

The case

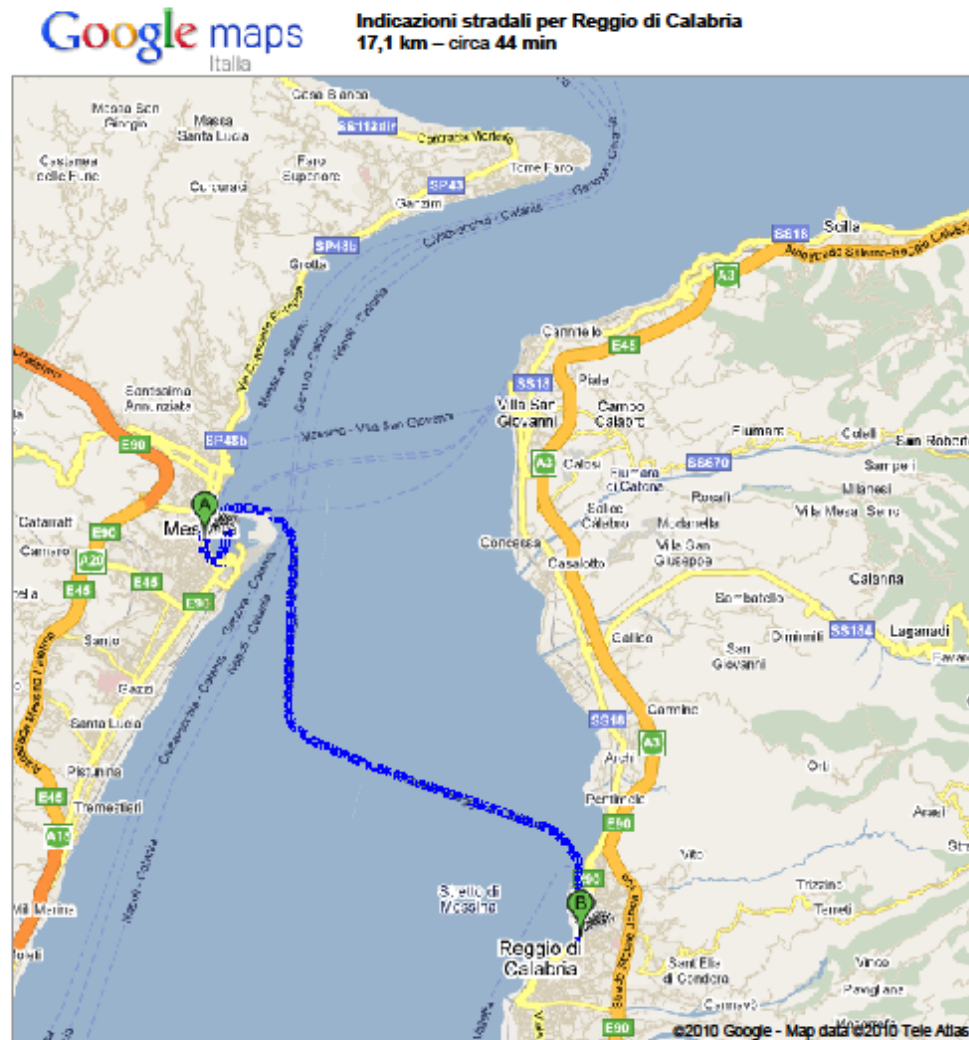
DIANO / TOURIST-CARONTE

(Decision no. 10650 (A267)
DIANO/TOURIST FERRY BOAT-CARONTE
SHIPPING-NAVIGAZIONE GENERALE
ITALIANA)

- At the national level, an important precedent in predatory pricing is the Decision about Diano / Tourist–Caronte case
- Diano Public Co. (from now on Diano) opposed Caronte Public Co. (Caronte), Tourist Ferry Boat Public Co. (Tourist) and Navigazione Generale Italiana (NGI). NGI was jointly controlled by Tourist and Caronte, that merged in a single economic subject due to a concentration process

The facts

- Before: Villa San Giovanni – Messina (VSG-ME) → ferry service for motorcycle transportation vehicles supplied by Tourist and Caronte (T-C).
- August 1998: Reggio Calabria – Messina (RC-ME) → ferry service for motorcycle transportation vehicles supplied by Diano.
- October 1998: Reggio Calabria – Messina (RC-ME) → ferry service for motorcycle transportation vehicles supplied by T-C.



- November 1998, Diano asked AGCM to intervene for presumed competition restriction by T-C, because of:
 - Charging fees under marginal costs
 - Overlapping schedules
- December 2000, AGCM begins a proceeding against T-C for (presumed) exclusionary strategy in fixing fees and schedule

Relevant economic theory

- Predatory pricing, when to intervene?
- If a firm exercise a dominant position and charges a price low enough to make negative profits.
- First of all, we must define the relevant market and then verify if the firm is dominant in the market.
- If the dominant position does exist, then we can go on to assess firm behavior and presumed abuse

Relevant market

- Market of ferry service for motorcycle transportation vehicles through Straits of Messina, excluding long-distance routes (Napoli, Salerno).
- Through the Straits, two markets: high and low quality. → Vertical product differentiation
 - RC-ME lower quality (35-40 minutes, difficult access). Higher demand, many possible courses, shorter time to wait.
 - VSG-ME higher quality (25-30 minutes, easier access from the motorway). Demand from **commercial vehicle and usual commuters** (less sensitive to schedule, much more to fees)

T-C is dominant? Yes!

- Market shares:

The table reports market share held by active firms for the period 1997-2000, based on revenues informations in ferry service through the Straits of Messina.

	T-C Group	FS	Diano
	Revenues %	Revenues %	Revenues %
1997	80	20	-
1998	79	20	1
1999	78	17	5
2000	79	17	4

- On the route RC-ME, market shares of the two involved firms suffered from stronger variations. T-C share moved from 42% to 47% with respect to revenues; hence, Diano's one moved from 58% to 53%.
- Attention to **market access conditions** by AGCM. Market access conditions on the route VSG-ME deter entry of new firms in the short run. Dominant position in this route persists in the long run (VSG is narrow, there's no room for more than 2 players, landing-places are assigned according to a four-years license). Entry in RC-ME route is easier (no bottlenecks, monthly license)

Between 1998 and 1999, VSG-ME route registered a 6% decrease in commercial passages; it's a countertendency with respect to 6,2% growth of the market as a whole. Similarly, in 2000 VSG-ME registered a 5% increase, back to 1997 levels, registering a 3,5% growth of the market as a whole and a 7% decrease on RC-ME route.

TAVOLA 2. STRETTO DI MESSINA: FLUSSI DI TRAFFICO DEI VEICOLI COMMERCIALI (n° veicoli trasportati)

Rotta	1997	1998	1999	2000
<i>V.S.Giovanni-Messina</i>	811.683	824.173	772.821	812.569
<i>R.C.-Messina</i>	-	18.933	122.635	113.891
<i>Totale</i>	811.683	843.106	895.456	926.460
<i>Tasso variazione</i>		3,9%	6,2%	3,5%

Predatory behavior? Yes!

- Consider T-C fees and schedules.
- Fees similar of or lower to Diano's on RC-ME route. Furthermore, 20% discounts to commercial vehicle in VSG-ME route.
- Frequent schedule overlapping.
- Not an easy analysis. To understand if there's a predatory behavior an assessment of T-C costs and revenues is needed with these new fees. In any case, it's hard to calculate transfer costs and prices between T-C and the controlled firm active in the RC-ME route.

TAVOLA 4 ROTTA REGGIO CALABRIA-MESSINA: CONFRONTO TARIFFE NGI-DIANO

	dal 14/10/98	dal 26/10/98	dal 5/03/99	dal 10/05/99	dal 29/10/99	dal 15/01/00	dal 18/12/00	dal 12/02/01
Solo andata								
NGI	7000	5715	6100	7000	6100	6100	7000	7500
Diano	7000	7000	7000	7000	7000	7000	7000	7000
Andata/ ritorno								
NGI	14000	11429	12200	14000	12200	12200	12200	12200
Diano	14000	14000	14000	14000	14000	12600*	12600*	12600*

Fonte: Dati forniti dalle parti e dalle Capitanerie di porto di Reggio-Calabria e Messina ²²¹ [Cfr.

AGOSTO 1998			SETTEMBRE-OTTOBRE 1998			OTTOBRE-GENNAIO 1998		
Diano 31/8		anticipo	Diano 13/9	NGI 1/10	anticipo	Diano 14/10	NGI 16/10	anticipo
						0.10	0.15	-0.05
						2.30		
4.30			4.30			4.50		
						6.00		
7.30			7.10	7.00	0.10	7.10	7.00	0.10
						8.00		
			9.40	9.30	0.10			
10.30						10.00	9.50	0.10
			12.10	12.00	0.10	12.00		
						12.30	12.20	0.10
13.30						14.00		
			14.40	14.30	0.10	14.50	14.40	0.10
16.30						16.00		
			17.10	17.00	0.10	17.10	17.00	0.10
19.30			19.40	19.30	0.10	19.30	19.30	0.00
						21.50		
			22.10	22.00	0.10		22.00	

- Predation Test:
 - Real costs reconstruction → *incremental costs* conception = **higher costs the firm must bear in the over-production phase with respect to the initial situation**. Incremental costs in the short- and in the long-run (the latter take into account even fixed and sunk costs).
 - Then comparing incremental costs and incremental revenues to understand if the firm is getting a loss.
 - Test: predatory behavior if the revenues are lower than the incremental costs in the **short run**. If revenues are higher than incremental costs in the **long run** dismiss the case. Doubts otherwise.

- a) in the **short run** you must consider costs of all inputs directly imputable to incremental production (in this case the RC-ME route), which will not be met anymore if that particular production would vanish (crew, fuel, insurance, port taxes, routine maintenance, variable costs of ticket offices, opportunity costs of the shipping craft);

- b) in the **long run**, you must consider costs that would be met even in case of vanishing of the increased production level. Besides of short run costs, in the analyzed case they must be considered costs for licenses and non-routine maintenance, infrastructural costs of ticket offices, and depreciation allowance of the shipping craft

- It comes out that T-C revenues on RC-ME route in 1999 and 2000 are not sufficient to cover incremental costs in the short- and, consequently also in the long-run. A 5-10% loss in the first year and a 25-30% loss in the second.
- Profits on VSG-ME route is higher than 40% both in 1999 and 2000.

Decision

- From the analysis it comes out that revenues of T-C Group on RC-ME route has not been enough to cover neither incremental long-run costs nor short run costs related to the provision of the service and that T-C Group can potentially recover all costs suffered to implement predatory strategy. We must think that providing ferry service through the Straits of Messina, T-C Group behaved in a predatory way and that this behavior is a violation of Law n. 287/90, Article 3.

- Pricing policy adopted after the entry of the rival firm has been feasible mainly because of position rents enjoyed by T-C Group in the VSG-ME route, where profits are very high. In other words, rents generated in the main route, a non-contestable market, allows the dominant firm to charge prices lower than short-run incremental average costs on RC-ME route, keeping an absolutely satisfying total revenue in the relevant market as a whole.

- Observed price strategy is aimed at preserving T-C Group's dominant position in the market of ferry services through the Straits of Messina, preventing entrant activities.
- It allowed the dominant firm to build up an aggressive *incumbent* reputation, discouraging in this way other potential entrants.
- Finally, the dominant position of T-C Group allows the firm to recoup costs of predatory strategy. As a matter of fact, once eliminated or reduced the entrant, and because of her *incumbent* reputation, dominant firm would be able to increase again price levels, recovering the loss suffered in the RC-ME route.

Fine and comments

- Fine: 4,5% of the revenues.
- For the first time *incremental costs* method was applied in Italy in alternative to variable costs method (it had been employed before just once in a US case and once more in Europe).
- Was it a coherent use of the incremental costs method?
Not really:
 - “landing licenses” and “infrastructural ticket office costs” should be considered among incremental costs if the entry in RC-ME route wasn’t considered a *per sé* exclusionary practice.
 - Staff costs (in excess)
 - Shipping craft costs (property craft, just amortized, no alternate use)