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2 July 2015

Hong Kong Competition Law Series: Part 17

2015 - THE YEAR OF COMPETITION IN HONG KONG

Predatory Pricing

CAN LOW PRICES EVER BE A BAD THING?

Price wars among competitors are often a positive sign of healthy competition. As businesses undercut each other on price, consumers benefit from more affordable goods and services.

Although it rarely happens, excessively low prices may harm competition when a dominant business deploys a below-cost pricing strategy to damage a competitor, drive an existing competitor out of the market, and deter potential competitors from entering. Smaller competitors may not have deep enough pockets to compete with a powerful business, and, when equally efficient, but smaller competitors are driven out of the market, the predating business can strengthen its market power to raise prices and exploit consumers. Ultimately, consumers may be left with fewer choices, higher prices or reduced quality of goods and services.

WHEN DOES LOW PRICING CROSS THE LINE TO BECOME PREDATORY PRICING?

Competition law recognises that aggressive discounting and price cutting are essential, pro-competitive behaviour and generally indicate the existence of a healthy market.

Businesses may be able to afford to price lower than the competition because they are more efficient or face lower costs of production.

Thus it is not sufficient for a competitor to complain that lower prices in the market are making life difficult. A number of criteria must be met before a pricing strategy can be considered predatory:

- A business with substantial market power prices a product or service below cost[1].
- The purpose of selling below-cost is to damage, or eliminate the competition; and
- Below-cost pricing is sustained long enough that as a result:
  - » Existing competitors have exited the market;
  - » New competitors are unable to enter the market; or
  - » Competitors are unable to compete effectively.

1 In this regard, the Competition Commission has indicated that it will consider pricing below average variable cost unlikely to be economically rational, but pricing below average total cost may be legitimate commercial behavior.

In some markets predatory pricing may not be a viable strategy at all. The following market characteristics may prevent a business from recouping its losses after implementing a predatory pricing strategy:

- There are many competitors, or other competitors with market power – a predatory pricing strategy is unlikely to effectively damage the competition.
- Entry barriers are low – competitors can easily re-enter, or new competitors may enter the market after prices return to normal levels.

In the absence of a likelihood of recoupment of losses, a predatory pricing strategy would make little commercial sense.

ARE THERE JUSTIFICATIONS FOR BELOW-COST PRICING?

Genuine commercial justifications for below-cost pricing may rebut an allegation of predation or justify the effects of such pricing on the competition.

The following are legitimate reasons for a limited duration of below-cost pricing:

- The pricing strategy is connected to the introduction of a new product or service.
- Below-cost pricing is required to penetrate a new market.
- The pricing strategy is necessary to meet the competition.
- The goods sold below-cost are perishable or damaged inventory.

Next Week

Next week we will take a look at anti-competitive tying and bundling.

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