, 1978 E. Comm. Ct. J. Rep. at 301, 21 Comm. Mkt. L.R. at 502.

³⁹ In its Fifth Report on Competition Policy, the Commission stated that "[i]n proceedings against abuse consisting of charging excessively high prices, it is difficult to tell whether, in any given case, an abusive price has been set since there is no objective way of establishing what price covers cost plus a reasonable profit margin." COMMISSION OF THE EUROPEAN COMMUNITIES, FIFTH REPORT ON COMPETITION POLICY 60 (1975). The Court of Justice disagreed with this view in *United Brands*, declaring that an excessive price "could . . . be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which would disclose the amount of the profit margin." *United Brands*, 1978 E. Comm. Ct. J. Rep. at 301, 21 Comm. Mkt. L.R. at 502.

therefore unfair.⁴⁰ Similarly, in *United Brands* the Commission determined that United Brands' banana prices in some EEC countries were up to fifty percent higher than its prices in Ireland.⁴¹ On this basis, the Commission deemed the prices United Brands charged in those countries excessive and therefore abusive under article 86(a).⁴²

The Court of Justice, in reviewing the Commission's decision in *General Motors*, accepted the Commission's notion of economic value.⁴³ The Court, however, rejected the same reasoning in *United Brands*, directing the Commission instead to discern whether the difference between the price actually charged and the costs actually incurred exceeded the product's economic value.⁴⁴ Additionally, the Court recommended that if the Commission encountered an excessive price, it should consider whether that price was excessive either in itself or when compared to competing products.⁴⁵ Finally, the Court advised the Commission to conduct detailed cost analyses in future predation cases, through the examination of complete production costs and margin data, in determining abusive price levels.⁴⁶

III. THE COMMISSION'S DECISIONS IN ECS/AKZO

A. *Predatory Pricing as Abusive Conduct*

The Commission's finding in ECS/AKZO that predatory pricing constitutes an abuse under article 86 of the Treaty of Rome evidences a critical development toward the maintenance of free and undistorted

⁴⁰ *General Motors*, 1978 E. Comm. Ct. J. Rep. at 1379, 17 Comm. Mkt. L.R. at 110. The Commission posited that an abuse of article 86(a) existed when a dominant enterprise charged a price "which [is] excessive in relation to the economic value of the service provided." *Id.*

⁴¹ *United Brands*, 1978 E. Comm. Ct. J. Rep. at 219, 21 Comm. Mkt. L.R. at 503.

⁴² *Id.*

⁴³ *General Motors*, 1975 E. Comm. Ct. J. Rep. at 1379, 17 Comm. Mkt. L.R. at 110.

⁴⁴ *United Brands*, 1978 E. Comm. Ct. J. Rep. at 301, 21 Comm. Mkt. L.R. at 502.

⁴⁵ *Id.* at 301-02, 21 Comm. Mkt. L.R. at 502-503.

⁴⁶ *Id.* at 302, 21 Comm. Mkt. L.R. at 503. The Court appreciated the complexity of working out production costs, and therefore presented some guidelines to aid the Commission in such analyses. Citing a study done by the United Nations Conference on Trade and Development, the Court recommended that the Commission focus upon such cost factors as "the pattern of the production, packaging, transportation, marketing, and distribution" in computing approximate production costs, and to then determine whether prices charged were excessive. *Id.*

competition in the EEC. Unfortunately, the Commission did not devise or adopt any objective method for determining when predatory prices exist. Because of this shortcoming, the decision failed to establish an adequate standard for future analyses of predation in the European common market.

The Commission's examination of predatory pricing in its ECS/AKZO Interim Measures Decision involved a case of first impression.⁴⁷ The original complaint filed by ECS with the Commission on June 15, 1982,⁴⁸ indicated that in December 1979, representatives from AKZO Chemie and AKZO UK threatened to force ECS from the market by selling AKZO products below cost.⁴⁹ According to ECS, this was an AKZO response to ECS' expansion of its benzoyl peroxide manufacturing from the flour milling sector of the market to the plastics sector.⁵⁰ The threat allegedly specified that AKZO would take this action unless ECS withdrew from the plastics sector.⁵¹ When ECS refused, AKZO reportedly carried out its threat.⁵²

In its ECS/AKZO Interim Measures Decision the Commission labelled ECS "a small independent producer of benzoyl peroxide."⁵³ Benzoyl peroxide is an organic peroxide used in both plastics and flour-treating.⁵⁴ The Commission then noted that AKZO UK, also a producer of benzoyl peroxide, possessed a 1982 total turnover which was many times greater than that of ECS.⁵⁵ The Commission continued by declaring AKZO UK the leading producer in all relevant

⁴⁷ ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 13 (1983). See *supra* note 13.

⁴⁸ ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 13. ECS filed a formal application with the Commission pursuant to article 3 of Regulation No. 17. See Regulation No. 17, *supra* note 2.

⁴⁹ ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 14.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* ECS originally brought the matter before the High Court of Justice in London, which granted an *ex parte* interim injunction prohibiting AKZO from reducing its prices. AKZO ultimately agreed not to lower its normal selling prices for benzoyl peroxide if the intention of the price reduction was to eliminate ECS. AKZO's agreement, which had the force of an injunction, expired in September, 1982. *Id.*

⁵³ *Id.* at 13.

⁵⁴ *Id.*

⁵⁵ *Id.* at 14. ECS had a total turnover in 1982 of £1.7 million (2,087,000 ECU). At the 1982 average year rate, £1.7 million equaled \$U.S. 971,151 AKZO UK's total turnover in 1982 amounted to £42,868,974 (76,478,000 ECU). At the 1982 average yearly rate, £42,868,974 equalled \$U.S. 24,489,560.

markets,⁵⁶ and found AKZO UK's economic power sufficient to both determine price levels in those markets and to eliminate smaller competitors.⁵⁷

The Commission followed its discussion of market power in its Interim Measures Decision by stating that "the charging of unfairly low selling prices in order to drive out a smaller competitor or offer it the choice between liquidation or acquisition by the dominant undertaking would fall within the terms of . . . [article 86(a)]."⁵⁸ The Commission neglected to provide a legal basis for this landmark ruling, which represented the first official recognition of predatory pricing as abusive conduct under article 86.⁵⁹

In its final decision on the ECS complaint, the Commission narrowed the relevant markets to one, the EEC organic peroxides market.⁶⁰

⁵⁶ *Id.* at 18. The first essential element required for application of article 86 is the existence of a dominant position. Whether a dominant position exists depends to a large extent upon the relevant market under examination. The relevant market defines the area of effective competition, and is determined by its geographic dimension and its product category. The deduction of the relevant market or markets varies with the facts of a given case; a broader market definition usually aids the defendant by decreasing his percentage share of the market, *but see infra* note 57. For a discussion of relevant markets see Van Bael and Bellis, *European Economic Community*, in *WORLD LAW OF COMPETITION* § 401[1] (J. von Kalinowski ed. 1982).

⁵⁷ ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 18. The markets considered relevant by the Commission in the ECS/AKZO Interim Measures Decision included the EEC organic peroxides market as a whole, the United Kingdom flour-milling additives market, and the United Kingdom submarket for flour-milling benzoyl peroxide. *Id.* In reaching its conclusions, the Commission relied upon AKZO estimates of its own market shares and those of ECS. In the 1982 EEC organic peroxides market, AKZO Chemie placed its share at 46% to 50%. AKZO estimated ECS' share of the same market was 1%. *Id.* at 14. AKZO estimated its share of the 1982 United Kingdom sub-market for flour-milling benzoyl peroxide at 52%, compared with ECS' share of 35%. *Id.* at 15. The Commission encountered difficulty in determining the respective shares of AKZO and ECS of the United Kingdom flour additives market, but concluded that AKZO UK appeared to have the largest share in that market. *Id.*

⁵⁸ *Id.* at 18. The Commission posited as one of the conditions to be met to grant interim measures "the establishment by sufficiently clear evidence of a likelihood of infringement." *Id.* at 17. The Commission apparently felt that "a sufficient presumption of a dominant position" was enough for it to then consider whether AKZO had acted abusively.

⁵⁹ The Commission, however, had informally considered predatory pricing as far back as 1966, when it opined that "price competition that is engaged for the purpose of ousting from the market a competitor who does not have sufficient financial resources to withstand for a longer period sales below cost price" might constitute abusive conduct under article 86. *Le Problèmes de la Concentration dans le Marche Commun.*, Etudes CEE, Serie Concurrence No. 3 at 29 (1966), as translated in Van Bael & Bellis, *supra* note 56, § 5.04.

⁶⁰ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No L 374) at 17.

The Commission found this market to be the one from which AKZO sought in the long term to exclude ECS.⁶¹ Upon examination of this market, the Commission discovered that AKZO possessed highly influential market power over both the price levels and competition in the market.⁶² In addition, AKZO estimated its own share of the market at fifty percent or greater, and had by its own account successfully eliminated competition from that market in the past.⁶³ Combining this information with AKZO documents which demonstrated the company's ability to prevent smaller firms from penetrating its markets, the Commission concluded that at all material times AKZO occupied a dominant position in the EEC market for organic peroxides.⁶⁴

The Commission next considered whether AKZO's conduct amounted to an abuse under article 86. In contrast to its Interim Measures Decision, the Commission in its final decision conducted a detailed examination of the relevant case law and the Treaty of Rome in finding AKZO's conduct abusive. Citing the *Continental Can* and *Commercial Solvents* decisions, the Commission declared that *any* behavior which undermines the purpose of article 3(f) may constitute an abuse of a dominant position under article 86.⁶⁵ Reiterating the *Continental Can* holding, the Commission concluded that any unfair commercial practice by a dominant undertaking intended to "eliminate, discipline or deter" smaller competitors would come within the scope of article 86's prohibition.⁶⁶

⁶¹ *Id.* at 17. The Commission determined that the geographic market in question included the entire EEC, since AKZO supplied its organic peroxides to all member states and because AKZO believed its geographic spread was significantly important to its market strength. *Id.*

⁶² *Id.* at 18.

⁶³ *Id.* In 1981, Scado, a producer of flour additives, withdrew from the EEC market. Annual AKZO reports from 1980 to 1981 document AKZO's belief that it had caused Scado's withdrawal through an aggressive AKZO pricing campaign leveled against Scado. *Id.*

⁶⁴ *Id.* In reaching this conclusion, the Commission also noted that AKZO's market share was equal to the market shares of all its competitors combined, that AKZO's market share had remained constant, and that AKZO offered a far broader range of products than any of its competitors. *Id.*

⁶⁵ *Id.* at 19.

⁶⁶ *Id.* Later in the decision the Commission held that "[t]he pursuance by a dominant firm of a strategy (sic) of eliminating competitors or potential competitors by unfair means differing from normal competition would in principle fall under article 86 whatever the detailed mode of implementation." *Id.* at 20.

B. The Commission's Cost Analyses, the Subjective Evidence, and the Commission's Test for Predation

In its complaint ECS alleged that AKZO intended to eliminate ECS through deep and prolonged price cutting.⁶⁷ The Commission responded by examining the relationship between AKZO's prices and costs. Perhaps because the ECS/AKZO matter presented the Commission with its first opportunity to consider predatory pricing as a method of elimination, the Commission's attempt to address the subject in its Interim Measures Decision proved cursory at best. In this initial decision, the Commission disregarded the Court of Justice's *United Brands* advice to seek complete production lost and margin data in determining abusive price levels; the Commission instead relied upon references to AKZO UK's "below cost prices" and sales "at a loss."⁶⁸ The Commission gave no indication what objective pricing evidence, if any, it analyzed in concluding that AKZO UK's prices were below cost.⁶⁹

In its final decision the Commission conducted a more thorough examination of AKZO UK's prices and costs. The Commission began by documenting a detailed AKZO plan to offer each of ECS' customers a range of flour additives at prices far below the then-prevailing level.⁷⁰ Other AKZO documents predicted that the successful capture of ECS' customers, with these attractive prices as bait, would result in a total loss to AKZO of Dutch Fl 170,000 per annum.⁷¹ AKZO UK in fact raised its prices for its own customers by ten percent in early 1980, while ECS prices to its own customers remained the same.⁷² This AKZO increase widened the customary price gap between the two suppliers, causing two of AKZO UK's customers to approach ECS for price quotations.⁷³ When ECS quoted one AKZO UK cus-

⁶⁷ *Id.* at 19.

⁶⁸ ECS/AKZO Interim Measures Decision, 26 O.J. EUR. COMM. (No. L 252) at 16.

⁶⁹ This may have been due to a lack of objective evidence at the time of the Interim Measures Decision. Though the Commission remarked that it possessed "details of costings" at that time, *id.*, in its final decision the Commission described the earlier proceedings as a period "[d]uring . . . which relatively limited financial and accounting information was available." ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 19.

⁷⁰ *Id.* at 8-9.

⁷¹ *Id.* at 9.

⁷² *Id.*

⁷³ *Id.*

toomer its then-current prices for flour additives, which were lower than AKZO UK's prices, AKZO UK began markedly dropping its own prices.⁷⁴

By December of 1980, AKZO UK was making selective offers to ECS' customers which were much lower than ECS' prices for those customers, and which were twenty to thirty percent below AKZO UK's price for its own customers for the same product.⁷⁵ As a result of AKZO UK's systematic low price offers, ECS gradually lost the business of three large customers and several smaller buyers.⁷⁶ ECS retained the business of several other customers only by reducing its prices to match AKZO UK's offers despite substantial cost increases for labor and raw materials.⁷⁷ Ultimately, ECS lost almost one-third of its flour additives business in the United Kingdom.⁷⁸

Following its examination of AKZO's plan to recruit ECS customers, the Commission considered AKZO UK's variable costs of

⁷⁴ *Id.*

⁷⁵ *Id.* at 10. Such selective charging of different prices to different firms for the same product is known as discriminatory pricing. Discriminatory pricing may constitute an abuse under article 86(c) of the Treaty of Rome, which prohibits "applying in relation to like parties unequal conditions in respect of like transactions, placing them thereby at a comparative disadvantage." Treaty of Rome, *supra* note 1, at art. 86. The Commission addressed the discriminatory pricing present in the instant matter by remarking that "the anticompetitive effect of AKZO's differential pricing involved not so much direct injury to customers but rather a serious impact on the structure of competition at the level of supply by reason of its exclusionary effect." ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 22.

⁷⁶ *Id.* at 11.

⁷⁷ *Id.*

⁷⁸ *Id.* at 14. In addition, the general decline in prices of flour additives forced ECS to "increase its bank borrowings substantially" in order to remain in business. *Id.* Due to its lack of available funds, ECS also reduced its budget for research and development, and delayed modifications to its plant. *Id.*

The Commission noted that AKZO "contested every important allegation of fact set out in the complaint of ECS and in the statement of objections." *Id.* at 11. According to the Commission, AKZO essentially claimed that "the Commission . . . allowed itself to be duped by [ECS] which was out to shift the blame for its own poor performance and bad investment decisions on to other participants in the market and ultimately on to the consumer." *Id.*

The Commission, however, refused to accept AKZO's arguments due to the documentary evidence present. The Commission emphasized that before 1980, AKZO UK effectively determined flour additives prices in the United Kingdom. *Id.* Though AKZO argued that it had to drop its prices as a defensive measure against ECS attempts to win over AKZO customers, the Commission countered that "[t]he circumstances and timing of the approaches made by AKZO UK to [ECS customers] are indicative of an aggressive campaign to displace the regular supplier." *Id.* at 11-12.

doing business. The Commission began by indicating that not only did AKZO UK supply particular ECS customers products at below-cost prices, but also that between 1981 and 1983 AKZO UK's entire flour additives business operated at a loss.⁷⁹ AKZO countered that its flour additives prices were above its variable costs, and therefore "always included a profit margin."⁸⁰ In response, the Commission noted that under AKZO's accounting classification, variable cost included only the cost of raw materials, energy packaging, and transport.⁸¹ AKZO treated several other major items, including labor, maintenance, warehousing, and dispatching, as fixed costs, although according to the Commission, accounting systems usually consider such items variable costs.⁸² The Commission adjusted AKZO's calculations to include these items as variable costs, then determined that the prices AKZO offered to ECS' customers between 1981 and 1984 fell well short of covering normally-defined variable costs.⁸³

Although the Commission mapped out a detailed analysis of AKZO UK's costs and prices, it discounted the importance of the results. The Commission stated that "article 86 does not prescribe any cost-based legal rule to define the precise stage at which price cutting by a dominant firm may become abusive."⁸⁴ Thus, the Commission refused to rely on an objective test for determining predation.⁸⁵ The Commission based its hesitancy on a belief that a test which examined only the aggressor's costs would fail to address all exclusionary con-

⁷⁹ *Id.* at 14.

⁸⁰ *Id.* The Commission defined variable costs as "costs which vary with changes in output and generally include materials, energy, direct labour, supervision, repair and maintenance, and royalties." *Id.* at 15 n.1.

⁸¹ *Id.* at 15.

⁸² *Id.* For example, Areeda and Turner's definition of variable cost includes "materials, fuel, labor directly used to produce the product, indirect labor such as foremen, clerks, and custodial help, use-depreciation, repair and maintenance, and per unit royalties and license fees." P. AREEDA & D. TURNER, ANTITRUST LAW § 712 (1978).

⁸³ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 15. The Commission continued by remarking that "[i]t is also important that in many cases AKZO often did not have to supply the material at the prices which it offered, leaving it to ECS to drop its prices so as to keep the customer and thus incur a loss." *Id.*

⁸⁴ *Id.* at 19.

⁸⁵ AKZO argued that its prices should conclusively be declared legal if set above its average variable costs. *Id.* AKZO based its argument on a test for predation devised by Harvard University law professors Philip Areeda and Donald F. Turner, discussed *infra* notes 102-15 and accompanying text.

duct, and that such a test would not lend sufficient weight to the "strategic aspect" of predatory behavior.⁸⁶

More important to the Commission than the cost analysis was the wealth of subjective evidence present concerning AKZO's underlying predatory intent.⁸⁷ This evidence consisted of unambiguous AKZO internal memoranda that documented a high level AKZO strategy to discipline, if not destroy, ECS.⁸⁸ These memoranda showed that AKZO's plan entailed offering prices below its costs to ECS customers in response to ECS' refusal to abandon its expansion into the AKZO dominated plastics industry.⁸⁹ The Commission found that AKZO's internal documentation not only directly contradicted its own arguments, but also corroborated in every important aspect the allegations of ECS.⁹⁰

⁸⁶ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 20.

⁸⁷ The Commission acquired this evidence during surprise investigations at AKZO Chemie and AKZO UK offices. See *supra* note 11.

⁸⁸ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 8. The Commission reported that it had "obtained from AKZO a number of important internal [AKZO] documents." *Id.* One document particularly damaging to AKZO was a note made by an AKZO manager, outlining the agendas of several meetings between AKZO and ECS which he attended in late 1979. The memorandum, dated December 7, 1979, "set out a detailed blueprint for the implementation of a plan to discipline and if necessary eliminate ECS." *Id.* See *infra* note 89 and accompanying text.

⁸⁹ *Id.* The Commission quoted the AKZO memorandum:

Discussion took place in the office of Engineering and Chemical Supplies at Stonehouse on 3 December. Mr. Sullivan, the managing director and principal shareholder of ECS, was informed that he could not expect any cooperation on the 'milling' side if he intended to enter the 'plastics' industry. It was confirmed to Mr. Sullivan that AKZO would take aggressive commercial action on the milling products unless he refrained from supplying his products to the plastics industry. It was decided not to take any further action until Tuesday, 11 December allowing time for Mr. Sullivan to react to the above proposal . . . [If] Mr. Sullivan does not react by midday on Tuesday, 11 December, the proposed action will be taken."

Id. The memorandum then outlined AKZO's predatory pricing strategy. *Id.* See *supra* notes 70-77 and accompanying text.

Another incriminating AKZO document mentioned the general drop in flour additives prices since 1979. This documented then "reported with satisfaction" that the drop had hurt ECS' profit margins more than those of AKZO. ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 13. The report concluded that one ECS customer had proven to be "a difficult 'nut' to crack," i.e., refused to switch to AKZO products, but the report speculated that "in time some of the mill [customers] will break away from ECS as pressure is maintained." *Id.*

⁹⁰ *Id.* at 11.

This subjective evidence greatly impressed the Commission, which referred to it as "convincing documentary evidence of a detailed plan . . . to eliminate ECS as a competitor."⁹¹ Notably, the Commission also listed several objective factors which reinforced the subjective evidence of AKZO's anticompetitive intent. Most important among these factors were AKZO UK's selective price cuts for ECS customers while maintaining higher prices for its own customers, AKZO UK's departure from its previous pattern of full-cost recovery in flour additives, and AKZO UK's subsidization of its below-cost transfer prices from its plastic and elastomers division.⁹²

The Commission thus employed the cost-based evidence available to substantiate the evidence of AKZO's subjective intent. Such an approach is logical where, as in the instant matter, an overwhelming array of uncontradicted subjective evidence exists. A similar approach, however, may not be feasible where documentation of predatory intent is not present. The Commission apparently realized this potential shortcoming when it remarked that "given the difficulty of proof [AKZO] would probably have succeeded in achieving its purpose of eliminating ECS had the Commission not discovered the evidence on which this decision is based."⁹³ The Commission summarized its attitude toward objective evidence in one paragraph:

There may be circumstances where the exclusionary consequences of a price cutting campaign by a dominant producer are so self-evident that no evidence of intention to eliminate a competitor is necessary. On the other hand, where low pricing could be susceptible of several explanations, evidence of an intention to eliminate a competitor or restrict competition might also be required to prove an infringement In the absence, however, of direct documentary evidence an exclusionary intention might be inferred from all the circumstances of the case.⁹⁴

At first glance the Commission's summary of predation seems sound; upon closer examination it becomes vague and inconclusive. The Commission failed to indicate what type of exclusionary con-

⁹¹ *Id.* at 21.

⁹² *Id.* The Commission stressed that dominant firms were entitled to compete on the merits, but that "[t]he maintenance of a system of effective competition . . . require[s] that a smaller competitor be protected against behavior by dominant undertakings designed to exclude it from the market not by virtue of greater efficiency or superior performance but by an abuse of market power." *Id.*

⁹³ *Id.* at 25.

⁹⁴ *Id.* at 21.

sequences would be so "self-evident" as to permit an excuse from the proof of intent requirement. Apparently, the injuries suffered by ECS due to AKZO's conduct failed to reach that level, though the Commission felt those injuries had a "serious effect" upon ECS's business.⁹⁵ In addition, the Commission did not pose any examples of how low pricing could be susceptible to more than one explanation. Finally, if the Commission were to infer an exclusionary intention "from all the circumstances of the case" it would possess extraordinary powers of interpretation in predation matters.

The Commission's reservations regarding cost-based evidence may stem from its stated belief that there exists an "inherent difficulty" in accurately determining costs.⁹⁶ The Commission, however, conducted a detailed analysis of AKZO UK's costs and convincingly established that AKZO UK had priced below its average variable costs. An examination of an alleged aggressor's costs and prices, though complicated, should be paramount in determining whether prices are predatory. While subjective evidence of an aggressor's intent should also be studied closely, the Commission's adoption of a test for predation, consisting of "whether the price cutting or other behavior constitutes unreasonable or unfair behavior intended to eliminate or damage the particular competitor,"⁹⁷ may result in inconsistent interpretations. As the United States Supreme Court has astutely observed, "[t]he reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow."⁹⁸ To avoid the uncertainty and unpredictability of a standard for predation based too firmly on subjective factors, the Commission should adopt a test that emphasizes both objective and subjective evidence. Such a test may be found in the decisions of the courts of the United States.

IV. PREDATORY PRICING AND THE U.S. COURTS

A. *The Areeda-Turner Test for Predation*

In contrast to the Commission and the European Court of Justice, the courts of the United States have considered numerous predatory

⁹⁵ *Id.* at 14. See *supra* notes 76-78 and accompanying text.

⁹⁶ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No L. 374) at 20.

⁹⁷ COMMISSION OF THE EUROPEAN COMMUNITIES, FIFTEENTH REPORT ON COMPETITION POLICY 85 (1986).

⁹⁸ *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927).

pricing cases.⁹⁹ Because of this experience, the Court of Justice will probably examine United States antitrust decisions, as it has done in other areas of competition law,¹⁰⁰ when it attempts to define predatory pricing.

Federal courts in the United States currently apply several versions of a cost-based analysis known as the Areeda-Turner test in determining whether a given price is predatory. Devised by Harvard University Professors Philip Areeda and Donald F. Turner in 1976, the Areeda-Turner analysis concentrates on the relationship between a firm's prices and costs to establish a clear dividing line between competitive and predatory pricing.¹⁰¹ Areeda and Turner break down the kinds of costs facing a firm into two categories. Fixed costs are those that remain constant despite changes in output.¹⁰² Such costs include management expenses, depreciation, property taxes, and other irreducible overhead.¹⁰³ Variable costs are those which fluctuate as output changes.¹⁰⁴ Typical costs in this category include materials, fuel, labor, utilities, and repair and maintenance.¹⁰⁵ Whether costs are considered fixed or variable depends upon the level of output and time.¹⁰⁶ Three different concepts of the cost per unit of production

⁹⁹ American case law has established predatory pricing as an antitrust offense within the proscription on monopolization or attempts to monopolize in section 2 of the Sherman Act. *See, e.g.*, *United States v. American Tobacco Co.*, 221 U.S. 106, 182, (1911); *Standard Oil Co. v. United States*, 221 U.S. 1, 43, (1911). Section 2 of the Sherman Act provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a felony." Sherman Act, 15 U.S.C. § 2 (1986).

In addition, the Clayton Act, as amended by the Robinson-Patman Act of 1936, protects companies from predation by prohibiting price discrimination. Clayton Act, 15 U.S.C. § 13a (1986).

¹⁰⁰ *See, e.g.*, *BRT v. Sabam and NV Fonior*, 1974 E. Comm. Ct. J. Rep. 313, 14 Comm. Mkt. L.R. 238 (1974) (discussion of relevant market as developed by United States federal courts); *Boehringer Mannheim GmbH v. Comm'n of the European Communities*, 1972 E. Comm. Ct. J. Rep. 1281, 12 Comm. Mkt. L.R. 864 (1973) (comparison of extraterritorial applications of United States and EEC competition law).

¹⁰¹ Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

¹⁰² *Id.* at 700.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 701. Areeda and Turner explain:

Virtually all costs are variable when a firm, operating at capacity, plans to double its output by constructing new plants and purchasing new equip-

are derived from fixed and variable cost: marginal cost, the increment of total cost that results from producing an additional increment of output;¹⁰⁷ average variable cost, the sum of all variable costs divided by output;¹⁰⁸ and average cost, the sum of fixed cost and variable cost divided by output.¹⁰⁹

According to Areeda and Turner, a rational, efficient firm always maximizes profits by pricing at marginal cost, "the competitive and socially optimal result."¹¹⁰ Therefore, Areeda and Turner argue that a price set at or above marginal cost should be presumed lawful.¹¹¹ Conversely, pricing below marginal cost should be conclusively regarded as unlawful, because a firm charging below-marginal cost prices "is not only incurring private losses but wasting social resources."¹¹² Areeda and Turner also believe that pricing below marginal cost greatly increases the possibility that competitors will be eliminated.¹¹³ Since preparing marginal cost records is not standard business practice, Areeda and Turner advocate the substitution of reasonably anticipated average variable cost for marginal cost in their formula.¹¹⁴ Finally, they conclude that instances of truly predatory pricing are rare.¹¹⁵

ment. Moreover, more costs become variable as the time period increases. The variable costs . . . are those incurred in what is usually termed the "short-run," namely, the period in which the firm cannot replace or increase plant or equipment. Conversely, in the "long-run" the firm can vary quantities of *all* inputs (plant and equipment as well as short-run variable inputs); thus, all costs are variable over the long run.

Id.

¹⁰⁷ *Id.* at 700.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.* at 711. Areeda and Turner argue that pricing at marginal cost ensures the proper allocation of resources, since "to force the firm to charge a higher price would reduce industry output and waste economic resources in the short run." *Id.*

¹¹¹ *Id.*

¹¹² *Id.* at 712. Areeda and Turner posit one exception to this rule. They propose that a price below marginal cost is justifiable if it is at or above average cost, since "it seems unlikely to have any significant anticompetitive consequences." *Id.* at 713. Areeda and Turner reason that such a case would occur only in instances of excess demand. If that excess demand is temporary, no new firms would attempt to enter the market. If permanent, such pricing would have, at most, minimal effect upon new entry, "since the price is higher than the monopolist's average cost at most efficient levels of output, and equally efficient rivals or entrants would be making above normal profits at that price." *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.* at 716. Traditional business accounts typically go no further than to show average variable costs. Marginal cost equals average variable cost (AVC) when AVC

The Areeda-Turner test for predatory pricing requires the careful cost analysis which the Court of Justice urged the Commission to undertake in *United Brands* and which the Commission conducted in its ECS/AKZO final decision. Notwithstanding criticism of the

is constant. Moreover, though there is a possibility that AVC will differ from marginal cost, AVC is a "useful surrogate" for predatory pricing analysis. *Id.* at 718.

¹¹⁵ *Id.* at 699. The federal courts, at least, appear to agree with this conclusion. Since Areeda and Turner published their article in 1975, the federal courts have heard approximately fifty-five predatory pricing cases. Many of those cases have been decided for the defendant on summary motions. For a summary of predation cases since 1975 and their dispositions, see Liebler, *Whither Predatory Pricing? From Areeda and Turner to Matsushita*, 61 NOTRE DAME L. REV. 1052 app. at 1077 (1986).

Some antitrust scholars, however, disagree with the Supreme Court's conclusion that predation is rare, arguing instead that the existing antitrust laws are not being properly enforced. Dr. Mueller argues that "President Reagan entered office with an agenda aimed at eliminating or greatly reducing government interference in all areas of business affairs, with antitrust 'reform' near the top of his list." *A New Attack on Antitrust: The Chicago Case*, 18 ANTITRUST L. & ECON. REV. 29, 32 (1986). Dr. Mueller adds that "by changing the enforcement personnel and policies of the antitrust agencies [and] by appointing judges with a known antiregulatory bias," the Reagan administration "has been successful in changing antitrust policy beyond the fondest hopes of [antitrust law's] enemies and the greatest fears of its friends." *Id.* at 32.

Professor Ponsoldt of the University of Georgia School of Law testified before Congress concerning the enforcement status of United States antitrust laws and remarked on the European reaction to that status:

Right now, my foreign law students and European colleagues express to me amazement or cynicism regarding the current divergence between the illusion of our antitrust rules and the reality of their nonenforcement. They simply do not believe our "Rule of Law" self-description at the present time; many believe, instead, that big business is virtually outside political and legal restraint.

Department of Justice Oversight and Authorization: Hearing Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 100th Cong., 1st Sess. (Feb. 26, 1987) (testimony of James F. Ponsoldt, Assoc. Professor of Law at the Univ. of Ga. The testimony is on file at the offices of the *Georgia Journal of International and Comparative Law*). See also Shepherd, *The Twilight of Antitrust*, 18 ANTITRUST L. & ECON. REV. 21 (1986).

While the Supreme Court adheres to the widely-held belief that predation is rare because it is not a viable business strategy, see *infra* note 117, others argue the opposite. See, e.g., Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. CHI. L. REV. 506, 515-23 (1974). Another view holds that such economic approaches are mistaken in assuming that firms are rational actors who always seek profit-maximization. This "experimental psychology" approach posits that "while predatory pricing may or may not be rational profit-making behavior, it is a response consistent with the general way in which human beings tend to respond to risk in real life." Gerla, *The Psychology of Predatory Pricing: Why Predatory Pricing Pays*, 39 Sw. L.J. 755, 756 (1985).

original test,¹¹⁶ the Areeda-Turner analysis has had a pronounced impact upon the United States federal courts. Although the Supreme Court has neither adopted nor rejected the analysis,¹¹⁷ almost every federal circuit court applies the test in some form.¹¹⁸ The circuit court applications are diverse, with the only common factor being their reliance on marginal or average variable cost as the primary measure of whether a price is predatory.¹¹⁹

¹¹⁶ Authorities have attacked the Areeda-Turner standard for a variety of reasons. See Bradley & Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards*, 66 CORNELL L. REV. 738, 768 (1981) (problems of proof involving calculations of average variable costs); Dirlam, *Marginal Cost Pricing Tests for Predation: Naive Welfare Economics and Public Policy*, 26 ANTITRUST BULL. 769 (1981) (emphasis on narrow efficiency goals); Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 HARV. L. REV. 869 (1976) (emphasis on the short-run).

¹¹⁷ The Supreme Court has only mentioned the Areeda-Turner cost-based test in one case, *Matsushita Elec. Indus. v. Zenith Radio Corp.*, 106 S. Ct. 1348 (1986). In *Matsushita* a group of United States manufacturers of television sets alleged that 21 Japanese television manufacturers had illegally conspired over a 20-year period to drive the United States firms from the United States market. The Japanese scheme allegedly consisted of maintaining artificially high prices for the Japanese televisions in the Japanese market, while maintaining low prices for those televisions which they exported to and sold in the United States. The Court broached the subject of production costs by noting that "[t]here is a good deal of debate, both in the cases and in the law reviews, about what 'cost' is relevant in such cases." *Matsushita*, 106 S. Ct. at 1355 n.8. The Court then declined to resolve the cost debate because the claim fell under section 1 of the Sherman Act, not section 2. *Id.* In other dicta, however, the Court alluded to possible future approval of the Areeda-Turner standard:

We do not consider whether recovery should ever be available on a theory such as respondent's when the pricing in question is above some measure of incremental cost. See generally Areeda & Turner (citation omitted). As a practical matter, it may be that only direct evidence of below-cost pricing is sufficient to overcome the strong influence that rational businesses would not enter into conspiracies such as this one.

Id. at 1355 n.9.

¹¹⁸ See *Henry v. Chloride, Inc.* 809 F.2d 1334 (9th Cir. 1987); *D.E. Rogers Assoc. v. Garner-Denver Co.*, 718 F.2d 1431 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984); *MCI Communications v. A.T. & T.*, 708 F.2d 1081 (7th Cir. 1983), *cert. denied*, 464 U.S. 891 (1983); *William Inglis & Sons Baking Co. v. ITT Continental Baking*, 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3rd Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982); *Northeastern Tel. v. A.T. & T.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980); *Pacific Eng. & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790 (10th Cir. 1976), *cert. denied*, 434 U.S. 879 (1977); *Int'l Air Indus. v. American Excelsior Co.*, 517 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

¹¹⁹ See *supra* note 118.

B. *The Inglis Decision of the Ninth Circuit*

The Court of Justice may wish to examine each adaptation of the Areeda-Turner test applied by the circuit courts of the United States to determine which, if any, supports both the Court's emphasis on cost data and the Commission's concern for subjective evidence. The circuit court with the most experience in the predatory pricing area, however, is the Ninth Circuit. Since the publication of Areeda and Turner's article in 1975, the Ninth Circuit has decided more predation cases than any other circuit.¹²⁰ In its leading predatory pricing decision, *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*,¹²¹ the Ninth Circuit devised a test which combines cost-based and intent-based evidence into a balanced, comprehensive formula for detecting predation.

The plaintiff in *Inglis* was a privately-owned bakery which distributed bread and rolls in northern California.¹²² ITT, one of the larger nation-wide wholesale bakeries in the United States, competed directly with Inglis in the northern California private label bread market.¹²³ Inglis alleged that because of the growth of private label

¹²⁰ According to one author, the Ninth Circuit has decided eleven predation cases since 1975. Liebler, *supra* note 115, at 1077-94. The Ninth Circuit ruled for the defendant in nine of those cases. See *Airweld, Inc. v. Airco, Inc.*, 742 F.2d 1184 (9th Cir. 1984); *Transamerica Computer v. IBM Corp.*, 698 F.2d 1377 (9th Cir. 1983), *aff'g* 481 F. Supp. 965 (N.D. Cal. 1979); *Zoslaw v. MCA Distrib. Corp.*, 693 F.2d 870 (9th Cir. 1982); *D & S Redi-Mix v. Sierra Redi-Mix & Contracting Co.*, 692 F.2d 1245 (9th Cir. 1982); *William Inglis & Sons Baking Co. v. ITT Continental Baking*, 668 F.2d 1014 (9th Cir. 1981); *Murphy Tugboat Co. v. Crowley*, 658 F.2d 1256 (9th Cir. 1981), *aff'g* *Murphy Tugboat Co. v. Shipowners & Merchants Towboat Co.*, 467 F. Supp. 841 (N.D. Cal. 1979); *Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *aff'g per curiam*, *ILC Peripherals Leasing Corp. v. IBM Corp.*, 458 F. Supp. 423 (N.D. Cal. 1978), *cert. denied*, 452 U.S. 972 (1981); *Pierce Packing Co. v. John Morrel & Co.*, 633 F.2d 1362 (9th Cir. 1980); *California Computer Prod., Inc. v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979); *Janich Bros. Inc. v. American Distilling Co.*, 570 F.2d 848 (9th Cir. 1977); *Hanson v. Shell Oil*, 541 F.2d 1352 (9th Cir. 1976). The Ninth Circuit received 23 predation cases between 1975 and 1982 alone. Hurwitz & Kovacic, *Judicial Analysis of Predation: The Emerging Trends*, 35 VAND. L. REV. 63 app. at 151-55 (1982).

In addition, the Ninth Circuit addressed the issue of predation in *Western Concrete Structures v. Mitsui & Co.*, 760 F.2d 1013 (9th Cir. 1985). In *Mitsui* the court overruled the lower court's finding that the plaintiff failed to allege facts which, if true, would have established predatory conduct. *Id.* at 1018. The court concluded that the plaintiff's allegations were thus sufficient to survive a motion to dismiss, and remanded the case. *Id.* at 1020.

¹²¹ 668 F.2d 1014.

¹²² *Id.* at 1024.

¹²³ *Id.* The *Inglis* court, however, failed to discuss the shares of the relevant market

bread manufacturers in the market, ITT instituted a systematic scheme of predatory pricing intended to eliminate independent private wholesalers.¹²⁴

Inglis introduced evidence that showed ITT had gradually reduced its prices over a period of several years.¹²⁵ Inglis argued that because of this pricing policy, both ITT and Inglis incurred substantial losses in the market until Inglis was driven out of business.¹²⁶ In addition, Inglis presented evidence that ITT had made competing offers to Inglis' customers, forcing Inglis to lower its own prices until it suffered lost revenues.¹²⁷ Inglis also documented the evidence of an ITT scheme designed to intentionally eliminate Inglis from the market.¹²⁸

Initially, the *Inglis* court took an approach to the alleged predatory pricing similar to that of the Commission in ECS/AKZO. In *Inglis* the Ninth Circuit posed as the general question in predation cases whether the plaintiff "was a casualty of vigorous, but honest, competition, or the victim of unfair and predatory tactics adopted by a company intent on monopolizing the market."¹²⁹ Unlike the Commission, however, the Ninth Circuit gave great weight in its analysis to cost-based information. Citing its approval of the use of marginal or average variable cost statistics in its previous determinations of predatory pricing,¹³⁰ the *Inglis* court stated that "[p]rices below the average total cost, but above the average variable cost, may represent a legitimate means of minimizing losses during [a] period of inade-

involved. The Federal Trade Commission, which originally dismissed Inglis' case against Continental, estimated these shares at 25.5% for Continental, 4.3% for Inglis. ITT Continental Baking Co., 104 FTC 280, 413 (1984). Unlike AKZO, Continental did not even hold the largest share of the relevant market; another competitor possessed 34%. *Id.* The FTC concluded that it was "highly unlikely that Continental could have acquired monopoly power in any of the relevant markets." *Id.* at 412.

¹²⁴ *Inglis*, 668 F.2d at 1024.

¹²⁵ *Id.* at 1025.

¹²⁶ *Id.* at 1026.

¹²⁷ *Id.* at 1025. Inglis actually lost only one of its clients to Continental. *Id.*

¹²⁸ *Id.* The evidence Inglis presented comes nowhere near the "smoking gun" produced by ECS. See *supra* notes 87-91 and accompanying text. According to the *Inglis* court, the evidence "principally consisted of a report prepared by independent consultants identifying strategies Continental might adopt to combat private label competition. One alternative involved maintaining prices 'to hasten wholesaler exits.'" *Inglis*, 668 F.2d at 1025.

¹²⁹ *Id.* at 1026.

¹³⁰ *Id.* at 1032 citing *California Computer*, 613 F.2d at 727; *Janich Bros.*, 570 F.2d at 848; *Hanson*, 541 F.2d at 1352.

quate demand."¹³¹ The court reasoned that it is less likely that pricing below average variable cost will be legitimate, since such a practice, if sustained, would not allow the firm to recover any portion of its fixed costs.¹³²

Although the *Inglis* court advocated the use of marginal or average variable cost statistics in establishing predation, it did not endorse the Areeda-Turner test without modification. Instead, the court incorporated proof of subjective intent into its analysis, examining such evidence with a focus upon what a rational firm would have expected its pricing policies to accomplish.¹³³ The court did not make production of such evidence mandatory, however, stressing that its focus did not require the plaintiff in every case to present evidence of the defendant's subjective state of mind.¹³⁴ Instead, the court indicated that predatory pricing may be proved through an analysis of the aggressor's prices and costs.¹³⁵ The court also specified that the defendant must have anticipated that its low prices would have a destructive effect upon competition and thus would enhance its market position.¹³⁶

A comparison of the initial discussions in *Inglis* and ECS/AKZO reveals that the Ninth Circuit relies more on cost-based evidence than does the Commission. While both decisions state that objective evidence alone may establish predation, the Ninth Circuit's threshold of anticipated destructive effect and increased market share appears lower than the Commission's touchstone of self-evident consequences. The two approaches agree, however, that pricing above average variable cost may in some instances be considered predatory. As the Commission explained, "[t]he important element is the rival's assessment of the aggressor's determination to frustrate its expectations . . . rather than whether or not the dominant firm covers its own

¹³¹ *Inglis*, 668 F.2d at 1035.

¹³² *Id.*

¹³³ *Id.* The court noted that pricing below average variable cost will result in "out-of-pocket losses" on each unit the firm sells. *Id.*

¹³⁴ *Id.* at 1034. The court then stated that "a price should be considered predatory if its anticipated benefits depended on its tendency to eliminate competition." *Id.* This statement mirrors the Court of Justice's stand on the elimination of competition. See *supra* note 34 and accompanying text. The Commission also stressed the importance of intent to eliminate competition in its final decision in ECS/AKZO. See *supra* note 66 and accompanying text.

¹³⁵ *Inglis*, 668 F.2d at 1034. The Commission also noted that predation could be proven solely with objective evidence. See *supra* note 94 and accompanying text. The Court of Justice made the same observation with regard to excessive prices in *United Brands*. See *supra* note 39.

¹³⁶ *Inglis*, 668 F.2d at 1035.

costs. There can thus be an anti-competitive object in price cutting whether or not the aggressor sets its prices above or below its own costs."¹³⁷ Moreover, both the Commission and the *Inglis* court stated that pricing below average variable cost may, under some circumstances, be a legitimate business tactic.¹³⁸

The *Inglis* court, however, took its examination of costs and intent one step further than the Commission. Rather than relying upon a cursory discussion of when objective evidence alone might be sufficient to establish predatory pricing, the Ninth Circuit devised a test for predation which features a shifting burden of proof, determined by cost-price relationships.¹³⁹ The *Inglis* test reiterates that a price must be a threat toward competition as well as an attempt by the defendant to realize monopoly power. Depending on the evidentiary circumstances present, the plaintiff must prove these anticipated benefits in one of two ways:

1. If defendant's price is above average variable cost, the *plaintiff* must prove that the price was nevertheless designed to injure competition and realize monopoly profits.
2. If plaintiff proves that defendant's price is below average variable cost, the *defendant* must show that its price was not designed to injure competition.¹⁴⁰

¹³⁷ ECS/AKZO Final Decision, 28 O.J. EUR. COMM. (No. L 374) at 20.

¹³⁸ *Inglis*, 668 F.2d at 1035; COMMISSION OF THE EUROPEAN COMMUNITIES, FIFTEENTH REPORT ON COMPETITION POLICY 85 (1986).

¹³⁹ The *Inglis* court stated:

[W]e hold that to establish predatory pricing a plaintiff must prove that the anticipated benefits of a defendant's price depended on its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power. If the defendant's prices were below average total cost but above average variable cost, the plaintiff bears the burden of showing defendant's pricing was predatory. If, however, the plaintiff proves that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.

Inglis, 668 F.2d at 1035-36.

¹⁴⁰ *Id.* One year after deciding *Inglis*, the Ninth Circuit addressed predation in *Transamerica Computer*, 698 F.2d at 1377. In that decision the court again refused to rely solely on cost-based analysis, saying "[a] rule based exclusively on cost forecloses consideration of other important factors, such as intent, market power, market structure, and long-run behavior in evaluating the predatory impact of a pricing decision." *Id.* at 1387. The court concluded that even prices set above average total cost might have predatory connotations; in such a case, however, the plaintiff

Subjective evidence of intent is integral to both situations. When the defendant prices above average variable cost, the plaintiff may still prove predatory pricing by presenting evidence showing the defendant's predatory intent. When the defendant prices below average variable cost, he may use subjective evidence to show that his price was not designed to injure competition, while the plaintiff might present subjective evidence to refute the defendant's explanation. Objective, cost-based evidence, however, remains the basis of the *Inglis* analysis. Rather than allowing subjective evidence of intent to determine predation, the *Inglis* test employs such evidence either to support or defeat the assumptions of legality established by cost factors.

Although several drawbacks to the *Inglis* analysis are apparent, these drawbacks do not destroy the value of the test. Commentators have noted that the cost data necessary for the analysis would require a massive discovery effort.¹⁴¹ But as evidenced by their prior decisions, both the Commission and the Ninth Circuit have managed to collect the evidence needed.¹⁴² Concern over jury competence to properly examine sophisticated cost data¹⁴³ is not justified in EEC matters, as the Commission and Court of Justice are the only triers of fact.¹⁴⁴ Finally, although any generalized definition of fixed and variable costs will be inapplicable to some industries,¹⁴⁵ the *Inglis* court has devised a workable test for distinguishing fixed from variable costs.¹⁴⁶

would have to prove predation by clear and convincing evidence. *Id.* at 1388.

Four circuits have addressed predatory pricing since the *Inglis* decision. See *Henry v. Chloride, Inc.* 809 F.2d 1334 (9th Cir. 1987); *Southern Pacific Communications v. A.T. & T.*, 740 F.2d 980 (D.C. Cir. 1984); *D.E. Rogers Inc. v. Gardner-Denver Co.*, 718 F.2d 1431 (6th Cir. 1983); *Barry Wright Corp. v. Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983). The Eighth and Sixth circuits have adopted the *Inglis* standard. *Henry*, 809 F.2d at 1346; *D.E. Rogers*, 718 F.2d at 1437. In contrast, the District of Columbia and First circuits declined to adopt any cost-based standard. *Southern Pacific*, 740 F.2d at 1006; *Barry Wright*, 724 F.2d at 233.

¹⁴¹ Havenkamp & Silver-Westrick, *Predatory Pricing and the Ninth Circuit*, 1983 ARIZ. ST. L.J. 443, 454.

¹⁴² See *supra* note 12 and accompanying text. In addition, the Commission's investigatory powers under Regulation No. 17 make it especially adept at gathering cost and price evidence. *Id.*

¹⁴³ See, e.g., *Inglis*, 668 F.2d at 1063 (Wallace, J., dissenting).

¹⁴⁴ See *supra* notes 1 and 19.

¹⁴⁵ P. AREEDA, ANTITRUST LAW § 715.2a at 146-47.

¹⁴⁶ The *Inglis* court proposed that "to determine whether particular costs are variable, one must evaluate the relationship of the prospective change in output to that level of output which presently exists." *Inglis*, 668 F.2d at 1037. The Court recommended that an analysis of average variable cost should begin with a comparison

The benefits associated with the adoption of the *Inglis* test greatly outweigh its possible shortcomings. Dominant firms will seldom choose to price below average variable cost. Those that do price below that level will know that such pricing will be legal if legitimate business concerns force them to do so. Dominant firms also will be deterred from pricing below average total cost unless they are confident that no predatory intent is involved. These factors will thus afford businesses a greater ability to predict whether their pricing practices will be considered predatory.

From the plaintiff's perspective, proof that the defendant priced below average variable cost will establish a prima facie case of predation. Thus, the plaintiff's burden to produce subjective evidence is less under the *Inglis* test than under an ECS/AKZO standard. Plaintiff's burden to prove predatory intent when defendant's prices are above average variable cost will be great, but it should be, for in most market settings, pricing above average variable cost will still be considered an example of "vigorous, but honest" price competition.¹⁴⁷

V. CONCLUSION

In its Fifteenth Competition Report,¹⁴⁸ the Commission addressed the ECS/AKZO decision. Refusing to adopt a *per se* test for predation based on marginal or variable cost, the Commission observed that "[t]here may be cases where sale below cost even by a dominant company is justified. Equally, a dominant firm does not need to sell below its own costs in order to bring prices to a level where competitors are forced from the market."¹⁴⁹ Having stated its policy, the Commission then failed to adopt any method of determining exactly which factors constitute predation. Instead, the Commission presented as its test "whether the price cutting or other behavior . . . constitutes

of production costs before and after the alleged predatory price reduction. Variable costs would be those expenses which increased because of the increased production and lower price. *Id.* at 1037. The court concluded that determination of fixed and variable costs must be decided on a case-by-case basis. *Id.* at 1038.

¹⁴⁷ Renfrew, *The Antitrust Jurisprudence of the Ninth Circuit*, 41 A.B. CITY. N.Y. 196, 224-25 (1986).

¹⁴⁸ COMMISSION OF THE EUROPEAN COMMUNITIES, FIFTEENTH REPORT ON COMPETITION POLICY 85 (1986).

¹⁴⁹ *Id.*

unreasonable or unfair behavior intended to eliminate or damage the particular competitor."¹⁵⁰

The Commission proposes a test full of sound and fury, but its application of that test in ECS/AKZO clarified the pitfalls that relying upon such noncommittal language creates. "Unreasonable" and "unfair" behavior might be easily identified in matters where subjective evidence abounds. The Commission, however, gave little indication of how it will determine the presence of those types of behavior in the absence of self-damning documentation. Application of an *Inglis*-type standard under the same circumstances would have provided the same result while also providing practical guidance to other actors in the market place. The Commission would have utilized its extensive cost analysis to establish that AKZO had priced below average variable cost, and then used the subjective evidence present to rebut any inference by AKZO that its pricing was justified. Had the subjective evidence not existed, the Commission still would have established a prima facie case of predatory pricing against AKZO.

Shortly after the Commission's decision in ECS/AKZO, AKZO lodged an action for annulment with the European Court of Justice.¹⁵¹ The Court possesses unlimited jurisdiction in competition cases, enabling it to review *de novo* both facts and law.¹⁵² If an appeal is successful, the Court may declare void all or part of the Commission decision. In addition, in cases such as ECS/AKZO where the Commission imposes a fine, the Court may cancel, reduce or increase the fine or periodic penalty payment imposed.¹⁵³

Despite its extensive powers of review, the Court's power is limited because the Commission is under no legal obligation to apply decisions of the Court in further Commission rulings.¹⁵⁴ The Court may, however, recommend that the Commission take certain action in upcoming matters of a similar nature. Thus, when it considers the ECS/AKZO decision, the Court of Justice should reaffirm the importance of

¹⁵⁰ *Id.*

¹⁵¹ See *supra* note 19.

¹⁵² Regulation No. 17 granted the Court of Justice this great power of review in competition matters. See Regulation No. 17, *supra* note 19.

¹⁵³ Regulation No. 17, *supra* note 2, at art. 17.

¹⁵⁴ The law of the EEC has as its foundation civil law systems of the European continent, which have rejected *stare decisis*. The Court of Justice itself, modelled upon the French *Conseil d'Etat*, does tend to follow its own decisions but deviates for good reason. See LASOK & BRIDGE, *supra* note 19, at 38-45. In the same manner, the Commission does not consider itself bound by previous Court of Justice decisions.

examining objective evidence in pricing cases.¹⁵⁵ The Court also should emphasize the importance of analyzing cost-based data in conjunction with evidence concerning subjective intent. By stressing the need to consider both objective and subjective evidence, the Court can strongly advise the Commission to adopt a test for predatory pricing that offers more predictability to businesses in the EEC and lessens the possibility of inconsistent applications of EEC law.

In its review of the Commission's ECS/AKZO Final Decision, the Court of Justice should strongly urge the Commission to apply a comprehensive test for predation similar to that developed by the Ninth Circuit in *Inglis*. The Commission should ultimately realize that its adoption of such a test will afford more guidance and predictability to undertakings in the EEC concerning what constitutes unfair pricing. If the Commission nevertheless chooses to muddle on with its nebulous ECS/AKZO test for predation, it may find that dominant firms, rather than curtailing their abuses, will instead work only to prevent the discovery of subjective evidence that documents their existing abusive practices.

Thomas G. Ehr

¹⁵⁵ See *supra* notes 44-46 and accompanying text.