

COSTS BENCHMARKS AS CRITERION FOR EVALUATION OF PREDATORY PRICING

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Abstract. *Predatory pricing is one of the forms of the abuse of a dominant position. Judicial institutions of the European Union and Commission during analysis of predatory pricing devote main attention to the relationship between costs and prices of the dominant undertaking. Moreover, attention is paid also to various cost benchmarks: average variable costs, average avoidable costs, average total costs and long run average incremental costs. European judicial institutions should pay less attention to the costs of a dominant undertaking than to evaluation of the effect of the actions of a dominant undertaking to consumers and competition in the market. Moreover, proposition of the Commission to use average avoidable costs in predation cases does not correspond to the practice of the Court of Justice and the General Court. The Commission should stipulate more clearly how average avoidable costs and long-run average incremental costs should be calculated in order to increase legal certainty of the undertakings. Establishment of prices higher than average total costs by the dominant undertaking should not be recognized as predatory pricing.*

Keywords: *abuse of dominant position, predatory pricing, average variable costs, average avoidable costs, average total costs and long run average incremental costs.*

Introduction

While assessing the novelty of this article, it should be mentioned that Lithuanian legal scholars have not published any articles or other studies on the cost benchmarks, which may be applied by a dominant undertaking during engagement in predatory pricing. The Court of Justice, the Commission and competition institutions in most member states perform extensive analysis of relationship between costs and prices of a dominant undertaking, while dealing with cases on predatory pricing.¹ Usually European judicial institutions are relying on test proposed by Areeda-Turner in order to evaluate predatory pricing. Moreover, attention is paid to different cost benchmarks: average variable costs, average avoidable costs, average total costs and long run average incremental costs. In case European judicial institutions find that a dominant undertaking established prices smaller than average variable/ average avoidable costs, it is presumed that the undertaking is engaging in predatory pricing. In certain business spheres the Commission proposes to rely on long-run average incremental costs instead of average avoidable costs. Prices, which are lower than average total costs and higher than average variable costs may be recognized as illegal if such prices have been established with intent to eliminate competitors. Only under exceptional conditions the Court of Justice and the Commission may recognize prices, which are higher than average total costs as illegal.

The object of this article is the regulation of the relationship between costs and prices in predatory pricing cases in the EU competition law and under the legal acts of the Republic of Lithuania.

The authors of this article analyze the decisions of the Court of Justice, the General Court and the Competition Council of the Republic of Lithuania (hereinafter – the Lithuanian Competition Council) and legal acts on predatory pricing of the EU and Lithuania.

The goal of this article is to analyze the establishment of different costs benchmarks in predatory pricing cases in the EU competition law

Various research methods were used in the article: logical, systematic analysis, comparative and linguistic.

1. Areeda-Turner Test (Average Variable Costs)

From 1890 the courts of the United States began to deal with predatory pricing cases. State institutions of the US especially aimed to protect small undertakings from the establishment of low prices by the dominant undertakings. In order to recognize

1 Relationship between costs and prices is evaluated in Brazil, Bulgaria, Canada, Chile, Czechia, Denmark, European Union, France, Germany, Hungary, Ireland, Israel, Italy, Jamaica, Japan, Kenya, Latvia, Lithuania, Mexico, New Zealand, Peru, Russia, Singapore, South Africa, Switzerland, Taiwa, Turkey, United Kingdom, United States [interactive]. [accessed on 11-08-2011]. <http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/FINALPredatoryPricingPDF.pdf>, p. 9.

actions of the dominant undertaking as illegal it was necessary to establish „predatory intent“, settlement of low prices and damage to competitors.² It should be noted that beneficial effect of small prices for undertakings and competition have not been estimated. Although claimants used to win most of cases concerning predatory pricing, later on a number of legal scholars came to conclusion that accusations of claimants in many cases were not well-grounded.³ This period is sometimes called era of populist actions against predation.⁴ During the present period the courts of the United States and legal scholars have not managed to create any unequivocal analytical system that would allow evaluating whether certain pricing may be regarded as predatory.⁵

In 1975 Phillip Areeda and Donald Turner (law professors from Harvard University) published the article in which they proposed first test for analysis of predatory pricing based on theory of costs.⁶ Areeda and Turner claimed that undertakings engage in predatory pricing quite rarely, therefore rules, which prohibit such actions should be formulated very clearly and should not deter undertakings from legitimate pricing.⁷ These professors claimed that marginal costs test will allow distinguishing acceptable competitive actions from predatory pricing.⁸ It is quite difficult to estimate marginal costs on the basis of business data and therefore Areeda and Turner intended to apply average variable costs instead of marginal costs test.⁹ Areeda and Turner noted that price, which is higher than average variable costs should be considered as legal and the price, which is lower than average variable costs should be considered illegal.¹⁰ Following proposal of Areeda and Turner in most predatory pricing cases competition institutions do not refer to marginal costs.¹¹

Scientific theory proposed by Turner and Areeda received much more recognition in the courts of the United States than scientific theories usually do.¹² When several

2 Hills, C. A. *Antitrust Advisor*. New Yoork: McGraw-Hill, 1978, p. 312–313; Austin, C. *Price discrimination and related problems under the Robinson-Patman act*. Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association, 1959, p. 46–47.

3 Koller, R. H. The Myth of Predatory Pricing: An Empirical Study. *Antitrust Law and Economic Review*. 1971, 4: 105. From 1890 till 1971 year 123 federal cases related to predatory pricing have been investigated in US. Predatory pricing was proved in 95 cases, or otherwise in 75 percent of all the cases.

4 Bolton, P.; Brodley, J. F.; Riordan, H. M. Predatory Pricing: Strategy Theory and Legal Policy. *Georgetown Law Journal*. 2000, 88: 250.

5 *Standard Oil Co. of New Jersey v. U.S.*, 221 U.S. 1 (1911) (in this case regional reduction of prices was recognized as illegal, without provision of clear rules, how such actions should be analyzed); see also, *United States v. Am. Tobacco Co.*, 221 U.S. 106 (1991) (it was established that pricing below costs contradicts to section of the Sherman Act, but it was not explained how predatory pricing is to be analyzed).

6 Areeda, P.; Turner, D. F. Predatory pricing and related practices under section 2 of the Sherman Act. *Harvard Law Review*. 1975, 88.

7 *Ibid.*, p. 699.

8 *Ibid.*, p. 716.

9 *Ibid.*, p. 716–717.

10 *Ibid.*, p. 733.

11 Unilateral Conduct Working Group, Int'l Competition Network, Report On Predatory Pricing (2008) [interactive]. [accessed on 11-08-2011]. <http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/FINALPredatoryPricingPDF.pdf>, p. 10.

12 Lieberer, W. J. Whither predatory pricing? From Areeda and Turner to Matsushita. *Notre Dame Law Review*. 1986, 61: 1052.

years after publication of this scientific theory have passed, a number of courts were referring to average variable costs test to a significant extent.¹³ At the present moment average variable costs test is not regarded as exceptional¹⁴, however, most courts use it in order to establish presumption on predatory pricing.¹⁵

The Court of Justice and competition councils of the member states in most cases rely on average variable costs test. The Court of Justice relied on this test in the first case on predatory pricing in the EU – *AKZO Chemie BV*.¹⁶ In this case the Court of Justice claimed that „prices below average variable costs (that is to say, those which vary depending on the quantities produced) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss, namely the total amount of the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced.”¹⁷ In *Tetra Pak* and *France Telecom* cases the Court of Justice and the General Court were also referring to average variable costs test.¹⁸

Authors of this article believe that Areeda-Turner test might be viewed critically because of a number of reasons. First, sometimes prices higher than average variable costs are treated as predatory. Secondly, average variable costs test is beneficial for the undertakings, which have high fixed and small variable costs, for example to those, who operate in the sectors of transport and software. In these sectors, even in the case of establishment of small prices, they will be higher than average variable costs. Therefore, application of average variable costs test, sometimes allows for the undertakings established in the market to prevent competitors from entering into the market. Thirdly, less attention should be paid to the analysis of average variable costs than to economic factors of the market.

The Lithuanian Competition Council was dealing with predatory pricing in a number of cases: Decision No. 1 of 28/01/1997 „*To fine UAB „AGA“*“¹⁹; Decision No. 1S-85 of 12/07/2007 „*Concerning termination of the inquiry into correspondence of UAB „AGA“ and UAB „Elme Messer Lit“ actions to the requirements of Article*

13 *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 88 (2d Cir. 1981), cert. denied, 455 U.S. 943 (1982); *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1359 (9th Cir. 1976), cert. denied, 429 U.S. 1074 (1977); *International Air Indus. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), cert. denied, 424 U.S. 943 (1976).

14 Hurwitz, J. D.; Kovacic, W. E. Judicial analysis of predation: the emerging trends. *Vand. L. Rev.* 1982, 35: 106.

15 *Instructional Sys. Dev. Corp. v. Aetna Casualty & Sur. Co.*, 817 F. 2d 639, 648 (10th Cir. 1987).

16 Case C – 62/86 *AKZO Chemie BV v. EU Commission*, [1991].

17 *Ibid.*, para. 71.

18 Case C – 333/94, *Tetra Pak International SA v. EU Commission*, [1996], para. 41; Case C – 340/03 *France Telecom SA v. EU Commission*, [2007] para. 130.

19 Decision of the Competition Council of the Republic of Lithuania of 28/01/1997 No. 1 „*To fine UAB „AGA“*“.

9²⁰; Decision No. 2S-1 of 21/01/2010 „Concerning correspondence of actions of State Enterprise International Vilnius Airport to Article 9 of the Law of the Republic of Lithuania on Competition and Article 102 of the Treaty on the Functioning of the European Union“²¹; Decision No. 1S-184 of 15/09/2011 „On termination of the inquiry concerning correspondence of actions of AB „Lietuvos geležinkeliai“ to Article 9 of the Law of the Republic of Lithuania on Competition“²²; Decision No. 1S-30 of 01/03/2012 „On termination of the inquiry concerning correspondence of actions of TEO LT AB to Article 9 of the Law of the Republic of Lithuania on Competition“²³. Only in one decision the Lithuanian Competition Council found that the dominant undertaking engaged in predatory pricing, i.e. in Decision No. 1 of 28/01/1997 „To fine UAB „AGA““. In the other four cases it was recognized that predation was not present.

By Decision No. 1 of 28/01/1997 „To fine UAB „AGA““²⁴ it was determined that UAB „AGA“ in 1996 held dominant position in the markets of gassy technical and medical oxygen. The Lithuanian Competition Council established that production of one balloon of gassy technical oxygen costs 7,92 LTL and production of one balloon of gassy medical oxygen costs 9,54 LTL. Subject to position of competitors UAB „AGA“ was selling gassy technical oxygen to different purchasers for 3,4-7,0 LTL for a balloon and gassy medical oxygen for 5,0-6,0 LTL for a balloon. Losses, which emerged because of this activity were covered by founders of UAB „AGA“, i.e. by Swedish Concern „AGA AB“ and AB HELD. Above mentioned circumstances allowed UAB „AGA“ to reduce prices substantially. The Lithuanian Competition Council on the basis of above mentioned arguments made conclusion that UAB „AGA“ by selling goods for the prices lower than costs abused dominant position and created obstacles for competing undertakings to develop their business. The Lithuanian Competition Council did not point out on the basis of what kind of costs it evaluated actions of UAB „AGA“. Although the Lithuanian Competition Council did not point out the specific costs benchmark, this have not caused any problem, since price of goods of UAB „AGA“ was apparently lower than costs of production.

In Decision No. 1S-85 of 12/07/2007 „Concerning termination of the inquiry into correspondence of UAB „AGA“ and UAB „Elme Messer Lit“ actions to the requirements of Article 9“ the Lithuanian Competition Council have not mentioned any specific type

20 Decision of the Competition Council of the Republic of Lithuania of 12/07/2007, No. 1S-85 „Concerning termination of the inquiry into correspondence of UAB „AGA“ and UAB „Elme Messer Lit“ actions to the requirements of Article 9“.

21 Decision No. 2S-1 of 21/01/2010 of the Competition Council of the Republic of Lithuania „Concerning correspondence of actions of state enterprise International Vilnius Airport to Article 9 of the Law of the Republic of Lithuania on Competition and Article 102 of the Treaty on the Functioning of the European Union“.

22 Decision No. 1S-184 of 15/09/2011 of the Competition Council of the Republic of Lithuania „On termination of inquiry concerning correspondence of actions of AB „Lietuvos geležinkeliai“ to Article 9 of the Law of the Republic of Lithuania on Competition“.

23 Decision No. 1S-30 of 01/03/2012 of the Competition Council of the Republic of Lithuania „On termination of the inquiry concerning correspondence of actions of TEO LT AB to Article 9 of the Law of the Republic of Lithuania on Competition“.

24 *Supra* note 19.

of costs on the basis of which predatory pricing should be evaluated. During analysis of predation the Lithuanian Competition Council simply mentioned that prices have to be lower than costs. In other decisions related to predation the Lithuanian Competition Council was expressly referring to average variable costs tests and to the decision of the Court of Justice in *AKZO* case.²⁵

On the basis of the above-mentioned decisions we may conclude that the Lithuanian Competition Council pursuant to proposal of Areeda-Turner dedicates main interest to the costs of dominant undertaking in predation cases. The Lithuanian Competition Council only on the basis of comparison of costs and prices of the relevant undertaking may come to conclusion that the undertaking is predating.²⁶ Moreover, in case of determination that the dominant undertaking is pricing below costs the Lithuanian Competition Council would make presumption that the undertaking is engaging in predation. The Lithuanian Competition Council described predatory actions as „actions, when undertaking deliberately seeking to eliminate a rival from the market, incurs losses setting very low prices, for instance lower than average variable costs“.²⁷ Legal acts adopted by the Lithuanian Competition Council do not stipulate clearly enough what costs benchmark has to be met in order to recognize prices as predatory. The Lithuanian Competition Council describes predatory prices just as being „very low“.

2. Average Avoidable Costs Test

William Baumol introduced average avoidable costs test and proposed to use it instead of the test of Areeda-Turner.²⁸ The proposed test was followed by the Commission in *Deutsche Post AG* case,²⁹ the Competition Council of Canada *Commissioner of Competition v. Air Canada* case, the US appeal court in *United States v. AMR Corp.* case³⁰ and by a number of competition councils from the other member states.³¹ Average avoidable cost is the average per unit cost that the predator would have avoided during

25 *Supra* note 21; *supra* note 22; *supra* note 23.

26 International Competition Network [interactive]. [accessed on 11-08-2011]. <http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/2007QuestionnaireDocs/LITHUANIA%20REPSONSE.pdf>, p. 5.

27 Resolution No. 52, 17/05/2000 of the Competition Council of the Republic of Lithuania „On the explanations of the Competition Council Concerning the establishment of a dominant position“. *Official Gazette*. 2000, No. 52-1516.

28 Baumol, W. Predation and the Logic of the Average Variable Cost Test. *Journal of Law and Economics*. 1996, 39.

29 Decision of the Commission of 20th March, 2001, *Deutsche Post AG*, (2001) OJ L 125/27.

30 Canadian Competition Tribunal. *Commissioner of Competition v. Air Canada* (2003), 26 C.P.R. (4th) 476, [2003] C.C.T.D. No. 9; *United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003). Baumol, W., *supra* note 28; Average avoidable costs test was mentioned in legal literature from 1981, Ordover, J.; Willig, R. An Economic Definition of Predation: Pricing and Product Innovation. *Yale Law Journal*. 1981, 91.

31 Average avoidable costs test is applied in Brazil, Canada, EU, Chile, France, Germany, Ireland, Jamaica, New Zealand, South Africa, United Kingdom and United States [interactive]. [accessed on 11-08-2011]. <http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/FINALPredatoryPricingPDF.pdf>, p. 10.

the period of below-cost pricing had it not produced the predatory increment of sales.³² Therefore, if alleged period of predatory pricing lasted for 10 months, average avoidable costs should be calculated by dividing a sum of costs that were used to production of additional goods during 10 months to a number of all the goods. Average avoidable costs test is a short term measure, since similarly to average variable costs test, they do not comprise sunk costs, which were experienced before engaging into predatory pricing.

Commission states that a dominant undertaking by establishment of prices lower than average avoidable costs may be recognized as engaged in predatory pricing, since during establishment of such prices undertaking incurs losses, which it would not have experienced if certain amount of products would not have been produced. Price of every item has to be equal or higher than average avoidable costs for the production of such item.³³ In case it is recognized that price lower than average avoidable costs was established, it is possible to make presumption that the undertaking is engaged in predatory pricing and the Commission does not have to validate its decision by evidence about real or potential elimination of competitor, by „predatory“ intent of the dominant undertaking, its possibility to recoup the losses in the future through (a return to) high prices and the other elements that could be used to strengthen its case.³⁴ The dominant undertaking may rebut presumption that it engages in predatory pricing by proving legitimacy of its aims, low chances for a recoupment of losses and by reasoning that its actions will not cause elimination of competitors. For example, low prices may be a part of advertisement campaign, be used for introduction of a new product and therefore may cause no elimination effect.³⁵

Notwithstanding the arguments, which acknowledge that average avoidable costs may be recognized as appropriate to use instead of the average variable costs³⁶, it is

32 Bolton, P.; Brodley, J. F.; Riordan, H. M., *supra* note 4, p. 2271.

33 Baumol, W., *supra* note 28.

34 European Commission, DG Competition, Brussels December 2005, DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf>>, para. 110.

35 *Ibid.*, para. 110.

36 It should be noted that Discussion paper published by the Commission in 2005 was basically intended for a interested parties to submit notes concerning position proposed by the Commission. Notes have been submitted by more than one hundred various companies, law firms and other subjects. Subjects that submitted notes differently evaluate proposition of the Commission to use average avoidable costs test instead average variable costs test. A number of undertakings congratulate intention of the Commission to use average avoidable costs test on the basis of the arguments provided by the Commission and W. Baumol: Commentary by the law firm Allen and Overy [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/055.pdf>>; Commentary by the law firm Ashurst [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/066.pdf>>; Commentary by the law firm Baker and McKenzie LLP [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/076.pdf>>; Commentary by the British Institute of International and Comparative Law [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/054.pdf>>; Commentary by the CBI UK [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/063.pdf>>; Commentary by the Shapiro & Hayes, CRA International, US [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/020.pdf>>; Commentary by the law firm Simmons & Simmons [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/069.pdf>>.

necessary to stipulate certain limitations of the average avoidable test. First, most of critical remarks, which were addressed in relation to the application of the average variable costs, may be also applied to the average avoidable costs. Second, in certain cases the benchmark of the average avoidable costs will be higher than the benchmark of the average variable costs and this means that in such cases it will be easier to prove that the undertaking engaged in predatory pricing.³⁷ Thirdly, the Commission should define the concept of the average avoidable costs more precisely in order for the undertakings to have possibility to use such costs more easily.³⁸ Fourthly, aim of the Commission to use the average avoidable costs does not correspond to the practice of the Court of Justice and the General Court and therefore undertakings may encounter legal uncertainty.³⁹

3. Long-Run Average Incremental Costs

A long-run average incremental cost is the average of all the (variable and fixed) costs that a company incurs to produce a particular product.⁴⁰ The Commission in the *Deutsche Post* case referred to incremental costs and admitted that the undertaking that produces several goods will not be recognized as a predator in the case its income will cover incremental costs of provision of certain service.⁴¹ The Commission claims that in

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- 37 This defect of average avoidable costs is emphasized by: Akman Pinar LL.B., LL.M., Ph.D. Candidate, Norwich Law School, Centre for Competition Policy [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/004.pdf>>; Freshfields Bruckhaus Deringer, DE [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/112.pdf>>; IBA, International Bar Association, BE [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/102.pdf>>; ICC, International Chamber of Commerce, FR [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/106.pdf>>; Gianni, Origoni, Grippo & Partners, IT [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/090.pdf>>.
- 38 This defect of average avoidable costs is emphasized by the CMS, Competition practice group [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/080.pdf>>.
- 39 This defect of average avoidable costs is emphasized by the Freshfields Bruckhaus Deringer, DE [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/112.pdf>> and IBA, International Bar Association, BE [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/102.pdf>>. Certain undertakings, which have submitted comments also note that calculation of average avoidable costs is more complicated than calculation of average variable costs: Assonime, Associazione fra le societa italiane per azioni [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/031.pdf>>; IBA, International Bar Association, BE [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/102.pdf>>; ICC, International Chamber of Commerce, FR [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/106.pdf>>.
- 40 European Commission, *supra* note 34, para. 64.
- 41 Decision of the European Commission of 20th March, 2001 in *Deutsche Post AG* case, 2001/354, para. 10. Long-run average incremental costs are also used by the Competition institutions in Brazil, Denmark, EU, France, Ireland, Italy, Jamaica, Russia, South Africa, Taiwan and United Kingdom [interactive]. [accessed on 11-08-2011]. <<http://www.internationalcompetitionnetwork.org/media/library/unilateralconduct/FINALPredatoryPricingPDF.pdf>>, p. 9. See also: *PostDanmark* case [interactive]. [accessed on 11-08-2011]. <<http://www.ks.dk/english/competition/national-decisions/national-decisions-2004/post-danmark-did-not-abuse-a-dominant-position-by-predatory-pricing/>>.

certain spheres of business, it is necessary to use long-run incremental costs in order to evaluate predatory pricing. The Commission admits that in certain spheres of business, establishment of prices higher than long-run average incremental costs, but smaller than average total costs, would be equal to establishment of prices higher than average avoidable costs and smaller than average total costs in other sectors.⁴² Long-run average incremental costs usually will be higher than average avoidable costs, since in relation to long-run average incremental costs attention is paid to all the fixed costs that are specific to the product and in case of average avoidable costs attention is paid only to specific fixed costs that characterize the product and which are experienced in order to eliminate competitors from the market.⁴³

The Commission indicates two situations when establishment of prices smaller than long-run average incremental costs may be recognized as predatory pricing. First, certain activity is protected by the legal monopoly.⁴⁴ Secondly, if specific costs were established in sectors, which have been recently liberalized or in which liberalization is in progress, for example, telecom sector.⁴⁵ In the first case when the undertaking is protected by the legal monopoly the Commission aims to ensure that a dominant undertaking will not use profit acquired in protected market for establishment in the other market, which is open to competition.⁴⁶ In another case the Commission endeavors to ensure that attempts for liberalization in certain sectors would not be disturbed by predators, who may attempt to sustain monopolistic conditions that were created by the previous legal monopoly. These sectors are related to network industries, which are characterized with high fixed and small variable costs.⁴⁷

A number of scholars welcomed decision of the Commission in the *Deutsche Post* case to follow incremental costs instead of average variable costs.⁴⁸ Long-run incremental costs test is suitable for industries in which undertakings experience high fixed costs and produce a lot of goods.⁴⁹ It is noted that average variable costs test is beneficial for the undertakings, which act in industries that require a lot of investment and when variable costs are close to nil.⁵⁰ In case prices are higher than average variable

42 European Commission, *supra* note 34, para. 124.

43 *Ibid.*, para. 65.

44 Case COMP/35.141-Deutsche Post AG (Decision of the Commission 2001/354/EC, adopted 20.03.2001, OL L 125, 05.5.2001, p. 27). See also. Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services, OJ C 39, 06.02.1998, p. 2-18, para. 3.1-3.4. and Notice on the application of competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles OJ C 265, 22.08.1998, p. 2–28.

45 Notice on the application of competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles OJ C 265, 22.08.1998, p. 2–28, para. 110–115.

46 European Commission, *supra* note 34, para. 125.

47 *Ibid.*, para. 126.

48 Ritter, C. Does the law on predatory pricing and cross-subsidization need a radical rethink? *World Competition*. Kluwer Law International. 2004, 27(4): 622.

49 Paul, A. G. *Recent Developments in Definitions of Abusive Pricing in European Competition Policy*. Bristol: University of Bristol and CMPO, 2000; Joskow, P. L.; Klevorick, A. K. A Framework for Analyzing Predatory Pricing Policy. *Yale Law Journal*. 1979, 89(2): 213–70.

50 Lang, T. J. *European Community Antitrust Law, Innovation Markets and High Technology Industries*. 1996

costs, dominant undertaking will be able to prevent newcomers in the market from retrieving their capital investment (fixed costs). However, during establishment of the costs benchmark attention should be paid to amortization which relates to fixed costs. Long-run incremental costs encompass variable and fixed costs, which would not have been experienced if product was not produced, i.e. they encompass sunk costs but do not encompass total costs. In this respect long-run incremental costs encompass costs, which could be attributed to production of a new product, as distinct from avoidable costs, which are not experienced if manufacturing of certain product is terminated.

The authors of this article believe, that long-run average incremental costs test is not universal and may be applied only in specific business spheres.⁵¹ Moreover, the Commission should describe more precisely how average avoidable costs and long-run average incremental costs should be calculated in order to ensure a legal certainty of the undertakings.⁵²

4. Establishment of Prices Higher than Average Avoidable Costs and Smaller than Average Total Costs

The Commission points out that while a dominant undertaking will have no reason to establish prices below average avoidable costs, since such prices do not maximize profit, the dominant undertaking may have reason to establish price above average avoidable cost but below average total cost.⁵³ Average total costs are calculated by dividing total costs (fixed and variable costs) by a number of produced goods. For example, if demand will fall substantially, then price maximizing short run profit may temporarily fall below average total cost, but such pricing will not entail losses by the mere production of goods. In this case pricing will not cover total costs, but all the variable costs and a part of the fixed costs will be covered. Therefore, it will not be possible to claim that

Fordham conference; See also: Access Notice by the EU Commission, which recognize that AKZO test may be not suitable for the telecommunications sector: Notice on the application of the competition rules to access agreements in the telecommunications sector, [1998] OJ C 265/2, para. 113–115.

51 This defect of long-run average incremental costs is emphasized by: IBA, International Bar Association, BE commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/102.pdf>>; ICC, International Chamber of Commerce, FR commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/106.pdf>>; CBI UK commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/063.pdf>>; RBB Economics, BE commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/068.pdf>>; Telecom Italia, commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/050.pdf>>.

52 This defect of long-run average incremental costs is emphasized by CMS, Competition practice group commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/080.pdf>>. It also mentioned sometimes that long-run average incremental costs test may be suitable for evaluation of wholesale trade, but is not suitable for the evaluation of retail trade. JWP, Joint Working Party of the Bars and Law Societies of the UK, BE commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/101.pdf>>.

53 European Commission, *supra* note 34, para. 111.

the undertaking engaged in predatory pricing.⁵⁴ The Court of Justice and the General Court recognize such pricing as illegal only if additional evidence on intent to eliminate competitors is presented.⁵⁵ The Court of Justice held in *AKZO Chemie BV*⁵⁶: “Moreover, prices below average total costs ... but above average variable costs, must be regarded as abusive if they are determined as part of a plan for eliminating a competitor. Such prices can drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them”.⁵⁷

The Commission notes that in order to evaluate whether a dominant undertaking intends to implement predatory strategy by establishment of prices higher than average variable costs and smaller than average total costs, attention should be paid to the following elements: direct evidence concerning predatory intent; evidence that elimination of undertakings from the market is possible; evidence on the actual or likely exclusion of the prey; whether certain customers are selectively targeted; whether the dominant company actually incurred specific costs in order for instance to expand capacity; the scale, duration and continuity of the low pricing; the concurrent application of other exclusionary practices; possibility to recoup losses.⁵⁸

The authors of this article believe, that in practice of the European Court of Justice it is possible to apply average total costs test only if special circumstances are present, since in this case variable and part of fixed costs are covered and pricing of the undertaking will not be so loss-making as establishment of prices, which are smaller than average variable/average avoidable costs.⁵⁹ Moreover, if average total costs test is applied, then high importance should be given to the intent of the dominant undertaking.

One of defects of average total costs is a fact that dominant undertaking sometimes may establish prices lower than average total costs even without any intention to eliminate a competitor. For example, if a new competitor in the market will establish low price, then demand of goods produced by a dominant undertaking may decrease.

54 European Commission, *supra* note 34, para. 111.

55 Former head of the general directorate for competition Philip Lowe supports this position. EU competition practice on predatory pricing. Introductory address to the Seminar. Pros and Cons of Low Prices. Stockholm, 5 December 2003 by Philip Lowe [interactive]. [accessed on 07-03-2012]. <http://ec.europa.eu/comm/competition/speeches/text/sp2003_066_en.pdf>. For example, professor Robert O’Donoghue, who is against prohibition of prices higher than average costs, points out that situation may be different if evidence on intent to eliminate competitor is submitted. Over-regulating lower prices: time for a rethink on pricing abuses under Article 82 EC., Florence, 2003.

56 Case C-62/86, *AKZO Chemie BV v. EU Commission*, [1991], para 16.

57 *Ibid.*, para. 72.

58 European Commission, *supra* note 34, para. 112.

59 Some of the subjects, who provided comments, do not agree with position of the Commission that prices higher than average avoidable costs and lower than average total costs should be recognized as predatory pricing. Law firm Ashurst commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/066.pdf>>; American Chamber of Commerce to the European Union commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/100.pdf>>; Baker and McKenzie LLP Union commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/076.pdf>>; E. Elhauge. Harvard Law School, US Union commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/072.pdf>>.

In case the dominant undertaking will establish prices equal to marginal costs, it might be possible to cover only variable, but not all fixed costs. In the amount in which costs are fixed, it is worthy for the undertaking to cover at least part of them, since without decrease of prices, the dominant undertaking may experience even higher losses. Certain scholars on the basis of the fact, that it is difficult to classify total costs, came to the conclusion that such pricing should not be prohibited.⁶⁰ The authors of this article believe that competition institutions through application of this test may deter a dominant undertaking from competition in prices. The Commission partly confirms such doubts, by stating that it is difficult to calculate average total costs of the undertaking, which produces a lot of goods, since certain total fixed costs are needed for production of more than one product and it is difficult to attribute them to different products.⁶¹

5. Establishment of Prices Higher than Average Total Costs

Establishment of prices higher than average total costs normally is not recognized as predatory pricing, since by application of such prices in most cases only less effective competitors may be eliminated. Such pricing will be viewed as illegal only if there are exceptional circumstances, which show that consumers will experience disadvantage.⁶² In the opinion of the Commission, establishment of prices higher than average total costs may be recognized as predatory pricing in two cases.

First, establishment of prices higher than average total costs may be recognized as predatory pricing if undertakings in a collective dominant position apply strategy to eliminate a certain undertaking and reduce its revenue, propose to certain clients' goods/services for a price lower than relevant undertaking does and mutually share losses, which are experienced because of detrimental trade.⁶³ This example is illustrated by the *Compagnie Maritime Belge* case, in which the Court of Justice prohibited any „collective exclusion or marginalization“, when dominant liner conference proposed to a number of subjects (most important buyers of a competitor) products/services for a low price in order that these prices correspond to the ones proposed by the competitor.⁶⁴ The Commission states that establishment of prices higher than average total costs should be regarded as illegal if it is proven that undertakings in a collective dominant position aim to eliminate competitor, that these undertakings together share losses and that pricing negatively affects competition in the market.⁶⁵

60 Areeda, P.; Hovenkamp, H. *Antitrust Law: An Analysis of Antitrust Principles and Their Application*. New York: Aspen Law & Business, 2002, vol. 3, para. 735.

61 European Commission, *supra* note 34, para. 65.

62 *Ibid.*, para. 127.

63 *Ibid.*, para. 128.

64 Joined cases C-395/96 P and C-396/96 P, *Compagnie Maritime Belge SA and Dafra-Lines A/S v. EU Commission*, [2000]; Lowering of prices in order to eliminate certain competitor from specific airlines was prohibited in German Bundeskartellamt Lufthansa case, decision 2002-02-18, B9-144/01.

65 European Commission, *supra* note 34, para. 128.

Secondly, the Commission proposes to recognize establishment of prices higher than average total costs as predatory pricing if dominant undertaking has certain unique advantages or acts in the market where economies of scale are very important and entrants to the market initially will have to operate at a significant cost disadvantage. The Commission believes that in the present case new competitors will be able to enter the market only by pricing lower than minimum level of effectiveness.⁶⁶ The dominant undertaking may prevent competitors from entering the market by pricing temporarily below the average total cost of the entrant and at the same time above average total costs of the dominant undertaking.⁶⁷

The Lithuanian Competition Council has admitted that establishment of the prices higher than average total costs should not be recognized as predatory pricing.⁶⁸ The Lithuanian Competition Council in its answers to the questionnaire published by the International Competition Network in 2008 admitted that establishment of prices higher than average total costs may not be recognized as predatory pricing.⁶⁹ The Lithuanian Competition Council defines predatory pricing as setting „very low prices“, but specific cost benchmark is not named. Therefore, it is possible to suppose that legal acts do not eliminate possibility to recognize establishment of prices higher than average total costs as a predatory pricing. However, legal acts adopted by the Lithuanian Competition Council require proving that dominant undertaking experiences losses and establishment of prices higher than average total costs do not cause losses to the undertaking. Therefore, we may suppose that establishment of prices higher than average total costs, should not be recognized by the Lithuanian Competition Council as a predatory pricing. The authors of this article support position of the Lithuanian Competition Council, which is different from position of the Commission.

In summary it should be said, that establishment of prices higher than average total costs should not be recognized as predatory pricing.⁷⁰ Actually, most competition

66 European Commission, *supra* note 34, para. 129.

67 *Ibid.*

68 *Supra* note 21, para. 3.3; *supra* note 22, para. 31.

69 Unilateral Conduct Working Group, Int'l Competition Network, Report On Predatory Pricing (2008), *supra* note 11, p. 32.

70 A lot of subjects do not agree with position of the Commission that establishment of prices higher than average total costs should be recognized as predation. American Chamber of Commerce to the European Union Union commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/100.pdf>>; Assonime, Associazione fra le società italiane per azioni commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/031.pdf>>; Baker and McKenzie LLP commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/076.pdf>>; Crowell & Moring law firm commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/078.pdf>>; Geradin, D.; Ahlborn, C.; Denicolo, V.; Padilla, J. Commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/057.pdf>>; E. Elhauge, Harvard Law School, US commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/072.pdf>>; Freshfields Bruckhaus Deringer, DE commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/112.pdf>>; IBA, International Bar Association, BE commentary [interactive]. [accessed on 11-08-2011]. <<http://ec.europa.eu/comm/competition/antitrust/art82/102.pdf>>; JWP, Joint Working Party of the Bars and Law Societies of the UK, BE commentary [interactive]. [accessed on 11-

institutions from different countries uphold the view that pricing above average total costs does not constitute predation.⁷¹ In case of prohibition to apply prices higher than average total costs of a dominant undertaking, the dominant undertaking would be deterred from effective competition and it may cause appearance of ineffective competitors on the market. In such case the dominant undertaking would not be motivated to establish low prices. Prohibition of such pricing would not be beneficial for consumers, who are in the core of a competition policy.

Conclusion

1. The Court of Justice and the Commission during analysis of predatory pricing should not recognize the relationship between costs and prices of the dominant undertaking as a key element. Main attention should be paid to the effect to competition in the market and consumers. Moreover, proposition of the Commission to use average avoidable costs does not correspond to the practice of the Court of Justice and the General Court. The Commission should propose more clearly how average avoidable costs and long-run average incremental costs should be calculated in order to increase legal certainty of undertakings. Long-run average incremental costs test is not universal and should be applied only in a part of business areas.

2. Only in exceptional circumstances prices higher than average variable/avoidable costs may be prohibited, since in this case part of fixed and all the variable costs are covered. In this case pricing of the undertaking is not as loss-making as by establishment of prices lower than average variable/avoidable costs. Establishment of prices higher than average total costs by the dominant undertaking should not be recognized as predatory pricing.

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- 71 Establishment of prices higher than average total costs is not recognized as predation in Brazil, Bulgaria, Canada, Czech, Denmark, France, Hungary, Ireland, Italy, Jamaica, Japan, Kenya, Latvia, Lithuania, Mexico, New Zealand, Peru, South Africa, Taiwan, Turkey, United Kingdom, United States. Only in exceptional circumstances such type of pricing is recognized as predation in Germany and Russia. [interactive]. [accessed on 11-08-2011]. <http://www.international-competitionnetwork.org/media/library/unilateral_conduct/FINALP_redatoryPricingPDF.pdf>, p. 9.

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KAŠTAI KAIP GROBUONIŠKOS KAINODAROS VERTINIMO KRITERIJUS

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Santrauka. Grobuoniška kainodara yra viena iš piktnaudžiavimo dominuojančia padėtimi formų. Teisingumo Teismas, Komisija ir daugelio valstybių nacionalinės konkurencijos tarnybos, nagrinėdamos grobuoniškos kainodaros bylas, ypač daug dėmesio skiria ūkio subjekto kaštų ir kainų santykiui. Europos teisminės institucijos, siekdamos įvertinti, ar ūkio subjekto nustatyta prekės kaina nėra mažesnė nei šios prekės pagaminimo kaštai, dažniausiai taiko Areeda-Turner pateiktą grobuoniškos kainodaros testą. Skirtingai nei taikant Areeda-Turner pasiūlytą kaštų įvertinimo testą, Europos teisminių institucijų bei kitų valstybių konkurencijos tarybų praktikoje, vertinant grobuonišką kainodarą atsižvelgiant į bylos aplinkybes, tiriama kainų atitiktis įvairiems kaštų matams: vidutiniams kintamiesiems kaštams, vidutiniams išvengiamiesiems kaštams, ilgalaikiams vidutiniams padidėjantiems kaštams bei vidutiniams bendriesiems kaštams. Pažymėtina, kad Europos teisminių institucijų praktikoje, nustatčius, jog dominuojančio ūkio subjekto kainos yra mažesnės nei vidutiniai kintamieji / vidutiniai išvengiamieji kaštai, daroma prielaida, kad ūkio subjektas taiko grobuonišką kainodarą. Autorių nuomone, vidutiniais kintamaisiais kaštais paremtą Areeda-Turner testą galima vertinti kritiškai dėl kelių priežasčių. Pirma, kartais grobuoniškomis pripažįstamos didesnės nei vidutiniai kintamieji kaštai kainos. Antra, net pripažinus ribinius kaštus tinkamais grobuoniškai kainodarai įvertinti, vidutiniai kintamieji kaštai, ekonomistų manymu, nėra tinkamas ribinių kaštų pakaitalas, nes, esant didelėms gamybos apimtims, jie bus mažesni nei ribiniai kaštai (taigi, bus nepakankamai atsižvelgiama į ribinius kaštus) ir tai lems neteisingas išvadas, vertinant grobuoniškos kainodaros taikymą. Trečia, vidutinių kintamųjų kaštų testas palankus ūkio subjektams, turintiems didelius fiksuotus ir mažus kintamuosius kaštus, pavyzdžiui, ūkio subjektams, veikiančiams transporto ir programinės įrangos sektoriuose. Šiose gamybos srityse net nustatytos mažos kainos bus didesnės nei vidutiniai kintamieji kaštai. Taigi vidutinių kintamųjų kaštų testo taikymas kartais leidžia rinkoje įsitvirtinusiems ūkio subjektams kliudyti konkurentams įeiti į rinką.

Tam tikrose ūkio srityse Komisija siūlo vadovautis ne vidutiniais išvengiamaisiais kaštais, o ilgalaikiams vidutiniais padidėjančiais kaštais, siekiant prieiti prie prielaidos dėl grobuoniškos kainodaros taikymo. Kainos, mažesnės nei vidutiniai bendrieji kaštai ir didesnės nei vidutiniai kintamieji kaštai, pripažįstamos neteisėtomis, įrodžius, kad jos buvo nustatytos siekiant pašalinti konkurentus iš rinkos. Tam tikromis aplinkybėmis Teisingumo Teismas ir Komisija neteisėta kainodara pripažįsta ir didesnių nei vidutiniai bendrieji kaštai kainų taikymą. ES teisminės institucijos turėtų skirti daugiau dėmesio dominuojančio ūkio subjekto veiksmų poveikio konkurencijai rinkoje ir vartotojams vertinimui nei dominuojančio ūkio subjekto kaštų analizei. Be to, Komisijos pasiūlymas vertinant grobuonišką kainodarą vadovautis vidutiniais išvengiamaisiais kaštais neatitinka Teisingumo Teismo praktikos. Komisija turėtų nustatyti aiškius kriterijus, kaip turėtų būti apskaičiuojami vidutiniai išven-

giamieji ir ilgalaikiai vidutiniai padidėjantys kaštai, kad būtų užtikrintas ūkio subjektų teisinis tikrumas. Ūkio subjektai, nustatantys didesnes nei vidutiniai bendrieji kaštai kainas, neturėtų būti pripažinti taikantys grobuonišką kainodarą.

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