Predatory Pricing

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How to Analyze Challenged Conduct for Monopolization?

- The slogan is: “Antitrust should protect competition, but not competitors”
  - But what does it mean in practice?
- Irrespective, at least as a predicate, any monopolization claim must establish a direct and causal link between the conduct at issue and significant harm to competition in a well-defined relevant market (or markets)
- But how should a decision-maker delineate conduct that does harm “competition” by harming scarce rivals from standard, day-to-day market interactions?

Sacrifice and Welfare Test Coincide

- The prescriptions from the profit sacrifice tests consistent with social welfare in many market settings
- Seeking profits is generally conducive to economic welfare: hence coincidence not surprising
- When incumbent can extract maximum profits from the market without distorting consumer choices, a choice of profit sacrificing strategy that harms competition is presumptively inimical to welfare
- Examples include a choice of product design or the price for access to a bottleneck input or raising rival’s cost of competing
- But when profit maximization leaves surplus un-extracted, even absent competition, there could be exclusion seemingly even without sacrifice

Example: Inferior Source of Supply

- An incumbent may have an incentive to exclude a rival when there exists an inferior alternative source of supply to its monopolized product
- Consumers demand a system with two components A and B and are willing to pay up to $100
- An entrant can produce standalone component B’ at a lower cost than incumbent. Incumbent profits increase by withdrawing its component B and charging a compensatory (=ECPR+) price for A
- Not an optimal strategy if another firm can offer A’. Then max price for A+B = willingness to pay for A’ + B’ < 100
- With these facts, incumbent has an incentive to foreclose the more efficient B’ in order to drive it irreversibly out of the market
- However, if incumbent could force A’ exit it would rather do that!
- In this example, profit sacrifice could be gauged against the profits under ECPR+

Example: Discounting

- Assume that, like in *Ortho v. Abbott*, a consumer demands a package of five products
- Abbott has a monopoly on three and two are competitive
- Abbott's bundled price for five tests is allegedly less than the price for three tests plus the incremental cost of the two competitive tests
- Abbott can extract full surplus from the buyer, without foreclosing Ortho from the competitive tests
- Clear profit sacrifice (but the case is not clear as to the non-coincident market that strategy would affect)

Example (Virgin v. BA)

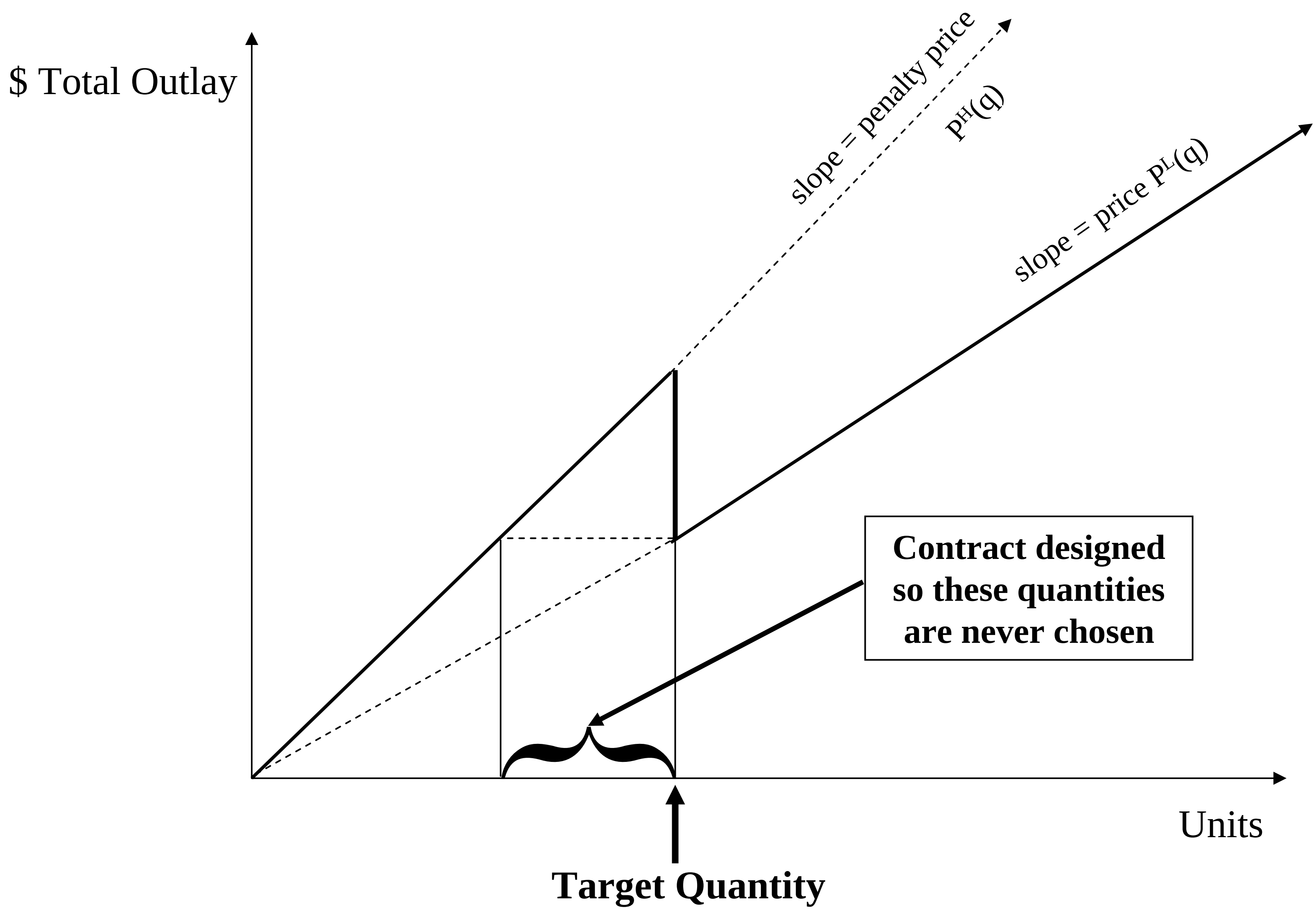
- Consumer <u>needs</u> 10 distinct products and is willing to pay $100 for each. It costs the incumbent $80 to make each product. An entrant can make any one (but only one) product for $70 and hence more efficient

  <u>Alternative 1</u>: Each product priced separately. Result: 9 products sell for $100 and one for $80 – a penny

  <u>Alternative 2</u>: Incumbent announces policy "Buy any 9 products and get 10th free." Entrant decides whether to sink $z to come in. If it does, competition ensues; if it does not, incumbent sets the price

  Equilibrium: E does not come in and I sets price of $111.10 per product

Example of Quantity-Forcing Contracts



Plenty to Focus on

- *Business strategies that have a "commitment" value are a more relevant focus for antitrust concerns with predation*
  - commitment to discount (Virgin v. BA)
  - commitment to a product design (IBM cases)
  - commitment to defend lucrative market ("new era" tying models)
  - commitment to create network economies ("aggressive" prices for market penetration)
  - commitment to raising rival's cost of competing

To Sum up

- The sacrifice test protects conduct that is part of competition, even if it harms and weakens competitors
- The sacrifice test is quite general in its applicability to diverse circumstances
- The sacrifice test is well-defined, though sometimes takes some work to sort out
  - Essential to keep track of the benchmark against which profits to be calculated
  - Benchmark is the profits that would be earned under competitive circumstances if rival were to remain viable