# The necessary limits to the control of "excessive" prices by competition authorities – A view from Europe

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**Abstract**

Excessive pricing is an area of competition law which differs significantly from most others. First, the notion of excessive pricing has failed to stimulate much economic analysis in Europe. This is in great part due to the fact that most studies on the economics of abusive pricing have focused on exclusionary pricing behavior, as such abuses are more frequent than exploitative ones. Moreover, excessive pricing is an antitrust offence only in a limited number of jurisdictions. There is also a widely accepted view that competition authorities are ill-suited to carry out price controls, a task which should be better left to sector-specific regulators. Because they intervene on an *ad hoc* basis, i.e. to sanction specific anti-competitive behavior, competition authorities cannot easily transform themselves into price regulators. Price regulation is a long-term effort which requires quasi-permanent supervision.

Against this background, the purpose of this paper is to review the case-law of the EU and of some of its Member States dealing with the control of excessive prices. This paper will also discuss current enforcement trends by the European Commission and National Competition Authorities, including recent cases and policy pronouncements by senior competition law officials. As will be seen, there is a growing consensus among competition agencies that controlling prices should be limited to exceptional circumstances. Moreover, where such circumstances justify them, given the inherent risks of costly mistakes and unintended adverse effects, price controls should be based on a sound economic analysis of market circumstances and carried out with the utmost caution.

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## I. Introduction

Pricing abuses represent a significant share of abuse of dominance cases initiated every year by European Union ("EU") and Member States' competition authorities. The vast majority of such cases concern "exclusionary abuses", i.e. pricing strategies adopted by dominant firms to foreclose competitors. Such strategies include a wide variety of measures, such as predatory pricing, price squeezes, loyalty rebates, selective price cuts, etc.[1] Only a small minority of cases concern so-called "exploitative abuses", which cover instances where a dominant firm is accused of exploiting its customers by setting excessive prices.[2] This paper will focus on this second category of abuses.

The control of excessive prices is based on the simple premise that, while in competitive markets the price of a good or a service should equal its marginal cost of production,[3] the same outcome is not guaranteed when the equilibrium price exceeds the competitive price due to the exercise of market power by the supplier of such good or service. In such cases, the price thus set will lead to allocative and productive inefficiencies. Consumer welfare will be affected by transfers of rents from consumers to producers (as consumers will have to pay higher prices than those prevailing in a competitive market) and production may be carried out by both efficient and less efficient firms (if prices exceed marginal costs, firms pricing above such marginal costs are able to stay in business). In such industries, preventing dominant firms from imposing "excessive" prices, i.e. prices "in excess" of the competitive prices, is thus justified by the apparent need to prevent such inefficiencies.

Yet, the deceptively simple logic put forward to justify controlling excessive prices is not without limitations. First, while this logic may apply to static industries where investments are limited and economies of scale absent, many industries exhibit dynamic features characterized by high-fixed costs (due to significant investments) and low marginal costs (due to economies of scale and scope). Forcing firms to price at marginal cost on pain of committing an exploitative abuse would lead to significant losses as firms would be unable to recover their fixed costs.[4] This would in turn deter firms from investing (as investments generate fixed costs) thereby negatively affecting innovation and growth. In these industries, which include, for instance, sectors such as information technology, consumer electronics and biotechnology, allowing firms to price above marginal cost is thus *dynamically efficient* and conducive to dynamic competition. This raises of course the problem of what an acceptable profit margin in such industries should be, a complex question which will be discussed below.

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[1] See R. O'Donoghue and J. Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, 2006, Oxford, in particular at pp.174-175.
[2] As well as, in some less frequent occurrences, the imposition of unfair trading conditions.
[3] This equilibrium price will be (i) *allocatively efficient* (as all consumers willing to pay a price in excess of the marginal cost of production will be supplied) and (ii) *productively efficient* (as goods and services will be produced by the most efficient firms, i.e. those with the lowest marginal cost of production).
[4] See S. Bishop and M. Walker, *The Economics of EC Competition Law*, 2nd ed. Thomson-Sweet&Maxwell, 2002, London at §6.19, p.191.

Excessive pricing is also an area of competition law which differs significantly from most others. First, the notion of excessive pricing has failed to stimulate much economic analysis in Europe. This is in great part due to the fact that most studies on the economics of abusive pricing have focused on exclusionary pricing behavior, as such abuses are more frequent than exploitative ones. Moreover, excessive pricing is an antitrust offence only in a limited number of jurisdictions. While high prices can lead to violations of competition rules in the EU, its Member States and a limited number of countries, most nations consider that the charging of high prices should not be controlled by competition authorities as the market will self-correct any pricing excesses by dominant firms.[5] There is also a widely accepted view that competition authorities are ill-suited to carry out price controls, a task which should be better left to sector-specific regulators.[6] Because they intervene on an *ad hoc* basis, i.e. to sanction specific anti-competitive behavior, competition authorities cannot easily transform themselves into price regulators. Price regulation is a long-term effort which requires quasi-permanent supervision. It also requires significant resources and expertise in a vast array of disciplines, including not only law and economics, but accounting and financial analysis.[7]

Against this background, the purpose of this paper is to review the case-law of the EU and of some of its Member States dealing with the control of excessive prices. This paper will also discuss current enforcement trends by the European Commission ("Commission") and National Competition Authorities ("NCAs"), including recent cases and policy pronouncements by senior competition law officials. As will be seen, there is a growing consensus among competition agencies that controlling prices should be limited to exceptional circumstances. Moreover, where such circumstances justify them, given the inherent risks of costly mistakes and unintended adverse effects, price controls should be based on a sound economic analysis of market circumstances and carried out with the utmost caution.

The remainder of this paper will be divided in six parts. Part II examines the standards set by the ECJ case-law for the assessment of whether prices charged by a dominant firm can be considered excessive within the meaning of Article 82(a) EC. This Part will focus in particular on the two-stage test adopted by the ECJ in its *United Brands* judgment. Part III reviews the significant practical difficulties encountered in ascertaining whether a price is excessive, and the potentially grievous consequences of an erroneous determination. These difficulties include: (i) finding an adequate cost measure and an appropriate profit margin; (ii) identifying proper benchmarks; and, in case of infringement; (iii) designing an appropriate remedy.

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[5] See, e.g., M. Motta and de A de Streel, "Exploitative and Exclusionary Excessive Prices in EU Law" in C-D. Ehlermann and I. Atanasiu (eds.), *What Is an Abuse of a Dominant Position?*, Oxford: Hart Publishing, 2006, p.91 at p.108 ("[E]xploitative practices are self-correcting because excessive prices will attract new entrants").

[6] Id. at p.109 ("[U]nlike an industry regulator, a competition authority's role is not to set prices, whereas an excessive pricing action de facto amounts to telling a firm that a price above a certain level would not be acceptable").

[7] See, for an illustration, F. Fisher and J. McGowan, "On the Misuse of Accounting Rates of Return to Infer Monopoly Profits", (1983) 73 *American Economic Review*, 82.

Part IV analyzes the various proposals made by law and economic scholars, as well as competition officials, to identify the (exceptional) circumstances in which competition authorities' interventions to control excessive prices might prove necessary. Part V reviews the decisional practice of DG Competition in the area of excessive pricing. Since the enactment of the EC Treaty in 1957, DG Competition has adopted only a handful of decisions condemning excessive prices charged by dominant firms. Moreover, we will explain that some of those decisions were driven by the specific circumstances of the cases and that others did not withstand judicial scrutiny. We will also see that in its recent *Port of Helsingborg* decision, the Commission rejected a complaint alleging that the fees charged by a port were excessive. The reasoning underlying this decision suggests that, in future cases, DG Competition will apply a strict standard in its assessment of allegations of excessive pricing.

Part VI briefly reviews and compares the manner in which excessive prices by dominant firms have been controlled by competition authorities in three of the EU's Member States (Germany, the Netherlands, and the United Kingdom). It concludes that while the competition authorities of these countries have been willing to investigate allegations of excessive price, they nevertheless adopted only a very limited number of decisions finding an abuse. It also shows that these authorities used distinct, and to some extent, inconsistent methodologies to assess whether the prices under investigation were excessive within the meaning of the applicable legal provisions.

Finally, Part VII contains our conclusions. We find, first, that Article 82(a) EC and equivalent national provisions allowing competition authorities and courts to control excessive prices charged by dominant firms have been enforced only infrequently compared to the bulk of the case-law on abuses of dominance. Clearly, competition authorities have focused their attention on *exclusionary* pricing measures seeking to foreclose competitors and restrict competition rather than on *exploitative* practices. Second, the reasons why such control of high prices by dominant firms remains a low priority for competition authorities are well known and generate little disagreement: (i) in most circumstances, high prices will be self-correcting as they attract new entrants; (ii) determining the level at which a price is "excessive" or "unfair" is a difficult and uncertain task; and, as already noted, (iii) DG Competition and the national competition authorities have no intention to become price regulators. Third, there is a wide consensus that controlling high prices imposed by dominant firms is undesirable in dynamic industries, where investments and innovation are critically important.

We conclude that provisions prohibiting the imposition of excessive prices by dominant firms should only be enforced in exceptional circumstances. These would occur where the following cumulative elements are present: where significant and long-lasting barriers to entry and expansion exist, where it is extremely difficult or impossible to remove them and where investments and innovation tend to be limited. Even in these circumstances, high prices may not necessarily result from exploitative behavior by a dominant firm as any price increase may simply reflect the regular operation of market mechanisms with which competition authorities should not interfere.

## II. <u>Standards set by the European courts' case-law and Member State's courts for assessing the excessiveness of a price</u>

Article 82(a) of the EC Treaty prohibits dominant firms from imposing "unfair purchase or selling prices or other unfair trading conditions".[8] While this provision is generally described as a tool forbidding excessive pricing, its reference to "trading conditions" suggests it can also be used to prevent the imposition of unfair terms and conditions by dominant firms.[9] The criteria for assessing whether a price is "unfair" within the meaning of Article 82 EC were established in some of the first competition cases brought before the European Court of Justice ("ECJ"). In its seminal *United Brands* ruling, the ECJ held that a price is deemed "excessive" when "it has no reasonable relation to the economic value of the product supplied".[10]

Importantly, the ECJ adopted the following two-stage approach for determining whether a price is excessive. Specifically, one would have to:

(i) "[Examine w]hether the difference between the costs actually incurred and the price actually charged is excessive"; and

(ii) "[I]f the answer to this question is in the affirmative, [determine] whether a price has been imposed which is either unfair in itself or when compared to competing products".[11]

In other words, a comparison between the price and the cost is first carried out to reveal the profit margin achieved by the dominant firm. If that profit margin is found to be "excessive", the dominant firm's pricing policy needs to be further investigated in order to determine whether the price is "unfair". The Court's judgment, however, did not provide further guidance on the application of the conditions comprised in this test. In particular, it did not clarify the basis on which to determine whether a price-cost difference is excessive. Similarly, it did not explain the notion of "unfair" price when applying the second branch of the test. This is problematic since terms such as "excessive" and "unfair" are inherently vague and devoid of meaning in the absence of an established economic test to determine whether a given price falls under their scope.[12] As will be seen below, these terms were somehow clarified in other judgments of the ECJ, although significant difficulties remain as to their application.

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[8] See generally on excessive pricing, R. O'Donoghue and J. Padilla, supra note 1 at Chapter 12.

[9] See, e.g., CFI, *Tetra Pak International SA v. Commission*, T-83/91 [1994] ECR II-755.

[10] See ECJ, *United Brands Company and United Brands Continentaal BV v. Commission*, 27/76 [1978] ECR-207 at §250. See also §251 ("This excess could, *inter alia*, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which would disclose the amount of the profit margin").

[11] Id. at §252.

[12] In addition, the Court brought further complexity by indicating in an *obiter dicta* that other methods could be devised to find whether a price is unfair. Id. at §253. National courts and competition authorities could thus approach excessive prices allegations through a variety of methods not necessarily mentioned by the ECJ in *United Brands*.

Unfortunately, subsequent cases referred to the ECJ only led to sporadic pronouncements on the methods applicable for establishing an excessive price within the meaning of Article 82 EC. The Court even seemed to abandon the *United Brands* two-limb test, and favor a more "integrated" approach based on various categories of benchmarking (which will be analyzed in greater detail in Part III below). In a first strand of cases, the ECJ directly compared the pricing policy of a dominant firm with the prices of equivalent firms active on neighboring geographic markets.[13] In a second strand of cases, the Court undertook to make comparisons between the prices charged by the same dominant firm (i) to various customers and (ii) over time.[14]

To date, it is thus difficult to find consistency in the standards relied on by the ECJ.[15] The most recent pronouncement of the Commission suggests that the two-limb test espoused in *United Brands* remains the relevant analytical framework for assessing whether a price is excessive. As will be further explained in Part V below, in *Scandlines Sverige AB v. Port of Helsingborg*, the Commission recalled that the evidence of an "excessive" profit margin was not sufficient in itself to establish an abuse.[16] The Commission underlined that it was bound to prove the existence of an "unfair" price pursuant to the second limb of the *United Brands* test, making thus clear that the two conditions for a finding of abusive excessive pricing set in *United Brands* were cumulative, rather than alternative. In other words, a finding of abuse can not be reached when only one of such conditions is met.

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[13] See ECJ, *Lucazeau and others v. SACEM and others*, 110/88 [1989] ECR-2811 at §25 ("When an undertaking holding a dominant position imposes scales of fees for its services which are appreciably higher than those charged in other Member States and where a comparison of the fee levels has been made on a consistent basis, that difference must be regarded as indicative of an abuse of a dominant position"). See also ECJ, *Corinne Bodson v. SA Pompes funèbres des régions libérées*, 30/87 [1988] ECR-2479 (to determine whether prices are unfair, "[I]t must be possible to make a comparison between the prices charged by the group of undertakings which hold concessions and prices charged elsewhere"). This test had already been implicitly referred to in ECJ, *Deutsche Grammophon v. Metro SB*, 78/70 [1971] ECR-487.

[14] See ECJ, *British Leyland Public Limited Company v. Commission*, 226/84 [1986] ECR-3263 at §§27-28 (where the Court recalled – in the lines of the *United Brands* language – that a price is excessive where it is "disproportionate to the economic value of the service provided". However, the Court concluded that the dominant firms' prices were excessive, because the price differential between the various services in question was not proportionate to the minimal cost differences between several services). A similar standard had already been applied in ECJ, *General Motors v. Commission*, 26/75 [1975] ECR-1367 at §12.

[15] The lack of clarity of the case-law is further aggravated by isolated rulings applying a different methodology. See e.g. CFI, *National Association of Licensed Opencast Operators (NALOO) v. Commission*, T-89/98 [2001] ECR II-515 at §72. The CFI applied an "efficient demand" benchmark, i.e. it checked whether dominant firm's efficient customers could still achieve profits, without suffering a competitive disadvantage.

[16] The decision arose from a complaint brought by Scandlines Sverige AB, a ferry operator active on the Helsingborg (Sweden) – Elsinore (Denmark) route, who sought to contest the pricing policy of the port of Helsingborg. See Commission Decision, 23 July 2004, Case COMP/A.36.568/D3 – *Scandlines Sverige AB v. Port of Helsingborg* at §158 ("In any event, even if it were to be assumed that the profit margin of HHAB [the dominant firm] is high (or even "excessive"), this would not be sufficient to conclude that the price charged bears no reasonable relation to the economic value of the services provided. The Commission would have to proceed to the second question as set out by the Court in *United Brands*, in order to determine whether the prices charged to the ferry operators are unfair, either in themselves or when compared to other ports (emphasis added)").

## III. Practical difficulties of controlling excessive prices

As seen above, excessive pricing is one of the most controversial doctrines in the field of competition law. In addition to the compelling argument that competition authorities and courts should not engage in price control, as this task is better left to specialized authorities, one reason for the controversial nature of this area of competition law lies in the insuperable practical difficulties inherent in ascertaining whether a price is excessive, and the potentially grievous consequences of an erroneous determination.

In substance, these difficulties have been encapsulated by competition lawyers and economists in three main criticisms.[17]

### A. Finding an adequate cost measure and defining an appropriate profit margin

The application of the first limb of the *United Brands* standard, which requires a determination of "whether the difference between the costs actually incurred and the price actually charged is excessive", generates two major difficulties. First, any determination of which of the dominant firms' costs should be taken into consideration is of the utmost complexity (1). Second, once this issue has been solved, the controversial question of what an acceptable profit margin is must be answered (2).

#### 1. Determining an adequate cost measure

Economic theory suggests that in a competitive equilibrium, the price of a good or a service should equal its marginal cost of production. Relying on marginal costs raises, however, a number of significant problems. First, reliance on the cost of an additional unit of output is meaningless in dynamic industries, which are characterized by high fixed costs and low marginal ones. For instance, innovative firms may invest extremely large sums of money to develop a new technology with the objective of licensing it against a royalty. While innovation generates very high fixed costs, the marginal cost of granting a single license to that technology will be equal or close to zero.[18] In innovation markets, any relevant cost measure should thus factor in the R&D expenditures of the dominant firm.[19] This leads, however, to the question of which R&D costs should be taken into account. Considering only the R&D costs directly linked to the development of a given technology would be under-inclusive as innovative firms have usually to engage in dozens of research projects to develop one successful technology.[20] The costs of failed

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[17] For a full account of these criticisms, see D. Evans et J. Padilla, "Excessive Prices: Using Economics to Define Administrable Legal Rules", (2005) 1 *Journal of Competition Law and Economics*, 97; See also M. Motta and A. De Streel, supra note 5

[18] This indeed only holds true when the innovative firm solely engages into the licensing of its technology. In contrast, if the innovative firm engages into production activities, it will incur a higher marginal cost, which will comprise production and distribution costs.

[19] See D. Geradin, "Abusive Pricing in an IP Licensing Context: An EC Competition Law Analysis", (June 2007), *TILEC Discussion Paper*, 2007-020 at p.14, available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=996491.

[20] See Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, [2004] OJ C101/2 at §8.

projects would thus also have to be taken into consideration.[21] However, accounting for such costs is a complex question on which there seems to be no consensus among economists.

Moreover, even in static industries, calculating costs – marginal or other – may be extremely complex. As pointed out by Motta and de Streel, cost calculations are even difficult for sectoral regulators (e.g., telecommunications or energy authorities), which have vast resources and substantial information on the markets they regulate.[22] Calculating the cost of production is particularly problematic in the presence of costs that are common to various products. For instance, a chemical plant may manufacture different lines of products with the same equipment, thereby making it difficult to allocate costs across these different products. There are a variety of methods to allocate common costs, none of which seems inherently superior to the others.[23] Similar facts can thus lead to different outcomes depending on the cost allocation method selected by the Court or competition authority in charge of the case in question. This very problem was recognized by the ECJ in *United Brands*: the court recognized the "considerable and at times very great difficulties in working out production costs which may sometimes include a discretionary apportionment of indirect costs and general expenditure and which may vary significantly according to the size of the undertaking, its object, the complex nature of its setup, its territorial area of operations, whether it manufactures one or several products, the number of its subsidiaries and their relationship with each other".[24]

In addition, should the calculation of the dominant firm's production costs be possible, it is well-known in economic theory that firms holding a paramount market position are not necessarily cost-efficient. The costs of the dominant firm under investigation may be abnormally high by virtue of cost inefficiencies (such as, e.g., "X-inefficiency") and therefore will constitute an inadequate benchmark for assessing the "excessiveness" of its pricing policy.[25] The ECJ recognized that difficulty in the *SACEM* case, and held that the relevant costs for the purpose of applying Article 82 EC were the costs of an "efficient firm".[26] But this statement is not particularly helpful as it is almost impossible to ascertain, in the abstract, the costs of an efficient firm on a given market.

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[21] Id. ("[T]he innovator should normally be free to seek compensation for successful projects that is sufficient to maintain investment incentives, taking failed projects into account"). See also E. Paulis, "Article 82 EC and exploitative conduct", *12th EUI Competition Law and Policy Workshop – A reformed approach to Article 82 EC*, Florence, 8-9 June 2007, mimeo at p.8 ("[I]nvestment costs should be taken into account when determining whether prices are excessive").

[22] See M. Motta and A. de Streel, supra note 5 at p.98 ("A direct calculation of the costs, which is already difficult for a sectoral regulator even when firms are subject to an accounting transparency obligation, may be virtually impossible for an antitrust authority").

[23] See, for a good account of these methods, M. Canoy, P. de Bijl and R. Kemp, "Access to telecommunications networks", *TILEC Discussion Paper, 07/2003* at pp.52 and following (these methods are i.e., equal proportionnate mark-up (EPMU), Pro-rata appointment, Incremental and stand-alone costs calculation and the "commercial negotiation" method).

[24] See, ECJ, *United Brands Company et United Brands Continentaal BV contre Commission*, 27/76 [1978] ECR-207 at §245. See also R. O'Donoghue and J. Padilla, supra note 1 at p.615.

[25] See M. Motta and A. de Streel, supra note 5 at p.97.

[26] See ECJ, *Lucazeau and others v SACEM and others*, 110/88 [1989] ECR-2811 at §29.

2. Identifying an adequate profit margin

Even when an appropriate methodology to carry out the price cost comparison has been identified, the definition of what constitutes an "excessive" margin or profit remains subject to debate. The Commission and the Courts have indeed (rightly) omitted to quantify a threshold above which profits become excessive. The case-law nonetheless indicates that dominant firms will only be sanctioned when their profit margin is "grossly exorbitant".[27] A common thread to all the cases is that Article 82 EC has been applied only when prices exceeded costs by more than 100% of the value of the product/service in question.[28]

Yet, such a margin in respect of the dominant firms' profits may, in some cases, still be overly restrictive.[29] Profit margins vary widely across industries. While in static industries small margins can often be observed as firms win or preserve market share by slightly undercutting their competitors (in which case a margin of, for instance, 25% may be exorbitant), much more significant margins (including margins over 1000%) can be observed and legitimately justified in dynamic industries. As noted above, such industries are characterized by heavy and risky investments. The risks stem from the fact that innovation is akin to a painful process of "trial and error". Firms generally experience a number of setbacks prior to developing a successful product and for that reason the road to success will very often be long.[30]

It could be argued that this issue could be addressed by including all R&D costs, including the costs of failed projects, in the costs taken into account for the price-cost comparison (see the preceding section). This would, however, ignore several important factors. First, as we have seen, computing the costs of R&D, including the costs of failed projects, is not an easy matter and there is always a risk that such costs may not be sufficiently taken into account. Second, there are situations where major innovations result from a "stroke of genius" rather than long and costly research. Imposing a cap on the profit margin resulting from a price-cost comparison would penalize the inventors of such major breakthroughs. Third, high margins in dynamic industries are hardly permanent as successful products are usually typically displaced by new products

[27] See E. Pijnhacker Hordijk, "Excessive Pricing under EC Competition Law ; An Update in the Light of 'Dutch Developments'", in Barry E. Hawk (ed.) *Fordham Corporate Law Institute*, (2002), 463 at p.474. See also J. Temple Lang et R. O'Donoghue, "The Concept of an Exclusionary Abuse under Article 82 EC", *GCLC Research Papers on Article 82*, July 2005, mimeo who explain at p.39 that Article 82 EC "[...] arguably applies only in cases where there are significant barriers to entry that cannot be overcome by investments in anticipation of monopoly rents". Available online at http://gclc.coleurop.be

[28] See E. Pijnhacker Hordijk, supra note 27.

[29] Assuming that an adequate cost measure is found.

[30] For instance, the price of a drug prescribed to patients will obviously be well above its marginal cost of production as this price generally needs to cover years of research over thousands of compounds, trials on animals and then human beings, and extremely stringent controls by health authorities. Thus, significant margins are justified by the need to compensate for the huge costs generally associated with the development of the drug in question, including the costs of failed projects, as well as those associated with the many complex procedures necessary to allow commercialization. Forcing firms to reduce their margins may thus constrain innovation.

developed by competitors. The video-game industry, for instance, has witnessed cut-throat competition between firms such as Nintendo, Sega, Sony, and more recently Microsoft, whose market shares and profits have fluctuated widely depending on which supplied the "must have" consoles and games at any given time.[31] The mobile telephony industry has similarly gone through three generations of standards since the arrival on the market of the first handsets and fourth generation standards are about to emerge.[32] In markets subject to Schumpeterian competition, the period during which substantial profits can be reaped may thus be short.

Finally, it should be noted that in its recent *Port of Helsinborg* decision, the Commission stated that even if the profit margin achieved by a dominant firm was high, or even excessive, this would not necessarily mean that its price is abusive.[33] In order to reach this conclusion, the Commission would have to proceed to the second question as set out by the Court in *United Brands* in order to determine whether the prices charged to the dominant firms are unfair, either in themselves or when compared to those imposed by competitors.[34] This second question is discussed in the next section.

## B. Identifying the appropriate benchmarks

While the first limb of the *United Brands* test focuses on a price-cost comparison to determine the excessiveness of a price, the second limb of the test suggests the need to benchmark prices. As will be seen below, the various benchmarks that have been applied by the Commission and the EC Courts to determine whether a price is "unfair" create serious difficulties.

### 1. The historical prices benchmark

In *British Leyland*, the ECJ undertook a comparison between the historical prices of the dominant firm and the prices it charged in the past.[35] The Court found that the fees had increased 600% during the relevant period, and considered as a result that they were abusive. In that case, it was manifest that the increase in fees was not justified by an increase in costs, but was a bold attempt by British Leyland to prevent parallel trade in motor vehicles.

However, in many other cases, applying such a benchmark may prove difficult. An increase in prices over a certain period may be due to a variety of factors distinct from

[31] See, e.g., D. Rubinfeld, "Competition, Innovation, and Antitrust Enforcement in Dynamic Network Industries" *Address Before the Software Publishers Association* (1998 Spring Symposium) San Jose, California March 24, 1998 available online at http://www.usdoj.gov/atr/public/speeches/1611.htm

[32] See, for a good account of the prospects in the communications industry, *Communications The Next Decade – A collection of essays prepared for the UK Office of Communications*, E. Richards, R. Foster and T. Kiedrowski (eds.), November 2006, available online at http://www.ofcom.org.uk/research/commsdecade/comms10full.pdf

[33] See Commission Decision, Case COMP/A.36.568/D3 – *Scandlines Sverige AB v Port of Helsingborg*, 23 July 2004, at §§102 and 137.

[34] Id. at §158.

[35] See ECJ, *British Leyland Public Limited Company v. Commission*, 226/84 [1986] ECR-3263.

the desire to exploit consumers. Prices may be legitimately adjusted to reflect changes in input prices (raw materials, labor costs, etc.), changes in market circumstances (end of a price war, etc.), efforts to increase margins to fund investments, etc. Moreover, in cyclical industries prices may vary significantly depending on the level of demand for the product at a given point in time.[36] While prices will decrease when demand is significantly below capacity, prices are likely to increase when demand is significantly above industry capacity. Such price increases reflect the normal competitive behavior and it would be inefficient to block them even if they resulted in periods where prices are significantly above costs. There is even a pro-competitive element in allowing such price fluctuations, as high prices are likely to stimulate entry thereby increasing the degree of competition on the market.

These difficulties may explain why "price differentials over time" is a benchmark that has hardly been used by the EC and Member States' competition authorities.

2. The geographical benchmark

In *United Brands* and *Bodson*, the ECJ compared the prices of a given product over different geographic markets.[37] In *United Brands*, the Court seemed to acknowledge that important price differentials between Member States could be deemed excessive if unjustified.[38] It thus went on to examine the price differentials charged by United Brands in several Member States. In *Bodson*, in order to determine whether prices charged by concession holders were excessive, the Court referred to the possibility of making a comparison between those prices (offered on a market which was not competitive) and "prices charged elsewhere" (on markets which were not covered by the public concession and which were therefore open to competition).[39]

A number of reasons suggest, however, that it is inappropriate to infer the "unfairness" of a pricing policy – and, accordingly, to declare it abusive pursuant to Article 82 EC – from the observation of geographic price differentials. First, preventing dominant firms from charging in some markets higher prices than in others would amount to prohibiting geographic price discrimination, a policy which cannot be

[36] See S. Bishop and M. Walker, supra note 4 at §6.19.
[37] See also, ECJ, *Ministère Public v. Tournier*, 395/87 [1989] ECR-2521 ("When an undertaking holding a dominant position imposes scales of fees for its services which are appreciably higher than those charged in other Member States and where a comparison of the fee levels has been made on a consistent basis, that difference must be regarded as indicative of an abuse of a dominant position. In such a case it is for the undertaking in question to justify the difference by reference to objective dissimilarities between the situation in the Member States concerned and the situation prevailing in all the other Member States"). Case 110/88, *Lucazeau v. SACEM*, [1989] ECR-2811 (another case concerning the level of royalties charged by SACEM for the playing of recorded music in discotheques).
[38] See ECJ, *United Brands Company and United Brands Continentaal BV v. Commission*, 27/76 [1978] ECR-207 at §239.
[39] See ECJ, *Corinne Bodson v SA Pompes funèbres des régions libérées* 30/87 [1988] ECR-2479 ("[I]t must be possible to make a comparison between the prices charged by the group of undertakings which hold concessions and prices charged elsewhere. Such a comparison could provide a basis for assessing whether or not the prices charged by the concession holders are fair") .

justified on the basis of efficiency considerations.[40] Basic economics also teach that a ban on geographic price discrimination can lead to undesirable distributive consequences.[41] When an operator sells a product or service at different prices depending on the conditions of demand in different countries, an obligation to adopt a uniform price will generally have adverse distributive consequences in the countries where prices are low. Indeed, the uniform price will certainly be higher than what consumers in those countries would have been charged in the absence of such an obligation. Mandatory uniform pricing will thus trigger a transfer of wealth from (generally poor) consumers in the low price countries to (generally rich) consumers in the high price ones. Even worse, the firm in question may simply decide no longer to serve consumers in the low price countries and focus on those in the high price countries.

In addition to the questionability of preventing price discrimination, comparing prices across geographic markets creates significant problems. A first difficulty relates to the selection of the market(s) against which prices will be compared. Markets may be selected because they present features that appear analogous to those of the markets in which the downstream firm is subject to an investigation (same size, relatively similar input costs, etc.) – and thus offer good comparators – or because they are markedly different (such as in *Bodson*) – and thus offer an interesting contrast. Yet, there may be markets where good comparators may be hard to find, as the costs and prices of a product/service may be directly linked to regulatory obligations. The insurance market is a good example of this phenomenon, as the scope of coverage typically depends on regulatory obligations which may vary significantly across borders.

A second issue relates to the need to take into account the differences in market conditions which could affect the validity of the geographic price comparisons. Prices may vary across geographic markets for a variety of reasons, such as differences in input costs, regulatory frameworks, taxes, purchasing power of the consumers, market concentration, etc. Aggressive pricing on some markets may also be a strategy used by dominant (and non-dominant firms) to stimulate sales of a product that has yet to receive consumer acceptance – a strategy commonly referred to as "penetration pricing" – or simply to respond to price cuts from competitors. In sum, the number of factors that need to be taken into account to ensure the analytical relevance of geographic price comparisons is such that this method, albeit theoretically attractive, may be hard to apply in practice.

3. The competitors benchmark

The so-called "competitors" benchmark consists in comparing the prices charged by the dominant company with those charged by its competitors.[42] Such a methodology was used in *United Brands* and *General Motors*. In *General Motors*, for instance, the

[40] See M. Motta and A. de Streel, supra note 5 at pp.112-113.
[41] See W. Bishop, "Price Discrimination under Article 86: Political Economy in the European Court", (1981) 44, *Modern Law Review*, 282, at pp.288-289.
[42] See R. O'Donoghue and J. Padilla, supra 1 at p.616.

Commission observed that the prices charged by the dominant firm were "twice as high" as the prices charged by rival agents/manufacturers for a similar service.[43]

Here again, reliance on this method is not, however, without problems. First, price differences may also be explained by different pricing strategies. For instance, new entrants may decide to price aggressively to gain market share, a strategy that an incumbent cannot necessarily afford to follow as, for instance, it may be less efficient than new entrants or, even if equally efficient, constrained in its pricing practices by competition law (e.g. by a prohibition of below-cost pricing). More fundamentally, forcing the dominant firm to reduce price differentials with competitors would have the effect of impeding competition, as lower prices may prevent entry or encourage exit.

Second, price differences among competitors may simply reflect variations in quality – in which case it is normal that the better products sell at a higher price. This problem is particularly acute where competing products, such as for instance consumer electronics goods, face some degree of differentiation. Should a competition authority assess the excessiveness of the prices of Apple's iPods by comparing them with the prices of Microsoft's Zune music player? Considering the different features of such products - despite the fact they tend to meet similar consumer needs - the answer can only be negative. The Commission recognised this problem in its *Port of Helsingborg* decision where it held it was not possible to meaningfully compare the charges imposed by the Port of Helsingborg with those of other harbors.[44]

Finally, and perhaps more fundamentally, the presence of competitors seem to suggest that the market in question is not subject to insurmountable barriers to entry.[45] As will be seen below, the existence of such barriers to entry is considered by scholars as well as by Commission officials as required for competition authorities to intervene against allegedly excessive prices.[46]

C. Designing an adequate remedy

Another significant problem arising from attempts to control prices imposed by dominant firms relates to the selection of the appropriate remedy when such prices have been found excessive.

Competition authorities can, for instance, declare that a given price is abusive and impose a fine on the infringing firm. But in general, most competition authorities are

[43] See Commission Decision of 19 December 1974, IV/28.851 – *General Motors Continental*, OJ L 29, 3 February 1975, pp.14–19 at §8.
[44] Commission decision, *Scandlines Sverige AB v Port of Helsingborg*, supra note 16 at §156 ("There would be insuperable difficulties in this case in establishing valid benchmarks which would imply that, for the port taken as reference, the profits (and the equity) related to the ferry-operations are segregated from those of the other activities. Such a comparison would need the same amount of effort for each port as the one required for the port of Helsingborg, with similar uncertainties as regards the precise level of the costs, profits and equity attributable to the ferry-operations").
[45] See M. Motta and A. de Streel, supra note 5 at p.113.
[46] See Section IV below.

reluctant to tell the dominant firm what the acceptable price will be unless they are willing to set a maximum price or profit margin. Should a competition authority nonetheless accept to provide indications on this issue, that would not be the end of the story. As pointed out by Emil Paulis, Director for Policy and Strategic Support at DG Competition:

> "intervening against excessive pricing may entail the risk of a competition authority finding itself in the situation of a semi-permanent quasi-regulator. The authority may have to come back time and again to the pricing of the dominant firm when cost or other conditions change in the industry, something that a 'generalist' competition authority is much less equipped for than proper regulators with their deep knowledge of and continuous involvement in their industries."[47]

Mr. Paulis suggests that an authority may, however, be able to establish a simple price comparison rule that can avoid such a situation. According to him, "[a]n example of such a rule could be that the dominant firm cannot charge more (or only X % more) in market A than it does in market B where the freely determined price in market B for some reason is more acceptable than the freely determined price in market A."[48] He acknowledges, however, that there may still be recurring problems with such a rule as "the dominant firm may come back after a few years claiming that conditions have changed and the rule needs to be revised."[49] This leads him to conclude that "these practical difficulties [are] so convincing and the risk of competition authorities arriving at the wrong result so great that enforcement actions against exploitative conduct in my view should only be taken as a last resort."[50]

Excessive pricing is also a form of abuse for which structural remedies appear of little help. Such remedies may be quite effective to deal with exclusionary abuses, such as for instance price squeezes or constructive refusals to supply (which often stem from the imposition of high prices on essential inputs needed by downstream competitors). As such abuses are made possible by the fact the dominant firm is vertically-integrated, structural remedies taking the form of vertical separation may prevent further pricing abuses.[51] But structural remedies are unlikely to be useful with respect to exploitative abuses since such abuses do not seek to exclude competitors, but rather to exploit consumers.

## IV. Limits to the application of Article 82(a) proposed by law and economics scholars

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[47] See E. Paulis, supra note 21 at p.3.
[48] Id.
[49] Ibid.
[50] Ibid.
[51] Recently, the Commission has shown interest for the application of structural remedies in sectors where high prices were sustained by virtue of important vertical integration. See European Commission, Press Release, "Commission energy sector inquiry confirms serious competition problems", IP/07/26 of 10 January 2007.

In light of the immense difficulties posed by the application of Article 82(a) EC to prices charged by dominant firms, the majority of scholars who analyzed this provision reached the conclusion that it should be implemented only in a narrow set of circumstances.

For instance, Motta and de Streel argue that competition authorities should only carry out excessive pricing investigations when the following conditions arise simultaneously:

i. High and non-transitory barriers to entry must be present on the market in question;
ii. The presence of a monopoly (or near monopoly) that results from current or past exclusive or special rights (i.e., legislation giving monopoly rights to one firm or limiting the number of firms that can intervene on a given market). Importantly, the authors specify that prices should not be subject to controls when the monopoly (or near monopoly) was acquired or maintained through investments as such controls could affect incentives to invest;
iii. There should be no effective way for the competition authority to eliminate the entry barriers; and
iv. There should no sector-specific regulator.[52]

Evans and Padilla also argue that an interventionist approach to excessive prices should be limited to situations responding to the following cumulative conditions:

a. "[T]he dominant firm enjoys a (near) monopoly position in the market, which is not the result of past investments or innovation, and which is protected by insurmountable barriers to entry";
b. "[T]he prices charged by the firm widely exceed its average *total* costs"; and
c. "[T]here is a risk that those prices may prevent the emergence of new goods and services in adjacent markets."[53]

There is a fair amount of convergence between these two proposed tests. First, both tests provide that interventions should be limited to circumstances where high and non-transitory barriers to entry can be identified in the market in question. Second, the dominant firm must enjoy a (near) monopoly position in the market, which is not the result of past investments or innovation. The Motta / de Streel test suggests that this position must have resulted from current or past *exclusive* or *special* rights. These conditions – the presence of a (near) monopoly right not justified by investment, but for instance created by statute – correspond to the majority of the excessive pricing decisions adopted by the Commission (*General Motors*, *British Leyland*, and *Deutsche Post II*) Perhaps, the greatest insight from these conditions is that competition authorities should not seek to control high prices in *dynamic* industries. As discussed above, placing a cap on profits in such industries would discourage investments and impede innovation. This

[52] See M. Motta and A. de Streel, supra note 5 at pp.109-112.
[53] See D. Evans and J. Padilla, supra note 17 at p.122.

would in turn harm dynamic (Schumpeterian) competition and in the medium to long-term hurt consumers, which would be deprived of the new, innovative products and services resulting from this form of competition.

The two proposed tests seem to diverge, however, in some fashion. Conditions (iii) and (iv) of the Motta and de Streel test are not referred to by Evans and Padilla, but it does not mean that they are inconsistent with the test they propose. As pointed out by Motta and de Streel, these latter conditions are essentially of an institutional nature whereas Evans and Padilla's test focusses on substantive conditions. The main differences between the two tests relate to conditions (b) and (c) of the Evans and Padilla test. Condition (b) requires that the prices charged by the dominant firm widely exceed average total cost. This is not a particularly contentious condition and it seems once again to be in line with the decisional practice of the Commission and the case-law of the ECJ. In *British Leyland*, for instance, the certificate fees for motor vehicles found excessive by the Commission had increased by 600% during the period under examination.[54] Similarly, in the *ITT/Promedia* case – which was settled prior to the adoption of a formal decision – the Commission was concerned that the prices charged by the Belgian incumbent telephony operator to publishers of telephone directories were almost 100% above the costs it incurred for the collection, treatment and provision of data to the publishers of directories.[55]

Condition (c) of the test proposed by Evans and Padilla, which requires a risk that the prices in question be such as to prevent the emergence of new goods and services in adjacent markets, is somewhat less straightforward. This condition seems to suggest that competition authorities should only care about excessive prices when they have exclusionary effects. One example of such a situation can be found in the so-called *Deutsche Post II* case in which Deutsche Post charged the full domestic tariff on mail coming from abroad but containing a reference to Germany (e.g., in the form of a German reply address).[56] The Commission considered that the tariff charged by Deutsche Post to foreign postal operators to distribute the incoming mail to the German addressees was above costs (as the costs related to the distribution of incoming international mail only represented 80% of the costs of distributing domestic mail) and decided that Deutsche Post, which at the time still enjoyed a monopoly for the distribution of mail, had abused its dominant position. The interesting part of this case relates to the fact that by imposing the full domestic tariff to incoming international mail, which originated in Germany (unless typical incoming international mail which originates abroad), Deutsche Post was not seeking to exploit its market power on the market for the distribution of mail, but to prevent so-called re-mailing practices, whereby some of its German customers sent abroad mail that was intended to German addressees (i.e., purely domestic mail) to benefit from cheaper rates offered by foreign postal operators. Deutsche Post's

[54] See ECJ, *British Leyland Public Limited Company v. Commission*, 226/84 [1986] ECR-3263 at §25.
[55] See European Commission, Press Release, "Settlement reached with Belgacom on the publication of telephone directories - ITT withdraws complaint", IP/97/292 of 11 April 1997.
[56] See Commission Decision of 25 July 2001, COMP/C-1/36.915 – *Deutsche Post AG – Interception of cross-border mail*, OJ L 331/40, 2001.

excessive prices thus did not have exploitation as their primary objective. They rather sought to prevent foreign operators from competing for the provision of domestic mail.

Interestingly, in a recent paper already referred to above, Mr. Paulis of DG Competition reviewed the Motta/de Streel and the Evans/Padilla tests. Mr. Paulis agrees with the condition, found in both proposed tests, that "intervention should [...] be limited to markets characterized by very high and long lasting barriers to entry", to which he would however add barriers to expansion.[57] In contrast, Mr. Paulis is "not convinced by the proposal to restrict intervention to situations where current or past exclusive or special rights are the cause of the dominant position."[58] He is also not convinced by the condition that excessive pricing inquiries should be limited to situations where there is no specific regulator as "[t]he Commission should maintain the option to intervene when a national regulator is not acting or is taking decisions that are not in conformity with Community law".[59] Mr. Paulis is not suggesting that the Commission should substitute itself to sector-specific regulators, which are better suited to engage in price controls, but only to intervene in the narrow situation where these regulators fail to properly discharge their price control duties.[60] Finally, Mr. Paulis is not seduced by condition (c) of the Evans/Padilla test as he does not think – without, unfortunately, explaining why – that the Commission's intervention should be limited to circumstances where this condition is present.[61] Mr. Paulis thus concludes his review of the proposed tests by stating that the only reasonable criterion that can be used to identify markets that could be candidates for interventions against excessive prices is the presence of "very high and long lasting barriers to entry and expansion."[62]

But does the above turn Mr. Paulis into an interventionist civil servant with respect to price controls? The answer can only be in the negative in light of the following passage from his paper:

> "There are two basic reasons why enforcement actions against excessive prices are particularly difficult – and especially so for a "generalist" competition authority. First, determining whether a specific price is "excessive" involves complicated comparisons of prices with costs of production and investment. This may involve difficult decisions about the profitability of a dominant firm. Determining whether a price is excessive may also involve difficult comparisons with whatever useful "benchmark" prices can be identified. [...]
>
> Second, intervening against excessive pricing may entail the risk of a competition authority finding itself in the situation of a semi-permanent quasi-regulator. The authority may have to come back time and again to the pricing of the dominant firm when cost or other conditions change in the industry, something that a "generalist" competition

[57] See E. Paulis, supra note 21 at p.6.
[58] Id. at p.7.
[59] Ibid.
[60] Ibid.
[61] Ibid. at p.8.
[62] Ibid. at p.6.

authority is much less equipped for than proper regulators with their deep knowledge of and continuous involvement in their industries.

I consider these practical difficulties so convincing and the risk of competition authorities arriving at the wrong result so great that enforcement actions against exploitative conduct in my view should only be taken as a last resort. In many markets prices may temporarily be high but once market forces have had the time to play out the prices will come back to more normal levels. In such cases it would be unwise to run the risk of taking a wrong decision and furthermore spend enforcement resources on solving a problem that would solve itself over time anyway (emphasis added)."[63]

Thus, the main thrust of Mr. Paulis' paper seems to be that while competition authorities should retain the ability to control excessive prices (as provided by Article 82(a) EC), they should only do so in the presence of "very high and long lasting barriers to entry and expansion". In addition, because of the difficulties raised by the control of high prices, intervention should be a matter of last resort, i.e. in situations where the Commission is unable to tackle these barriers to entry and expansion when, for instance, such barriers result from exclusionary abuses. It is thus only in the presence of "natural" barriers to entry that the Commission should intervene against excessive prices.[64]

## V. Decisional practice of DG Competition

During the period 1957-2002, DG Competition adopted only four formal decisions condemning a dominant firm for charging excessive prices (*General Motors*, *United Brands*, *British Leyland*, and *Deutsche Post II*). Three of these decisions were atypical and two of them were struck down by the ECJ.

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[63] Ibid. at pp.2-3.

[64] The views of Mr. Paulis are not isolated within DG Competition as, for instance, Philip Lowe, Director General of DG Competition declared in 2003 that:"…[The Commission is] aware that it is extremely difficult to measure what constitutes an excessive price. In practice, most of our enforcement focuses therefore as in the US on exclusionary abuses, i.e. those which seek to harm consumers indirectly by changing the competitive structure or process of the market…..And in my view, we should continue to prosecute such practices where the abuse is not self correcting, namely in cases where entry barriers are high or even insuperable." P. Lowe, "How different is EU anti-trust? A route map for advisors – An overview of EU competition law and policy on commercial practices" [Speech] ABA 2003 Fall Meeting. Interestingly, Mr. Lowe seems to have more sympathy than Mr. Paulis for the argument that enforcement against excessive prices should be limited to situations where the dominant firms were former statutory monopolies as he added the following sentence to the above statement: "It probably makes also sense to apply these provisions in recently liberalized sectors where existing dominant positions are not the result of previous superior performance." In March 2007, Mr. Lowe confirmed this view in stating that: "High prices certainly harm consumers in the short run. But is that a sufficient case for intervention by a competition authority? What if high prices would in the medium term attract entry and spur competition? If there are no high or insurmountable barriers to entry, it might well be that high prices are actually likely to be, on balance and with a longer term perspective, good for consumers. There is much more for consumers to gain through increased competition than a mere decrease in prices: competition brings more choice, scope for differentiation in quality, innovation, etc." P. Lowe, "Consumer Welfare and Efficiency – New Guiding Principles of Competition Policy?" 13th International Conference on Competition and 14th European Competition Day, Munich 27 March 2007.

*General Motors*, *British Leyland*, and *Deutsche Post II* were atypical for the following reasons. In the first two cases mentioned the Commission did not really seek to prevent the dominant firms in question from exploiting their dominant position on a given market, but sought to prevent them from hindering parallel trade between Member States.[65] In *General Motors*, the Commission decided that General Motors had violated Article 82(a) by charging excessive prices for the delivery of type-approval certificates (over which it had a legal monopoly) for new General Motors cars imported into Belgium. In that case, General Motors' objective was not to exploit its legal monopoly in the provision of conformity certificates, but to discourage parallel imports of Opel cars from other EU Member States into Belgium. While in the appeal lodged by General Motors the ECJ supported the reasoning of the Commission, it nevertheless annulled the decision on the grounds that General Motors had voluntarily reduced its price for the service in question and refunded the excess amount as soon as it realized that its prices were too high.[66] Similarly, in *British Leyland*, the car manufacturer demanded a high price for the issuance of type-approval certificates as a way of discouraging individuals from importing cars from Member States where they were sold at lower prices.[67] The price was condemned as excessive, but viewed by the ECJ as part of a policy of maintaining price differential across Member States rather than as an attempt to reap monopoly profits.[68] Finally, as seen above, in charging the full postal tariff for the distribution of incoming international mail originating from Germany (so-called remail), Deutsche Post was not such much seeking to exploit its monopoly in the distribution of mail as preventing remailers from competing on the German market for domestic mail. By the same token, Deutsche Post was preventing its domestic customers from benefiting from the development of an internal market in postal services.

Although some cases initiated by the Commission against excessive prices during that period did not lead to a formal decision,[69] the small number of decisions adopted by

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[65] See M. Motta and A. de Streel, supra note 5 at p.107.
[66] See ECJ, *General Motors v. Commission*, 26/75 [1975] ECR-1367 at §22.
[67] See ECJ, *British Leyland Public Limited Company v. Commission*, 226/84 [1986] ECR-3263 at §29.
[68] Id. See also D. Geradin and N. Petit, "Price Discrimination Under EC Competition Law: Another Antitrust Doctrine in Search of Limiting Principles?", (2006) 2(3) *Journal of Competition Law and Economics*, 479.
[69] Note that, in the telecommunications field, the Commission also intervened against high prices on a few occasions at the end of the 1990s. Its enquiries did not lead, however, to the adoption of formal decisions as the cases were eventually taken over by the national telecommunications regulators. In July 1998, for instance, the European Commission opened in-depth investigations into a number of cases relating to fixed-mobile interconnection rates on the ground that these rates were excessive. See IP/98/707 of 27 July 1998 and IP/98/141 of 9 July1998. After a short inquiry, the Commission closed some of these files on the ground that the investigated firms had voluntarily decided to lower their rates. In other cases, it stayed its proceedings in view of action taken by the national regulatory authorities. See "Commission closes mobile telecommunications cases after price cuts", IP/98/1036, 26 November 1998. This example suggests that the Commission has intervened to control excessive prices on a greater number of occasions than the formal decisions mentioned above. But these cases, as well as some other cases initiated by the Commission at the end of the 1990s, responded to particular circumstances. After spending much of the decade trying to create competition in the telecommunications sector though liberalization measures, the Commission was impatient to see its efforts translating into lower prices for the consumers. In this sector, former monopolies benefited from incumbency advantages and retained some form of natural monopolies. Another specific

the Commission tends to suggest that it has generally refrained from investigating exploitative price abuses and focused instead on prosecuting exclusionary pricing practices (for which the number of decisions adopted is much more significant). The Commission's approach was aptly summarized in its XXIV$^{th}$ Report on Competition Policy (1994) in which it stated:

> "[t]he existence of a dominant position is not in itself against the rules of competition. Consumers can suffer from a dominant company exploiting this position, the most likely way being through prices higher than would be found if the market were subject to effective competition. The Commission in its decision-making practice does not normally control or condemn the high level of prices as such. Rather it examines the behaviour of the dominant company designed to preserve its dominance, usually directly against competitors or new entrants who would normally bring about effective competition and the price level associated with it (emphasis added)."[70]

Since 2002, the Commission has adopted only one formal decision with respect to exploitative abuses. In *Port of Helsingborg*, the Commission rejected a complaint by Scandlines, a ferry operator, that the port of Helsingborg had abused its dominant position by charging excessive and discriminatory port fees.[71] As regards the allegation of excessive pricing, the Commission drew the conclusion that it possessed insufficient evidence to conclude that the port charges had no reasonable relation to the economic value of the services provided by the port to the ferry operators. This decision is interesting for a number of reasons.

First, as noted above, the Commission confirmed that the two parts of the *United Brands* must be satisfied to prove the presence of excessive prices contrary to Article 82(a) EC: "While a comparison of prices and costs, which reveals the profit margin, of a particular company may serve as a first step in the analysis (if at all possible to calculate), this in itself cannot be conclusive as regards the existence of an abuse under Article 82."[72] A high profit margin cannot thus be sufficient to evidence an abuse. In order to establish an abuse, the Commission must assess the costs actually incurred by the dominant firm in providing the products/services in question (the costs of production) and make a comparison with the prices actually charged (first step). It must then assess whether the prices are unfair when compared to prices charged by competitors, or whether the prices are unfair in themselves (second step).[73]

Second, the Commission decision illustrates the fact that it will not easily accept that another product/market constitutes a relevant benchmark. The Commission explained that in the case at hand it was not possible to draw any conclusion from comparisons with other ports, as regards the level of their respective fees, for the following reasons: (i) each port established its own specific charging system; (ii) most of the ferry-owners had

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aspect of this line of cases, it that, because of the complexities of controlling prices, the Commission has whenever possible transferred such cases to sector-specific regulators.

[70] See European Commission, XXIVth Report on Competition Policy 1994, §207.

[71] See Commission Decision, *Scandlines Sverige AB v Port of Helsingborg*, supra note 16.

[72] Id. at §102.

[73] Ibid. at §103.

individual agreements with the port in question whereby they paid less than indicated in the official tariff on which a comparison would be based; (iii) the list of services provided within the port charges varied between ports; and (iv) each port differed substantially from the others in terms of their activities, the size of their assets and investments, the level of their revenues and the costs of each activity. The Commission concluded that a comparison of the prices must be made on a consistent basis. In the case in point, this notably implied that (i) the products/services provided were comparable and (ii) the charging systems could allow a meaningful comparison.

Third, in *Port of Helsingborg*, the Commission considered that "determination of the economic value of the product/service should also take account of other non-cost related factors, especially as regards the demand-side aspects of the product/service concerned."[74] This means that the higher prices imposed by a dominant firm may simply reflect the fact that the product/service they provide has greater value for the consumers (e.g., due to the prestige of the brand, etc.) than comparable products /services provided by competitors. As pointed out by the Commission, "[t]he demand-side is relevant mainly because customers are notably willing to pay more for something specific attached to the product/service that they consider valuable. This specific feature does not necessarily imply higher production costs for the provider. However it is valuable for the customer and also for the provider, and thereby increases the economic value of the product/service."[75]

In this unusually long decision, the Commission explains in detail why it decided to reject the Scandlines complaint and makes clear that the *United Brands* test is strict (because it requires that its two limbs be met to justify a finding of abuse) and that it will not be easily convinced by complaints alleging that a dominant firm has committed an abuse by charging an excessive price. The Commission thus placed on itself a heavy evidentiary burden to demonstrate in future cases that prices charged by dominant firms should be condemned as violations of Article 82(a) EC.

## VI. The control of excessive pricing in Germany, the Netherlands, and the United Kingdom

This Part briefly reviews and compares whether and how excessive prices charged by dominant firms have been controlled by competition authorities in three of the EU's Member States. We successively review the control of excessive pricing in Germany (A), the Netherlands (B) and the United Kingdom (C). Section D contains a short comparative analysis. For each of the Member State surveyed, we address in turn the legal basis allowing the national competition authority/national courts to control excessive prices, the methodologies adopted to control such prices, and the relevant case-law. These countries have been selected due to the fact that it is generally accepted that they have sophisticated competition policies enforced by well-staffed and active competition

[74] Ibid. at §226.
[75] Ibid. at §227.

authorities.[76] The number of excessive pricing investigations is thus likely to be much lower in other Member States of the EU.

## A. Germany

### 1. Legal basis

The legal basis for dealing with excessive pricing under German law is Article 19(1) and (4) of the "Act against Restraints of Competition" (ARC). According to Article 19(1) ARC "the abusive exploitation of a dominant position by one or several undertakings is prohibited." The control of excessive prices in German law relies predominantly on Article 19(4) ARC, which supplements Article 19(1) with a number of examples of abuse practices.[77] Pursuant to Article 19(4), an abuse may be deemed to arise in particular if a dominant undertaking "demands payment or other business terms which differ from those which would very likely arise if effective competition existed" or "demands less favorable payment or other business terms than the dominant undertaking itself demands from similar purchasers in comparable markets".

### 2. Test applied to determine excessive pricing

It results from the limited excessive pricing case-law (see subsection 3, below) that the legal test used by the Bundeskartellamt (hereafter the Federal Cartel Office or "FCO"),[78] the Oberlandesgericht (OLG) Düsseldorf[79] and the Bundesgerichtshof ("BGH")[80] to determine whether a dominant undertaking applies excessive prices – generally dubbed as "Vergleichsmarktkonzept" – can be decomposed in four steps, which are described hereafter. [81]

#### 2.1. Determination of the benchmark price

Pursuant to Article 19(4) prices can be excessive in two sets of circumstances.

First, this will be the case where they "differ from those which would very likely arise if effective competition existed" ("als ob Wettbewerb"). This means that the FCO has to use as a hypothetical benchmark the price that would prevail "as if" ("als ob") competition existed on the relevant market. In practice, the FCO will typically use as a benchmark the prices set by undertakings operating in markets where effective

[76] Other Member States could have been added, but they would have burdened the analysis without necessarily adding much.

[77] See Götting, in: Loewenheim/Meessen/Riesenkampff, Kartellrecht, Bd. 2, GWB, §19, para 58.

[78] The FCO is the competent authority for dealing with cartels, abuses of dominant positions and merger control in Germany. It applies domestic law as well as Articles 81 and 82 EC.

[79] The OLG is the Higher Regional Court which has exclusive competence for appeals against decisions of the FCO.

[80] The BGH is the German Supreme Court. It is competent for appeals against decisions of the FCO.

[81] Other tests, such as tests based on the assessment of whether profits are reasonable, are evoked in the German legal literature. However, such test is largely rejected (see Möschel in Immenga/Mestmäcker, GWB, 3. Auflage, §19 Rn. 157) and has until now not been applied by the BGH.

competition prevails ("Vergleichsmarktkonzept"), although this might not always be possible.[82] The FCO will specifically look at prices prevailing in other geographic markets ("räumliches Vergleichsmarktkonzept"), but may also engage in price comparisons with other relevant markets (i.e., comparable product markets or temporal markets).[83]

Second, prices can be excessive when they are higher "than [those which] the dominant undertaking itself demands from similar purchasers in comparable markets". Here the prices imposed by the dominant undertaking will be compared to the prices it charges in comparable markets, which are thus used as a benchmark.

In contrast with the tests relied upon by the European Commission and other national competition authorities, price-cost comparisons will not be carried out by the FCO, although in the *TEAG* case the FCO prohibited the inclusion of certain costs in the calculation of the fees for access to the network.[84] This form of comparison has never been embraced by the BGH, however.[85] The main reason is probably that the wording of Article 19(4) ARC invites the FCO to compare prices, rather than analyze prices in relation to costs. Moreover, as discussed above, price-cost comparisons are notoriously difficult to make and may lead to erroneous results.

### 2.2. Adjustment of price ceiling

[82] For instance, in the *Stadtwerke Mainz* case, which concerned fees for the use of electricity networks, the FCO decision was based on a comparison between the revenue that Stadtwerke Mainz achieved per kilometer network with the revenue that another network monopolist, RWE Net AG achieved per kilometer network. On appeal, the order was, however, annulled by OLG Düsseldorf on the grounds that the fixing of a revenue ceiling leads to price regulation which is outside the competence of the FCO, that the FCO drew upon a comparison with only one undertaking (RWE Net AG) and that adjustments to the benchmark price were so significant (adding 50% to the RWE price to cover for structural differences) that it became meaningless.[82] The BGH, however, subsequently annulled the decision of OLG Düsseldorf and referred the matter back to OLG Düsseldorf on the grounds that it could not be excluded that with additional fact-finding concerning the comparable market and the necessary price adjustment, the decision of the FCO might in fact be correct. The BGH judgment thus confirms that, in special cases, such as for instance those dealing with network monopolists, it might be possible to take just one other undertaking as the basis for the comparison. The case is now closed as the competence for price regulation in the electricity sector has been transferred from the FCO to the Federal Network Agency.

[83] KG WuW/E OLG 4627 – *Hamburger Bezinpreise.*

[84] In the *TEAG* case (Beschluss vom 13.2.2003 B 11-45/01) the FCO prohibited TEAG to reflect in the fees it charged for access to its network certain costs which it considered to be non-justified. It also imposed a cap on the fees which could be charged by TEAG. The FCO order was subsequently annulled by the OLG Düsseldorf because it was found that the setting of a price ceiling was outside the competence of the FCO. Also, the OLG ruled Article 19(1) and (4) ARC do not prohibit a given price calculation but only abusive prices (OLG Düsseldorf, WuW/E DE-R 1239 (1243) – *TEAG*). Therefore the inclusion of non-justified costs in calculation of the network access fees does not necessarily lead to abusive prices. The FCO must not restrict its control to factors leading to the determination of the prices, but must assess the prices as such (OLG Düsseldorf, WuW/E DE-R 1239 (1243) – *TEAG*). Since the FCO did not appeal the decision – the reason being the transfer of the competences in the electricity sector to the Federal Network Agency (TB 03/04, p. 132)[84] – the BGH did not have the opportunity to rule on the appropriateness of a price-cost analysis.

[85] It is only mentioned in the case BGH, WuW/E BGH 1445 - *Valium I.*

The prices observed on markets selected as benchmarks will, in a second step, have to be adjusted to take into account the possible presence of structural differences between these markets and the market on which the dominant firm subject to the investigation operates.[86] To make prices comparable, these differences have to be adjusted by increasing or reducing the prices observed on the markets used for the comparison. The adjustments can only take into account structural differences between markets or firms but not individual differences between firms, such as turnover or financial strength.[87] However, individual attributes and particularities may constitute an objective justification (see the fourth step discussed below).[88]

### 2.3. Substantially higher price

Under German law, an abuse can only be found if the price set by a dominant firm is substantially higher than the benchmark price identified in step 1 as adjusted following step 2 above ("Erheblichkeitszuschlag").[89] This required "margin" comes on top of the adjustment discussed in subsection 2 because it serves a different purpose. While the adjustment described in step 2 is meant to make prices comparable by taking into account structural differences, this "margin" is necessary for a finding that a higher price is really an "abuse".[90] This "margin" will be calculated on the basis of all the relevant factors.[91]

### 2.4. Objective justification

Finally, a price that is substantially higher than the adjusted prices (step 2) to which is added the margin (step 3) can still be justified in the presence of an "objective justification",[92] which must be based on a comprehensive analysis and balance of the competing interests.[93] For instance, the BGH has stated in one case that the finding of excessive pricing could be excluded if the prices applied by the dominant firm do not cover its costs after all costs have been properly allocated and all possible steps for cost-cutting have been taken.[94] Although it is generally accepted that the concept of objective justification must be applied to excessive pricing, its scope and application remain unclear.

This methodology thus seems to place a heavy burden on the FCO when it seeks to determine whether prices charged by dominant firms are excessive within the meaning of Article 19(4) ARC. It seeks to overcome the difficulty of identifying adequate benchmarks against which dominant firms' prices can be compared by providing for

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[86] KG WuW/E OLG 2053.
[87] BGH WuW/E DE-R 1513 (1518) - *Stadtwerke Mainz.*
[88] BGH WuW/E BGH 1445 – Valium I.
[89] BGH WuW/E BGH DE-R 375- *Flugpreisspaltung*; BGH WuW/E DE-R 1513 (1519) – *Stadtwerke Mainz.*
[90] BGH WuW/E DE-R 1513 (1519) – *Stadtwerke Mainz.*
[91] Id.
[92] BGH WuW/E BGH 1965 – *Gemeinsamer Anzeigenteil*; BGH WuW/E BGH 1445 – *Valium I.*
[93] Götting, in: Loewenheim/Meessen/Riesenkampf, Kartellrecht, Bd. 2, GWB, §19 Rn. 78.
[94] BGH WuW/E BGH DE-R 375 – *Flugpreisspaltung.*

various adjustments (step 2) and a kind of "security margin" (step 3). These efforts may, however, lead to other significant difficulties, such as how to properly adjust observed prices on markets selected as benchmarks and what the level of the "security margin" should be.

3. Brief overview of the case-law

There are very few cases in Germany in which the competent authority, the FCO, sought to condemn as excessive prices charged by dominant firms. The FCO opened a limited number of formal investigations, but in most cases these investigations were closed without a final decision – often following a commitment of the companies concerned not to increase prices. Only in a handful of cases was a final decision taken by the FCO; however, most of the adopted decisions were subsequently annulled or altered by the competent courts.[95] The main precedents are the *Vitamin B12* case[96] and the *Valium* cases,[97] which were decided in the late 1970s and which confirmed that excessive pricing could, in principle, be an abuse under Article 19 ARC. Until 1980, only four prohibition decisions were taken by the FCO and this picture remained unchanged after the 1980 amendment of the ARC.[98]

In the last few years, most cases dealing with excessive prices concerned network industries and in particular, fees charged by network operators for giving access to their infrastructure.[99] These cases concerned mainly the electricity sector, where a number of investigations were opened,[100] but only two decisions have been taken, in *Stadtwerke Mainz*[101] and *TEAG*.[102] Some investigations also took place in other network industries, such as natural gas,[103] water,[104] telecommunications,[105] and air transport.[106] Yet, most of

[95] Appeals against decisions of the FCO can be lodged with the Higher Regional Court in Düsseldorf whose decisions in turn may be appealed before the German Supreme Court (BGH).
[96] BGH WuW/E BGH 1435 – *Vitamin B12*, BKartA WuW/E KKartA 1482
[97] BGH WuW/E BGH 1445- *Valium* I; BGH WuW/E BGH 1678 – *Valium II*, BKartA WuW/E BKartA 1526.
[98] See Möschel, in: Immenga/Mestmäcker, GWB, 3. Auflage, §19, para. 152.
[99] In this paper we cover 1999 to 2006, as reported in the FCO´s own activity reports (Tätigkeitsberichte) of 99/2000, 01/02; 03/04 and 05/06.
[100] The first investigation was opened against e.dis Energie Nord AG; see TB 99/00, p. 130. For other investigations see in particular TB 01/02, p. 29, 36ff. Also TB 05/06, p. 30 concerning shifting of opportunity costs related to emission certificate trading.
[101]BGH WuW/E DE-R 1513 – *Stadtwerke Mainz.*
[102] See also the prohibition order of FCO concerning prices for meter and allocating services in electricity supply (TB 01/02, pa.168) has been annulled by OLG Düsseldorf on appeal (OLG Düsseldorf WuW/E DE-R1236) because OLG disagreed with the FCO´s market definition.
[103] TB 03/04, p. 139 – Coupling of gas and oil prices or additional premiums. All investigations have been closed without formal decision (vgl. TB 05/06, p. 30), since the competence to control prices has been transferred to the Federal Network Agency (see below).
[104] TB 03/04, p. 140 – discontinued following commitments. TB 05/06, p. 134 closed following undertakings.
[105] Fees for use of user data telecommunications inquiries (TB 03/04, p. 157, gegen DTAG – closed without formal decision after DTAG decreased prices by 45%)
[106] Airfare (TB 99/00, p. 28, p. 154: Berlin – Frankfurt: The 1997 decision of the FCO has been annulled by the (then competent) KG Berlin, because Lufthansa did not attain cost coverage on either of the concerned

these inquiries did not lead to a decision finding an abuse and in the few instances in which they led to the adoption of such decisions, these were subsequently struck down by the courts.

The decisions concerning network industries dealt with highly specific factual circumstances and, for this reason, the analytical framework underlying them cannot easily be transposed to other markets. First, the two electricity cases referred to above relate to pricing schemes which were of an exclusionary nature rather than an exploitative one. In both cases, the main objective of the FCO was not so much to prevent the operator of an essential network (in these cases, electricity transport networks) to reap monopoly profits as to stimulate or protect competition in downstream electricity supply markets. TEAG, for instance, was a competitor of the third parties relying on its network.[107] High network access prices could thus allow it to harm its rivals on the downstream electricity supply markets. As noted above, these cases also have to be placed in the context of the major efforts made by competition and regulatory authorities in the 1990s to create competition in network industries or at least to maintain prices at reasonable levels when competition is not yet – or will never be (natural monopolies) – present on the market.

Second, the German legislator has recently recognized the specificities of price control in the electricity and gas sectors. The specific nature of price control in such sectors is manifested in a new draft bill, which proposes the enactment of rules on excessive pricing that are stricter than the general rules applying to all other abuses.[108] Moreover, the competence for the control of prices in the electricity sector has been recently transferred from the FCO to the Federal Network Agency (Bundesnetzagentur). This prompted the FCO to close all files relating to this sector.[109] This development strengthens our view that competition authorities are poorly suited to control prices and that, because they have more resources and oversee a sector on a permanent basis, price controls are much better dealt with by sector-specific authorities.

## B. The Netherlands

### 1. Legal basis

markets. The KG´s judgment has been annulled by BGH on appeal in 1999; case finally closed without decision)

[107] In the other electricity case, Stadtwerke Mainz did not directly compete with access seekers downstream. Stadtwerke Mainz was active in the distribution of electricity only until 1999. Yet, Stadtwerke Mainz holds a 33.3% share in Kraftwerke Mainz Wiesbaden AG which supplies electricity to the company entega GmbH which has taken on the distribution of electricity in 1999 from Stadtwerke Mainz and in which Stadtwerke Mainz has a 22% shareholding. In any case, in the FCO decision it is explicitly state that competitors cannot use the network at appropriate prices and that they cannot compete without the use of the network.

[108] See Draft bill of 27 June 2007 against pricing abuses in the energy supply sector: BT-Drs. 16/5847, available (in German) at: http://dip.bundestag.de/btd/16/058/1605847.pdf

[109] See Article 58 para 2 Energiewirtschaftsgesetz..

In Dutch law, the legal basis allowing the competition authority and the courts to prohibit excessive prices is found in Article 24 of the Dutch Competition Act (DCA), pursuant to which "undertakings are prohibited from abusing a dominant position".

The legislative history of Article 24 DCA makes it clear that it is inspired by and is intended to be interpreted in accordance with Article 82 EC, and the Dutch Competition Authority ("NMa"), which is in charge of implementing the DCA, regularly finds authority for its decisions in the ECJ case-law. Decisions of the NMa can be challenged, first in an "objection" procedure before the NMa itself, and thereafter before Rotterdam District Court.

2. Test applied to determine whether a price is excessive

As a rule, the NMa assesses whether a dominant firm's prices are excessive by examining

> "whether there is too great a disproportion between the costs and the price actually charged. To determine this, the realized return is compared with a measure of the cost of capital. For this, the WACC is the measure".[110]

The NMa generally distinguishes the *cost component* and the *profit component* of the dominant undertaking's prices. Excessive prices may be the result of passing on excessive costs and/or an excessive profit margin. The NMa usually assesses first whether costs have been correctly allocated to the products or services in question, an exercise we have seen is essential when the company under investigation is a multi-product firms. It then compares the return on invested capital with the Weighted Average Cost of Capital ("WACC").[111] Only if the return is durably and significantly above the cost of capital does the NMa find that prices are excessive. In a number of cases it has particularly emphasized the need for a *durable* and *significant* excess before an abuse can be found. For the purposes of such cost and profitability analysis the NMa generally commissions an outside study.

The foregoing test is applied consistently but not without exception. In two cases concerning the rates charged by collecting societies discussed below, the NMa tested the allegedly abusive prices on the basis of an international comparison, but only after explaining that, given the nature of a collecting society's business, the normal cost analysis approach was not a suitable method.

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[110] See NMa decision of 27 September 2005, case 3528/199, *UPC*, para 40 ; see also NMa decision of 27 September 2005, case 3588/201, *Casema*, para 48, and NMa decision of 12 June 2003, case 1793/222, *Voorburg, Wasseraar & Melissen v. Casema*, para 39. All NMa decisions quoted here are reproduced on the NMa's web-site at http://www.nmanet.nl/engels/home/Index.asp (English version), where an informal English translation of some decisions is available.

[111] The determination of a firm's WACC involves a calculation of its cost of capital in which each category of capital is proportionately weighted. All capital sources – common stock, preferred stock, bonds and any other long-term debt – are included in a WACC calculation.

## 3. Brief overview of the case-law

Since the adoption of the DCA on 1 January 1998, the NMa has launched nine investigations relating to excessive pricing. At first sight, this number of cases might suggest an aggressive excessive pricing enforcement policy on the part of the NMa, but this is misleading. Firstly, there are several cases dealing with similar facts (e.g., two cases on KLM airline rates and three cases on cable television subscription tariffs). Secondly, in only one of the cases discussed below (*Interpay*) did the NMa make a finding of excessive pricing, and even that finding was dropped following an objection (an "appeal" to the NMa itself). Thus, while the NMa has been willing to entertain a number of complaints alleging the imposition of excessive prices by dominant firms, thorough inquiries led to the conclusion that such allegations were groundless. The excessive pricing decisions of the NMa are briefly summarized below.

### 3.1. The *KLM* cases

*Vereniging Vrije Vogel v. KLM* concerned the rates charged by the Dutch carrier KLM for flights between the Netherlands and the Dutch Antilles.[112] The NMa investigated these rates following two complaints, but came to the conclusion that they were not excessive and that KLM had not abused any dominant position. To reach that conclusion, the NMa first examined whether KLM's costs had been correctly allocated to its various routes, and found that this was the case. It then assessed whether tickets sold in the Netherlands (as opposed to in the Antilles or elsewhere) contributed disproportionately to KLM's profits on the relevant routes, and found that this was not the case. Tickets sold in the Netherlands contributed proportionately less to KLM's profits than tickets sold elsewhere.[113] Finally, it compared KLM's returns on each of the relevant routes with its WACC, and found that the returns exceeded the WACC only by a minor amount (the exact amount is redacted in the non-confidential published version). The NMa's finding that KLM's prices were not excessive was confirmed on appeal.

*Shiva v. KLM and SLM* was another case targeting the Dutch carrier, this time regarding alleged abusive pricing by the joint venture between KLM and SLM (Suriname Airways) on its flights between Amsterdam and Paramaribo (Suriname, South America).[114] Following a complaint, the NMa investigated KLM/SLM's airline rates on those routes but found that they were not excessive. The NMa's approach was analogous to that in *Vereniging Vrije Vogel v. KLM*. It found that KLM/SLM's costs had been correctly allocated, and that airline tickets sold in the Netherlands contributed proportionately less to profits on the relevant route than tickets sold elsewhere. Comparing KLM/SLM's profits with its WACC, the NMa found that the ratios for 1998-

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[112] See NMa decision of 8 November 2000, cases 273 and 906, *Vereniging Vrije Vogel v. KLM* and *Swart v. KLM*.

[113] The logic behind this second test is that, even if KLM's costs and profits might not be excessive, yet the prices charged in the Netherlands might make a disproportionate contribution to those profits and therefore be excessive. In the case at hand, tickets sold in the Netherlands made a lower contribution to KLM's profits than tickets sold elsewhere, hence KLM's rates could not be considered excessive on that count.

[114] See NMa decision of 8 October 2000, case 11, *Shiva v. KLM*.

1999 could indicate abuse of dominance. However, the NMa accepted that rates in any one year were not a suitable benchmark given the strong fluctuations observed from year to year. On the basis of the average ratio over the period 1998-2001, the NMa found that the actual return was only marginally above the WACC, and that KLM/SLM's prices were not excessive.

### 3.2. The cable operators cases

*Municipalities of Voorburg and Wassenaar and Mr Melisen v. Casema* was a case where in 1989-90 Casema, a cable operator, increased its subscription rates for standard packages of television channels.[115] Two municipalities and one private person filed complaints with the NMa alleging excessive pricing. The NMa rejected these. The NMa first assessed Casema's costs and, on the basis of an external study, reduced the acceptable costs by about a quarter. The NMa then compared Casema's profits (bearing in mind that reduction) with its WACC. The NMa found that Casema's profits were "no more than several percentage points" above the WACC, both before and after it increased its rates in 1999-2000.

Casema was the subject of another investigation concerning its rates for cable television and radio subscriptions.[116] The NMa first examined whether Casema was incurring unreasonable costs, and then (after correcting for unreasonable costs) looked at the ratio between Casema's return on investment and its cost of capital. The NMa found that the return on investment was "[1-2.3]"[117] times the cost of capital in 2003 and 2004, but only slightly above the cost of capital in earlier years. Given that Casema's return on investment was close to its cost of capital before 2003, the length of the investment cycle, the arrival of new technologies and the prospect of sector-specific tariff regulation, the NMa found that it was not established that Casema was achieving returns on investment which were *durably* above its cost of capital. The NMa held that, whilst Casema had achieved "reasonable to high" returns for several years, there was not too great a disproportion of a durable nature between its costs and its prices. The NMa added that the high returns on investment could act as an incentive for other undertakings to innovate. It concluded that Casema had not charged excessive prices.

The third and final case in this sector concerned UPC, another cable operator.[118] Following an increase in UPC's subscription rates, the NMa conducted an investigation, in parallel with that in the *Casema* case discussed above. Its reasoning and findings in *UPC* were analogous to those in *Casema*.

### 3.3. The collecting societies' cases

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[115] See NMa decision of 12 June 2003, case 1793/222, *Voorburg, Wassenaar & Melissen v. Casema*.
[116] See NMa decision of 27 September 2005, case 3588/201, *Casema*.
[117] The precise figure being confidential.
[118] See NMa decision of 27 September 2005, case 3528/199, *UPC*.

*KHN v. Sena* concerned a collecting society (SENA) with a statutory monopoly over the collection and redistribution of neighboring rights royalties.[119] KHN, an association of hotel, restaurant, and café businesses filed a complaint with the NMa alleging that SENA applied excessive rates. The NMa rejected SENA's complaint.[120] KHN lodged an objection (an "appeal" to the NMa itself), which was rejected. On appeal, the Rotterdam District Court annulled the NMa's decision for lack of reasoning and required the latter to rule again.[121] On 22 July 2005, the NMa issued a new decision, again rejecting KHN's complaint, on the following grounds.[122] The NMa first referred to the method of judging prices on the basis of costs, but added that this was not a suitable criterion as SENA did not incur significant costs (other than organization costs) related to the level of its rates. The NMa then compared SENA's rates with those in Belgium, Denmark, Germany and the UK for equivalent licenses (licenses for hotels, restaurants and café's) and found that SENA's rates were low to average (average for background music; relatively low for entertainment music). It therefore found that SENA's rates were not abusive.

In February 2007, the NMa published the findings of a study in which it had examined (outside the context of infringement proceedings against specific undertakings) what are the appropriate methods and criteria for judging whether the tariffs applied by collecting societies are compatible with Article 24 DCA.[123] In its report, the NMa mentions the method of examining whether tariffs are geared to costs, but states that this is not practicable where prices cannot or can hardly be related to costs, as is the case for the collection of royalties. The NMa goes on to examine two alternatives (international price comparisons and an assessment of tariff differentiation by collecting societies) but states that neither method is satisfactory. The NMa concludes that the DCA has limited value as an instrument for assessing collecting societies' rates, and calls for another form of price supervision (e.g. *ex ante* price-setting by a regulator).

In *Fresh FM v. Buma*, Fresh FM, a local radio station, lodged a complaint with the NMa alleging that Buma, an organization which has a statutory monopoly for the collection of music copyright royalties, was charging excessive rates.[124] The NMa reiterated the point it had made in its report of February 2007 that cost-geared pricing, international price comparisons and assessment of tariff differentiation are not appropriate methods. It nevertheless compared Buma's rates with those of foreign collecting societies, given that this was the only practicable (if unsatisfactory) method, and that it is consistent with ECJ case-law (*SACEM*). That comparison resulted in a mixed picture, with Buma applying sometimes higher and sometimes lower rates for a

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[119] "Neighbouring rights" are sometimes also referred to as "related rights". These are broadly speaking the intellectual property rights of performers (as opposed to authors) of works. In some legal systems this is covered by copyright.

[120] See NMa decision of 27 August 2002, case 2319, *KHN v. SENA*.

[121] See Rotterdam District Court judgement of 10 January 2005, case MEDED 03/1561 – KNP, *KHN v. SENA*, available online at www.rechtspraak.nl

[122] See NMA decision of 22 July 2005, case 2319, *KHN v. SENA*.

[123] Available online at http://www.nmanet.nl/Images/Cbo%20s%20conclusies%20NMa_tcm16-99888.pdf

[124] See NMA decision of 10 May 2007, case 3295/78, *Fresh FM v. Buma*.

comparable license. The NMa found that Buma's rates were not higher "across the board", "let alone several times higher as was the case in the Sacem judgment". It therefore rejected Fresh FM's complaint.

3.4. Other cases

In *Interpay*,[125] the NMa investigated the tariffs which Interpay, a joint venture of eight Dutch banks operating the Dutch payment (debit) card system, charged for the use of its system.[126] In its decision of 28 April 2004, it found that these tariffs were excessive and constituted an abuse of Interpay's dominant position, and imposed a fine of €30,183,000[127] on Interpay. The NMa held that Interpay was dominant on the Dutch market for payment card system services and judged Interpay's tariffs excessive on the following grounds. The NMa first assessed whether Interpay's reported costs were correctly allocated to the relevant services. On that basis, it rejected certain costs. Next it compared Interpay's Return on Invested Capital ("ROIC") with its WACC, and assessed the result on the basis of the following criterion: "If the realized return is <u>durably considerably</u> higher than the [WACC] then there will be abuse in the form of excessive tariffs (emphasis added)". The NMa found that, over the period 1998-2001, Interpay's average ROIC was 130.1% pre-tax (84.5% after tax), whilst its WACC was 13.0% pre-tax (8.5% after tax). On that basis Interpay's tariffs were judged excessive. The following three paragraphs from the decision show the emphasis placed by the NMa on the size of the discrepancy between Interpay's ROIC and WACC:

> "219. In addition, the Director-General of NMa concludes on the basis of the comparison made by Mazars that the returns realised by Interpay/BeaNet on network services for PIN transactions were five to seven times greater than the standard return for the services on a lasting basis, during the entire four-year period of the study and in each separate year. The Director-General of NMa therefore concludes that during the period of the study the returns were excessive.
>
> 220. The Director-General of NMa is therefore of the opinion that the relationship between the actual costs incurred and attributable to network services for PIN transactions and the tariff actually charged for network services for PIN transactions were greatly disproportionate. The tariffs charged by Interpay/BeaNet are therefore excessive in nature and in the light of the realised return, as set out in the table contained in paragraph 216, may clearly be regarded as unfair.
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> 221. As was stated above, the Director-General of NMa does not expect cost-oriented prices from an undertaking with a dominant position and exercises the necessary caution

[125] On 31 January 2003 and 20 December 2004 the NMa issued two more decisions concerning Interpay, following a complaint that one of the fees which Interpay charged petrol station operators for payments with MasterCard was excessive. Here the NMa found, following an *initial* investigation, that there were no indications of excessive pricing, and rejected the complaint on those grounds. These decisions arguably have little value as precedents.

[126] See NMa decision of 28 April 2004, case 2910-700, *Interpay*.

[127] The NMa also found a restrictive agreement between Interpay's shareholders, i.e. eight Dutch banks, and imposed fines varying from €500,000 to €3,900,000 on the individual banks. This aspect is not further discussed here.

before taking action against the price levels, in accordance with section 24 (1) of the Competition Act. Against this background, the Director-General of NMa considers it justified to take action in the present case. In this regard, the Director-General of NMa emphasises that it has been established that the initial losses incurred by Interpay/BeaNet were recovered fully in the years prior to the period of the study, namely 1998 up to and including 2001. In addition, the Director-General of NMa has assessed the excessiveness in the present case cautiously on the basis of the study carried out by Mazars. In calculating the standard return on the basis of the WACC, Mazars made its calculations of the beta and capital structures using considerable bandwidths and, in the choice of the various parameters, made its calculations in a manner which was advantageous to Interpay/BeaNet (for instance, the ceiling in the case of the beta and the high risk premium in the case of debt capital). In calculating the realised return on the basis of the ROIC, Mazars took the balance sheet of DCS as the point of departure, as a result of which the calculated yields were lower than the actual yield realised, which was once again to the advantage of Interpay/BeaNet. In the light of these actual economic circumstances and the fact that the realised return is in the present case (still) five to seven times greater than the standard returns, as result of which the excessiveness of the returns is proven, in the opinion of the Director-General of NMa there is due cause to take action in accordance with section 24 (1) of the Competition Act. In addition, the disproportionality is so great that the Director-General of NMa deems it hardly possible that Interpay/BeaNet cannot be aware of it".

The parties argued that the NMa should have based itself on an international price comparison. The NMa rejected this because (i) ECJ case-law does not require such a comparison; (ii) the NMa considered such a comparison would be unreliable; and (iii) foreign card system operators may (also) be charging supra-competitive prices.

Interpay and its shareholders lodged an objection against the NMa decision (i.e. an "appeal" to the NMa itself), following which the NMa withdrew its finding that Interpay's prices were excessive.[128] It decided that an assessment of the parties' arguments would require a complex and time-consuming investigation (e.g. regarding the appropriate method for calculating the ROIC and the validity of certain data), and that this would not be opportune. In reaching this view the NMa referred both to a settlement agreement between the Dutch banks and certain trade associations, and to increased competition in the market, the combination of which had resulted in a reduction in the rates paid by retailers.

## C. The United Kingdom

### 1. Legal basis

The provision of the UK competition law that deals with abuses of a dominant position is Section 18 of the Competition Act 1998 ("CA 1998"). Section 18 of the CA 1998 is closely modelled on Article 82 EC and contains what the CA 1998 calls the "Chapter II prohibition". Excessive prices charged by dominant companies are

[128] The NMa upheld its finding of a restrictive agreement between Interpay's shareholders, but reduced the fines imposed on the individual banks.

specifically caught by Section 18(2)(a), which is an exact reproduction of the wording of Article 82(a) EC. The main substantive difference between the Chapter II prohibition and Article 82 EC is one of jurisdiction. The Chapter II prohibition applies only to firms holding a dominant position (i) within the UK and (ii) whose conduct affects trade within the UK.

The authority charged with the general enforcement of the CA 1998 is the Office of Fair Trading ("OFT").[129] In addition to its general powers of investigation in individual cases of breaches of UK competition law, the OFT may also initiate more general market investigations. Such market investigations are not conducted by the OFT itself but by the Competition Commission ("CC"),[130] to which the matter is referred. Under Section 131 of the Enterprise Act of 2002 ("EA 2002"), the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts, or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.

Finally, the UK courts are also competent to apply the Chapter II prohibition in legal proceedings brought by private parties.[131] In addition, appeals of decisions taken by the OFT or by the sectoral regulators in competition law matters may be brought before a specialised jurisdiction, the Competition Appeal Tribunal ("CAT").[132]

2. Test applied to determine excessive pricing

Given that UK competition law must be interpreted in a manner consistent with EC law, the legal standard for the prohibition of excessive pricing follows the principles and legal standards identified by the ECJ for the application of Article 82 EC.[133] This is

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[129] In addition, there are a number of sectoral regulatory authorities which apply the competition law provisions concurrently with the OFT within the regulated sectors. The sectoral regulators are the Office of Communications ("OFCOM"), the Gas and Electricity Markets Authority ("OFGEM"), the Director General of Water Services ("OFWAT"), the Northern Ireland Authority for Energy Regulation ("OFREG NI"), the Office of Rail Regulation ("ORR"), and the Civil Aviation Authority ("CAA").

[130] The Competition Commission is an independent public body established by the CA 1998. It replaced the Monopolies and Mergers Commission ("MMC") on 1 April 1999. The Commission conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries. Every inquiry is undertaken in response to a reference made to it by another authority: usually by the OFT but in certain circumstances the Secretary of State, or by the sectoral regulators under sector-specific legislative provisions relating to regulated industries. The CC has no power to conduct inquiries on its own initiative.

[131] Currently, all claims arising in England and Wales pleading a breach of EC or UK competition law must be issued in or transferred to the High Court of England and Wales, which acts in practice as a specialsit jurisdiction.

[132] The CAT is a specialist judicial body with cross-disciplinary expertise in law, economics, business and accountancy. The function of the CAT is to hear and decide appeals and other applications or claims involving competition or economic regulatory issues. The CAT was created by Section 12 and Schedule 2 to the EA 2002 which came into force on 1 April 2003.

[133] Under the Chapter II prohibition, the legal test for a finding that the prices charged by a dominant firm are excessive is therefore the one laid out by the ECJ in *United Brands*, i.e. a price will be considered as excessive where "it has no reasonable relation to the economic value of the product supplied". See Guideline 414a at 2.1. In accordance with the *United Brands* test, the OFT recognises that an any judgment

explicitly recognised by the OFT in its Guideline 414,[134] which contains an extensive discussion on how the OFT will deal with excessive pricing claims under the Chapter II prohibition of the CA 1998. The methodology used to establish that a price is excessive is, however, different from the ones used by the German Federal Cartel Office and the Dutch NMa examined above.

2.1. Methodology proposed in the guidelines

The OFT will usually assess excessive pricing cases by considering (i) cost and price benchmarks and (ii) evidence of excessive profits by the dominant firm.

***Cost and price benchmarks***. In order to address whether an undertaking's prices are higher than would be expected in a competitive market, the OFT considers that the following benchmarks might be used:[135]

i. Comparisons with prices of the same products in other markets;
ii. Comparisons with underlying costs; and
iii. Comparison with prices in another time period.

The OFT notes in Guideline 414 that this list of indicators is not exhaustive and that the analysis of excessive prices will depend on the specific facts of the case in hand. To demonstrate that excessive prices had been set, the OFT will usually consider several indicators as well as the possibility that seemingly high prices are an integral part of the process of competition in the market concerned.

***Assessment of excessive profits.*** The OFT states that evidence of supra-normal profits may indicate that competitive pressure was not strong enough to keep prices at competitive levels and bolster other evidence that excessive prices were being charged. However, supra-normal profits will not always indicate competition problems (see below). According to the OFT, it is unlikely that a dominant firm would be found to have charged excessive prices solely on the evidence of supra-normal profitability.

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of excessive prices requires an analysis of costs and that the question to be asked is “whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to other competing products.” See Guideline 414a at 2.2.

[134] OFT Guideline 414a, “Assessment of Conduct”, available online at http://www.oft.gov.uk/shared_oft/business_leaflets/competition_law/oft414a.pdf

[135] See Guideline 414a at 2.7.

The OFT considers that the analysis of any excessive pricing case would also require ascertaining whether supra-normal profits could be justified as a fair return on an earlier investment.[136] Guideline 414a suggests that when assessing whether a dominant firm has earned supra-normal profits, the OFT may consider a variety of measures:

i. Economic measures of profitability include the internal rate of return ("IRR") and net present value ("NPV");
ii. Given that the period over which prices are alleged to be excessive may be less than the economic lifetime of an activity, it may be more appropriate to employ measures such as return on sales, gross margins, "truncated IRR", return on capital employed, and market valuations;
iii. Evidence on how an undertaking's profitability compares with that of similar undertakings operating in a competitive market.

In sum, and as will be illustrated below with our analysis of the *Napp* case, the OFT intends to look at a variety of factors when investigating excessive prices rather than focusing on one particular aspect like the level of prices (see Germany) or the level of profit (see the Netherlands).

2.2. Apparently high prices or profits are not necessarily excessive

As seen above, the OFT has cautioned that it is important to distinguish excessive prices from seemingly high prices that are an integral part of the competitive process. In line with the considerations we expressed above in Part III, the OFT recognizes that high prices may reflect short term shifts in demand or supply, provide a fair return on earlier investments, or act as a signal for existing and potential competitors, respectively, to expand output and to enter a market.[137] Guideline 414a provides a number of examples of cases where prices and profits of a dominant firm which, at first sight, might appear to be excessive will not amount to an abuse.[138]

First, high prices will often occur for short periods within competitive markets. For example, an increase in demand that could not be met by current capacity or a supply shock that reduced production capacity would lead to higher prices. The OFT considers that where high prices are temporary and/or likely to encourage substantial new investment or new entry, they are unlikely to cause concern.

Second, a firm might be able to sustain supra-normal profits for a period if it was more efficient than its competitors. In this case, the efficient firm might simply be reaping the rewards of having developed lower-cost techniques of production, supplied higher quality products or been more effective at identifying market opportunities.

[136] See Guideline 414a at 2.15.
[137] See Guideline 414a at 2.5.
[138] See Guideline 414a at 2.16 et seq.

Third, the OFT accepts innovation markets may be characterised by high prices and profits. As noted in Part III above, successful innovation may allow a firm to earn profits significantly higher than those of its competitors. However, a high return in one period could provide a fair return on the investment in an earlier period required to bring about the innovation. These costs include investment in R&D and should take into account the risk at the time of the investment that the innovation might have failed. In markets where undertakings innovate regularly, high profits may be temporary, for example because they act as a spur to competitors to innovate further and to the incumbent to innovate to maintain its position. Persistently high prices and profits are unlikely to be of concern if they result from a series of successful innovations, as distinct from exclusionary or collusive behaviour.

The OFT also notes it is important not to interfere in natural market mechanisms where high prices and profits will lead to timely new entry or innovation and thereby increase competition. In particular, Guideline 414 makes clear that the OFT is concerned that competition law should not undermine appropriate incentives for undertakings to innovate. Concern about excessive prices will be more likely in markets where price levels are persistently high without stimulating new entry or innovation.

In sum, the OFT clearly indicates that in most circumstances high prices do not have exploitative features and that correcting such prices may hurt the competitive process. Its emphasis on the need not to interfere with dominant firms' incentives to invest and innovate is particularly important. Reducing such incentives is indeed one of the main risks created by price controls.

3. Brief overview of the case-law

In the foregoing analysis, we introduce a distinction between the price investigations carried out under Chapter II of the Competition Act 1998 and those conducted under Section 131 of the Enterprise Act of 2002 (market inquiries).

### 3.1. Chapter II cases

The UK case-law on excessive pricing is very limited. Two recent cases, however, deserve attention. The first important case is *Napp*, the first decision made by a UK competition authority in application of the Chapter II prohibition and the only OFT decision condemning a dominant firm for excessive prices under that prohibition.[139] Napp, a small pharmaceutical company based in the UK, launched in 1980 the first sustained release morphine ("SRM") product to appear on the UK market under the name MST CONTINUS ("MST"). According to Napp, MST was the gold standard for the treatment of severe chronic pain. Napp held a patent on MST between 1980 and 1992. The patent protected the sustained release formulation rather than the morphine sulphate itself. From 1980 to 1991 MST was the only orally administered SRM product on the market in the United Kingdom. Despite the fact that Napp's patents had expired in 1992, Napp continued to hold about 95 percent of the total market for oral SRM tablets and capsules in the UK.

In its decision, the OFT identified two classes of purchasers of SRM products: (i) the "community segment", comprising patients who purchase the medicine on prescription from doctors and accounting for 90% of SRM sales; and (ii) the "hospital segment", comprising sales to hospitals under tender procedures and which accounted for the remaining sales. Napp's share of each of these two segments of the market was above 90%. Having found that Napp held a dominant position in the market for SRM products, the OFT examined Napp's pricing policy and concluded that Napp had been charging excessive prices to the "community segment" of the SRM market.

The OFT relied on two methods for determining whether Napp's prices were excessive in the community segment: by benchmarking prices and by benchmarking price-cost margins. In benchmarking prices, the OFT first observed Napp's prices to the community segment are between 33% and 67% higher than those of its competitors, and typically around 40% higher.[140] It then noted that prices in the community segment have remained largely unchanged during the 10 year period following expiry of its patent[141] and that Napp's NHS list price can be up to 10 times the prices at which MST is supplied to hospitals[142] and between 4 and 7 times higher than export prices.[143] In benchmarking price-cost margins, the OFT observed that Napp's gross profit margin on sales to the community segment was higher than 80% whilst its margin on other products sold to the

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[139] OFT Decision of 30 March 2001, *Napp Pharmaceutical Holdings Limited* [2001] UK CLR 585, available online at http://www.oft.gov.uk/shared_oft/ca98_public_register/decisions/napp.pdf
[140] Id. at §207.
[141] Id. at §213.
[142] Id.
[143] Id. at §221.

NHS was of approximately 30% to 50%[144] and whilst Napp's most profitable competitor in the community segment earned less than a 70% margin.[145] In light of the above analysis, which relied on a variety of benchmarking tests (also referred to as a "preponderance-of-the-evidence"), the OFT decided that Napp's prices on the community segment were excessive. It imposed a fine of £3.21 million on Napp for breach of the Chapter II prohibition.[146]

Napp appealed the OFT's decision to the Competition Commission Appeal Tribunal ("CCAT").[147] In a judgment handed down on 15 January 2002, the CCAT upheld the OFT's decision, ruling that all the findings of fact contained in the decision confirmed (i) that, during the period of the infringement, Napp's prices in the community segment were significantly higher than would be expected in a competitive market; and (ii) that, during the period of the infringement, there was no significant competitive pressure to bring them down to competitive levels, nor was there likely to be over any reasonable time scale.

Although this case represents a precedent in which the OFT found a dominant firm guilty of charging excessive prices, its finding of excessive pricing may in great part be due to the unusual circumstances of the case. Napp was a case including both exploitative and exclusionary prices. In other words, Napp's prices were both exploitative (on the community segment) and predatory (on the hospital segment). While the OFT chose to run the case as two separate abuses, this particular instance of excessive pricing could instead have been framed as a form of recoupment from Napp's predatory strategy, rather than as an abuse in its own right.[148] The contrast between Napp's prices for the same product on the community and hospital segments was also striking and hard to justify making in the OFT's eyes a finding of excessive pricing quite easy.

Commentators have nevertheless criticized the methodology relied upon by the OFT. While its "preponderance-of-the-evidence" approach seems to limit the risk of mistakes by relying on a variety of benchmarks, some of the tests proposed fail to convince. Evans and Padilla, for instance, note that the OFT's observation that Napp's prices have not decreased since the end of patent protection does not necessarily mean that these prices are excessive. The length of patent protection is set arbitrarily and may not be sufficient for a firm to recoup its risky investments in developing the product in question. Moreover, MST's brand recognition may have allowed it to maintain a significant premium over its generic competitors. Similarly, the comparison between

[144] Id. at §224.
[145] Id. at §226.
[146] It should be noted that the amount of the fine also took into account a finding that Napp had engaged in predatory pricing in its sales of SRM products to the hospital segment.
[147] At the time of the facts, the CCAT was the judicial body charged with reviewing such decisions. As noted at above, the CCAT has in the meantime been replaced by the CAT. See Case 1001/1/1/01 *Napp Pharmaceutical Holdings Limited and subsidiaries v Director General of Fair Trading*, judgment of 15 January 2002, available online at http://www.catribunal.org.uk/documents/JdgNapp150102.pdf
[148] See A. Fletcher and A. Jardine, "Towards Appropriate Policy for Excessive Pricing", *12th EUI Competition Law and Policy Workshop – A reformed approach to Article 82 EC*, Florence, 8-9 June 2007, mimeo.

Napp's prices in the community and hospital sectors may be misleading for the purpose of establishing of the excessiveness of the prices in the former sector. Napp's prices in the hospital being found predatory, they cannot be considered as a valid benchmark for what would be a competitive price.

In sum, and without pushing the analysis further, the *Napp* decision should be seen in the light of the circumstances of the case (where the prices of a firm are both excessive and predatory). Absent the predatory component of the case, which clearly distorted the competitive process in the hospital segment of the market, it is not clear whether the OFT would have investigated Napp's prices in the community market as a stand-alone violation of Chapter II.

The second important case, this time concerning proceedings commenced by private parties, was recently decided by the Court of Appeal. In *Attheraces*,[149] the Court of Appeal overturned what had been the first ever final judgment by the High Court finding an abuse of a dominant position in breach of Article 82 EC and of the Chapter II prohibition and giving declaratory relief. The facts were as follows. Attheraces ("ATR") supplies overseas bookmakers with a broadcast and data service covering horseracing from British racecourses. The High Court had before it a claim brought by ATR alleging that the British Horseracing Board ("BHB") had a monopoly in the supply of pre-race data to broadcasters and bookmakers who require such information for their business and had abused its dominant position contrary to Article 82 EC and section 18 of the CA 1998 by threatening to terminate the supply of pre-race data to ATR (an existing customer) and charging excessive, unfair and discriminatory prices for the horseracing data.

Although the claim was upheld at first instance by the High Court, the Court of Appeal allowed the appeal on the grounds that an abuse of dominance had not been established. The main issue under appeal was whether BHB had engaged in excessive pricing, as this allegation was central and affected the other two allegations of abuse. Relying on the test set out by the ECJ in *United Brands,* the High Court had sought to evaluate the economic value of the product by reference to the competitive price, which it considered to be the cost of producing it plus a reasonable profit (a cost+ analysis).[150] The Court of Appeal, however, found that this determination of economic value was too narrow. It found that the price of the product in a competitive market might be above or below the reasonable margin determined through a cost+ analysis.[151]

The Court of Appeal also held that, when assessing a claim of excessive pricing, it is necessary to consider all the relevant circumstances. In the case at hand, the Court of Appeal also found that there was little evidence that competition in the downstream

[149] Court of Appeal, Judgment of 2 February 2007, *Attheraces Ltd & Anor v The British Horseracing Board Ltd & Anor* Rev 2 [2007] EWCA Civ 38, available online at http://www.bailii.org/ew/cases/EWCA/Civ/2007/38.html
[150] Id. at §149.
[151] Id. at §208.

market was being distorted by the demands made by BHB on ATR.[152] In this respect, the Court of Appeal held that the High Court had erred by not taking into account the economic value of the product to the purchaser. The Court of Appeal found that it had not been shown that ATR could not make a reasonable return at the prices charged. On the contrary, ATR was making a handsome profit from overseas bookmakers.[153] The Court of Appeal considered that the benefit derived from overseas bookmakers from BHB's data had a bearing on whether the price charged was excessive.

Importantly, the Court of Appeal noted that although the price demanded by BHB might seem unfair, this was not enough to constitute an abuse. It stated that "Article 82 [...] is not a general provision for the regulation of prices. It seeks to prevent the abuse of dominant market positions with the object of protecting and promoting competition. The evidence and findings here do not show ATR's competitiveness to have been, or to be at risk of being, materially compromised by the terms of the arrangements with or specified by BHB (emphasis added)."[154]

This judgment is important for a variety of reasons. First, the Court of Appeals found that prices exceeding costs plus a reasonable margin (cost+) were not in themselves excessive within the meaning of Article 82(a) EC or the equivalent UK provision. This observation is correct and of considerable importance. Clearly, control of prices under Article 82(a) EC or Chapter II should be distinguished from the sort of rate-of-return regulation carried out by sector-specific regulators with respect to natural monopolies. Second, in line with *Port of Helsingborg*, the Court of Appeals considered that the value of a product for the buyer was relevant for the purpose of assessing the excessiveness of a price. Demand-side considerations were thus relevant factors in excessive price inquiries. Finally, the Court of Appeals noted that the price charged by BHB for its intermediate product (pre-race data) would not have the effect of driving any firm out of business on the downstream market. As pointed out by the Court, the "case [was] about who was going to get their hands on ATR's revenues from overseas bookmakers."[155] This last observation is noteworthy as it seems to add a further condition for a finding of excessive pricing, i.e. the fact that the prices in question should have an impact on downstream markets by excluding one or several firms from the market. Overall, the Court of Appeal seems to place strict limits on the application of abuse of dominance provisions to high prices.

### 3.2. Market Investigations

As noted above, the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that the level of competition in a given market in the UK is not satisfactory. Such market investigations will not concern conduct by a single firm, but focus on more general market structures and on possible remedies to make them more competitive. These inquiries have thus little in common with Chapter 2

[152] Id. at §214.
[153] Id.
[154] Id at §217.
[155] Id. at §214.

of the Competition Act abuse of dominance cases, but for the fact they can lead to some form of price controls.

Although several market investigation references considered whether prices were excessive, most were carried out under a statutory framework no longer in force, and as such offer little value as precedent.[156] In this respect, it is sufficient to note that the UK competition authorities identified, at the time, a few cases of excessive prices contrary to the public interest and imposed remedies seeking to cure the problems. In certain cases, the CC concluded that prices were not excessive despite widespread public perception that they were unreasonably high, or higher in the UK than in other comparable markets.[157]

Where the UK competition authorities determined that prices were excessive, a variety of remedies was adopted. Such remedies included, for instance: a reduction of prices to a certain level;[158] commitments not to raise prices without government approval;[159] publication of a list of prices;[160] or maintenance of prices within a specified formula.[161] However, in practice, the Competition Commission has generally preferred remedies designed to make the investigated markets work more effectively, as opposed to regulating prices directly.[162]

Interestingly, in a recent policy speech, Amelia Fletcher and Alicia Jardine of the OFT consider that "[competition] authorities should wherever possible endeavour to address the causes of the abuse – that is, the market circumstances that allow the excessive pricing to occur – rather than using price regulation to address the symptoms."[163] They thus potentially see a greater role for agency intervention designed, for instance, to eliminate barriers to entry than for measures attempting to constrain market operators' pricing freedom. The type of intervention foreseen by Fletcher and Jardine include, for instance, measures designed to reduce switching costs, facilitate shopping around for customers, increasing the level of comparable information across suppliers, and reducing the level of asymmetric information between firms and customers.[164] As pointed out by these authors: "Such interventions – where effective – have the potential to generate far greater benefits for consumers than price regulation, since enhanced competition will typically be more effective at driving up quality, service and innovation and driving down costs. At the same time, they do not have the downsides of price regulation described above."[165] This observation echoes the view of many scholars and agency officials according to which price regulation should be seen as a last

[156] The majority of such investigations were carried out by the defunct Mergers and Monopolies Commission pursuant to the Fair Trading Act of 1973 and the Competition Act of 1980.
[157] See e.g. *New Motor Cars* Cm 1808 [1992]; *The Supply of Recorded Music* Cm 2599 [1994].
[158] *Chlordiazepoxide and Diazepam* HCP [1972-73] 197.
[159] *Ready Cooked Breakfast Cereal Foods* HCP [1972-73] 197.
[160] *Gas* Cmnd 500 [1988].
[161] *Classified Directory Advertising Services* Cm 3171 [1996].
[162] See Fletcher and Jardine, supra note 148.
[163] Id.
[164] Id.
[165] Id.

resort. Measures designed to remove barriers to entry or other factors impending competition are preferable as they are easier to administer, carry lower risks of market distortions, and are generally more effective at enhancing long-term consumer welfare.

D. Comparative analysis

This section does not ambition to provide a detailed comparison of the German, Dutch, and UK competition policies with respect to the control of excessive pricing, but rather to make a number of basic observations.

First, the review of the excessive pricing case-law of these three countries shows that while competition authorities were willing to devote resources to investigate excessive price allegations made by complainants, the vast majority of these complaints were either rejected or led to decisions confirmation that the prices in question could not be considered as excessive with the meaning of Article 82(a) EC or the equivalent national provision. Remarkably, over the past decade, the German FCO, the NMa and the OFT only adopted a handful of decisions condemning dominant firms for excessive prices and some of these decisions did not withstand judicial scrutiny. This suggests that, while these competition authorities have the statutory powers to control excessive prices imposed by dominant firms, this does not appear to be one of their enforcement priorities, which, as observed above, seem clearly focused on preventing exclusionary pricing schemes. This also suggests that when these competition authorities decided to investigate what appeared to be excessive prices, their inquiry generally led to the conclusion that the prices in question could not be considered as excessive. In this regard, the Dutch example is enlightening. While the NMa conducted nine excessive price investigations, only one led to a finding of excessive prices. The decision in question was, however, dropped following an appeal by the investigated firms.

Second, it is striking to observe that these competition authorities have relied on radically distinct methodologies to assess whether the prices in question were excessiveness. As we have seen in Part II, EC competition law does not impose a specific methodology to assess the excessiveness of prices. Instead, the Commission and the Community courts have relied on a variety of methodologies, including price cost comparisons and various forms of benchmarking. The freedom left to the national competition authorities to choose among such methods or even to select other methods led to curious disparities. While, for instance, the German Federal Cartel Office and the German courts focused on various forms of price comparisons (thereby ignoring whether the profit margins realized by the investigated firms were excessive), the NMa and the Dutch courts focused on the reasonability of the dominant firms' profit margin on the relevant product. In *Napp*, the OFT opted for a different strategy based on a variety of comparisons (benchmarking) covering both prices and profit margins. This confirms the view of the majority of experts that there is no single generally accepted methodology to assess the excessiveness of prices. The distinct methodologies used by these competition authorities raise significant problems and are subject to considerable limitations. The multi-fold approach followed by the OFT seems to suggest that controlling high prices is at best guesswork, the risks of which can be limited by multiplying the points of

comparison. But, as discussed above, even this approach may encounter difficulties and, in any event, requires significant resources to be devoted to the inquiry. If anything, our survey of the case-law confirms the uncertainties surrounding the enforcement of Article 82(a) EC and the equivalent national provisions.

Finally, there seems to be a consensus emerging that in sectors characterized by heavy investments and the preponderance of innovation controlling high prices (or profits) may not be desirable, as it may adversely affect incentives to invest and innovate and negatively impact dynamic competition. As illustrated by the Dutch collecting societies' cases, controlling high prices may also be impossible when intellectual property rights (e.g., copyrights or patents) exist. Indeed, no model seems reliable enough to deal with such complex cases.

## VII. Conclusions

This paper has attempted to make several points:

First, while Article 82(a) EC and equivalent national provisions allow competition authorities and courts to control excessive prices charged by dominant firms, these provisions have been enforced in a very small number of cases compared to the bulk of abuse of dominance case-law. Clearly, competition authorities have focused their attention on *exclusionary* pricing schemes seeking to foreclose competitors and reduce competition. Attempts to exclude competitors through abusive schemes have led to hundreds of investigations and a large number of decisions. In contrast, competition authorities' efforts to prevent alleged *exploitative* schemes are anecdotal at best and in any event controversial.

Second, the reasons why the control of high prices by dominant firms is a low priority for competition authorities are well-known and generate little disagreement. First, in most circumstances high prices will be self-correcting as they attract new entrants. Controlling prices in such circumstances would not only be useless, but also impede competition. Second, determining the level at which a price is "excessive" or "unfair" is a difficult and uncertain task. Competition authorities have relied on a variety of methods to assess the excessiveness of prices imposed by dominant firms all of which are subject to considerable limitations. There is thus not one method of controlling excessive prices, which is both easy to apply and limits to an acceptable extent the risk of mistaken decisions. Third, DG Competition and the national competition authorities have clearly expressed the view that they have no intention to become price regulators as they are not adequately equipped to carry out such a mission, which requires significant resources and the need to ensure permanent supervision over regulated firms. Their intervention will thus remain exceptional and focus on cases where significant and long-lasting barriers to entry can be observed. Yet, even in such cases, the competition authorities' primary efforts should be to remove such barriers and, only if this task proves impossible, consider the possibility of controlling prices.

Third, there is a wide consensus that controlling high prices imposed by dominant firms is undesirable in dynamic industries, where investments and innovation are critically important. These industries are characterized by the taking of significant financial risks. Only the prospect of making significant returns will attract entrepreneurs. With rare exceptions, any significant profits reaped by winners of the investment race will be temporary, as displaced competitors will continue to invest to devise new, attractive products and regain market share. Markets for consumer electronics clearly illustrate this process as no firm has been able to take commercial success (and the large resulting profits) for granted. There is significant evidence that capping prices or profits will hurt firms' incentives to invest, harm dynamic competition and deprive customers from new products. The temporary gains achieved by the control of prices will thus distort innovation markets and eventually hurt consumer welfare. The Dutch experience with collecting societies suggests that there may be instances, in particular those involving intellectual property rights, where price control may simply be impossible.

In light of the above, provisions prohibiting the imposition of excessive prices by dominant firms should only be applied in exceptional circumstances. A consensus seems to emerge that such circumstances include situations where (i) significant and long-lasting barriers to entry and expansion exist; (ii) it is impossible to remove them; and (iii) investments and innovation tend to be limited. It also appears that in a number of jurisdictions (e.g., Germany), excessive price investigations have focused on sectors where dominant firms hold exclusive rights ("legal monopolies") or which were recently subject to liberalization. Even in such circumstances, high prices may not necessarily result from exploitative behaviors as increases in prices may simply reflect the normal operation of market mechanisms. There is also a general consensus that competition authorities should generally defer to sector-specific authorities in industries where such regulators exist (telecommunications, etc.), with the competition authorities' interventions being limited to situations where the specific regulators have failed to properly discharge their duties. Finally, price control inquiries should be limited to circumstances where the competition authority in question has sufficient resources to carry out a proper investigation. Where such resources are scarce, competition authorities may be better advised to deploy them on exclusionary cases.

Whether or not countries whose competition law does not provide for the control of excessive prices should modify their legislation to allow for such controls is an open question. The majority of nations with competition law regimes consider that controlling excessive prices is not a proper mission for competition authorities who should instead focus their resources on ensuring that the competitive process is not distorted. The prohibition of excessive prices charged by dominant firms is essentially a European oddity, although it has been emulated in limited parts of the world. While DG Competition and EU Member States' national competition authorities see no reason why they should deprive themselves from a legal tool that is contained in the EC Treaty (Article 82(a)) and, by implication in their national legislation, they have voluntarily chosen to enforce this provision with caution and only as a last resort.