

Competitive Pricing in Competition Law ~ Food for Thought from the Privy Council.

By Jennifer Skilbeck
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Analysis of anti-competitive pricing by a dominant firm has always been difficult. Practitioners will be familiar with the general rule set out in *AKZO* (Case C-62/86 *AKZO Chemie v Commission* [1991] ECR I-3359) in respect of predatory pricing - pricing below average variable costs is regarded as predatory when practised by a dominant firm, and pricing below average total costs is predatory with proof of intention.

In some jurisdictions evidence of scope for recoupment is also required. However, the principles have never really convinced either economists or, probably, practitioners, and it is unlikely that anyone really believes that pricing below variable cost can have no purpose other than to eliminate competition, if only because the cost concepts involved have no ready counterpart in the accounting or decision-making practices of dominant firms.

Against this background, a judgment delivered last year by the Judicial Committee of the Privy Council deserves more attention than it has received so far. *Carter Holt Harvey Building Products Group Ltd v The Commerce Commission*, delivered on 14th July 2004, was an appeal from New Zealand. The Privy Council rejected the European jurisprudence as being "unreliable" in its application to the New Zealand statutory regime. In so doing, and in having to identify an alternative approach, the Privy Council threw into useful relief the difficulties the law faces in arriving at a solution to the issue of low pricing by dominant firms, and in particular in determining where the consumer interest in low prices in the short term might in fact be counterbalanced by anti-competitive effects in the longer term.

The facts were relatively simple, though not perhaps typical, because the alleged unlawful behaviour took place in an adjacent market. INZCO (the relevant trading name of the appellant), was the leading manufacturer of a range of home insulation products, one of which was a highly profitable fibreglass mat called Pink Batts. INZCO responded to emerging competition by setting up a

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number of distribution agreements with retailers under which it was the “preferred” supplier, central to the success of which was its ability to supply the full portfolio of insulation products.

A new entrant supplied a new, environmentally friendly product, Wool Bloc, made entirely of natural wool. It was priced to compete with Pink Batts, was sold direct to final customers, and began to gain a significant market share in the Nelson area of the South Island. INZCO’s distributors demanded a similar product, and INZCO introduced a new product, Wool Line, priced at a premium above Pink Batts, and which was expensive to produce. After it failed to achieve significant market penetration, INZCO offered Wool Line to its distributors on a 2-for-1 basis, acknowledged to be below the cost of “production, transport and delivery”.

This strategy coincided with a price increase for Wool Bloc. INZCO’s sales improved. It was accepted in the Privy Council that INZCO’s intention was to remove Wool Bloc from the market, not in order to protect Wool Line, but to protect the much more significant and profitable Pink Batts, a strategy that appears to have been largely successful. The Commerce Commission’s finding of abuse was upheld at first instance and in the Court of Appeal.

The Privy Council, in a majority judgment, considered the case law on predatory pricing. EU cases were “unreliable” as a guide to interpreting the relevant New Zealand statutory provision: “No person who has a dominant position in a market shall use that position for the purpose of...”. In EU law there did not have to be the causal connection between dominance and abuse clearly required in New Zealand. In EU law undertakings have a “special responsibility” not to strengthen their dominant position through unfair means. This “special responsibility” has been expressed in a number of ways by the ECJ. The dicta are clear in general terms, but as the following familiar dicta indicate, none in fact provides much practical guidance in determining the distinction between permitted behaviour in Europe and, for example, New Zealand:

“The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.” (Case 85/76 *Hoffmann La Roche v Commission* [1979] ECR 461§91);

“the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market.” (Case 322/81 *Michelin v Commission* [1983] ECR 3451 §57);

“Article 82 prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality” (Case C-62/86 *AKZO Chemie v Commission* [1991] ECR I-3359 §70);

“The actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case which shows that competition has been weakened” (Case C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951 §24).

In EU (and UK) law there are a certain number of relatively clear “rules of thumb” for dominant firms to follow- in relation to predatory pricing, margin squeeze and discriminatory pricing, for example. Where they apply, there is no need for either the dominant firm or a tribunal to consider directly the nature of the “special responsibility” or whether in any particular case the consumer interest is actually best served, in the long run, by prohibiting the behaviour in question or by allowing the dominant firm to reduce its prices for the benefit of its customers.

As regards New Zealand law, by contrast, the Privy Council interpreted the relevant statutory provision on the basis of the counterfactual, namely whether a non-dominant firm would engage in the same practice. (The minority did not find the counterfactual approach helpful and noted that it arose not out of statute but dicta in one case). Comparison with a counterfactual, of course, relieves the dominant firm of any “special responsibility”.

The Privy Council noted that “the trader is entitled, before he enters upon a line of conduct which is designed to affect his competitors, to know with some certainty whether or not what he proposes to do is lawful.” Yet even so the Privy Council was divided with the majority and minority ultimately taking strongly opposing views.

The majority (Lords Bingham, Hope and Carswell) decided that INZCO had engaged in the kind of behaviour that any firm would engage in, in order to maintain its market share. In particular, the absence of any prospect of recoupment meant that predatory intent was unclear. Further, in the absence of recoupment there was no reason why, if there were pricing below avoidable cost in any market, such a practice would be particularly associated with dominance.

The Privy Council did not refer to the apparent evidence of recoupment on the facts, namely the restoration of the fortunes of Pink Batts – it was clear that recoupment was understood by their Lordships to be an increase in prices, rather than the restoration of profits in a market in which the dominant firm had suffered from the activities of a competitor. Neither did the Privy Council specifically consider the consumer interest, the importance of which they had emphasised, although it was reasonably clear that the end result would be the removal of any environmentally friendly insulation product from the market.

The minority (Lord Scott and Baroness Hale) took a different view, rejecting the analysis of the counterfactual. They pointed out that since the whole purpose of the pricing strategy for Wool Line was to protect Pink Batts, in which INZCO clearly had a dominant position, it was “unreal” to pose a counterfactual in which Pink Batts was not dominant, because in that case there would be no significant market to protect. They concluded that the behaviour was a result of INZCO’s dominance, and was unlawful.

Although the reasoning of the Privy Council is not directly applicable to cases under EU law, it did go to the heart of the matter in trying to find some principle that would distinguish abusive pricing from competitive pricing, without relying on the “rules of thumb” of EU competition law. It is not at all clear what the “responsibility” of the dominant firm amounts to in practice. In fact, the more successful competition law is in increasing competition, the more the dominant firm may find its hands tied by “the rules of thumb” in circumstances where its own customers, who after all constitute the majority, are penalised by unnecessarily high prices. A price sensitive customer may be obliged to change to a competitor simply because the law will not permit his present supplier to meet the competition.

There are no obvious answers, of course, and it is not suggested that the Privy Council found a solution. However the judgment draws attention to an alternative analysis which, though it proved no easier to apply, did at least focus directly on the central issue of how markets work rather than applying a mechanistic rule. The fact that such a powerful tribunal argued strongly both positions serves to illustrate the difficulty inherent in such an exercise.

Implicit in the European approach, however, is an assumption that the boundaries between prices that are too high, competitive, or too low are fixed and determinable by reference to costs. But competition is not like that, or is no longer like that, as the realization of the single market - and the liberalisation of the telecommunications market in particular - has demonstrated. Perhaps in this respect competition law is now a victim of its own success.

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