

PREDATORY PRICING IN COMPETITION LAW

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Submitted to the Graduate School of Arts and Social Sciences
In partial fulfillment of
the requirements for the degree of
Master of Arts
in Economics

Sabancı University
Fall 2009

PREDATORY PRICING IN COMPETITION LAW

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DATE OF APPROVAL:

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ACKNOWLEDGEMENTS

I would like to thank to all those who gave me support towards the completion of this thesis. Especially, my advisor Assoc. Prof. Dr. Izak Atiyas was really helpful at every step of my thesis. I am very thankful to him.

I also want to thank my family and friends, who always supported me by preparation of this thesis.

Lastly I want to thank The Scientific and Technological Research Council of Turkey for providing me the necessary funds for completing my thesis.

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ABSTRACT

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BY SIMGE ŞAŞMAZ

Keywords: Predatory pricing, Turkish predatory pricing cases

Predatory pricing can be described as an anticompetitive strategy, with which the predator aims to deter entry to the market or to expel other players from it, in order to gain market share and extra profits, related to the dominant position it will have. The feasibility of this strategy has been questioned by the economists and several theories about the reasons and feasibility of predation have emerged in time. In addition to that, different criteria and tests, related to these theories, have been introduced to the economics literature, to serve for predation analysis.

From the beginning of 1900s on, several firms have been accused with predatory pricing charges. Competition authorities in different countries have dealt with these accusations and analyzed cases in light of the proposed criteria and tests. Most important examples came from United States and European Union exercises. It can be argued that United States competition authority followed classical economic theory arguments in their decisions, whereas European Union Commission followed modern theory arguments.

This thesis examines predatory pricing in detail with its theory and real life examples from United States, European Union and Turkey. It aims to compare the approach of the competition authorities in these countries to predatory pricing, by analyzing different cases.

ÖZET

REKABET HUKUKUNDA YIKICI FİYATLANDIRMA

BY SIMGE ŞAŞMAZ

Anahtar Kelimeler: Yıkıcı fiyatlandırma, Türkiye’deki yıkıcı fiyatlandırma davaları

Yıkıcı fiyatlandırma, yıkıcının pazar payı ve bununla bağlantılı olarak olağandışı kar kazanmak amacıyla, pazara girişi engellemek veya pazardaki diğer oyuncuları pazardan çıkarmak için uyguladığı rekabete aykırı bir strateji olarak tanımlanabilir. Bu stratejinin uygulanabilirliği ekonomistler tarafından sorgulanmış ve zaman içinde bu stratejinin uygulanabilirliği ve sebepleri üzerine çeşitli teoriler ortaya çıkmıştır. Bunlara ek olarak, yıkıcı fiyatlandırma analizi için bu teorilerle alakalı çeşitli kriterler ve testler ekonomi literatürüne girmiştir.

1900’lerin başından itibaren, çeşitli firmalar yıkıcı fiyatlandırma ithamlarıyla suçlanmıştır. Ülkelerin rekabet kurumları, bu suçlamaları öne sürülen testlerin ve kriterlerin ışığında değerlendirmiştir. Bu konudaki en önemli örnekler, Amerika Birleşik Devletleri ve Avrupa Birliği’ndeki tecrübelerden gelir. Rekabet kurumunun kararlarını alırken, Amerika Birleşik Devletleri’nde klasik teorinin, Avrupa Birliği’nde ise modern teorinin argumanlarını takip ettiği söylenebilir.

Bu tez, yıkıcı fiyatlandırmayı teori kapsamında ve Amerika Birleşik Devletleri, Avrupa Birliği ve Türkiye’de yaşanmış örnekleriyle detaylı olarak ele almaktadır. Ayrıca, farklı rekabet kurumlarının yıkıcı fiyatlandırma davalarına yaklaşımlarını, ayrı davaları inceleyerek karşılaştırmayı amaçlamaktadır.

1. INTRODUCTION

Pricing is an important tool that can be used for or against competition. It is assumed that under perfect competition all prices will be equal to the marginal cost levels, as firms operate efficiently. According to this assumption, lower prices will be perceived positive for competition. But this inference will not be true for all cases, because of the “predatory pricing” phenomenon. Sometimes competition itself can be hurt because of very low prices. The most general definition of predatory pricing has been done by Bolton and Riordian as the price decrease to gain additional market power by eliminating competitors.

In former times predatory pricing have been thought as a reasonable strategy, but especially after McGee it has been stated that predatory pricing is irrational and rarely practiced in real life, whereas more recent arguments are in favor of predatory pricing again. It is claimed that predatory pricing can be a rational strategy in special circumstances. According to this argument underlying causes of low prices have to be questioned very well. Higher prices will end up in extraordinary profit gains for the dominant firms, whereas lower prices will deter entry into the market and hurt competition in long run, thus it will again lead to higher prices with extraordinary profits. Also there is another issue named as non-price predation, in which predator firm try to increase the costs and create barriers for its competitors with abuse of its dominance position. In non-price and price predation, the predator mainly shares similar characteristics. Thus, it becomes very important to create a control mechanism with application of certain, special tests, for hindering predation. Applied tests should be not over inclusive, leading to the error of stating nonpredatory prices as predatory, nor under inclusive, missing predatory prices and hurting competition in the long run.

Predatory pricing analysis has a long history. In US, first important case about predatory pricing was Standard Oil Company suit, which can be considered as the reason for publication of Clayton Act in 1914. Until McGee, cases were analyzed mostly out of scope of economics, but after his contributions to this area, suits were investigated in light of a new point of view. Until late 1980s, there were not any significant predatory pricing cases in European Union.

Thus, AKZO case can be considered as the first important suit in predatory pricing area in European Union history. Because of this time lag, it can be said that European Union's decision process used the advantage of being a late comer, and have been cherished by US experience. As Turkish competition law has been prepared according to the European Treaty, it can be stated that at the beginning it has been more affected by European experience, although there are differences between them.

This thesis aims to give some examples of predatory pricing cases in these three different parts of the world and try to analyze and compare different approaches used by the competition authorities for the analysis of these cases. In the next section, different theories and concept of predatory pricing will be explained with referring to its historical background. Then criteria and tests for predatory pricing will be explained in detail. Afterwards United States, European Union and Turkey practices and examples will take place in consecutive sections. Sixth chapter will be about different key indicators, which is been used in decisions of predatory pricing cases. The seventh chapter will conclude the discussion.

2. PREDATORY PRICING

2.1 The Concept, Definition and the Theory

2.1.1 The Concept and Definition

Competition can be considered as one of the most important points, that helps to ensure efficient use of scarce resources. Competition laws and authorities try to protect this mechanism against abusive practices like predation. Even though, at first sight, low prices can be seen in favor of consumers and competition, in real life they can be harmful. Thus there must be some criteria, set for control mechanism.

The competitive implication of price reductions is an important issue in competition regulations. On one hand low prices can be interpreted as a consumer friendly exercise, pointing out the efficiency of the firm. On the other hand it can arise as a result of abuse of the firm's dominant position. So in the analysis of predatory pricing cases, different aspects have to be taken into consideration.

In order to analyze this concept, first it has to be defined. There exist different definitions about it. According to Bolton and Riordian, predatory pricing in economic terms can be defined as "a price reduction that is profitable only because of the added market power the predator gains from eliminating, disciplining or otherwise inhibiting the competitive conduct of a rival or potential rival." (Bolton and Riordian, 2000, 2242) In other words a price cutting exercise can be defined as predatory pricing, when the predator only benefits from it in the long run, by gaining market power and ability to raise prices again, thus driving its rivals out the market. Thus, the prices charged by firms are not profit maximizing in the short run, but will be profit maximizing in the long run. Predatory pricing can be used as a tool either against existing rivals, in order to exclude them from the market or against potential rivals in order to prevent them from entering to the defined market. When competition in the market is assured, it is assumed that firms will be obliged to operate more effectively, and will thrive to reduce their costs and prices, and, in parallel to that, consumers will be able to enjoy the better quality goods and services at a lower cost and higher availability. But in predatory pricing cases, as rivals (potential or existing) will be excluded, in the long run the result will

be reduced innovation, leading reduced efficiency, less output and higher prices. In order to inspect these exercises, basic rules depending on cost, market structure, recoupment and intention have to be defined. (Bolton and Riordian,2000 ,2242)

2.1.2 The Theory

2.1.2.1 Historical Background

Although from the Sherman Act on predatory pricing was prohibited in legal terms, until recently a solid theory was not developed. One of the early papers analyzing predatory pricing is written by John S. McGee in 1958. He analyzed the “Standard Oil” case and tried to come out with some explanations about this phenomenon. Through a long time, “Standard Oil” case has been considered as the most classic example of predation. It is believed that Standard Oil Co. of New Jersey charged predatory prices and gained its monopoly power with this strategy. It has eliminated all competitors in different markets one by one. Also the entrants faced predatory prices, such that they have been discouraged to enter. McGee (1958) analyzed this case and argued that Standard Oil has not gained its monopoly power through predatory pricing. Also in his article, he has pointed out four reasons as to why predatory pricing is not a reasonable hypothesis.

First he stated that a firm with greater market share will incur greater losses from a reduction in prices, as it sells more units. Critics put forward against this argument stress that it underestimates the possibility that the predator can charge different prices in different markets. When the firm discriminates prices, its losses will be not such crucial as McGee assumed to be.

Secondly, he explained that predatory pricing will be only profitable when small firms leave the market and the predator can recoup its losses. He stated, even if smaller firms get out of the market, their facilities will not disappear. As a result of this situation, new firms can use these facilities and enter the market, whenever they see the possibility of profitability. Thus the predator can not recoup its losses as it has expected. But we must take into account that this argument does not take sunk costs into account. By entering a market, generally

firms may incur sunk costs not depending on production. If these are considered, it can be easily concluded that entry decisions will not be as easy as McGee assumes.

The third argument made by McGee is the “deep pocket” theory. Shortly the deep pocket theory can be explained as follows. Firms with higher market share can access greater financial resources, thus can engage in a price war, whereas smaller firms with limited access to financial funds, can not survive prices below cost. Sooner or later these small firms will be out of the industry and leave the market to the predator, as they can not get enough financial resources. In this period, the predator can recoup its losses by setting prices above the competitive level. Although it has some point, in real world theoretically small firms get financial resources from banks and other financial institutions, when they can prove that this funding enables them to stay at the market and as a result the predator will end its strategy.

Finally McGee argues that in order to be considered as an economically rational strategy, predatory pricing must be not only feasible but also more profitable than other possible strategies. It is stated that in most cases a merger strategy will be more profitable. As in predation period, prices are below cost level, the predator will gain less than the merger case, so it will not be rational. This argument can also be criticized from different point of views. To begin with, when new firms see the possibility to be sold out to the incumbent firm with higher profit, they will enter the market. Secondly, there could be different strategies, other than predation and merger, such as aggressive price behavior. Using these strategies can be more beneficial for the incumbent firm. The last criticism to this argument depends on legal framework. In some countries, it is not allowed for dominant firms to buy rivals, in order to protect the competitive environment.

Recently with developments in economic theory new explanations for predatory pricing, challenging McGee’s economic analysis, have emerged. The increasing number of observations related to predatory pricing practices has helped the development of these new theories. But the main reason of this new point of view is the developments in the field of game theory. Modern game theory approach enables more complex analyses of different situations that can arise. These new theories explain predatory pricing in a dynamic framework and under asymmetric information, whereas McGee’s arguments relied on static analysis under symmetric information. In this new formulation, it has been shown that when firms act strategically they can gain profit. Basically it depends on influencing the rival’s

expectations about the competition and profitability in the market. According to Paul Milgrom (1987, 937-938), any price decrease can discourage rivals in the market, and it can lead to decreased investment levels and deterrence of entry to the market due to decreased profitability. The predator will benefit from the new market conditions, as it will operate as monopoly.

Especially in industries where continuous innovation and intellectual property rights play an important role, predatory pricing exercises can be more influential. As the industry involves in more complex processes, asymmetric information will affect the analysis more, so the possibility of predatory pricing resulting in higher profits will increase.

To sum up, predatory pricing can be considered as a rational and profit maximizing strategy under asymmetric information. McGee's assumptions were challenged by different theories, like reputation, signaling and financial market predation models. These recently developed models have one important feature in common; they provide solutions to markets under asymmetric information. In other words, predation can be a profitable strategy only in a world with uncertainty and imperfect information. If all the firms and investors –players in the market- have perfect information (on preferences, technology level, available financial resources for each firm, etc...), predation would never occur, as it would not be profitable for the incumbent. But in real life competition occurs under asymmetric information, thus predatory pricing exercises can exist. In the next sections, reputation, signalling, financial market predation and other models will be explained in detail.

2.1.2.2 Reputation Models

In reputation models, it is assumed that the incumbents' behavior against a potential entrant will affect future potential competitors as well. Under asymmetric information the incumbent can create a reputation of being cost effective and strong, such that new entrants would not choose to operate in these markets. This effect will exist when the incumbent firm operates in a number of "identical" markets or in the same market in successive time periods. When predator operates in two or more markets, engaging in predatory pricing exercises in one market will create a reputation of being strong, such that potential competitors in other markets will not enter. The market or time period, in which the incumbent sets predatory price

can be seen as the demonstration market. Firms' actions in this market (or time period) will alienate potential entrants in other markets and the firm will recoup its losses. Potential competitors will not choose to enter, as they see that the incumbent will set aggressively low prices, such that they could not fight and make profit. Thus, predatory prices allow the incumbent to increase its prices in other markets and make extra profits. (Milgrom and Roberts, 1982, 280-281)

The main point to consider in reputation models is that they give rational solutions only under asymmetric information. Selten (1975) has shown in his paper that a weak incumbent with a cost structure similar to the entrants' will always accommodate under symmetric information, so predatory pricing will never occur. But under asymmetric information, reputation effect can be seen as a mechanism to prevent entry into markets and thereby protecting monopoly profits of the incumbent. The predator -even a weak one- can guarantee its position, if it can represent itself as a tough player, having lower costs than its competitors. Existing rivals can exit the market, when they can not compete with the prices, and potential competitors or entrants will be discouraged to enter the market, when they believe that this exercise can be repeated in the future.

For the reputation strategy to take place, some conditions have to be fulfilled first. According to Bolton and Riordian (2000, 2303-2304) four preconditions must be present for the existence and success of predatory pricing. These preconditions are:

- “1. The predator; a dominant multi-market firm, faces localized or product limited competition or potential competition sour alternatively, operating within a single market, the predator faces probable successive entry over time.
2. The alleged reputation effect either reinforces another identified predatory strategy pursued by the predator; such as financial market predation, or is based on the perceived probability that a predator who has once cut price in response to new entry is likely to repeat that conduct in the future.
3. The predator deliberately pursues a reputation effect strategy.
To prevent over inclusiveness, the proposed rule requires proof that the predator deliberately sought to acquire an entry-deterring reputation as a profit-seeking strategy.
4. The potential entrant observes the exit or other adverse effect experienced by the predator's existing rival in the demonstration market, such knowledge is to be presumed if it is commonly known in the industry.”

The first condition enables the predator to create its reputation as a strong incumbent, which can cut prices, whereas it can recoup its losses in other markets or time periods. In other words, the game has to be played in several different periods or markets, in order to

benefit from reputation and get monopoly profits at a different market or later time period by hurting actual or potential competition.

By the second condition the credibility of the reputation policy plays an important role. If the predators' credibility pursuing this strategy is credible, then potential or existing competitors will be aware of the fact that they will face lower prices and they will exit the market. But although it is weakly plausible, even an incumbent can pursue this strategy and be successful, when asymmetric information is available. The entrant or potential competitor will believe that the predator has some advantage and can set lower prices, when they get into the same market. So they can choose not to fight.

To increase the effect of reputation strategy there must be also some viable evidence for the competitors. The evidences can be in different forms, like proof of cooperate plans to engage in reputation predation, publicizing failure examples of entry into the market, keeping information about the firms' financial and investment situation secret and persistence in application of the predation strategy. These evidences help the predator in the sense that it enables competitors believe in the strategy.

Finally, the entrants have to know that other competitors exit the market because of the predatory activities of the incumbent firm. Otherwise it can enter the market, if it believes that the older ones have operated not as much effective as itself. But when the reason of the exit decision is the predatory strategy, the new competitor will be discouraged for entry, as it sees that it will get economic harm by low market profitability when entering the market.

In the equilibrium Kreps and Wilson (1982) have shown that, when asymmetric information is introduced in this game, even a weak incumbent will choose to fight the entry by creating a reputation effect and new firms will stay out of the market. Towards the end of the game, the weak incumbent may give up pretending as a "tough" one, and some firms can enter the market, but still uncertainty from the entrants' point of view will continue as if the incumbent can be a real tough one.

2.1.2.3 Signalling Models

Signalling models are similar to the reputation models in the sense, that they also deal with imperfect information, but in these models uncertainties about the cost and production structure of the firms have been introduced. In markets with imperfect information, signaling may enable a predator to mislead its rival into believing that market conditions are unfavorable, even when they are not. Milgrom and Roberts (1982b) have developed the first signalling model in economic literature. In their model, the entrant only observes prices set by the monopolist incumbent. It revises its expectations about whether the incumbent is a weak or strong one. For the entrant it is a profitable strategy to get into a market with a weak incumbent. But the entrant only knows that with some probability it will face the weak incumbent, thus it has to decide under uncertainty.

Solutions to this model involve two equilibria, one separating and one pooling equilibrium. In separating equilibrium case, weak and strong incumbents set different prices. On one hand the strong incumbent sets a price lower than the monopoly price – even lower than its costs- , signaling efficiency. On the other hand, the weak incumbent will charge monopoly price. In this case the entrant will surely know which type of incumbent it faces and decides accordingly. When the incumbent is weak, it will choose to enter, otherwise not. In the pooling equilibrium case, both type of incumbents charge monopoly price. In the first type equilibrium, the low price charged by the incumbent can be interpreted as predatory, but it does not decrease welfare in total, as consumers will face monopoly price in the second period and the firm truly signals its cost structure. In opposition to it, pooling equilibrium decreases total welfare, when there is only a weak incumbent instead of a strong one. A weak incumbent will sacrifice its current profits, in order to recoup its losses in the second period.

In these models, both cost levels can be advantageous depending on the setting. Low cost of the incumbent is an advantage as other competitors will not enter in the market, when the incumbent signals its cost structure. But in a game, in which entrants assume that they will have similar (or identical) cost structure to the incumbent, they can deter entry, when the incumbent signals, that it bears high costs. Because in an oligopolistic market structure, higher costs are related with lower profits, new firms will not choose to enter the market. (Harrington 1986)

Another signaling model has been introduced by Fudenberg and Tirole (1986). The “signal-jamming” model consists of two periods and it is assumed, that the incumbents’ characteristics are common knowledge, whereas the entrant has to build its expectations on future profits from current returns, not on cost levels. The entrant does not know the value of the fixed costs and is not certain about them in the second period as well. As the result, predation in the first period will cause to the entry of some firms, but less than compared to complete information case. In this type of games, entrants try to obtain the level of demand, but the predator misleads them, by pretending as there is less demand than expected under normal condition. So again under imperfect information, firms that possible will enter the market under complete information, will be deterred from entry. Another point to mention is that (373) lower prices in this model can be below or above marginal costs of the incumbent, so it will be a better strategy not to use Areeda- Turner test, in order to determine predatory price.

A related model is test market predation. In the test market predation models, the entrant tries to enter a market with a new product, where the incumbent has an established brand. The entrant can choose to enter a smaller “test” market, in order to learn the market characteristics and its products demand. Market conditions are unknown to the entrant, but the incumbent has adequate information. Thus the incumbent will set predatory prices in the test market, such that the demand for the new product will be less. The entrant will think that the demand for its product is low in this market and will deter entry. (Scharfstein, 1984)

These models have in common the existing uncertainty for existing market conditions. They try to give proper solutions, when players do not know different characteristics of the market and show that under uncertainty predatory pricing can be profitable for the incumbent.

2.1.2.4 Financial Market Predation

The theory of financial market predation is another tool by analyzing the situation under imperfect information. Although it is similar to “deep pocket” theory, it helps to explain why a firm could not find a creditor; even both sides will gain at the end. “Deep pocket” theory assumes that the incumbent has greater resources, which it can use in the predatory period to survive, whereas the entrant does not have this chance, if it does not borrow from another firm

or financial institution. In financial market predation models it is explained that the reason of the limited funding capability of the entrant is endogenous, meaning that under asymmetric information the creditor can not be sure about the cost and effort structure of the firm. When the incumbent charges predatory prices, the entrant will get lower or no profits. Normally in such a case the financial institution refrains from giving credits, thus the predator will recoup its losses, when it operates as a monopoly.

In these models, again the main point is imperfect information. The creditors can not know the existing conditions in the market. Thus they can not know surely, why the entrant incurs losses. It can be because of the predatory activities of the incumbent firm or of the inefficient use of the firms' resources. So lenders sign contracts depending on the amount of firms' internal assets, limiting funding capabilities of the firms. In this context, again incumbent firm will be able to get more financial resources and with these new financial resources it will continue its predatory strategy more aggressively. As the result, entrants will deter entry, as they can not get enough financial support to survive the predatory period.

From another point of view, even if lenders have enough knowledge about the market, and support the entrant in every possible condition (even when it incurs losses) by announcing it publicly, the entrant may fail to operate efficiently and use its resources for production. Thus, creditors will find also this strategy not optimal, as they can not assure the use of the given credit. Because of moral hazard problem between the principal (lenders) and the agent (entrants) predation can take place in imperfect financial markets.

2.2 Criteria for predatory pricing

Generally, competition authorities try to detect cases, where predatory pricing practices hinder competition in the market and thereby hurt consumers. The exact nature of the analysis depends on the characteristics of the legal framework, but in general competition authorities also consider several different criteria, mainly defined on quantitative measures. The most

important ones are market structure and firm's position in the market, cost-price relation, recoupment possibilities and intention of the firm.ⁱ

2.2.1 Dominant Position of the Firm

In general it is expected that a firm has to be in a dominant position in the defined market, when it aims to be price setter. Otherwise its impact on the general price level in the market will not be continuous and effective, thus the predatory exercise can not achieve its aim. Different indicators such as market share, economic strength and excess capacity of the predator firm can be counted as indicators of the dominant position of the firm. Competition authorities in different countries and regions stress different indicators more. For an example, in the US market share is an important indicator in assessing the dominant position, whereas in the European Union it is also possible to see cases, where firms with smaller market share are involved in predatory pricing activities. Thus it can not be said that a single criteria is more important than the other ones, their weights differ in analyzing the cases and taking decisions.

In most cases, dominant position of a firm in a market has been analyzed according to its market share. It is assumed that a firm with greater market share will easily set or affect the price level, as it can support its pricing decision with greater supply of the product. Other smaller firms will have to adjust their strategies according to this decision, as they do not have enough capacities to supply the whole market. As a result, the predator's greater market share enables pricing decisions to be more effective, both in the supply and price level sides. Also the ratio of other firms' market shares to the predator one is important. As the difference between the markets shares of the firms increases, their competition and negotiation power decreases in general. So the predatory prices exercised by the incumbent firm will be more effective. (Hovenkamp 1999, 347-348)

ⁱ This section draws on EKDI, B. (2003, "Gümrük Birliği Çerçevesinde Damping ve Yıkıcı Fiyat Uygulamaları") and KARA, A. (2003, "Hakim Durumun Kötüye Kullanılması Aracı Olarak Yıkıcı Fiyat Uygulaması ABD ve AT Uygulamalarından Dersler")

When the incumbent lowers its prices below the competitive level, the demand for the product will increase. So the firm must have enough production capacity to meet the increased demand in the market. If its capacity is less than the new market demand, this strategy would not be successful, as the consumers will buy the product from other suppliers even at a higher price, so other competitors will be not injured by predatory prices and will continue to operate in the market. The predator's ability, immediately to increase the production level, depends on the excess capacity of the firm. If it does not have enough excess capacity, it will have to invest in production facilities.

Williamson (1977) incorporated the dominant position and production capacity of a firm into the predatory pricing analysis. He argued that since pre-entry and post-entry predatory pricing strategies differ from each other, alternative criteria must be used for the analysis and suggested a set of rules for controlling both output level of dominant firms and pricing strategies of all firms.

Before other competitors enter the market, firms that already operate in the market could invest in production capacities and increase output level, causing a price decrease without violating Areeda- Turner rule. Before the entry period, incumbent can invest in excess capacity, as a threat to entry, and until entry it can reduce output level and increase price, leading to higher profit. But according to this new proposed rule the incumbent can not expand its output level, even if it has sufficient capacity, in response to entry for a period of 12-18 months. (OECD, 1989, 22) In this time period entrants can gain customers and experience without facing predatory activities. In addition to that also when prices are greater than average variable costs, the dominant firm has to reduce its output level until prices decrease to its competitive level. Williamson argues that under this simpler operating rule efficiency will be greater both before and after entry. Furthermore he proposed that long run average cost level has to be used in cost-based pricing rules. Otherwise even equally efficient competitors could be deterred entry, as they have to incur fixed costs, which they can not recover when prices are equal to average variable costs.

McGee and Areeda and Turner have criticized these rules especially in terms of output criterion. McGee (1980, 307-316) argued that after entry of new firms in the market incumbent will choose to co-operate rather than fight, thus even the incumbent has excess capacity it will not use them.

2.2.2 Pricing Strategy

When markets operate competitively, under normal conditions it is expected that the inefficient firms will be driven out of the market. But firms charging lower prices can aim to injure competition in the market. Thus, to find out the real reasons behind lower prices becomes the main issue for a proper evaluation. It could be that the incumbent operates more efficiently and this will be favored for the competition. But also it could be the result of predatory pricing activities of the firm. At this point, the relationship between costs and prices become important and it needs to be analyzed properly.

When analyzed historically in the early years of the Robinson-Patman Act, smaller firms have been protected from discriminatory price cutting exercises done by large firms. But no special interest was taken for the reason of low prices, although low prices could be the result of competition and will be in interest of consumers. In 1975 after the publication of the Areeda-Turner article, also courts began to analyze this relationship depending on a certain standard based on sales below average variable cost (AVC), which does not depend on fixed costs of the firm. Over succeeding years critics to Areeda-Turner rule have been charged. They argued, that predatory prices can also be viewed as the result of the strategic interaction in the market (not aiming to let other competitors to exit), thus an effective control mechanism requires to consider strategic factors and long-run welfare effects. (Posner, 1979, 925-942) Thus alternative, improved rules have also been proposed by economists. In the next two sections, the basic standards will be explained in detail.

2.2.2.1 Price under AVC

Under perfect competition, price of a product or service is assumed to be equal to its marginal cost and it is assumed that firms will make zero profit. To decrease prices below marginal cost levels –even for a short time period- is not a rational strategy for a firm, because since the firm can not cover its costs in such a setting, it will incur losses, even if it sells more units. Prices under marginal cost level will be considered as the result of market power of the

firm, because in order to make profits in the long run, it has to increase prices above the competitive level and to affect the price level it has to be in dominant position. But the problem with this argument arises with the definition of marginal cost. If the cost level can not be defined properly, the analysis will lead to wrong results. Areeda and Turner (1975) suggested that marginal cost is mainly a function of variable cost. Hence they argue that short term average variable costs of a firm can be used to test for predation instead of its marginal costs.

2.2.2.2 Price between AVC&ATC

To analyze price levels between average variable cost and average total cost for predatory pricing came out mainly as a result of criticisms against Areeda-Turner rule. It is stated that average variable cost was very difficult to determine and short-term cost tests were not adequate to determine predatory pricing. Also the evidence showed that the Areeda-Turner rule was “a defendant’s paradise.” Thus in most cases an augmented Areeda- Turner rule has been adopted instead of the classic one. This new formulation included cost-based presumptions, intent and market structure. (Bolton and Riordian, 2000, 2253) By using this formulation, courts adopted that a price below average variable cost was presumptively unlawful, while a price above average total cost was conclusively lawful. In Bolton and Riordian (2000,2253) it is clearly stated as “A price falling between these two cost benchmarks was presumptively lawful, but the presumption could be rebutted by evidence of intent and market structure.” Factors other than price-cost tests are weighted differently in several courts. In some cases, evidences of the firms’ intention are stressed more than the existing market structure, sometimes the reverse occurs. But in general the main point is that even a price above average variable cost level can be considered as predatory price under special conditions.

In accordance with these two types of cost criteria, there are two types of cost based analysis, one depending on short term costs and one depending on long term costs. Both types try to use accurate rules and to give explanations for predatory pricing cases, but they have their own advantages and disadvantages.

As stated above, the most known test for the short term cost based analysis is developed by Areeda and Turner (1975, 688-689). In their article they stated that a firm can not be accused of predatory pricing if it tries to maximize its profits in the short run. As known short run profit maximization requires marginal cost to be equal to marginal revenue, which equals its price under perfect competition, thus price below marginal cost can be considered as an indicator of predatory pricing. But as marginal costs are hard to calculate, Areeda and Turner suggested using average variable cost instead of marginal cost. The paper concludes that prices equal or higher than average variable cost have to be assumed as lawful, whereas prices below average cost level have to be considered as illegal. Afterwards Areeda and Turner modified these per se rules and argued that prices below average total cost level have also to be analyzed, in other words “for prices above average variable costs they replace the standard of per se legality with a presumption of legality.” (OECD, 1989, 21) This rule aims to protect firms, operating as efficient as the incumbent one. Although in some periods, this can lead to “limit pricing” or elimination of smaller firms, even if they could increase competition, because of disadvantages they have, this rule forces incumbent to operate more efficiently.

There have been criticisms against Areeda and Turner’s cost test, as it misses long run effects of predation by analyzing only the short run performance of the firm. Posner (1976, 191-192) proposed that long run marginal costs are a better test for predation than short run variable cost tests, as it includes post- predation period costs too. The incumbent can eliminate equally or more efficient competitors, by exercising predatory prices, and it would hurt competition, if smaller firms do not have enough financial resources to bear the burden in the short run. But if long run effects of predation are taken into account with a cost analysis, predation could become more obvious.

Thereupon Baumol (1996) criticized using average total costs as an indicator for predatory pricing, because of the fact that in real life all plants produce several goods at the same time, thus average total cost of an single product can not be surely estimated. According to Baumol, all fixed costs that are not sunk yet, have to be added to the total costs and average costs have to be calculated afterwards. He states that a firm will exit the market when its costs related to production are arising. Thus by predatory pricing tests it will be more appropriate to use average avoidable costs instead of marginal costs, because in such a case equally efficient

firms will not be eliminated from the market. Average avoidable cost differs from average variable cost, by costs related to fixed assets, which can be avoided by producing less or selling more. Rental cost of an extra space in warehouse is added to variable costs, whereas not to the avoidable costs. When the firm produces less or sells more, it will not need this extra space, such that it will not pay for it. Because average avoidable costs only include costs of production, it will more appropriate to use this measure by cost analysis for more or less equally efficient firms.

2.2.3 Intent

Another criterion for detecting the aim of low pricing strategy is the analysis of the intention of the firm. The strategy of low prices can be simply the result of the market dynamics, or it can arise because of the incumbents' aim to deter entry and get monopolistic profits in other periods.

Intention of the firm, exercising extraordinary low prices, is an important factor in analyzing for predatory pricing. In his paper, Greer incorporated several factors including non-economic ones into the analysis of the firms intent. (Greer 1979, 247-248) According to his classification, some of non-economic components are threat mails and phone calls, notes and conversations about hurting competitors, secret financial reports of competitors, constraints on firms, working with competitors. Factors like selective price decreases, increases in the incumbents' production capacity, intense advertisement, increases in raw material inventory, cost- price relationship, geographical borders and timing of charging low prices can be interpreted as economic components used for proving predatory pricing. But there have been some criticisms against non-economic factors. Motta (2004, 449) states that internal papers and conversations should not be taken very seriously, as in most firms' headquarters such papers can be found. It will be better, to give more importance to economic factors by analyzing the intention of the firm.

2.2.4 Recoupment

Recoupment is another important criterion for predatory pricing. In economics it is assumed that all agents behave rationally and try to maximize their profits. According to this assumption the incumbent, charging predatory prices, has to gain extra profits because of this activity, otherwise it will not be a rational strategy.. The predator can get higher profits afterwards, because of the increased market power or changes in market conditions.

For the competition authority showing of probable recoupment suffices for a case, it does not seek proof of actual recoupment. The most likely reason for this practice is that when proof of actual recoupment has been required, the incumbent could delay the decrease in prices, until risk of suit vanishes, if it will be hard to explain that other economic conditions are reasons for the price decrease. But in general, the incumbent will exercise predatory prices after this period. (Bolton and Riordian, 2000, 2269) Also by the analysis of the case, the strategic theory and the post predation evidence have to be considered. The emphasis on these features differ between cases (e.g. cases with weak theoretically background need stronger post predation evidence, vice versa) but in all decisions both theoretical and post predation evidences have to be taken into account. For the competition authority it will suffice, when after the predation period, the predator gets an increased ability to raise and maintain high prices, suggesting that, it will recoup its losses. In addition, when the incumbent can exclude its competitors or deter entry in the market with predatory pricing, it will result in having greater market share and ability to charge higher prices, thus again there will be evidence for recoupment. Also in cases where predatory theory is persuasive, again post predation evidence must be shown, to get the verdict.

In order to sum up, by using theory and post predation evidences it can be concluded, that probable recoupment exists, without need of showing actual recoupment. When there is a strong theory of predatory pricing based on economic analysis, with evidences showing the consistency of the theory and post predation market structure and conditions, and showing the exclusion of the competitors because of below cost prices, it will be reasonable to interpret this phenomenon as probable recoupment.

Baumol stressed in his paper (1979) the importance of the ability to increase prices and its effects in post-predation period. He argued that the incumbent can decrease its prices in response to an entry, but it has to limit its price for a five year period at its predation level, even after the exit of competitors. If the firm increases price level before the end of five year period, without any significant increase in production costs, prices can be considered as predatory. As firms use predatory prices in order to get monopolistic profits afterwards, such a rule will limit the probability of recoupment of their losses. An advantage of this rule is that it does not require computing and control cost level of the firms, as it mainly does not aim to analyze price-cost relationship. Also by using this rule, firms equally efficient as the incumbent one will have a chance to operate in the market. As the incumbent has to include its long term costs, that equally efficient firms must also bear, by setting the price, and thus these new entrants can choose to enter the market. Although Baumol has proposed to fix price level for a five year period of time, there can be increases in price level in accordance with changes in cost and demand. But this can be criticized, as the predator can use this exception and increase its price level, even the conditions in the market do not need any adjustment. Thus, actions taken by the predator would have to be strictly controlled. Another problem can arise, when firms hesitate to decrease prices even if they have to, because of their fear of losing the ability to raise prices again. (OECD, 1979, 25)

Another test for predatory pricing is proposed by Scherer (1976). Like Williamson, he suggested that analysis of predatory pricing must include factors surrounding the incumbent's conduct, its intent and the consequences of its conduct beside cost based tests. He argues that applying only cost based tests can lead to overlook cases, which serve for long run efficiency maximization. Cost based rules cause the predator in holding excess capacity and charging price below marginal cost. But not every action taken by the dominant firm in the market can be interpreted as predatory, thus the circumstances including the intent of the incumbent and consequences of these actions have also to be analyzed.

Phlips supported Scherer and introduced a "rule of reason" standard. He aimed to determine whether the conduct of the incumbent has caused the entrants to lose in the long run, using all available evidence at hand. According to his definition of normal competitive price (a non-collusive profit-maximizing oligopoly price), he states that the victim has to prove that the predators' pricing scheme was the cause of negative profitability in the long

run. At the same time, the predator has to prove that it charges the non-co-operative equilibrium price in the market after entry of the new firms. A better justification will be if the incumbent can prove that prices charged do not imply foregone profits compensated by larger profits in other markets now or in the future. (OECD 1989,25)

2.2.4.1 Characteristics of the market

The probability of the success of predatory pricing also depends on the market characteristics, thus the predator needs to analyze barriers for entry and exit and production facilities other than theirs as well.

As explained earlier the predator aims to recoup its losses with monopoly profits it will get after the predation period. But there arises a problem. As new firms see that they could get extra profits in this market, continuously new ones will try to enter. Thus it will be harder for the incumbent firm to set predatory prices, when entering market is easy and less costly for the new firms. In such a case, the incumbent can not get monopoly profits, as new firms will enter the market and it will have to fight and exclude them, there will be less probability to recoup its losses. The incumbent will set predatory prices, if and only if it can set monopolistic prices in the period, between the exclusion of the old competitors and entrance of the new ones and profits it earns in this period exceeds its losses. But inversely, when entering the market is costly and time consuming, the incumbent will more likely exercise predatory prices and to get monopolistic profits afterwards. (Joskow and Klevorick 1979, 227-231).

Another important feature in recoupment is the characteristics of production facilities of competitors. The success of predatory pricing also depends on other firms' production capacities. The incumbent will fail in lowering prices, when the competitors sell their production facilities to new firms, willing to enter the market. In such a situation these new entrants will buy equipments –most probably- cheaper than their market price, and thereby they will get an advantage in fixed costs compared to the incumbent one. (Hovenkamp 1999, 351). And as the total production capacity in the market continues to operate, the predator will not recoup its losses. But there can be also exceptions to it. When the competitors' production facilities can serve for producing not only for differentiated goods, but also for more generally

used ones, it will increase the probability of operating the new firms in other markets, thus the incumbent will again get monopolistic profits. Or if there exists excess supply in the market, outsider firms will not be willing to buy the equipments, and the incumbent will not face any competition (Hovenkamp 1999, 351).

The last technique proposed for testing predatory pricing came from Joskow and Kleworick (1979, 223) They argued that market structure is the main determinant in predatory pricing strategy and price cuts have to be analyzed differently in different markets. If for all price decreases in every market same tests have been applied, then it could arise two types of mistakes. First, according to the test results it can be stated that predatory pricing exists, where it does not. Second, reversely there can be cases where predatory pricing exists, these tests have not caught. Both types of mistakes will lead to economic inefficiency. Thus, Joskow and Kleworick proposed a two stage test technique, incorporating other tests explained before. According to this new approach, first the market in which firms operate has to be tested by analyzing three components: (a) short run monopoly power of the firm, (b) conditions of entry and (c) dynamic effects of competitors and entrants. If the first part of the analysis shows no evidence about predatory pricing being a profitable strategy, then any price cut has to be considered as lawful. But if it can be stated that price decreases in this market leads to extra profits, then the second part of the test have to be applied.

The second part of Joskow- Kievorik rule includes a number of cost based tests and elements from rule-of –reason approach. But the main difference from rule-of-reason approach is that intent becomes a relevant but not necessary factor. According to the cost based test results, prices under average variable cost have to be considered as predatory prices. Price levels between average variable and average total costs have to be presumed predatory, if the reverse has not been proved by the firm.

3. US PRACTICES

3.1 Legal Framework

In US, antitrust legislations have been first stated in Sherman Act (1890), afterwards in Clayton Act and the Federal Commissions Act in 1914. But predatory pricing activities are analyzed under two different rules. First of them is the second part of the Sherman Act, which has been enacted in 1890. It stresses on the monopolization such that:

“§ 2 Sherman Act, 15 U.S.C. § 2

Monopolizing trade a felony; penalty

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, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court. “

In other words according to Sherman Act (2nd part), predatory pricing can be considered as a tool for monopolization attempts, thus it has to be punished. Although in Sherman Act conditions against monopolization attempts has not been clearly stated, in Spectrum Sports case, the Court summarized three conditions for predation: (a) predatory or anticompetitive activities, (b) intent for monopolization and (c) high probability of success (Spectrum Sports case, 1993, 890-91)

Robinson Patman Act is the second rule that can be used in predatory pricing cases. It has been enacted in 1936 and includes some changes for price regulation rules in Clayton Act. In general it aims to deal with discriminatory pricing issues, thus it is more applicable in cases where predatory prices can be considered also as discriminatory prices. The main difference from the Sherman Act is that in Patman Act, the probability of hurting competition is considered as a sufficient condition for predation. Success probability of monopolization attempts is not necessiated.

3.2 Historical Background

In US, issues about competition and therefore competition laws have a long history. Laws about predatory pricing were on special interest, because it could easily affect firms' entry and exit decisions to new markets. On the one hand, if the law contains strict rules about predation, even efficient firms can leave the market. On the other hand, if the law does not strictly define the boundaries for predation, firms will not be willing to enter price competition, such that it will result in inefficiently high level of prices in the market. Thus the tone of the competition law is very important in predatory pricing cases. In US, examples of different cases have led to new applications of the laws by courts, such that US competition and predation laws have been evolved along time. Also, two different laws (Sherman Act - 2nd part- and Robinson Patman Act) show two different points of view for predatory cases and the evolution of US competition policy.

Until 1970s, laws against predation have been thought as rules against monopolization attempts. But decisions of the courts about predatory pricing cases, were not based on economically sound arguments. Many firms have been separated into smaller independent entities, because they were afraid to be accused with monopolization charges, when their size increases. "Standard Oil" Case can be shown as an example of this era. In his article "Predatory Price cutting: The Standard Oil (N.J) Case", McGee argued that the Standard Oil case was taken as an example for many other predatory pricing cases, because many people believed that Standard Oil became monopoly as a result of predatory prices it charged. (1958, 137) In this period, some of price lowering activities have been interpreted as predatory pricing, even if they were results of competition. (Bolton, Brodley ve Riordan 2000, 14) According to Koller's analysis of 95 court cases, only 23 cases can be interpreted in predatory pricing context, in which actual predation was attempted in seven cases (thirty percent) and succeeded in only four (seventeen percent). (Koller, 1972)

Thus, resulting decisions of these cases were mostly in favor of litigants. In this era, criteria taken into consideration in courts were mostly competitive power of firms operating in the market, geographical price differences, prices below average total cost level and predatory intent. But it has been argued that the cost analysis was not done in much detail, which can lead to false conclusions.

Because of the critics about the criteria used in courts, and the confusion between predatory and competitive low prices, courts have tried to use sound economical arguments in their decisions. At this point Areeda and Turner rule about cost- price level analysis have been used as an important tool in decision taking process, because it introduced a per-se cost analysis. As explained in previous parts, Areeda and Turner proposed that only prices below average variable cost level have to be considered as illegal, prices between average variable and average total cost levels have to be considered as legal, until reversely proven. But these tests had also disadvantages. Calvani also stated that the main issue with this cost test is its application in real life. (Calvani, 1999, 5) Although cost criteria are known, it is very difficult to collect related information and decide accordingly. Thus, as cost based tests do not incorporate market specific factors affecting price level decisions into analysis and short term cost analysis was not appropriate for all markets, courts have began to consider other factors like market structure in which firms operate, and intention of firms, along with cost analysis.

In time, as explained above courts decisions depended on different factors, but after Brooke case these factors have been consolidated depending upon certain criteria. Before Brooke decision, according to Sherman Act the court looked for three conditions to exist for predatory pricing. These were the existence of predatory or anticompetitive agreements and concerted activities, intention for monopolization and high probability of success of these actions. High probability of hurting competition was the only argument, which Robinson Patman Act takes into consideration. But after Brooke decision, the court stated two conditions for predatory pricing cases, which are existence of below cost price level and probability of recoupment. Recoupment in this context includes all possible forgone profits and their interests. Thus in order to speak of predatory pricing, recoupment after the low price period must be highly probable. Nowadays, in US, low prices are considered as a predatory pricing case if and only if when prices increase after competitors exit the market and the predatory firm is able to recoup it losses in the market. Otherwise, low prices are mainly seen as the result of effectiveness and competition. Beside of these conditions, in some cases reputation effect is also considered as another factor for predatory pricing. Reputation effect plays an important role in entry decisions of new firms into the market, thus courts have taken this effect into consideration if market conditions enabled such kind of act.

3.3 Leading Cases

In US history there are many different cases for predatory pricing, but here two cases – Brooke and Matsushita- will be analyzed in detail. Brooke case can be considered as an important example in predatory pricing lawsuits. With the Brooke decision, proof of below-cost pricing and proof of recoupment became necessary conditions for the analysis of predatory pricing. Thus, it can be said that Brooke decision created a new framework for predatory pricing analysis.

Matsushita case is another important example, as it has brought a new point of view for the analysis of predatory pricing cases. In this case, the importance of the markets' characteristics has been questioned. If the market, in which firms operate, is not appropriate for predatory pricing being a profitable strategy, then price decreases do not have to be examined for predation. In the next two parts, these two cases will be examined in more detail.

3.3.1 Brooke

The Brooke case (1993) is important in US predatory pricing history, as it incorporated two main points – proof of recoupment and proof of below cost pricing- into the big picture. The suit began with the complaint of Liggett (a.k.a. Brooke Group), a relatively small player in tobacco market in US with 2.3% market share. The company stated that Brown & Williamson charged predatory prices in generic cigarettes market. In the US tobacco market, total demand decreased, but prices continued to increase. Liggett came with the idea of “generic” cigarettes, which are cheaper than branded cigarettes. Consumers reacted positive to this price change and the market share of generic cigarettes increased. Other firms, R.J. Reynolds and Brown&Williamson, have chosen to adjust their prices according to this new strategy and in US tobacco market a price war has begun, which had ended with the suit. The court decided depending on the recoupment and proof of below cost pricing criteria, that prices can not be considered as predatory.

In Brooke Case, the court also analyzed two conditions for predatory pricing. One of them is price level below cost and the other one is recoupment probability. The first condition has been previously analyzed before Brooke case. But the second condition, which can be stated as proof of recoupment, was a new condition added to the analysis. Proof of recoupment requirement is an important condition in differentiating predatory pricing from other anticompetitive predatory actions. In the Brooke decision it is clearly stated as:

“Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.”(Brooke Decision, 509 U.S. 224).

The proof for recoupment will be two sided, such that firms charging predatory prices have to be able to increase their prices afterwards in order to cover their losses in predatory period and get additional gains. But the court also stressed that recoupment probability also depends on the market structure in which firms operate. Thus, it will be better, if at first market conditions such as entry barriers, market concentration, etc... have been analyzed. After this analysis, the case will be analyzed in detail, if market conditions enable firms recoup their losses. Otherwise it would not make any sense to argue about the case, if market conditions are not in favor of predatory pricing. Afterwards, two conditions have to be checked. There can be high probability of actual predation, if prices above competitive level could be charged after predation period. Or as a result of the firms’ increased market power recoupment could be possible with high probability. This new point of view has been also explained in Brooke decision:

“Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. Determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market....If market circumstances or deficiencies in proof would bar a reasonable jury from finding that the scheme alleged would likely result in sustained supracompetitive pricing, the plaintiff’s case has failed. In certain situations— for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate.”(Brooke Decision, 509 U.S. 226).

The court interpreted low prices without recoupment probability as a consumer welfare enhancing tool, and decides accordingly. Thus, it tried to find and to evaluate cases with actual predation suspect, which will harm competition and welfare in the society.

3.3.2 Matsushita

In Matsushita Case, National Union Electric Corporation (NEU) and Zenith have accused 21 Japanese corporations or Japanese-controlled American corporations that manufacture and/or sell "consumer electronic products" (primarily television sets) with the argument that they charge predatory prices in order to exclude domestic manufacturers. They argued that these Japanese firms charged monopolistic prices in their own countries, in order to compensate their losses in US market, for 20 years long. They also added that, if this predatory strategy could be successfully ended, then consumer welfare would be hurt by monopolistic prices, which will be charged by Japanese firms.

In 1986 US Supreme Court has reached a verdict and rejected the arguments of US companies. In the decision, it has been argued that even after "20 years long predatory pricing period", total market share of Japanese companies have not reached half of the market, whereas two US companies operate as first and second firms in the market. In such a situation it can not be the case, that predatory prices are executed as an abuse of dominant position power. In addition to this argument, the court stated that the market, in which firms operate, was a technology oriented market with fast changing environment characteristics and was not appropriate for predatory pricing. Even if the market was an appropriate one for abuse of dominant position, Japanese firms had not achieved the dominant position in 20 years and there was not any meaningful clue, to take the dominance in the market in another 20 years. As a result, they could not get monopolistic profits if they could not dominate the market, so there was not a probability of recoupment. US firms could not show any evidence about an anticompetitive collusive agreement between firms or about a conspiracy against them.

4. EU PRACTICES

4.1 Legal Framework

In European Union, competition policy and articles are based on articles of Rome Treaty. One of the basic aims of European Union is “the establishment of a system ensuring that competition in the internal market is not distorted.” (Article 3(g) of the EC Treaty) Thus, special articles against anticompetitive agreements and concerted practices of firms and governments have been established. To summarize shortly, Article 81 of the EC Treaty is mainly against anticompetitive actions and collusive agreements between firms. It states that:

“...all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market...”

All horizontal and vertical agreements are considered under this article, but exceptions are also taken into consideration in the 3rd part of the Article, as some agreements (Ex: agreements for R&D joint ventures) may improve consumer welfare, although it can also hurt competition. Thus in Article 81(3) special cases have been introduced, for which Article 81(1) will be exempted. These were:

“...which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.”

Article 82 of the Economic Treaty is about abuse of dominant position. It can be interpreted as the base of the situational analysis. In this article, which predatory pricing activities have to be prohibited, has been described. In Article 82 of the EC Treaty it is stated that:

“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 insofar 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”

Especially part (a) of the Article 82 can be associated with predatory pricing cases. It clearly states that unfair price levels will not be accepted and thus punished.

There are also two more articles about competition. Article 86 deals with the application of competition policy to state institutions and Articles 87-89 deal with the regulation of state funds given to third parties.

4.2 Historical Background

In European Union, rules and regulations against anticompetitive actions of firms were passed into law much later than US. In accordance with this time gap, it can be said that European authorities have not changed their approach as much as US did. Mainly their emphasis laid upon strategic behaviour of the predator firm and its intent. To this extent in the decision process, the authority involved in an detailed analysis including qualitative and quantative factors instead of an purely per se price-cost analysis. Reputation and financial characteristics of the firm, internal messages can be listed within these factors. In light of the points stated above, it can be supposed that European Commission is following modern theory than classical one.

In recent decisions this approach became more visible, as the authority tried to question the necessity of indicators which it took into consideration in predatory pricing cases. In Tetra Pak and Wanadoo cases, it became obvious, that the Commission did not take recoupment as an necessary precondition for predation contrary to US experience. Also in cost analysis, European Commission refrained to apply a per se price cost test. In AKZO case it aimed to implement an approach including both cost and intent analysis. (AKZO decision, para 74) The cost test is based on the assumption, that prices above average total cost levels can not be considered as predatory, but prices between average variable costs and average total costs can be thought as predatory, if the firms' intent supports this predation argument. Thus, even in cost analysis, the decision depends on the intent of the firm. In general, it can be concluded

that the Commission aims to analyse every case depending on its own structure and needs, an approach closer to modern theory.

4.3 Leading Cases

Although in Europe competition history is shorter than US history, there are also important cases, which are used as reference to other suits. In this part three cases – AKZO, Tetra Pak and Wanadoo- will be analyzed in detail. AKZO, as the first one of these three examples, can be considered as the milestone of predatory pricing decision. It can be said that AKZO decision is a referral point for cases afterwards, as it clearly shows the reasoning steps of competition authority in the decision process of predation cases. Tetra Pak case is a good example for comparison of US and European point of view in predatory pricing analyses. It is also important for understanding the significance of existing circumstances, at which predation occurs. In Tetra Pak, objection of the firm with the referral to AKZO case has not been considered as reasonable, although both cases were analyzed by the same authority under same rules. Thus, it can be concluded that qualitative factors of cases are important in the decision process. Wanadoo case is one of the most recent cases about the predatory pricing issue. It is an interesting case as it deals with predatory pricing for ADSL-based Internet access retail services for the general public. In the decision the authority expresses its opinion about the key indicators of predatory pricing by not evaluating recoupment as a necessary precondition of predatory pricing. In next three parts, these cases and decisions will be analyzed and their reasoning will be interpreted.

4.3.1 AKZO

ECS/AKZO decision is one of the most important predatory pricing cases in European Union, as it clearly shows important points in the analysis of European Competition Committee for predatory pricing cases. The case arose in 1979 with the complaint of ECS

(Engineering and Chemical Supplies (Epsom and Gloucester) Ltd), that AKZO Chemie BV charged predatory prices in UK flour market, what ECS could not follow.

At the beginning of 1980s, in United Kingdom three firms (AKZO, ECS and Diaflex) were operating in the organic peroxide (benzoyl peroxide) market. Their market share in 1982 were %52 (for AKZO), %35 (for ECS) and %13 (for Diaflex). ECS sold its entire production as a flour additive in the United Kingdom and Ireland, whereas AKZO operated in whole Europe and sold its products to plastic producers as well. AKZO's market share was above 50% not only in United Kingdom flour additives' market but also in Europe plastics' market. In 1979, ECS began to trade with plastic producers in other countries and as its major competitive AKZO threatened ECS with below pricing strategy in UK flour additives market, which is main market of ECS's production and revenues.

The Competition Authority have taken into account other factors than prices by decision process. Written documents belonging to AKZO, market condition, competition strategy of AKZO are other factors analysed among cost structure, pricing strategy and dominant position of AKZO. In cost analysis, AKZO stated that it charged competitive prices between average variable and average total cost level, and proposed to use Areeda and Turner test in this case. But the Commission rejected this proposal and declared that it does not incorporate long term objectives into account, and only focuses on short term efficiency concerns. The authority clarified that even prices above average total cost can be evaluated as predatory, if it can damage competition in the long run. (AKZO Decision, para 75-79) AKZO limits its price reduction strategy only in United Kingdom flour additives market not all to the European plastics market, because AKZO aims to harm ECS and decrease its power. At the end, with this pricing strategy AKZO's total revenues would not be affected as much as ECS. This argument shows that European Competition Authority is more likely to follow modern economic theory in the case of predation, as it considers different measures for cost analysis.

Another important factor in this case was the dominant position of AKZO in both markets. Although its market share is a sufficient indicator for its dominant position, other characteristics of AKZO serve as signs of dominance. With its huge production capability, AKZO had organizational and know-how advantages compared to smaller competitors. Even in recession periods it had the power to increase its prices, whereas other firms could not compete as they did not have the same product portfolio. In addition to that, in former periods

new entrants in plastics market could not compete with AKZO, as it charged prices below competitive level during the entry period. (AKZO decision, para 69) The last argument can be evaluated as “reputation effect”. It can be said that the competition authority took reputation effect also into consideration, although the term is not clearly stated in the decision. Also the choice of the market definition supported this idea. In this case, the market is defined as the whole plastics market instead of flour additives market in United Kingdom. According to the committee, the main aim of AKZO was to protect its dominant position in plastics market, where profit margins are much higher than flour additives market. Thus, in order to protect long run profits, it became important stopping ECS to operate in plastics market. (AKZO decision, para 46)

The Commission aggregated all these arguments in an intent test, as there were disagreements between AKZO and the authority in cost analysis issue. Thus, the Commission tried to show dominant firm’s intention of predation. The written documents of AKZO against ECS, selective price reductions in flour additives market and prices below average variable cost charged by AKZO were arguments used in intent test by committee. At the end the authority decided that these were parts of a plan for elimination of ECS from plastics market and stated that AKZO was guilty for abuse of dominant position and predatory pricing.

4.3.2 Tetra Pak II

Tetra Pak case (1997) can be considered as another important example in the history of European Competition Authority. In this decision the difference between European and US points of view for recoupment in analysis of predatory pricing can easily be seen. The case arose with the complaint about the anticompetitive prices, Tetra Pak charged in Italian non-aseptic cartons and machines market, in order to eliminate its competitors. Tetra Pak was worldwide dominant firm in aseptic and non-aseptic machines and cartons market. Its market share reached 92% in aseptic machines and cartons market, where it only competes with one company. For the aseptic market, also entry barriers strengthen the dominant position of Tetra Pak. (Tetra Pak, para 100) In non - aseptic markets, Tetra Paks’ market share was around 40%, whereas its competitors Elopak and PKL have 27% and 11% market shares respectively. Again it can be concluded, that in general Tetra Pak is in dominant position in

non-aseptic cartons and machines markets. (Tetra Pak, para 101) But for proving the dominant position of Tetra Pak, in the decision European Commission added that Tetra Pak used its dominance in aseptic markets as a tool for abuse in non-aseptic cartons and machines markets in Italy. (Tetra Pak, para 104) Thus, the case can be analyzed under Article 86 of Rome Treaty.

In both aseptic and non-aseptic machines markets, Tetra Pak stipulated the usage its own cartons with its contracts, which can be seen as a sign its intent for monopolization of the market and abuse of dominant position. Tetra Pak's financial strength is another advantage for monopolization attempts, as it can tolerate greater losses than other firms. At this point, predatory pricing became a reasonable strategy, as competitors could not survive losses, which arose because of below cost pricing strategy. The competition authority analyzed the situation in Italy and United Kingdom markets and concluded that Tetra Pak was considered guilty of predatory pricing. Tetra Pak raised an objection against the decision with the argument that the court has to prove its intent for predation, as it did not have recoupment probability afterwards. However European Commission rejected this argument by saying that recoupment requirement would not be appropriate in the circumstances of the present case, as the firms' intention can easily be concluded from its six year long pricing strategy, as it could not serve any other economically reasonable explanation than predation. (Tetra Pak, para 150) US and European Committee decisions differ at this point, as in US decisions recoupment probability is taken more seriously into consideration. But at this point it is also important to highlight that European Commission may well include the recoupment test under different conditions, although it does not necessitate questioning it in all cases.

4.3.3 Wanadoo

In July , 2003 the European Commission declared that Wanadoo Interactive charged predatory prices for ADSL-based Internet access retail services for the general public between March 2001 and October 2002. Wanadoo Interactive is part of the France Télécom group, which is a %56 state owned company. In France Wanadoo operated in ADSL-based high speed Internet services and cable based access services markets. Between January 2001 to

September 2002, Wanadoo's market share rose from 46% to 72%, on a the ADSL-based high speed Internet access services market. At this period also the market grew more than four times under Wanadoo's dominance. In the decision process, the Commission investigated at first the dominance argument, what is true obviously. Then, as the second move, it analysed the cost structure of Wanadoo's services and the relation between costs and prices. It came out, that Wanadoo charged prices below average total cost level. In the decision it is stated that in such markets firms can bear recovery costs, which is defined below:

“This approach is based on the consideration that it is not the firm's objective to produce an instantaneous profit. Rather the firm will seek to achieve a level of recovery of recurrent costs (network costs and production costs) which is sufficient to ensure that the margin between revenue and recurrent costs will, within a reasonable time, also cover the non-recurrent variable costs invested in the commercial development of the particular product, on items such as advertising, promotion, marketing etc. The non-recurrent variable costs are accordingly adjusted and spread over a certain period in line with the principle of the depreciation of assets.” (Para 76)

But even after cost tests for recovery are applied, it has been recorded that Wanadoo's intent for predation was undoubtful. In addition to that indirect proofs for the predation intent of Wanadoo such as internal documents are cited in the decision. For the recoupment case the Commission followed the same approach in Tetra Pak case, which supposes that recoupment is not a necessary precondition for proof of predation. Thus the dominant firm has to prove that it can not recoup its losses in order to show its innocence, otherwise it can be accused with predation. As all findings indicate the abuse of dominance and existence of predatory prices the European authority charged a fine of €10.35 million on Wanadoo Interactive.

5. TURKISH PRACTICES

5.1 Legal Framework

In Turkey, the main law concerning anticompetitive practices have been published in 1994 in official gazette, in other words only 14 years ago. Main purpose of this law is as stated in Article 1 of the 4054th section of Turkish Constitutional Law:

“The purpose of this Law is to provide the protection of competition by ensuring necessary regulation, supervision and the prevention of abuse of dominant position by those enterprises which are dominant in the market and the agreements, decisions and practices which prevent, restrict or distort competition within the markets for goods and services.”

It serves to ensure competition in all markets and includes measures against anticompetitive actions. (Law 4054, Article 2) In article 4 of the same law, practices against competition have been described. Exemptions to these practices have been stated in article 5, for which these provisions are not relevant. Abuse of dominance have been analyzed as a different issue and explained in Article 6. In this article it is stated that:

“Any abuse, by one or more enterprises acting alone or by means of agreements or practices, of a dominant position in a market for goods and services within the whole or part of the territory of the State, is unlawful and prohibited.

Abusive practices are, in particular, as follows:

- a) To prevent, directly or indirectly, other enterprises in its area of commercial activities or practices which aim to impede the activities of the competitors in the market?
- b) To make discrimination, directly or indirectly, by way of imposing dissimilar conditions for equivalent and same rights and obligations to the purchasers who have equivalent position
- c) To make the conclusion of contracts subject to the acceptance of restrictions concerning resale conditions such as the purchase of other goods and services or acceptance by the intermediary purchasers to display other goods and services or maintenance of a minimum resale price
- d) Practices which aim to distort competition in a market for goods and services by means of taking financial, technological and commercial advantages created by the dominant position in another market
- e) To restrict production, marketing or technical development thereby causing a disadvantage for the consumers.

Especially parts (a) and (d) of the Article 6 can be incorporated with predatory pricing cases. It includes both dominant position abuse and emphasize on price effects of different types of abuse. It also clearly states that these activities are against competition and will be punished.

The substantive rule about competition (Article 7) deals with mergers and acquisitions. It stresses that mergers and acquisitions are unlawful and prohibited, if they serve to strengthen or creation of dominant position in a market.

5.2 Leading Cases

Beginning from the issue date of the competition code, many cases have been brought against firms which have been involved in anticompetitive agreements and concertive practices. Turkish Competition Law, used in analysis of the anticompetitive actions, resembles European Competition Law. In analysis of predatory pricing cases, Turkish authority investigates the four key indicators in following course. At first, economic dominance of the predator has been interrogated. If the firm is not dominant in its relevant market, the case is dropped immediately. Extraordinary low prices are questioned in the second stage, by using cost tests. A firm charging prices below its cost level, can be considered as predator, if there are also signs of intent for deterring entry of new competitors or expelling existing ones. The last indicator for predation is recoupment probability. Firms can be willing to bear losses, in order to gain above competitive level profits in later periods. The Turkish Board examines all predatory pricing cases in this framework, but there can be exceptions in the analysis according to the existing conditions. For example, a case can be considered as an example for predatory pricing, although the firm is not in dominant position in related market.

5.2.1 Coca Cola Decision

In this section, the predation suit of Coca Cola in 2004 will be analysed. The distribution company of Coca Cola has been accused with the complaint that it has practiced predatory pricing strategy in soda / soft drink market. The decision regarding this suit has

been an important one, in the sense that the authority has used all related economic analysis tools for the evaluation.

The competition authority began its analysis with the definition of the related market. In the decision, it has been clearly stated that the related market has to include all substitutable goods and services. (“Coca Cola – Predation” (2004) Turkey Competition Board 04-07/75-18, pp.3) In order to define the characteristics of the goods sold in the soft drink market, and whether they are substitutable or not, the authority has used multiple regression analysis and Granger causality tests. (“Coca Cola – Predation” (2004) Turkey Competition Board 04-07/75-18, pp.5) The results of both multiple regression analysis and Granger causality tests, showed that the related market has to include soft drinks. Afterwards, the dominant position of Coca Cola in this related market has been questioned. Although Coca Cola was not dominant in soda market, it has been stated that in total soft drink market Coca Cola was the dominant player. In accordance with the analysis, other elements like relative market shares of firms, entry barriers to the market, brand power, financial strength, distribution channels have been analysed, before the cost structure study. The analysis has been ended with the cost – price analysis. The authority has decided, that this case could not be taken as predation according to the evidence.

In its second defense, Coca Cola, has referred to the Michael Porter’s model. The degree of dependence to other firms has been evaluated according to the five criteria, which are entry potential to the market, degree of competition, bargaining power of both consumers and producers and availability of substitute goods. (“Coca Cola – Predation” (2004) Turkey Competition Board 04-07/75-18, pp.25) The analysis of these five criteria show that Coca Cola depends on other companies in the market by taking pricing decisions. Thus, it is in a dominant position, when taking non- alcoholic hot drinks like coffee and tea into the market definition. But in its investigation, the competition authority clearly states that as hot drinks could not be substitutes for the defined product portfolio, they could not also been added to the related market, thus Coca Cola is the dominant player in the non-alcoholic soft drinks market. Although prices charged were mostly below average total cost level, it could not be interpreted as predatory prices in the specified soda market, as long as the intent for predation could not be proved.

Another interesting point in the defense of Coca Cola is that it includes the four main criteria used for predatory pricing analysis. It is declared that the competition authority in Turkey has been following EU's practices and thus, it did not take recoupment criterion into consideration. ("Coca Cola – Predation" (2004) Turkey Competition Board 04-07/75-18, pp.34) In its decision, the authority accepted this point of view and investigated the suit according to three main criteria, but it also made additional comments on recoupment. ("Coca Cola – Predation" (2004) Turkey Competition Board 04-07/75-18, pp.44) As the reason for this decision, the problematic nature of the proof of recoupment has been shown. ("Coca Cola – Predation" (2004) Turkey Competition Board 04-07/75-18, pp.42)

5.2.2 LPG Market Decisions

LPG is used for heating, cooking in houses, as an energy source in industry and instead of fuel in automobiles. Because of these different utilization areas and purposes, it is supplied to the customers in different forms and packages. Thus, their respective markets also differ from each other. As in the decision process, the evidence of dominant position is an important factor in determining predatory pricing, at first respective market is defined. In Turkey, from 1998 onwards there were three cases, with one involving two separate decision processes because of the rejection made to the Council of State after the first one. Suits mainly dealt with bottled gas and LPG forms used in automobiles, thus the authority investigated for the proof of the dominant position in these markets.

In 1998, the first case in LPG market has been tied to a decision. The complaint was that seven LPG producing firms (Aygaz, Mogaz, Likidgaz, Milangaz, Milgaz, Ipragaz, Sihirgaz) charged price below cost in bottled gas market, with the intention to throw their competitors from the market. A local producer in Adiyaman sued them because of concerted practices, in which they were involved in order to be able to act as one dominant firm and to get monopolistic power in the market. The authority has defined bottle gas market as relevant market and Adiyaman as the relevant geography. The authority found out a meeting document, from which it can be obviously concluded that these firms aim to expel their local competitors from the bottled gas market with special discounts and below cost prices. ("Adiyaman – LPG Distribution" (1993) Turkey Competition Board 93/750-159, pp.20) In

addition to these findings it is stated that bottled gas were sold to the distributors below cost prices. The prices used in the analysis, were compared to the distributors' costs, not to the production costs, which could not be appropriate from economic point of view. Another interesting point in the analysis was that the firms' market shares were not studied in detail. The authority argued that the main problem in this case was concerted practices of these seven firms against local ones, not a direct abuse of dominant position. Thus for this case a detailed analysis for dominant position and price- cost comparison was not necessary. This decision of the authority was sent to council of state with the objection of sued firms and in 2005 the case was again evaluated by the competition committee. But at the end of this second evaluation, the decision did not changed and firms were obliged to pay a fine for their former strategy. ("Adıyaman – LPG Distribution/ 2nd decision" (2005) Turkey Competition Board 05-73/986-273, pp.15,16)

In 2002, second case came to the Competition Board for assessment. In this case, two firms (Demiroren and Milangaz LPG) were accused of predatory pricing and forming a cartel in filling gas for automobiles market. The geographic market is stated as Ankara, Kayseri, Trabzon and Sivas. Another accusation is that Milangaz charged higher prices for filling gas to POAS compared to prices charged to other competitors, what is leading to a decrease in the number of customers for POAS and hurting competition. In the analysis, the authority stated that the firm has to be in dominant position, in order to be accused with predatory pricing according to the 6th article of 4054. It can be said that dominance is a necessary precondition for predatory pricing charges. Like most cases, the evaluation began with the investigation of dominant position. The authority found out, that Aygaz was the dominant firm in the relevant market, and Demiroren Group followed Aygaz in market share. ("Demiroren- Milangaz LPG Distribution" (2002) Turkey Competition Board 02-48/611-246, pp. 6) Thus it can not be charged with predatory pricing indictment. For Milangaz's anticompetitive prices, the authority declared that the prices charged to POAS have not differed in the specified period, only the internal prices of Milangaz were fallen, leading to a competitive advantage for Milangaz. But as Milangaz was not dominant firm in the market, it could not fulfill the first requirement for abuse, other elements were not questioned and the firm cleaned of all charges. ("Demiroren- Milangaz LPG Distribution" (2002) Turkey Competition Board 02-48/611-246, pp.7)

The last suit was again about bottled gas market. Demiroren LPG group was taken to court with the complaint that it charged predatory prices for 12 kg bottled gas in Konya. Again the authority looked for the dominant position of Demiroren in Konya bottled gas distribution services market. But as Demiroren did not have enough market share for dominance, accusations have been rejected by the authority without involving in cost analysis. (“Demiroren – Abuse of dominant position” (2006) Turkey Competition Board 06-13/150-35, pp. 3)

5.2.3 Telecommunication Market Decisions

In 2002, telecommunication services market consists mainly from two branches, basic services (infrastructure services, etc...) and added value services including mobile communication services, which is the growing segment with the introduction and increasing usage of mobile phones. In Turkey, Turk Telecom was the state monopoly for basic telecommunication services until recently. This segment has been taken into the privatization program by the state and Turk Telecom became a private company. By added value services market the picture changes. Turkcell is the leader firm in this market with several competitors like Avea and Vodafone. These two markets are tied to each other with the minimum fees charged for every mobile and home phone call and line usage between these firms. Turkish cases in telecommunication services market are mostly about the campaigns and fees charged by GSM companies, as it was the only branch in which competition exists.

In telecommunication services market three cases have been tied to a decision in 2003. Two of them were about predatory pricing conduct of Aycell. In the first one, the issue was the minimum fee charged by Turk Telekom to its former partner Aycell. It is claimed that Turk Telekom differentiated its fee structure in advantage of Aycell, and charge lower prices for the calls between fixed lines and Aycell. Another argument was that Aycell could set predatory prices, as its costs decreases with this fee structure. Thus Turk Telekom and Aycell were accused because of dominant position and predatory pricing. In the analysis, the authority also questioned if Turk Telekom aimed to use its dominance power in the mobile communication sector with these pricing structure. In the decision it is stated that Aycell’s pricing strategy could not be described as predatory, since as a new firm it is not in dominant

position and could not aim to deter entry or to expel its competitors. The recoupment probability is also out of question, since it could not charge extraordinary high prices afterwards because of the competitive characteristics of the market. The fees charged by Turk Telekom have been investigated, too. The problem was that the minimum fees could not be lower than a specific amount (Birim Temel Ucreti, BTU), which is determined by the mobile communication services firms itself. Every firm in the market pays BTU for the calls between the lines of Turk Telekom and other GSM companies. Other GSM firms than Aycell have defined an equal amount for this fee, Turk Telekom could not charge lower prices to them. But as Aycell did not have specified a strict amount for it, Turk Telekom could charge lower fees. As BTU is paid to every single firm in the market (including Turk Telekom), it has been concluded that it could not be used as a predation tool. (“Turk Telekom – Aycell ” (2003) Turkey Competition Board 03-28/346-146, pp.5-6) According to these findings the authority decided to reject the accusations. (“Turk Telekom – Aycell ” (2003) Turkey Competition Board 03-28/346-146, pp.5-6)

In the second case again Aycell was accused of predatory pricing. It has been argued that Turk Telekom involved in cross subsidy and used its power in basic services market, in added value services market for supporting Aycell. It is also added that Aycell’s tariffs for its corporate customers were predatory, which it can bear only with the financial support of Turk Telekom. In their analysis, the authority agreed in the argument, that as a partner Turk Telekom financially supported Aycell and covered its losses, with its revenues in the basic services market. The authority stated that Turk Telekom could be charged for cross subsidy, if it can be proven that Aycell followed predatory pricing strategy in added value market. (“Turk Telekom – Aycell – Predatory prices in GSM services market” (2003) Turkey Competition Board 03-56/655-301, pp.8) After this point, Aycell’s pricing strategy have been analysed for four indicators, which can be summarized as economic dominance, extraordinary low price, intent and recoupment. Although Aycell’s prices were far below its costs, it could not be considered as predatory, since other arguments indicate that Aycell uses this pricing strategy only to enter the market not to hurt its competitors. As a new firm, Aycell’s market share was lower than its competitors in the relevant market. Also, it was obvious, that Aycell aimed merely to gain new customers with this strategy, not to expel existing ones. As three of these preconditions did fail to exist, the authority decided to reject all charges against Aycell and

Turk Telekom. (“Turk Telekom – Aycell – Predatory prices in GSM services market” (2003) Turkey Competition Board 03-56/655-301, pp.8)

In the third case in 2003, Turkcell proceed against Turk Telekom with the accusations of predatory pricing and price squeeze. Turk Telekom executed a three month long discount campaign, in which it discounted fees 50%, for abroad phone calls all day long and for the domestic phone calls within the time interval 20:00-08:00 of day. At the same time it increased the amount of the monthly rents for the services it supplied to other GSM and internet services firms by 5 %. Turkcell claimed that, Turk Telekom aimed to abuse its dominant position, and tried to offset its losses because of the campaign with its increasing rental revenue. For predatory pricing charges the authority compared the pricing structure of Turk Telekom with the ones of GSM firms. It became obvious that per minute fee for phone calls between fixed lines were much lower than between GSM and fixed lines even before the campaign period, which means that people will prefer to use fixed lines even before the campaign. According to this argument, it can be said that with the campaign it is mainly intended to increase the time for the existing phone calls between fixed lines, not to catch the customer base of GSM users. For the price squeeze accusation, the authority checked the price levels for the rental services in other countries, and found out that even the increased prices in Turkey were not lower than the average level of other countries. (“Turk Telekom – Rental line/ Cross subsidy” (2003) Turkey Competition Board 03-28/347-147, pp. 4) With these evidences the authority decided to drop the case.

In the last and more recent case (“Turk Telekom – Abuse of dominant position” (2008) Turkey Competition Board 08-41/556-209) Turkcell was accused with abuse of dominant position. It is argued that in its special tariffs Turkcell violated the pricing rules set for added value market and charged predatory prices. In the decision process, the authority compared Turkcell’s tariffs with the ones of complaining firm. It came out that the complaining firms’ tariffs were much higher than from ones of Turkcell, although the cost structure of the complaining firm enabled to set lower prices. The authority agreed with the argument that Turkcell was the dominant company in the relevant market, but by looking the cost structure it concluded that complaining firm did not aim to compete in prices with Turkcell. As a result the authority decided that Turkcells’ lower prices would not complicate other firms’ presence

in the market or serve to elimination of the other firm from the market, thus the case has been dropped.

5.2.4 Internet Services Market Decisions

Internet services market can be divided into two parts, one deal with the infrastructure services to internet supplying firms and the other one deal with supply of internet service to end customers. It can be classified as a sub branch of telecommunication services market, because of the nature of services supplied. In most countries, internet services related infrastructure is owned by telecommunication companies, as both sectors use same equipment in their services because of the organizational efficiency. There were three cases for predatory pricing in Turkey. Especially one case is interesting; in the sense that the arguments resemble the Wanadoo case in the European Union. It is about prices of the internet services provided to end customers. A preliminary injunction has been issued, but the end decision for this case has not been published until today.

In the first case, issued in 2002, Turk Telekom was targeted with the accusation of abuse of dominance and predatory pricing by providing infrastructure services to intermediary companies. It is claimed that Turk Telekom enforced intermediary internet services providers to rent VPOP (Virtual Point of Presence) infrastructure, which was provided by its partner company TNet. VPOP usage would hurt competition, as all internet provider firms would serve same package with same benefits. Besides of this it is stated that Turk Telekom charged predatory prices to its corporate customers in broad band internet provision. In addition to these arguments, it is also argued that TNet charged predatory prices to end customers, which is an anticompetitive strategy by itself. Infrastructure services for provision of internet were a monopolistic market in that time period, and in Turkey Turk Telekom operated as monopoly. The competition authority investigated for cross subsidy and predatory pricing arguments using a detailed cost analysis. After the cost analysis, it is declared that TNet and Turk Telekom are charging below cost prices in both broadband and dial up internet services markets. Unlike to other examples the authority has not questioned intent and recoupment arguments, and decided that these prices were predatory. (“Turk Telekom – Abuse of dominant position in internet infrastructure market” (2002) Turkey Competition Board 02-

60/755-305, pp.57-64) The authority rejected VPOP argument with the claim that VPOP usage served for efficiency in the market. (“Turk Telekom – Abuse of dominant position in internet infrastructure market” (2002) Turkey Competition Board 02-60/755-305, pp.59) Turk Telekom objected to this decision and applied to the state of council. In 2006, the competition authority issued a new decision, but its judgment did not change. It still argued that Turk Telekom was abusing its dominant position in both markets and has to be penalized for it.

In 2007, TTNNet again was accused charging below cost prices in internet providing services to end customers. The issue began with a campaign named “Yaz Fırtınası”. It is argued that the prices in this campaign were far below costs and TTNNet abused its dominant position in this market. As being the dominant player in this market, TTNNet was only questioned for below cost pricing. The committee implemented three different cost analyses for this case. In the first one, profit margins for each package provided in this campaign were analysed. Although extra costs like free modem provided to customers had not been added to this calculation, it became out, that the profit margin was positive only for two packages. It clearly showed that TTNNet could not bear its losses with this campaign in short term. (“TTNet – Yaz Fırtınası” (2007) Turkey Competition Board 07-59/676-235, pp. 10) In the next step, it has been questioned whether if TTNNet could offset its costs with these profit margins. Also at this step it has been concluded that to offset these costs seemed not possible. (“TTNet – Yaz Fırtınası” (2007) Turkey Competition Board 07-59/676-235, pp.13) As the last step, long term cost analysis has been conducted. In this part, the authority referred to Wanadoo Case, and emphasized the similarity between two cases. Thus Turkish Competition Board used a similar test structure including long term gains, but the result did not changed. (“TTNet – Yaz Fırtınası” (2007) Turkey Competition Board 07-59/676-235, pp.13-14) After this investigation, the authority issued a temporary decision and stopped the campaign until the end decision has been declared. As a note, until now, the Competition Authority did not publish its final decision about this case.

Another important case has been about the campaigns “TumEvIsAvea320”, “Sirketler icin ADSL” done by TTNNet and Avea, and “Ucretsiz Ev/Is Arama Firsati” done by Avea, respectively in internet services and telecommunication services markets. These two firms have been accused with abuse of dominant position, in the markets they operate. Charges including predatory pricing, cross subsidy, bundling and tying exercises and price squeeze

have been analysed by the authority. In the first part, related with campaigns ““TumEvIsAvea320”, the competition committee admits that TTNNet is dominant player in ADSL market. But it has been added that as the products promoted in these campaigns could also been bought independently, thus tying and bundling accusations could not be valid, which freed TTNNet from charges. By the analysis, competition authority did not only include the position of firms, it also investigated the cost structure of the products and other quantitative criteria like the number of participants to the campaign, the magnitude of discounts given to consumers, consumer preferences and related products characteristics. (“Avea – TTNNet – Predation” (2008) Turkey Competition Board 08-57/912-363, pp.12-16)

By the analysis of the other two campaigns, the authority checked for cross subsidy and price squeeze practices. It has been stated that cross pricing (subsidy) charges could be valid, if and only if there exists predatory pricing, thus predatory pricing argument has also been investigated. When analysed for predation, again other criteria then price – cost structure have been added to the picture. In the decision it has been stated that the campaign could not be evaluated as predation, as recoupment and intent criteria could not be affirmed by looking to the evidences. (“Avea – TTNNet – Predation” (2008) Turkey Competition Board 08-57/912-363, pp.44)

6. ANALYSIS OF THE PRACTICES OF US&EU&TURKEY

6.1 Intent- Recoupment

Intent and recoupment are important key elements of predatory pricing as well as economic dominance and extraordinary low prices. As explained in previous chapters, in basic terms intent can be defined as the willingness of the dominant firm to deter its competitors with predatory prices. Recoupment on the other hand can be defined as the chance of offsetting losses occurred in predatory period with higher prices charged afterwards. Although it seems that they are closely tied together, the existence of intent does not always imply that recoupment strategy will succeed for sure. Hence, US and European competition authorities tend to consider both arguments separately.

In the first period of US predation history, intent has been considered as an important proof for predation, but afterwards this perception changed. It has been claimed that some arguments in internal documents, which were mostly showed as proof of intent, can be because of harsh competition as well as intent for predation. Thus, intent has been evaluated as a subjective argument. In addition to these statements, a firm, which would involve in predation, would act more carefully, in order to hide its true aim. (Bishop 1992, 3). Because of these reasons, US authority tends to incorporate recoupment into the analysis. Result of intent has been questioned in detail and the prices will be accepted as predatory if and only if recoupment will occur with high probability. Otherwise intent is accepted as a sign of harsh competition. Even if the predator aims to deter entry of other firms in the market and hurts competition, it will not be stated as predation without recoupment. Thus, US authority integrated intent analysis into recoupment and in a way eliminated it.

As US competition authority's decisions are more likely affected by the classical economic theory, which does not accept the existence of predatory pricing in real life. Thus, the authority tried to complicate to prove predatory pricing. By adding recoupment test into the picture, it expected from the plaintiff to prove the probability of getting profits in the long run as result of predation. With this approach the cases were more likely to be rejected, as recoupment is a difficult factor to prove for sure.

The European authority appraised intent test as a tool for understanding the strategic behavior of the predator. A decision taken only after cost analysis will not be enough for determining the real aim of the dominant firm. AKZO case is an important example for showing the importance of intent analysis. By looking only at cost structure and prices, it could be concluded that AKZO had not been involved in predation, as it charged prices higher than the average variable cost level. But the internal documents and strategic moves of AKZO in different markets indicated predation, as they all served nothing but to expel ECS from plastics market. Besides in European Union unlike US, proof of intent requires a systematic evaluation of economic and non-economic factors and depends not only subjective criteria.

In European authority decisions, recoupment is not seen as a necessary precondition for proving predation. Unlike US, in EU experiences intent is taken more seriously into consideration, as it is assumed that predation can occur in real life and is a serious threat for competition. This assumption is in accordance with modern economic theory, which is followed in decisions of European Authority. Besides of these statements, it can be concluded that European authority integrates implicitly recoupment in decisions under abuse of dominant position argument. AKZO case can be shown as an example for this claim, too. In the decision it is claimed that the predator aimed to expel its competitors from the market and increase prices afterwards to gain monopolistic profit, which can be thought as a different definition of recoupment. (AKZO case, para 71)

Turkish competition law is inspired by European Treaty, but by the analysis of intent and recoupment arguments, it can be said that examples lie in between classical and modern economic theory. Turkish authority takes both intent and recoupment into consideration and analyses cases according to these different indicators. Both arguments are taken as necessary preconditions for predation, thus in order to prove predation the existence of intent and recoupment probability will be questioned at the same time.

6.2 Concept of dominance

Often it is believed that predatory pricing strategy can be exercised by dominant firms, because theoretically dominant firms can more likely recoup their losses afterwards with an increase in their sales. But in real life there can be cases, in which prices below cost level were charged not by dominant firms, but by firms with smaller market share in that specific market. Although that does not seem as a reasonable strategy in the first place, it can be a reasonable one when analyzed more deeply.

This can happen because of two motives. In the first one, the firm may want to increase its market share in that specific market and become dominant. In order to get the dominant position, it can abuse its dominance in another market and charge predatory pricing in that specific one. As the firm has enough financial capabilities, it can exercise such a strategy financially and bear losses in that specific period. In other words, the firm can see this as an investment for the long run and exercise predatory pricing strategy. In the second motive, the firm can use its dominance in a closely related market and charge predatory prices, in order to strengthen its dominance in the related “main” market. Although the firm does not aim to become dominant in the market, in which it charges predatory prices, it will gain enough extra profits to recoup its losses, which can be as a matter of fact a reasonable strategy.

As explained above, predatory pricing must not necessarily be related with dominance in the specific market. To analyze financial strength of the firm instead of dominance can be seen as a more realistic approach for predatory pricing cases. Even for firms, which are not dominant in their markets, predatory pricing strategy can be seen as rational, if the firm can not act independently from its other competitors. With this pricing strategy the firm can be freed of its rivals and after being dominant it can gain extra profits in that market to recoup its losses.

Some differences can be seen if the cases in United States, European Union and Turkey are analyzed in the light of this information. United States competition authority’s approach is emphasizing concept of dominance more than European Commission. In United States, in predatory pricing cases firms were questioned at first about the dominance, which is parallel to the classical theory arguments. Brooke case can be shown as an example for this approach. As Brooke was not in dominant position in the tobacco market in US, it has been assumed

that Brooke can not recoup its losses and charges against it were rejected. In Matsushita case, objections were rejected again because of non existence of dominant position. Thus, it can be said that abuse of dominant position was the main argument in analyzing in suits in US.

In European Union, cases were investigated more detailed in terms of concept of dominant position. Three main arguments, which are dominant position, abuse of the financial strength and effect of predatory pricing strategy, were questioned in interpretation of predatory pricing suits. At least one of the arguments -abuse of financial strength and effect of predatory pricing strategy- have to be exist in the market, in which the firm operates in dominant position, in order a pricing strategy to be defined as predatory. For example, in AKZO case the market definition has been enlarged, such that both abuse and dominance has been exercised in the same market.

It can be said, that predatory pricing analysis in Turkey is more close to the United States experience in that aspect. In charges about predatory pricing, dominant position of the predator is one of the necessary conditions. Generally, it is assumed that firm has to be in dominant position in the specified market, in order to be accused with predatory pricing charges. But as well as the dominance in specified market, the dominance in related markets has also been questioned against cross subsidy arguments. If there exists a link between the predatory pricing and cross subsidy arguments, then there will be a chance to blame firms for involving in anti competitive actions. In Turk Telekom and Aycell case (2003), which has been explained earlier, the market share of Aycell in the related market has been analyzed and it came out that Aycell was not dominant. As Aycell was not dominant, prices it charged have not been considered as predatory. It has been added that Turk Telekom can not be accused with cross subsidy, as Aycell has not been involved in predatory pricing. As the result, both firms have been proven innocent because of the charges against them.

7. CONCLUSION

Basically, predatory pricing can be described as price reduction done by a firm for a short time because of factors other than efficiency. The firm mostly aims to gain or protect its market power with this strategy. After the predation period with higher market share, the firm will increase prices over the competitive level and gain extra profits to offset its losses. Thus, although lower prices are generally seen as in favor of competition, in predation cases they will hurt competition and consumer welfare in the long run.

In order to prevent predation to happen, competition authorities try to set some criteria or tests as control mechanisms. As an example, in US, where predation has been an issue for competition authorities since the beginning of 1900s, there has been some changes in the approach for analyzing predatory pricing cases. At the beginning, concept of dominance has been investigated more likely as a precondition for predation. But as time passed, new factors have been added to the “check” list. Among them Areeda and Turner’s price - cost analysis may be shown as a milestone in predatory pricing analysis. According to their proposal, low prices could be a sign of healthy competition as long as they are over average variable costs. Prices under average variable costs can be used as proof of predation, whereas prices above average total costs did not have to be questioned for predation. For prices between average variable and total costs, the plaintiff has to bear the burden of proof of predation, which means that until reversely is proven, the firm charging prices between average variable and total cost levels could not be accused with predation. This test has introduced a more systematical way into the analysis of cases.

After the Areeda and Turner cost test, there has been several different tests emerged. They mostly tried to incorporate predatory pricing analysis with quantitative analysis methods for other indicators, like intent and recoupment. Greer’s Two-Tier test can be shown as another example. He emphasized the importance of the conditions in the relevant market and proposed analyze the market, if it is appropriate for predation, before other indicators have been questioned. He stated that when the market was not suitable for predation, the probability of a firm to involve in such exercises would be lower than it has been otherwise. Thus, he added a new type of analysis into the picture, and several new tests for predation analysis came out.

Competition authorities benefited from these several tests and analyzed suits against predation in their countries. Although laws for competition were alike in most countries, the interpretation of these laws could differ from one case to another. It can be said that United States competition authority followed classical economic theory more close, whereas European competition authority pursued an approach, which is more similar to modern economic theory. Thus, their analyses of predation cases differ from each other. US competition authority depends more on quantitative proof (like cost, dominance – market share analysis, etc...) whereas European Commission tries incorporating other arguments as well. It can be said that Turkish experience lies in between these approaches. Turkish authority emphasizes the importance of cost and economic dominance analysis as well as intent and recoupment arguments. It also investigates the real aim of the firm charging predatory prices besides the factors affecting the situation.

In order to sum up, it has to be stated that predatory pricing is an important issue in competition, as the effect of lower prices on economy can be very significant. Since the proof of predation necessitates incorporating several factors affecting the market and firms, the analysis has to be done in detail. If possible, it would be better to apply the relevant tests and investigate the issue from different points of view.

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