Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

09-Jan-2012

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS**
**COMPETITION COMMITTEE**

DAF/COMP/WP2(2011)7/REV1
Unclassified

## Working Party No. 2 on Competition and Regulation

# EXCESSIVE PRICES

**-- Background Paper --**

**17 October 2011**

*The attached document is the revised version of the Background Paper of the roundtable on Excessive Prices held on 17 October 2011 at the meeting of Working Party No.2 of the Competition Committee. It will be compiled into the proceedings of the discussion soon to be published.*

Please contact M. Frank Maier-Rigaud if you have any questions regarding this document [phone number: +33 1 45 24 89 78 -- E-mail: frank.maier-rigaud@oecd.org].

**JT03314096**



English - Or. English

**TABLE OF CONTENTS**

**Annexes**

# EXCESSIVE PRICES

***Background Paper by the Secretariat*** [*]

## 1. Introduction

1. The concept of exploitative abuse and more specifically the prohibition of an abusively excessive price[1] has to be considered one of the most controversial issues in competition policy. On the face of it, this is paradoxical, given that consumer harm and efficiency considerations have been considered one of the most important justifications for competition law interventions. The concept of consumer harm has been identified as the "intellectual cornerstone of competition policy".[2] The efficient allocation of resources, in turn, is considered the economic cornerstone of competition.[3] Many regulatory authorities spend much of their time and resources considering whether prices are "too high". Yet interventions by competition authorities to deal with these problems directly are considered controversial at best.

2. The many reasons for this reluctance to intervene include important concerns to preserve the allocative function of prices as signals of scarcity, particularly if such signals result in new entry or other forms of investment and innovation. In order to fully capture the reasons why antitrust and regulatory intervention in case of excessive prices is so contentious and to understand the pros and cons of intervention and its practical difficulties, the scope of this paper is deliberately broad. It explicitly covers both, excessive prices as antitrust offense and also touches upon excessive prices as a regulatory problem in the widest possible sense.

---

[*] This paper was prepared by Frank Maier-Rigaud. Annexes 1, 3, 4 and 6 were prepared by Anna Pisarkiewicz and Annex 2 was prepared by Jung Won Song.

[1] The terms "excessive pricing" and "excessive prices" are both used in the competition literature. In addition, the term "price abuse" is used in Asian countries as synonym for "excessive prices" and not as a more comprehensive category comprising various price-based abuses such as predation or margin squeeze. The term "excessive prices" is preferable to "excessive pricing" as it is semantically more appropriate and the latter implies "too much pricing". It is probably based on a false analogy to predatory pricing and while both terms are used interchangeably without possible misunderstandings in the competition community, the term may be misleading in an advocacy context where people not familiar with special competition terms are addressed.

[2] Williams (2007:131).

[3] In the context of exploitative pricing one should note that the exploitative abuse of monopsony power, as evidenced by excessively low prices depriving for example farmers of a fair price for their products is likely to require a total welfare approach. Excessive or unfair prices in this paper will omit exploitatively low prices. See, however, Case 298/83 CICCE vs. Commission, [1985] ECR 1105, [1986] 1 CMLR 486, where the Court rejected a complaint that the European Commission had refused to condemn unfairly low prices paid by a monopsonist for lack of sufficient evidence. See also The Association of British Travel Agents and British Airways plc, OFT decision of 11 December 2002, [2003] UKCLR 136. For a discussion of consumer versus total welfare standard see Elhauge (2009b) and the interesting discussion of the paper by Barry Nalebuff, Paul Seabright and others in Competition Policy International, Vol. 5(2), 2009 and Elhauge's reply in Vol. 6(1), 2010.

### *1.1. A brief sketch of the history of excessive prices*

3. The problem of excessive prices is as old as economic reasoning itself and while it is not possible to give a detailed account of the history of relevant economic thought, a brief but necessarily sketchy overview of the origins of excessive prices appears warranted not only to understand the historical origins of excessive price concerns but also to get a first understanding of the evolution of the underlying concepts and how the concern about fair prices and the debate of what constitutes economic value has shaped economic thinking.

4. The idea of a just, fair or natural price and with it the concept of economic value and rudimentary equilibrium notions can be traced back to ancient Greece and has therefore occupied political philosophers and economists for well over 2000 years.[4] Already at that time writers were concerned with exploitation through unfair prices and attempted to define economic value and with it just prices. In fact modern price theory, a core area of economics, is the result of many political philosophers and economists grappling with these questions over centuries.

5. The belief that economic value is inherent to the good itself, defines the economic writings from Plato and Aristotle[5] through scholastic writers such as Thomas Aquinas[6] up to Adam Smith.[7] The original notion that value is an objective quality permanently inherent in a good pervaded economic thought in one form or another, leading for example to the objective (Marxist) labour theory of value and Ricardo's objective production cost theory of value.[8] These objective theories of value were finally superseded by the theory of subjective value in the so-called marginalist revolution[9] that was followed by the classic publications of Chamberlin and Robinson that founded modern price theory.[10]

6. The concept of just price in turn is closely related to the notion of equilibrium that first appeared in its most rudimentary form as equivalence. What was given in an economic transaction should be equal in intrinsic value to what was taken.[11] The link between the natural price and the concept of equilibrium

---

4 See for example Denis (1990:82ff.).

5 Aristotle is the first to define and discuss monopoly (Politics, I, 11 and Ethics, V, 5) condemning monopoly prices as "unjust". See Schumpeter (1954:60f.).

6 Thomas Aquinas (1225-1274) discusses the concept of just price in his treatise Summa Theologica. The just or fair price was supposed to be one just sufficient to cover the costs of production and to allow the worker and his family to live. He considered it immoral for sellers to raise prices simply because buyers were in pressing need for a product: "If someone would be greatly helped by something belonging to someone else, and the seller not similarly harmed by losing it, the seller must not sell for a higher price: because the usefulness that goes to the buyer comes not from the seller, but from the buyer's needy condition: no one ought to sell something that doesn't belong to him."

7 According to Schumpeter (1954) Smith grappled unsuccessfully with the concept of economic value. In fact it was the paradox of value, namely that – to use Adam Smith's own example - water, though useful, has usually no exchange value whereas diamonds though usually not useful have a high exchange value, that led him to reject a utility based approach to the concept of value.

8 The cost theory of value remains of competition policy relevance till this day as it was suggested by the European Courts in the first leg of the United Brands test. See section 5 below.

9 According to Pribram (1983:614) "The emergence of marginal utility analysis signified a victory of hypothetical reasoning in the fight against the substance concept of the goods and the traditional Scholastic belief that the value of a good must be conditioned by some quality inherent in the good."

10 See Robinson (1933/1969), coining the term monopsony and Robinson (1934) as well as Chamberlin (1933/1962).

11 Pribram (1983:612).

becomes more apparent in Smith's writings where, according to Schumpeter (1954:308) Smith's normal price is simply the price at which it is possible to supply, in the long run, each commodity in a quantity that will equal 'effective demand' at that price, i.e. the price that in the long run will just cover cost.

7. Schumpeter implies that already Aristotle may have been close to the solutions proposed by some contemporary authors to the problem of excessive prices:

> *"It is not farfetched to equate, for Aristotle's purpose, monopoly prices with prices that some individual or group of individuals have set to their own advantage. Prices that are given to the individual and with which he cannot tamper, that is to say, the competitive prices that emerge in free market under normal conditions, do not come within the ban. And there is nothing strange in the conjecture that Aristotle may have taken normal competitive prices as standards of commutative justice or, more precisely, that he was prepared to accept as 'just' any transaction between individuals that was carried out at such prices."*[12]

8. Irrespective of whether Schumpeter's interpretation of Aristotle is correct or not[13], the passage is of interest as it points to the fundamental question of the appropriate benchmark for assessing whether prices are unfair, unjust or excessive that remains unresolved till this day.

### *1.2. Exploitative versus exclusionary conduct*

9. The most controversial theory of harm in competition law in general and within the category of exploitative abuses in particular is charging an abusively excessive price. While many arguments have been given against intervention by competition authorities in excessive price cases, there also exist many arguments in favour of such intervention. Furthermore, regulation and regulatory interventions with the aim of curbing excessive prices are prevalent not only in those jurisdictions that allow for excessive price cases under their antitrust laws but also in those where excessive price abuses are not an antitrust offense.[14] Furthermore investigations that were induced by political pressure to investigate excessive price concerns have subsequently revealed that the prices were in fact triggered by exclusionary abuses.

10. Under exploitative abuses, it is the high price itself that is deemed problematic, whereas under exclusionary conduct high or higher prices tend to be the result of the exclusionary practise. In fact any anticompetitive behaviour involves exploitative elements as all anticompetitive conduct ultimately leads to exploitation.[15] While a clear line is normally drawn between these types of abuses, exploitation occurs in both instances. They are also not mutually exclusive as, at least in those jurisdictions where exploitative

---

12 Schumpeter (1954:61).

13 See for example the contrary treatment of Aristotle in Pribram (1983:14ff.) in his section on "The Doctrine of the Just Price". In any case any theory of what constitutes a "just" price requires a set of assessment criteria that allow the distinction between "just" and "unjust" prices.

14 For example, although the US case law excludes excessive price cases, price gouging laws and laws against usury exist on the state level and several federal regulators have price regulation powers. While active public enforcement (as opposed to private enforcement via private damage claims) of the Robinson Patman Act seems to have declined substantially, the Act prohibits price discrimination, an exploitative abuse. See Davidson (2011:49ff.).

15 Röller (2008:525f.) points out that "In fact, the sole purpose of firms engaged in exclusionary practices is to increase market power, which in turn will allow firms to increase their rents." The same applies, however, also to pro-competitive behaviour as he points out. In fact, "if there were no possibility to ever exploit one's market power, there would be no incentive to compete."

conduct is considered an abuse, there may be some scope for determining under what general type of abuse the case will be conducted.[16]

### *1.3. Decision errors and implications*

11. The reasons against regarding excessive prices as abuse include *inter alia* the risk of reducing investment incentives (both of firms already in the market and potential entrants) and the legal uncertainty that may be associated with the vagueness of the concept[17]. There is also a risk in particular for competition authorities (discussed in section 7) to overstep their mandate in light of political pressures.

12. However, not all commentators oppose such interventions. Reasons in favour of enforcing and prohibiting excessive prices as an antitrust offence include *inter alia* cases of limited potential for market self-correction due to permanently high entry barriers, the lack of a regulator or of effective action by an existing regulator. One of the most prominent reasons in favour of excessive price cases in light of the consumer orientation of most competition laws is that excessive prices exert the most direct negative impact on consumers.

13. All these arguments taken together suggest a high risk of error in both, intervening either as a legislator or a law enforcement authority when intervention would not have been warranted (type I error) and not intervening when intervention would have been warranted (type II error).

14. While the probability of type I and type II errors has been considered higher in excessive price cases than in other suspected competition law infringements, an additional problem arises due to the asymmetry of costs associated with each error. In fact the costs of a type I error, i.e. a false condemnation, is likely to outweigh the costs of a type II error, i.e. a false acquittal. The reason for this is that a non-intervention bears the hope of the market self-correcting through entry, resulting in competition and the usual benefits associated with it such as lower prices, higher quality and more variety, while in the meantime "only" distorting allocative efficiency through its effect on prices.[18] An intervention in turn "only" affects pricing, i.e. allocative efficiency, while it bears the risk of undermining dynamic efficiency, possibly even foreclosing the market to entry.

15. The paper discusses:

- the grounds for and against intervention in general (section 2);
- the respective role of competition and regulatory authorities if sufficient grounds for intervention exist (section 3);
- appropriate screens for an initial selection of cases (section 4);
- legal tests and a selection of interesting and (in)famous cases (section 5);
- different methodologies that attempt to objectify the concept (section 6);

---

16 See section 7. In addition, excessive price abuses have also been combined with other abuses in a single case.

17 Of course vague rules also provide for weak incentives so that the vagueness of the concept is ambivalent.

18 Note, however, that exploitative patent hold-up may also have dynamic repercussions affecting the stylized presentation of expected decision error costs presented.

- "abuse shopping" and abusing excessive price cases as a substantive and procedural shortcuts (section 7);

- the difficult issue of remedies, private actions and disgorgement as well as fines (section 8).

16. It has been said that the "determination of an exploitative effect necessarily involves, therefore, the need to make a subjective judgement as to the appropriate level of prices and output in a particular market."[19] As this paper will demonstrate this is not an easy task and the literature is divided on whether regulators and competition authorities in particular should be placed in such a position.

## 2. Do excessive prices require intervention?

17. This section summarises the general justifications given in the literature in favour and against intervening in case of excessive prices (see Table 1). The question of who should intervene, if at all intervention is warranted, is discussed in section 3.

**Table 1. The pros and cons of intervention**

| Ground for non-intervention | Ground for intervention |
|---|---|
| markets are self-correcting | markets are not always self-correcting (market failures exist) |
| regulatory failure may aggravate market failure | conduct causes a reduction in consumer welfare |
| cost of intervention even if it successfully redresses market failure exceeds its benefits | conduct causes a reduction in total welfare (deadweight loss) |
| Intervention is redundant as excessive prices are competed away | may fill the gap in the competition law and allow a second shot if the authority missed exclusionary conduct |
| price regulation/ remedies are difficult to devise | increases popular support for competition policy |
| uncertainty/arbitrariness of the concept (determining excessiveness is difficult) | link between entry and excessive pre-entry price is spurious |
| prohibiting monopoly prices is tantamount to prohibiting monopoly | excessive price abuses are a competition law infringement |
| distorts investments, and firm behaviour generally possibly fostering "gold-plating" | public policy considerations/ will of the legislator/ political pressure (primacy of politics) |

18. Opinions for and against such intervention might reflect differences in the fundamental preconceptions of how markets work. Referring to the US and the EU respectively Gal (2004:345f.) writes:

> *"The U.S. views the unregulated economy as essentially competitive, if the creation of artificial barriers is prohibited. This approach places significant emphasis on the working of the market and considers monopoly created by means other than artificial barriers to be relatively unimportant. It also reflects the limited role granted to government in regulating markets directly and the social, moral and political values attributed to the process of competition. EC law reflects a lesser belief in the ability of market forces to erode monopoly and a stronger belief in*

[19] Esteva-Mosso and Ryan (1999:189). The criticism concerning the subjectivity of excessive price cases is likely to derive from the higher theoretical objectivity of other abuses rather than the lack of subjectivity in the conduct of any particular case by a competition authority.

*the ability of a regulator to intervene efficiently in setting the business parameters of firms operating in the market. It also reflects a stronger emphasis on distributional justice."*

19. The fundamental preconceptions referred to by Gal are plausible but they are unlikely to have spontaneously emerged. The preconceptions in any economy initially comprised of mostly competitive industries with a great degree of economic flexibility and dynamism are likely to be different from those that evolved in an economy that right from the beginning exhibited a significant number of companies with market power. Obviously the role and the perception of exploitative abuses are likely to differ and the question whether provisions on excessive prices are desirable will vary from economy to economy and may also change over the long term.

### *2.1. The excessive price phenomenon*

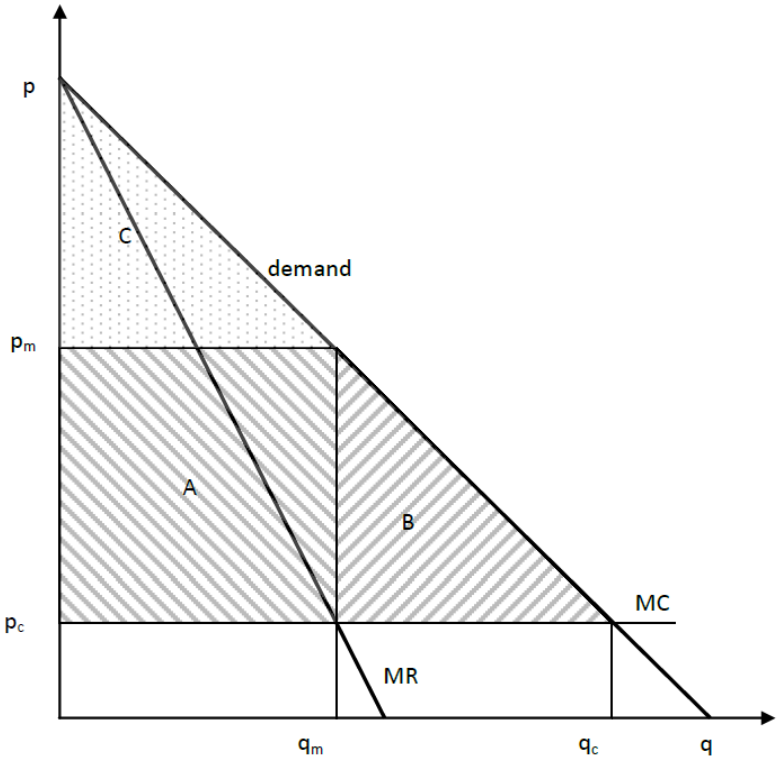
20. The competitive price is often considered the appropriate benchmark for assessing excessive prices. As the concept of competitive price has no solid foundation in economics, understanding price formation and equilibrium prices is a precondition for better understanding what a competitive price may be.

21. Figure 1 introduces equilibrium prices under perfect competition and under monopoly for the simple case of constant marginal cost (MC).[20] The equilibrium monopoly price $p_m$ is substantially above $p_c$, the competitive equilibrium price.[21] Area A designates the consumer surplus that is "transferred" to the monopolist for the quantities still sold and area B, is the consumer surplus lost associated with a transition from competitive to monopoly prices. The consumer surplus lost, also called the deadweight loss, is associated with the reduction in quantity from $q_c$ to $q_m$ as some consumers who bought at $p_c$ do not value the good sufficiently to also buy at $p_m$.

[20] Marginal cost is the increase in the firm's total cost that results from an increase in output by one unit.

[21] The necessary assumptions for a perfectly competitive equilibrium are rather restrictive and include the assumption that the economies of scale are small relative to the size of the market, that information is perfect and that output is homogenous so that firms are price takers, i.e. firms cannot influence the market price. In addition, no entry or exit barriers are assumed.

**Figure 1. Pricing under monopoly and under perfect competition**

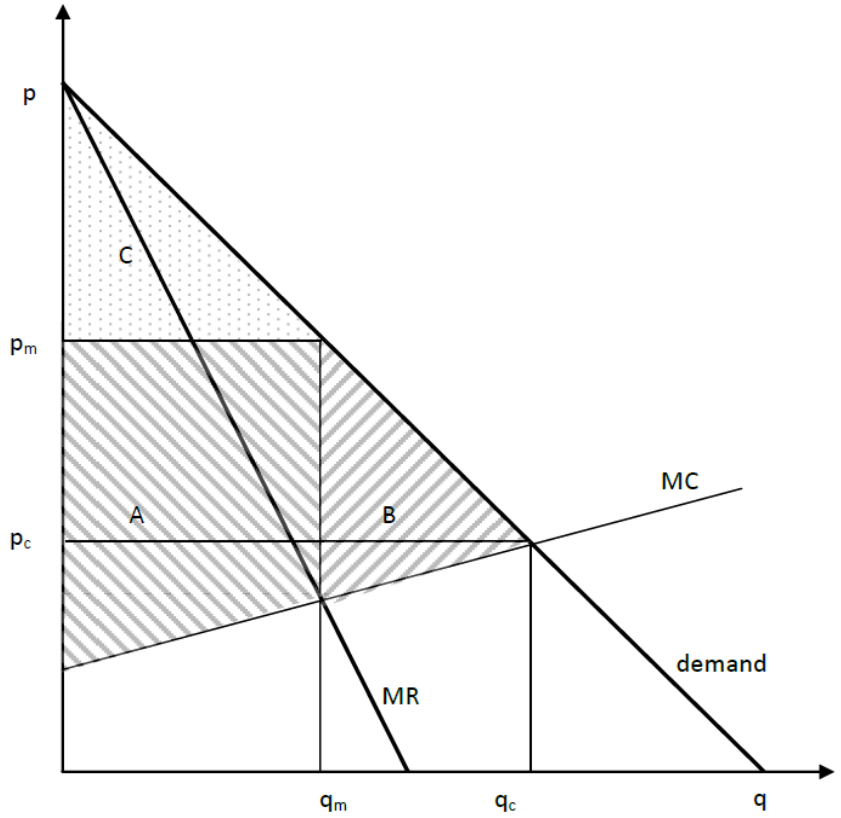



22. A slight variation of market conditions is introduced in Figure 2 that depicts equilibrium prices under competition and monopoly in the case of increasing marginal cost. As before, we can see that the monopolist is not pricing independently of cost and demand. What we can see now in contrast to Figure 1 is that firms under perfect competition may be able to cover their fixed or sunk cost as infra-marginal units allow for profits relative to marginal cost. Figure 2 gives an intuitive illustration that shifts in demand may cause varying price levels in perfectly competitive markets when marginal costs vary with quantity. Observing changes in price or price increases even if new prices are substantially higher than former prices is therefore in line with a perfectly competitive market structure.

23. The more relevant case in the context of excessive prices is cost economies of scale, i.e. a decreasing, as opposed to constant or increasing, marginal cost curve. The reason for this is that increasing economies of scale are a natural barrier to entry. In such a case we get the opposite effect and marginal cost pricing will not only fail to cover any sunk or fixed cost but will also not allow to cover variable cost (see section 6 for an introduction and discussion of various cost concepts).Under these conditions, prices may be substantially above marginal costs without implying a lack of rigorous competition in the market.[22]

[22] This has in fact led to a move from the perfect competition benchmark towards a workable competition standard. See the classic article by Clark (1940).

**Figure 2: Pricing under monopoly and perfect competition with increasing marginal cost**




24. Having introduced the equilibrium prices under perfect competition and monopoly for different marginal cost curves in Figure 1 and Figure 2, it is important to emphasize the distinction between equilibrium and the characterization of equilibrium itself. While competition tends to lead to prices converging to equilibrium, it depends on the type of competition which equilibrium obtains. In Figure 1 and Figure 2, the two types of equilibria depicted are the equilibrium price quantity combination that a (non-price discriminating) monopolist would charge ($p_m$, $q_m$) with the equilibrium price quantity combination that would obtain under perfect competition ($p_c$, $q_c$).[23] As a result, the actual equilibrium outcomes have to be distinguished from the predicted (instantaneous) convergence to equilibrium, driven in both instances by profit maximization. The fact that in both instances equilibrium is reached in an effort to maximize profits, is the reason that has led some authors to claim that there is no such thing as an excessive price from an economic point of view.[24]

25. As the concept of competitive price is not defined, it could be interpreted as any price that obtains under equilibrium conditions, including the monopoly price. In this case competitive would refer to the process of profit maximization under constraints and would simply be a synonym for equilibrium. Alternatively the concept of competitive price could be interpreted as the equilibrium price that obtains under competition. This interpretation allows any equilibrium price short of monopoly to be considered

23 Of course there are other market theories that produce a marginal cost pricing equilibrium besides perfect competition. For example marginal cost pricing is predicted for capacity unconstrained, homogenous product one-shot Bertrand (price) competition. Even in a monopoly model with a perfectly contestable market, the equilibrium price may equal marginal cost.

24 See Annex 3 and 4 as well as Section 5 for a discussion of the United Brands test as applied in the Port of Helsingborg cases.

competitive, ranging from equilibrium prices under duopoly or oligopoly to equilibrium prices under perfect competition.

26. In the UK Napp case the OFT for example stated that a price is to be considered excessive "if it is above that which would exist in a competitive market"[25]. As perfectly competitive markets are only one among many possible competitive markets, the reference is unlikely to be to marginal cost based pricing. On the other end of the spectrum, the reference is unlikely to refer to the equilibrium pricing in a market short of being monopolistic.[26] As market power in the narrow economic sense is found on a continuum between these two extremes, locating the "competitive price" is not trivial.

27. In the Mittal case (See Annex 1) the Competition Appeals Court of South Africa proposed a definition of what a competitive price is that is reminiscent of Schumpeter's interpretation, quoted above, of what Adam Smith may have considered a "normal" price. In trying to establish what the South African legislature meant in using the term "economic value" as borrowed from EU law, it stated that "'economic value' is the notional price of the good or service under assumed conditions of *long-run competitive equilibrium*. This requires the assumption that, in the long run, firms could enter the industry in the event of a higher than normal rate of return on capital, or could leave the industry to avoid a lower than normal rate of return on capital. It does not imply perfect competition in the short-run, but rather competition that would be effective enough in the long run to eliminate what economists refer to as 'pure profit' – that is a reward of any factor of production in excess of the long-run competitive norm, which is relevant to that industry or branch of production."[27] This definition boils down to the long run average cost (LRAC) of an efficient firm. As will be shown in section 6, this is the price at which an efficient firm will just cover its total cost.

### *2.2. Grounds for non-intervention*

28. Many commentators have argued against treating high prices as an abuse or as excessive. The arguments range from market characteristics over properties of regulation and inherent practical difficulties to general concerns including fairness considerations. These arguments do not necessarily contradict the generally recognized need for regulatory intervention in certain specific cases such as public utilities.

29. The main justification found in the literature, often not elaborated upon in much detail, concerns the inherent self-correcting properties of markets. Although the market is viewed as capable of self-correction with respect to exploitative abuses quite generally, this is particularly evoked for excessive prices.[28]

---

25 Case CA98/2/2001 Napp Pharmaceuticals Holdings Ltd and Subsidiaries, Decision of the Director General of Fair Trading on March 30, 2001, para 203.

26 It should be noted that the claim that prices will never be above the monopoly price (often linked to the idea that therefore excessive price abuses are identical to a monopoly offense) is of theoretical value only in the context of exploitative abuses. In an exclusionary context it may very well be that the only effectively exclusionary price is substantially above the monopoly price. While this is not profit maximizing for the monopolist in that market, the exclusionary strategy may well maximize profits over all markets, for instance up and downstream markets if one thinks of vertical foreclosure. Such a strategy of constructive refusal to supply may well involve rational monopolist pricing above the monopoly price in one of the markets. See Maier-Rigaud et al. (2011) for a refusal to supply case where such prices could be observed.

27 Competition Appeal Court of South Africa, 70/CAC/Apr07, §40 (emphasis in original).

28 See Lowe (2003).

30. The summary by Gal intended to describe the evolution of the US approach nicely captures this view:

> *"The hands-off approach was based, at its inception, on the belief in the self-correcting tendency of the market and the limited role of government in regulating markets. The modern paradigm is based on a dynamic analysis of the market and the economic effects of monopoly pricing regulation. The basic premise still remains that most markets are competitive and monopoly tends to be self-correcting. But even when markets are not competitive, it is believed that the costs of regulation are likely to outweigh its benefits."*[29]

31. The belief in market forces as the solution to (temporary) market failure is often bolstered by the (perceived high) likelihood of regulatory failure. In other words, even if market forces will not be swift or fully effective in eroding excessive prices, regulatory intervention, due to potential regulatory failure may not be a solution.[30] This scepticism particularly concerns price regulation. It is of course inextricably linked to the difficulties of determining what a "reasonable" as opposed to an "excessive price" is in an environment characterized by asymmetric information. Even if some coherent approach could be devised by a regulator, the degree of remaining uncertainty is typically viewed as sufficiently high not to warrant intervention.[31]

32. The reason for self-correction is normally associated with entry or, in a wider sense, the contestability of the market. From that point of view, regulatory intervention in the market process is redundant as excessive prices will be competed away by new entry.[32] The probability of market entry is often viewed as directly related to the price level with higher, possibly excessive prices, attracting more entry.[33] In contrast, regulating prices down may inhibit the entry and/or expansion by competitors.[34]

33. The potential chilling effect of regulating prices down has led some authors to develop additional screens[35] that would exclude the possibility of excessive price cases in industries where innovation and investment are important.[36]

---

29 Gal (2004:358).

30 See Gal (2004:355).

31 In addition to regulatory failure it may simply be that the cost of regulatory success exceeds the cost of the market failure.

32 See Ezrachi and Gilo (2008), who, however, do not agree with this assessment.

33 That high prices are an important market signal, stimulating entry is almost never questioned. See for example Elhauge (2009a:512) "High prices also provide an important market signal that encourages other firms to enter, which would create competition.." or Furse (2008:78) "One effect of compelling an undertaking in a dominant position to reduce its prices is to dampen this entry incentive.". See, however, Ezrachi and Gilo (2008) who among other aspects emphasize that post-entry prices are the relevant variable for entry. See also Ezrachi and Gilo (2010a) and (2010b).

34 While entry and expansion of competitors may become more difficult if prices are regulated down, this does clearly not depend on the pre-entry prices or the regulated price cap but on the post-entry or post-expansion prices. As long as the price cap is not a binding constraint for the post-entry price that the dominant firm would choose post entry or post expansion, price regulation cannot inhibit entry or expansion. See section 2.3 for a more detailed discussion on this point.

35 The screens are proposed in addition to the requirement of establishing dominance as required in all jurisdictions where excessive prices are a competition law abuse.

36 See section 4. This line of argument presupposes a clear causal relationship between R&D and innovation. This is, however, disputed and it is generally recognized that innovation is typically not observed in the

34. The risk of chilling investments and with it innovation is probably by analogy to industries with capacity constraints. Clearly, high profits due to insufficient capacity are likely to be short-lived as they will be competed away once more capacity is added to the market. In that case high prices may indeed fulfil their basic purpose of signalling scarcity and inducing a reallocation of resources.

35. Further down the hierarchy of grounds against intervention are the inherent (technical) difficulties of properly identifying and subsequently addressing high prices. Assessing prices both *ex post* but even more so *ex ante* is difficult for both competition authorities and regulators.[37]

36. Some of these difficulties may be due to cyclical demand or demand shocks that can lead to transitory price effects as discussed in the simple model in Figure 2 above. They may also be due to two- or multi-sided markets, where "excessive profits" that are made with one product or service or in one market may be given away in another.[38] So while it is certainly possible for a two- (or multi-) sided platform to abuse its market power and charge excessive prices, this has to be simultaneously determined with regard to all sides of the market. "Seemingly excessive prices on one side of the market may simply be the mirror image of seemingly predatory prices on the other side, and both prices may be the results of the balancing act that the platform must do to attract both sides of the market."[39]

37. Another substantial difficulty arises with respect to industries where intellectual property rights (IPRs) play a substantial role as the relationship between costs and prices will be much more difficult to measure.

38. All these difficulties have led some authors to conclude "that it could be extremely difficult for young authorities and courts to deal with complex pricing rules".[40]

39. Determining and measuring what constitutes an unfair or excessive price is difficult.[41] It is difficult for both regulators and competition authorities even if it is standard in utility regulation. Irrespective of these difficulties (and whether they are symmetric or not), regulation is of an *ex ante* nature, so that general concerns about legal certainty are reduced compared with *ex post* intervention in price decisions.

40. There is a risk of chilling innovation if an excessive price intervention affects expected revenues and reduces the chances of successful R&D cost recovery. Depending on how the standard for intervention

---

type of concentrated markets where excessive price abuses are likely to occur. Generally speaking innovation is linked to individuals rather than re-investing firms. See Davidson (2011:62ff.) and the review of the works by Solow, Denison Jewkes, Sawers and Stillerman discussed there.

37 Some of these difficulties are listed for example by Fletcher and Jardine (2008:535) who conclude on a positive note that "while it is true that assessment of excessive pricing can sometimes be difficult, it would be wrong to overstate these difficulties." (p.541)

38 See OECD (2009) or Fletcher and Jardine (2008:534) who present the example of an electronic toothbrush producer with proprietary brush heads. While this would render the firm a monopolist in brush heads and would allow it to obtain high profits there, these "excess profits" are likely to be competed away even if consumers do not engage in any form of lifecycle assessment, as long as the firm faces effective competition on the primary electronic toothbrush market.

39 OECD (2009:13f). Note that in some jurisdictions it would matter whether the consumers that pay the elevated prices on one side of the market are identical to those receiving the benefits on the other side of a two-sided market.

40 See Terhechte (2010) for whom the Mittal case (see Annex 1) is such an example.

41 See Lowe (2003) or Ezrachi and Gilo (2008).

is designed it may also encourage so-called gold-plating, that is, lessen incentives for cost reductions and building up so-called x-inefficiencies.[42] Price caps have the potential of distorting investment incentives generally and more specifically incentives for efficiency[43] and cost reductions and incentives to innovate.[44] It also distorts price incentives[45].

41. Excessive price intervention triggers a risk of succeeding "too much" in the competitive process and ending up as a price regulated monopolist. This may provide incentives for throttling activities just before the perceived intervention threshold.[46]

42. If competition is viewed as a process in which firms take part and only "the best" succeed in becoming monopolists, the very laws that characterize the prices that such a winning firm charges as "unfair" may be unfairly denying the firm its legitimately earned rewards.[47] Of course this argument rests on the assumption that exclusionary conduct is prohibited and effectively enforced, that merger control functions properly and that monopolization is an abuse in itself, i.e. that the process of competition is undistorted by anti-competitive behaviour.

43. An even more fundamental concern with controls on excessive prices is the argument that prohibiting high prices as "excessive" is identical to prohibiting monopoly prices which in turn is tantamount to prohibiting monopoly.[48]

### *2.3. Grounds for intervention*

44. Competition is desirable because it promises better outcomes for society. The negative implications of market failure and monopoly for society are well recognised. Excessive prices in turn are the simplest and clearest manifestations of these negative effects and this naturally invites the proposition

---

42 See, however, Paulis (2008:518) who, without stating it explicitly, makes a behavioural economics argument on the likelihood of such effects by suggesting that "many innovators are just as motivated by the sheer joy and stimulus of the innovative process itself".

43 Depending on how excessive prices are calculated, cost efficiency may be punished. Assuming that own cost are used for the calculation and assuming further that a benchmark firm has much higher cost. The more efficient firms prices could be found to be excessive as it has higher price cost margins and higher profitability.

44 *Ex ante*, any potential restriction on the possible recoupment of investments via higher prices are an important element in determining the profitability of investments. This is relevant in particular for contests such as patent races or spectrum auctions where the winner takes all. In order for firms to compete in such contests their expected profits have to be positive, regularly implying huge mark-ups to counter the low probability of "winning".

45 The example given by Fletcher and Jardine (2008:537) is price regulation in the form of average price regulation over two markets. If the firm faces competition in one of the two markets it may be able to lower prices in that market and deterring entry without sacrificing profits as it could raise the price in the other market thereby maintaining the regulated price average.

46 The likelihood that deliberate reductions in Research and Development result in a loss in market share and position are, however, considered to be more important than the risk of being subjected to price regulation. See Areeda and Hovenkamp (2002:58ff.).

47 See Gal (2004:353f.)

48 See Lowe (2003). While controls of excessive prices may constrain the monopolist from charging the profit maximizing prices, the prohibition of exclusionary abuses impose a qualitatively similar constraint on the profit maximizing behaviour of the dominant firm rendering this argument rather vacuous.

that society can simply and directly outlaw such excesses. Most non-specialists almost certainly believe that the main task of competition authorities is to prevent high prices.

45. The reluctance of authorities to intervene against exploitative abuse has been termed paradoxical.[49] After all, the prevention of the creation and abuse of market power to the benefit of consumers is among the most prominent reasons for competition policy. The elimination of dead-weight loss and the quantity "restrictions" together with the x-inefficiency of monopoly are the main reasons given for regulatory intervention. As monopoly is the ultimate form of (supply-side) market power, competition policy is directly linked to the economic disadvantages related to this market structure. The same holds from a regulatory perspective as monopoly is also the basic workhorse for explaining the benefits of regulation. The main problems that economics textbooks describe with respect to monopoly or dominance is the exploitation of consumers paired with allocative inefficiency.[50] In fact, the textbook monopoly abuse are high prices.[51]

46. The fundamental problem is that confiscating profits deprives the market of its primary incentive to deliver benefits for society. Therefore, the credible grounds favouring intervention are those which have a degree of nuance by seeking to remedy competitive market failures without undermining the core drivers of efficient markets.

47. One of the key reasons in favour of intervention in excessive price cases is when markets lack self-correction or at least lack self-correction within a reasonable time frame. Modern economics recognizes many market failures causing this problem. Competition authorities, as the guardians of functioning markets, are well aware of the conditions required for markets to generate socially desirable outcomes. Market power may be based on other factors than superior efficiency or performance, such as first mover advantages in a network industry.

48. In small economies, i.e. economies capable of supporting only a small number of firms in most of their industries, entry barriers and natural market conditions may make it easier to gain and preserve monopoly power for longer periods of time even if superior performance is lacking.[52]

49. The same applies to market power that may be traced back to formerly state owned monopolies or was achieved through political patronage or corruption. In particular where such businesses have substantial infrastructure assets (sometimes gifted to them), it can take very substantial periods of time before their positions are eroded by the market.

50. In these instances the industry structure may not evolve, the market may simply not be able to remedy itself and dominant positions will not be eroded. Proponents of this view typically do not negate that self-corrections are possible nor do they negate that such corrections actually occur in a majority of cases. In those cases where self-corrections seem unlikely within a reasonable period of time, however, intervention is considered justified.

---

49 Lyons (2007:70) summarizes the paradox by stating "*it is good to* prohibit only those exclusionary practices which can be expected to result (directly) in an exploitative abuse…but at the same time it is bad to prohibit directly exploitative practices!".

50 See for example Lyons (2007:65ff.) or Williams (2007:129). For a textbook example see Church and Ware (2000).

51 Lyons (2007:67) rightfully points out that there is no reason to restrict the analysis of exploitative abuse to prices as product quality, service levels and product range are alternative variables in the choice set of dominant firms.

52 See Gal (2003) and Gal (2004).

51. Although regulating prices down reduces the incentives to enter the market, recall that entry depends on expected post-entry prices not on pre-entry prices. Ezrachi and Gilo (2008) develop this argument further and show that in a majority of cases and irrespective of whether entry barriers are high or low, excessive prices as such are insufficient to attract new entry. In addition they demonstrate that, rather counter-intuitively, intervention on the basis of excessive prices may encourage rather than discourage entry as it tends to allow potential entrants a better understanding of post entry prices.[53]

52. Another key argument in favour of excessive price interventions, and more specifically interventions by competition authorities, are so called gap or second-shot cases. As pointed out by Peeperkorn (2009:613), "The possibility under U.S. law to effectively intervene against acquisition of dominance may also partly explain why the possibility to intervene against exploitative conduct is not included in the Sherman Act or other U.S. antitrust laws." In other words, excessive price cases may fill the "acquisition of dominance" gap in those jurisdictions where dominance can be legally acquired by exclusionary means.[54] While Röller (2008:529) calls this an "important gap", the argument may have lost some of its bite at least at the EU level as the EU version of the Rambus case[55], that arguably is an excessive price case, was not presented as such. As the US Rambus case was conducted as a monopolization case, and as both cases treated essentially the same conduct, the EU Commission apparently found a way of both, filling the gap and at the same time avoiding the treatment of Rambus as (explicitly acknowledged) excessive price case.

53. Other arguments in favour of excessive price interventions deal with perception. First of all, excessive price abuses may increase public support for competition policy.[56] Irrespective of the actual merits of intervention or its long term repercussions, the regulation of excessive prices may strengthen the public support and political power of the authority. This is particularly true if prices on essential basic products and commodities are significantly reduced.[57] As coined by Terhechte (2010) "the regulation of

---

53 Their argument essentially relies on the signals potential entrants can derive from pre-entry prices with and without excessive price regulation in a standard two stage entry game where entry is rational if the incumbent has high cost. For entry to occur unequivocally, high cost incumbents have to charge different prices from low cost ones in equilibrium (called a separating equilibrium). They show that excessive price regulation may reduce the scope for a pooling equilibrium, i.e. where high and low cost incumbents charge the same prices not allowing the potential entrant to deduce its cost. This renders a separating equilibrium, which reveals whether the incumbent has high or low cost, more likely, in turn allowing an assessment of post entry prices and profitability and thereby increasing entry. While one may want to be cautious in basing policy on abstract game theoretic models, this style of analysis is also often used to support non-intervention. See also Ezrachi and Gilo (2010a) and (2010b).

54 On this point see also Lyons (2007:82f.), Röller (2008:528f.), Elhauge (2009a:513), Paulis (2008:519) and Werden (2009:661).

55 The EU commitment decision avoids the term excessive price and emphasizes instead the deceptive conduct (patent ambush) employing the term "unreasonable royalties". (See Case COMP/C-3/38626 Rambus available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/38636/38636_1192_5.pdf and press release IP/09/1897 available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1897&format=HTML&aged=0&language=EN&guiLanguage=en. Neither the decision nor the press release contains references to the terms "exploitative", "exploitative abuse" or "excessive" (except in a different meaning as excessive liability).

56 Alternatively and perhaps more understandably, competition authorities may fear losing support at a time of public anger over high prices if they remain inactive.

57 This argument may be of increased importance in jurisdictions with an only limited competition culture where the risk of being perceived as an authority incapable of addressing what may be considered an obvious competition problem by the general public, may result in a backlash of other efforts made by the authority.

excessive prices could serve as PR strategy for competition authorities or in light of the visibility could help in creating a competition culture".

54. Another argument that focuses on the perception of excessive price regulation by competition authorities rather than on the perception of the general public is that price regulation – contrary to this perception - occurs in many instances and is foreseen in many laws and regulations outside the standard context of regulation of public utilities.[58] Reference to fair and reasonable prices are also made in other parts of competition law, for instance in the context of horizontal agreements, where third party access to a standard must be fair, reasonable and on non-discriminatory terms (FRAND) to be admissible. A similar example is the UK Link case in which the OFT concluded that an agreement between all UK banks concerning ATM machines would only qualify for exemption if the charge was set no higher than cost recovery.[59] Another example concerns the regulation of unfair contract terms that require hidden charges to be "fair".[60]

55. In the context of UK market investigations the UK Competition Commission regularly examines markets in which prices are found to be excessive and while it has typically not resorted to price regulation, this option remains available.[61]

56. Finally a type of matter of fact argument has been provided. It rests on the simple observation that there exist many jurisdictions with legal provisions in place concerning excessive prices. Where excessive prices fall under competition law, intervention by the competition authority may often be required[62] and there may simply be no way of escaping "the fact that, from time to time, complaints about alleged exploitative pricing abuses have to be investigated"[63].

### 3. Regulation versus competition law

57. The debate on the application of competition law versus regulation has mainly focussed on the role of competition law where sector specific regulation is in force and has not focussed on specific infringements or theories of harm.[64] In addition there is of course an important but largely advocacy based debate on competition assessment and how rules and regulations can be improved and streamlined.[65]

58. Also with a sector focus, the OECD has explored the factors that government decision-makers should take into account when deciding on the appropriate division of tasks between competition

---

58 See section 5.

59 OFT Decision of 11 May 2000, Link Interchange Network Ltd, Case No. CP/0642/00.

60 The example given was the threat of the OFT concerning default fees charged by credit card issuers for late payments, which were considered substantially above cost. See OFT (2008). For an excessive price case on a similar issue, see the Korean Credit Card Case described in Annex 2.

61 See Fletcher and Jardine (2008:540) who note that in practice other remedies have been preferred to regulating prices directly.

62 Of course even in these jurisdictions there typically is some discretion regarding interventions and also regarding the technical assessment of what constitutes an excessive price abuse.

63 Forrester (2008:551).

64 See OECD (2011a).

65 See OECD (2010a), (2010b) and (2009b).

authorities and regulatory authorities in network industries and sectors opened to greater competition in a past roundtable.[66]

59. The debate on the regulated conduct defence focuses mainly on whether regulation or competition law should take precedence and under what conditions companies may refer to regulatory compliance as alleviating factor in an antitrust context. The discussion of regulation versus competition law in the specific context of excessive prices is broader and concerns the question of the respective roles of competition authorities and regulators more genuinely as it does not focus on questions of precedence in areas of jurisdictional overlap. Discussing the respective roles in the context of excessive prices seems particularly warranted in light of the fact that excessive prices have been rejected not only by individual authors but by whole jurisdictions as not falling under the remit of competition law.

60. While the title of this section suggests that institutional responsibility to deal with excessive prices is given either to the competition authority or to a sector regulator, implying also that conceptual boundaries are aligned with institutional ones, the reality is often more complex. Indeed, competition law and policy principles are often central to regulatory policies.[67] A common implicit assumption appears to be that whenever competition law fails or has little chance of success, price regulation by a specialist regulator is an appropriate answer. In turn, instances exist where price regulation is removed once appropriate competition tests are satisfied.[68]

61. It should come as no surprise that competition law will not always provide the right tools to wield against market failure. In turn, not all market failures can be effectively addressed and redressed by sector specific regulation.

62. Regulatory failure has sometimes been due to a mismatch between the tool deployed and the problem to be addressed.[69] While this is true for specific regulatory instruments, the broader question of whether competition authorities or regulatory authorities are more likely to have the appropriate combination of tools and expertise in their respective repertoire may be crucial in properly addressing excessive prices. Of course this presupposes that excessive prices are considered a problem that should and can be successfully addressed. While it is largely considered uncontroversial that regulatory intervention is warranted for example for public utilities and that sector regulators are better placed than competition authorities in performing these regulatory functions, this is not the case with respect to excessive prices.

63. The question of the allocation of tasks between competition authorities and (sector) regulators is of course moot in those jurisdictions where excessive prices are not considered an antitrust offense. As in these jurisdictions regulators may nevertheless be entrusted with similar powers on a sector level, understanding the logic behind this (extreme) distribution of tasks may still provide important insights to

66 See OECD (1999). In that report it was noted that "we will not deal with how both might evolve in the long run depending on the tasks they are assigned and any appropriate changes that legislators might eventually wish to make in their overall mission statements, powers and structures." OECD (1999:17). The same applies here.

67 Under EU Directives on Telecommunications for example, regulation is linked to the concept of significant market power (SMP). Similarly Australia and to some extent New Zeeland have subsumed regulation into a general competition framework, implying for example that regulations are removed if the existence of sufficient competition can be demonstrated.

68 Concerning interstate electricity markets in the US for example, the Federal Energy Regulatory Commission (FERC) removes types of price regulation if electricity generators can prove that they are subject to competition on the basis of FERC's competition test.

69 Breyer (1982:191) notes: "regulatory failure sometimes means a failure to correctly match the tool to the problem at hand".

those where a different distribution is in place. This is of course also true of potential conflicts between regulators and antitrust authorities.

64. In "gap" and to a more limited extent also in "second-shot" cases, the division of tasks is simple as such cases would clearly fall under the remit of competition law. This is not necessarily true for the other arguments advanced in favour of intervention. According to Blumenthal, the question of the allocation of tasks seems *a priori* excluded at least when ongoing monitoring is required:

> *"Governments have a number of regulatory tools at their disposal for responding to perceived market defects. If a particular monopoly presents a problem that is so severe and intractable that enforcement officials believe the only effective remedy would entail ongoing monitoring and supervision of price, we should be asking whether a sectoral regulator with the appropriate competencies is available. And if none is, we should be asking whether the market failure is really of such a character that one should be constituted."*[70]

65. Important legal differences between the US and for example the EU exist with respect to excessive prices as antitrust offense. Despite these differences, the reluctance to engage in "price regulation" appears to also be shared by the European Commission:

> *"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."*[71]

66. This view is seemingly also shared by other jurisdictions:

> *"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, competition law should not undermine appropriate incentives for undertakings to innovate."*[72]

67. As has been righty emphasized "to conflate competition law with regulation is a fundamental error"[73] but there is also a danger that competition authorities, eager to free themselves of difficult responsibilities, prefer to point to specific sector regulators as appropriate bodies to deal with alleged excessive price cases. While an effective division of tasks should be sought, it is not clear whether such division implies no role for competition authorities, in particular if competition laws assign corresponding responsibilities. This "hot potato" dimension of the distribution of tasks has been provocatively formulated by Jenny:

---

70 Blumenthal (2008:580). Noting, however, that "(F)from the perspective of the economy as a whole, competition enforcement .. qualifies as the default regulatory tool." Blumenthal (2008:576).

71 European Commission XXIVth Commission Report on Competition Policy 1994, para 207 (1994), See also European Commission Vth Commission Report on Competition Policy 1975, para 76 (1975) and European Commission XXVIIth Commission Report on Competition Policy 1997, para 77 (1997).

72 See OFT (2004). Note again that it is generally not pre-entry prices and profits that attract entry. There are circumstances, however, where pre-entry prices convey information about post-entry profitability of an entrant. This is particularly the case if high pre-entry prices are due to capacity constraints or other supply constraints. More trivially, post-entry prices will not be above pre-entry prices.

73 Furse (2008:83).

> *"..are we ready to go on record saying that we think price gouging should be untouchable because we need to avoid deterring investment? If we do that, politicians will say, 'Ok, competition authorities are useless, so let's enact some price gouging laws.'"*[74]

68. For the purpose of this paper regulatory authorities are defined as regulators covering one or a small number of sectors where the government believes the public interest would not be adequately advanced merely by relying on private markets supervised by a competition authority and decides therefore to empower an individual or institution to directly specify market outcomes such as price and quality.[75]

69. Table 2 provides an overview of major differences between competition authorities and regulatory authorities.

74 Jenny (2008:498).

75 (OECD 1999:18).

**Table2. Comparison of Competition Law and Regulation**[76]

| | Competition law/ competition authority | Regulation/regulatory authority |
|---|---|---|
| Policy goals | Efficiency, consumer welfare, protect the competitive process | Efficiency, consumer protection, infrastructure investments, universal service, environmental goals… |
| Intervention threshold | dominance | varies |
| Frequency of intervention | selective | Continuous, universal |
| Information | No systematic market monitoring, burden of proof on authority | Systematic market monitoring, burden of proof on companies |
| Sector knowledge | lower | high |
| Independence | high | lower |
| Capture risk | lower | high |
| Instruments | Behavioural and structural remedies, fines | Price regulation[77] |
| Organisational culture | Functioning markets are the rule, interventions the exception | Interventions are the rule, functioning markets the exception |
| Staff size | smaller | large |
| Judicial review[78] | full | often limited |

70. A distinction often emphasized in the literature on excessive prices is that:

> *"Regulation is an ex ante process, aiming at dictating conduct and commercial behaviour, as a substitute for real competition until the market can work properly. Competition law aims at forbidding and punishing anticompetitive conduct. With the exception of merger control it applies ex post."*[79]

71. This dichotomy of *ex post* control through a competition authority and *ex ante* regulation through regulatory authorities is somewhat artificial as the institutional diversity is in reality much larger and goes beyond a simplistic *ex ante* intervention versus an *ex post* oversight approach.

---

76 Modified and expanded from Haucap and Uhde (2008:255). See also OECD (1999:24ff.). The Figure assumes that competition law and regulatory policies are not conducted by a single authority as is the case in some OECD Member Countries. It further does not distinguish between characteristics that are likely to be permanent and those that could be changed, such as for example the intervention threshold on the one side and the expert knowledge on the other.

77 With the move from cost-based regulation to incentive based regulation and mechanism design, regulators may also regulate quality to avoid companies trading off quality and price.

78 See Lavrijssen, Essens and Gerbrandy (2009).

79 Forrester (2008:564f.). Note that in some jurisdictions merger control may also be *ex post*.

72. Nevertheless, one reason that such a distinction may be relevant is the problem of legal certainty. Any legal rule that seeks to prohibit excessive prices should be reasonably capable of *ex ante* application by a dominant firm at the time it formulates its pricing policy.[80] Clearly this is much more of a concern for interventions based on competition law than for regulatory approaches.[81]

### *3.1. Legitimacy and mandate*

73. Discussing legitimacy or the mandate of competition authorities to enforce excessive price abuses may seem superfluous as such provisions can either be found in the jurisdictions' relevant competition law provisions or not. As a result, it is clear that a competition authority that proceeds in bringing an excessive price case based on its particular excessive or unfair price laws is certainly mandated to do so. Nevertheless, there is a distinction between competition authorities on the one hand and regulators on the other concerning legitimacy and in analogy there may also be a distinction between competition authorities when they deal with abusively excessive prices on the one hand and competition authorities enforcing merger control or anti-cartel provisions on the other.

74. Regulators typically have a sector specific mandate with closely prescribed powers.[82] In the context of excessive prices, or price regulation more generally, the legitimacy typically derives from the specific mandate to regulate a well-defined product or service and to determine the price of that well-defined product or service based on a particular methodology. Such a sector specific regulator regularly collects the needed data, conducts the necessary analysis, organizes the required hearings, follows the foreseen appeal procedures and implements the price in accordance with its specific mandate.

75. In contrast, a competition authority has a very broad mandate as it is typically responsible for enforcing competition law in all sectors of the economy. While this wide power is limited to the application of competition law and constrained by the courts, it is wider in scope than the power of a sector regulator.[83]

76. The decision to find a particular price to be abusively excessive is, for example, outside the remit of a sector regulator who often starts its work on the very basis that a particular price is to be regulated.[84] While regulating prices or ordering a remedy once it has been established that intervention is warranted is something both may have in common, the decision to intervene is made by the legislator in case of the sector specific regulator and not by the regulatory authority itself.

---

80 "..even if it is accepted .. that exploitative pricing should be controlled, there is the difficulty of translating this policy into a sufficiently realistic legal test. A legal rule condemning exploitative pricing needs to be cast in sufficiently precise terms to enable a firm to know on which side of legality it stands." (Whish 2003:689).

81 Fletcher and Jardine (2008:537) state that "..it seems likely that the 'deterrent' effect of excessive pricing rules – whereby dominant firms in the economy endeavour to keep prices below their 'best guess' as to what constitutes excessive pricing – has the potential to be substantially more problematic than the ex post [the authors probably mean ex ante] regulation of those dominant firms whose pricing has explicitly been found to be exploitative.".

82 While this may be true for price regulation it may not hold generally as regulators deal with large firms on a daily basis on a wide range of issues allowing for "soft power", or in other words, being in the regulator's "good books" will not be something that a firm will casually sacrifice implying some discretionary power of the regulator.

83 Although it could also be viewed as being more constrained as the intervention threshold is much narrower.

84 As hinted at previously, for instance in the context of SMP in Telecommunications regulation, these classical dividing lines are shifting.

77. In contrast, the choice of the sector, of the methodology used and of the remedy imposed will be in the discretion of the competition authority but almost never in the discretion of a regulator.[85] In case of a regulator, the sector and the desirability of intervention is (typically) determined by the legislature that does not attempt to objectively derive whether a particular price is abusively excessive or not but intervenes on general public policy grounds.[86]

78. In particular for those who doubt that excessive price cases can be built on objective criteria, such as an objectively identified margin between price and cost, this difference in powers is important. This is presumptively what Fox is getting at when she writes:

> *"American law rests on the principle that price should be controlled by the free market unless Congress has in effect determined that the market cannot work and has established a regulatory commission"*[87]

79. To the extent that one believes that concepts such as "economic value" or "excessive price" are difficult to meaningfully define objectively, one may prefer to embrace a normative approach. This would then be much closer to the situation described by Justice Stewart in his threshold test for "hard-core pornography" in 1964:

> *"I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But* ***I know it when I see it*** *[emphasis added], and the motion picture involved in this case is not that."*[88]

80. Typically legislatures, not courts are considered the appropriate bodies for such normative decisions, which explains at least in part why Stewart's quote is often cited. As is also apparent from the quote from Fox above, many authors, even those against any intervention on the basis of price alone, would already feel much more comfortable if decisions on excessive prices were taken by the legislature when determining what sectors and also products and services require price control rather than by courts or competition authorities.

81. There may be situations in between the two "extremes" just presented, where excessive price abuses are covered under competition law but where the legislature nevertheless emphasizes the desirability of an application of these provisions in particular instances. An example of such a specific provision temporarily introduced into competition law can be found in Germany. Section 29 ARC was introduced into the German competition law. It concerns abuses by gas and electricity companies and will be discussed in some detail in section 5 and Annex 2. As arguably the reason for the introduction was mainly to give more extensive powers to the competition authority and to emphasize the specific concerns of the legislator, such provisions are certainly capable of fully addressing the legitimacy concerns raised above.

---

85 A possible exception to this may be UK market investigations.

86 The legislative decision in the case of a competition authority is very general and broad as it does for example neither involve the specification of the sector nor the methodology to be used.

87 Fox (1986:993).

88 See Justice Potter Stewart's concurring opinion in Jacobellis vs. Ohio 378 U.S. 184 (1964). The case concerned possible obscenity in the Louis Malle film "Les Amants" (The Lovers). See also Gewirtz (1996). The idea that something may be hard to describe, but instantly recognizable when spotted, has also been dubbed the elephant test.

82. In addition to competition authorities receiving regulatory mandates, there are many examples where competition powers have been given to sector regulators.[89] In the US, for instance, certain competition assessment functions are given to sector regulators such as in the aviation industry (the power to decide airline alliances and mergers) and in railroads (the power to authorise conferences). As a result, the institutional boundaries may in reality be less strict than suggested here.

### *3.2. Second-shot and gap cases*

83. One of the arguments advanced in favour of excessive price abuse as an active instrument in the competition law enforcement toolbox relates to the possibility that such cases may be used to correct for earlier enforcement "mistakes".[90] Just as errors in merger control may be caught at a later date through an abuse of dominance case, excessive price cases may allow correcting type II errors (false acquittals) in the area of exclusionary conduct (and merger control).[91] The idea behind this argument is that a competition authority may either not be aware of exclusionary conduct or, in the presence of uncertainty, may underestimate the exclusionary effects of a certain conduct. If that happens, and if the dominant position of a firm is strengthened while the exclusionary abuse that allowed the strengthening remains unprosecuted, the authority could intervene on the basis of excessive prices.[92] This argument has also been made by Régibeau (2008:653) who evoking the uncertainties involved in exclusionary cases and merger control, points to the added value in maintaining a rule against exploitative pricing as "additional" tool to help restrain the behaviour of dominant undertakings.

84. Another key argument advanced in favour of excessive price cases are so-called gap cases.[93] In jurisdictions where the acquisition of monopoly power as such is not caught by competition law, cases based on excessive prices may be a way of filling the enforcement gap. In jurisdiction where the acquisition of monopoly power is caught by competition law, the "second shot" argument could in turn apply when the authority in fact missed the opportunity to prosecute the exclusionary abuse leading to dominance.

---

89 This is the case for example in the UK with respect to the gas and electricity markets (Ofgem) and with respect to telecommunications (Ofcom) and in Singapore with respect to the telecommunications authority (iDA). In addition to the specific provision introduced into the German competition law, there are also other, more comprehensive examples where regulatory powers have been given to competition authorities as for example the Australian Energy Regulator which sets prices for energy network infrastructure and is a semi-autonomous part of the Competition and Consumer Commission (ACCC). The broadest regulatory power given to a competition authority is probably the market inquiry tool of the UK Competition Commission.

90 See Röller (2008:529).

91 This is essentially what happened concerning roaming charges in the EU. See Maier-Rigaud and Parplies (2009).

92 "As a result, one may argue that two instruments are better than one. In other words, exploitative abuses can be stopped whenever the exclusionary abuse has had an actual effect, even where it was previously deemed unlikely" (Röller 2008:530) Röller cautions though that one may legitimately wonder whether a better policy response would not be to reduce mistakes rather than to rely on a second shot with an exploitative theory of harm. The analogy to merger control seems reasonable where it is generally considered preferable to prohibit a merger or require divestitures than to try to deal with its anticompetitive effects in a monopolization case afterwards.

93 An additional advantage of interpreting excessive price case in this way is that it would provide for a partial explanation of the differences between the US and the EU approach. See Paulis (2008:519).

### *3.3. Specialised sector knowledge and regulatory capture*

85. One of the main practical reasons advanced for the reluctance of competition authorities to engage in excessive price cases is the risk for competition authorities of becoming entangled with price regulation, possibly on a day-to-day basis, and that competition authorities simply do not have the specialized sector specific knowledge that would allow them to do this properly.[94]

86. Representative of this view and focussing on considerations of institutional design, Blumenthal questions "whether competition agencies have the competence to engage in classical price- and profits utility style regulation. As generalist agencies, we lack the right people. We lack the skill sets. We lack adequate industry expertise. Experience has shown that when we've tried to step into the role of utility-style regulators, we've bungled the task."[95]

87. This concern over the lack of specialized sector knowledge may even be exacerbated in competition law systems that rely on non-specialized courts to take final decisions. Indeed, many competition authorities are required to go to court to obtain orders or levy fines. In administrative law systems in contrast, the differences between competition law enforcement and regulation are more limited and can more easily be addressed by corresponding staffing decisions. Similarly to regulatory authorities such systems combine investigative and prosecutorial functions in the competition authority thereby distinguishing themselves from the typical regulator only by the latter's additional adjudicative function.[96]

88. In addition, even where regulators' decisions are subject to judicial review, their decisions may be accorded greater deference than rulings by competition authorities. This difference arises from the fact that competition agencies are charged with enforcing a law of general application, as opposed to drawing up and enforcing industry or even firm specific rules presumably based on information and expertise extending beyond what a court could appreciate and apply.[97]

89. The argument of inadequate specialized knowledge has several facets to it as it is not only due to the recruitment of specialized staff, something a competition authority may in principle mimic, but also

---

94 As pointed out by Siragusa (2008:646) this is linked with the perception that excessive price cases require a price regulation type of remedy: "One of the reasons for the reluctance to enforce unfair pricing under Article 82 [102 TFEU] is that the competition authority may become entangled with the day-to-day monitoring of pricing behaviour. That fear is steeped in the conviction that the 'right prices' are *the* remedy to excessive pricing offences. If one were to choose the structural remedies option, that fear would clearly be seen as being misguided. The regulator would remain in charge of price setting, while the antitrust authority would be responsible for reforming market structure. In fact, structural remedies may usefully supplement the arsenal of tools given to the regulator." A discussion of types of remedies in excessive price cases can be found in section 8 below.

95 Blumenthal (2008:578). Note that this argument is the only reason advanced by Blumenthal in "cautioning against even limited intervention by competition agencies against high prices". (578)

96 Fox (1986:992) discussing excessive prices in the EU writes that European Law "assumes that high pricing is unfair, it assumes that unfairly high pricing can be identified by the courts, and it implies that courts are better mechanisms than markets to correct unfairly high pricing. The Community's legal standard is not the model of clarity" At least the part of the argument concerning courts seems to confuse the US system with the system in the EU.

97 OECD (1999:27f).

builds on the fact that the focus on a particular sector limits the range of possible problems and allows for faster learning as the regulator moves from one regulatory decision to the next.[98]

90. Of course, competition authorities could develop or acquire sectoral knowledge.[99] However:

> *"Some have suggested that competition authorities could develop the needed competencies and might be superior to classical regulators in intervening against excessive pricing in traditionally unregulated sectors. On this view, competition authorities would be more limited in their interventions. They would be more likely to look to market mechanisms before adopting more intrusive steps, they would be more sensitive to the distortions they were causing, and they would be more willing to recede from intervention after the markets had corrected adequately. They would also be less susceptible to capture. All these points have merit. But as a matter of institutional design, they come at an unacceptable cost."*[100]

91. While both competition authorities and regulators vitally require independence from the firms they oversee, there is reason to believe that regulatory capture is a real problem. In particular and closely linked to the greater sector specific knowledge, it is widely accepted that regulators are more prone to capture than competition authorities. Compared with sector-specific regulators, staff and senior decision-makers at authorities covering the whole economy are less likely to have the kind of in-depth industry specific knowledge, contacts, and outlook that would make them particularly valuable later on as employees with or lobbyists and consultants for those they are currently influencing. In general the frequent and repeated interaction between regulators and regulated firms tends to make capture a greater risk for regulators.[101]

92. Over time, there is a risk that along with sharing similar information about an industry, regulators will come to share the industry's perspective. This could include its fear of fostering greater competition which could make it harder for regulators to run cross-subsidisation schemes, or to promote policies such as environmental protection and energy security. Over the long haul, these contributions could be just as important for the regulator's own survival as ensuring that a large group of poorly organised consumers enjoys reasonable service quality and prices.[102]

93. Indeed, the non-sector specific nature of competition authorities that is seen as a major obstacle to successful price regulation by competition authorities has the flipside benefit of leading to "less chance of 'capture'"[103].

---

98 It should also be noted that often the comparison between competition authorities and regulators not only reveals different skill sets but substantially larger staff size on the part of regulators. See Table 2 above.

99 That sectoral knowledge of competition authorities can be limited is implicit in the decisions to launch sector inquiries by the European Commission. At the same time, sector inquiries are also a good example of how competition authorities may be able to gain sector specific knowledge. EU sector inquiries have the further advantage that they are based on much more powerful information gathering powers than most regulators have at their disposal. The EU energy and pharmaceutical sector inquiries, for example, generated data bases that were unique on the European level and contain data that is not available to regulatory counterparts.

100 Blumenthal (2008:579).

101 OECD (1999:28).

102 OECD (1999:28).

103 OECD (1999:21).

### *3.4. Competition authorities as residual regulators*

94. Competition authorities may have a role to play as residual regulators or regulators of last resort particularly for sectors not requiring permanent regulators.

95. While it may be tempting for competition authorities to defer to regulators or the legislature, despite clear legal provisions in the competition law, it is doubtful whether this approach will always be compatible with a light handed approach to regulating and intervening in markets. Not all problems of excessive prices will require permanent oversight and price regulation on a continuous basis.[104]

96. As pointed out by Lyons, it "is not unusual to hear the argument that high prices should not be considered under Article 82 (now 102), but should be left to specialist regulatory agencies. But on what grounds should sectors be selected for price control?"[105] In particular in cases where there are no strong *ex ante* grounds for regulation, it may in fact be much less restrictive to allow companies to compete without subjecting them to regulation in the knowledge that a competition authority could still intervene *ex post* in case competition really does not develop and prices become or remain exploitative. Weak *ex ante* grounds for setting up a specialized regulator may also simply be due to the fact that the problem is non-recurring or not recurring sufficiently often.[106]

97. Permanent regulation may turn out to be a disadvantage. Few regulatory authorities have effectively managed to cut back on regulation over time and finally closed their doors as the market had become competitive and no longer required regulation.[107] A competition authority, already due to the cultural differences mentioned in Table 2 above, is much more likely to withdraw the generally unwanted regulatory task once a sufficient degree of competition emerges.[108]

---

104 Another aspect concerns the potential of crowding out more efficient regulation. This may occur both, when the competition authority intervenes in cases where it is not well placed to do so and in cases where it does not intervene despite the fact that a permanent regulatory body is an inappropriate solution. While a competition authority may feel compelled to tackle the issues as a regulator of last resort for example in the absence of a sector specific regulator, even clumsy intervention is likely to reduce the pressure on the legislature to intervene properly and may in the long term hinder a more appropriate solution. The problem is identical with reversed roles under voluntary crowding out when the competition authority steps aside when in fact it would have been the preferred choice.

105 Lyons (2007:84).

106 A variant of this, that arguably could apply for example to the EU Port of Helsingborg cases (see Annex 3), is that the problem is trans-boundary, i.e. concerns different jurisdictions in an asymmetric way and the creation of a supra-institutional regulator is politically unfeasible. While networks of national regulators can go a long way in addressing such problems, as demonstrated in the EU, this may not always be the case, in particular if the problem concerns very specific products or services as opposed to the standard regulated industry sectors.

107 Forrester (2008:554) notes that "regulators have a reluctance to find that effective competition will be sustainable in the absence of regulation". He goes on to note his concern for the lack of expertise and autonomy in national telecoms regulators referring to several annual reports (10-12th report) of the European Commission on European electronic communications regulation and markets.

108 It has similarly been suggested that there may be a role for competition authorities to act as temporary price regulators in instances that may be characterized as price gouging. For example in case of a natural disaster, the competition authority would assume the role of a temporary price regulator as urgent action would be needed and the excessive price could easily be determined with respect to the price prevailing prior to the natural disaster and the intervention would be relatively short-lived. Lewis (2009:588, Footnote 4)

98. In transition economies, monopoly positions in some sectors may be significant but non-permanent reflecting the pattern of past capital investments, when decisions about plant size and ownership were not market-based. In such cases firms may still have substantial market power for many years after liberalization. In such cases, if the price is persistently excessive, temporary price regulation may be appropriate but may not warrant the creation of a specialized sector regulator.

99. A drawback of assigning competition authorities the role of regulators of last resort is that involving a competition authority in regulatory matters including "decisions having very important distributional as well as efficiency implications" [109] may be problematic as this is "inherently more political than might be considered optimal for a body that in its general enforcement functions wants and needs to be regarded as an impartial overseer intent on advancing general public welfare rather than dividing a pie among competing interests."[110]

### 4. Appropriate screens for pursuing excessive prices

100. Several screens have been proposed in the literature to narrow the legal scope for opening excessive price cases in those jurisdictions where excessive prices are considered an abuse in the law.[111] The following excerpt from a speech of the former Director General of DG Competition contrasting the situation in the EU with the one in the US, demonstrates some of the difficulties of jurisdictions that have excessive price provisions but try to limit the scope of application to specific conditions:

> "*Under US law excessive pricing by a monopolist does not attract liability. Exploitative practices are regarded as self-correcting because the exercise of market power to raise prices will normally attract new entrants.*
>
> *As regards exploitative practices, we are obviously aware that in many markets intervention by a competition authority will not be necessary. We are also 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.*
>
> *It is not in our power to change the Treaty. 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. It probably makes also sense to apply those provisions in recently liberalised sectors where existing dominant positions are not the result of previous superior performance."*[112]

101. In light of the difficulties inherent in the concept of excessive price abuses, it is not surprising that conditions for a sensible narrowing of the scope have been sought. The range of conditions span from screens designed to identify the "exceptional circumstances"[113] under which excessive prices should be

---

109 OECD (1999:22).

110 OECD (1999:22).

111 In the words of Blumenthal (2008:577): "what are the narrow, focussed circumstances – what are the extensive preconditions that must be satisfied – before intervention would be warranted". An overview of proposed screens in addition to their own proposal can be found in Motta and de Streel (2006) and Motta and de Streel (2007).

112 Lowe (2003).

113 Evans and Padilla (2005:120).

pursued to more encompassing screens focussing only on entry barriers.[114] Some of these screens directly relate to the regulatory environment or in a wider sense also concern liberalisation and privatisation. Others focus on the way dominance was obtained and include the notion of "gap" or "mistake" cases.

102. The discussion of possible screens focuses on identifying which markets could be candidates for possible intervention against excessive prices of a dominant firm. This section emphasizes the individual conditions and less the particular bundles of often cumulative conditions that have been proposed. The focus will be on the three most often cited conditions while all other propositions are nevertheless discussed in a separate subsection as well.

103. In addition the practical legal problems concerning the use of screens as "unofficial" policy constraint in excessive price cases are discussed. These potential problems are related to the particular legal environment within which competition law takes place and may therefore concern different jurisdictions in varying degrees.

### *4.1. High and non-transitory entry barriers*

104. This requirement is based on the fundamental proposition that competition authorities should not intervene in markets where it is likely that normal competitive forces over time eliminate the possibilities of a dominant company to charge high prices.[115]

105. Generally three types of entry barriers can be distinguished. *Legal* barriers to entry refer to statutory monopoly provisions or any other special rights and conditions imposed by regulation or law. *Structural* barriers relate to basic industry conditions such as for example cost and demand. *Strategic* barriers, in contrast, are intentionally created or enhanced by incumbents essentially for deterring entry into a market. Obviously *strategic* entry barriers can directly be tackled by competition authorities by pursuing the underlying exclusionary conduct. The proposed screen is therefore focussing on the former two types of entry barriers, in particular structural barriers.

106. The existence of high and non-transitory *structural* entry barriers are probably considered the most important single requirement for conducting an excessive price case.[116] It is the only screen proposed by Paulis (2008:522) but is certainly also not in contradiction to the statement by Justice Scalia in the US Trinko case if sufficient emphasis is placed on "at least for a short period":

> *"The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices — **at least for a short period** [emphasis added] — is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct."*[117]

---

114 See Paulis (2008). In addition, some authors, such as Werden (2009) or Fox (1986) have rejected the idea of excessive price cases altogether.

115 See Motta and de Streel (2007:22f.).

116 Evans and Padilla (2005:119). It could also be considered the lowest common denominator across the various screens proposed.

117 *Verizon Commc'ns Inc. vs. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, p. 407 (2004). http://law.onecle.com/ussc/540/540us398.html

107. High and non-transitory entry barriers defined in this way basically imply that there is neither an effective way for the competition authority to tackle the entry barriers directly nor a hope that such barriers are only of a transitory nature. If that is the case, the authority can tackle the barriers indirectly by advocating in favour of lifting legal barriers and liberalizing the sector (in case of legal entry barriers) or, in case of structural barriers it can advocate a regulatory solution.

108. Not only to render the advocacy work more effective but also to have a fall-back option in case it ultimately fails, it has been proposed to follow a two pronged approach, coupling advocacy efforts with the opening of an excessive price case by the competition authority.[118]

### *4.2. Super dominance and its origin*

109. One of the most fundamental conditions discussed in the literature is the requirement of a monopoly or near monopoly position, or, in other words, super dominance.[119] While all jurisdictions require dominance[120] in order to find an abuse to begin with, one of the proposed screens has been to raise the bar even further. The reasons for this are of course related to the fact that the more the monopoly scenario is left behind in favour of an oligopolistic market structure, the less likely the market power of a dominant firm will be sufficient to generate excessive prices. In addition, the higher the degree of market power, the more unlikely the market will self-correct within a relevant timeframe. While this proposed screen has not gone as far as narrowing down the scope for cases to monopoly situations, it requires the other firms in the market to be fringe players incapable of effectively constraining the dominant firm. An additional argument for raising the bar higher may also be due to the resulting legal certainty to firms that may still be considered dominant but would clearly not pass the super dominance test.[121]

110. A separate screen that has been proposed in this context concerns the origin of the dominant position. In general terms the argument has been made by Vickers (2003) that "appropriate public policy towards firms with actual or potential market power depends on the cause of the market power". While authors such as Paulis (2008:520) have been sceptical of including either the origin of the dominance or super dominance in the equation, some authors have emphasized this aspect as a practical way of linking excessive price cases with exclusionary abuses and of identifying candidate sectors.

111. The most common argument for considering the origin of the dominance is due to current or past special or exclusive rights. This of course targets former government monopolies or any other company that benefitted from what could be considered legal entry barriers in the past.[122] This argument appears to

---

118 This is proposed by Paulis (2008:521).

119 See for example van der Woude (2008:619) speaking of monopolistic or quasi-monopolistic market structure or Motta and de Streel (2007:24f.).

120 For a discussion of collective dominance in the context of excessive prices see section 7 below.

121 See, however, subsection 4.5 below discussing the general constraints of such screens and the possibly resulting limited legal certainty.

122 Evans and Padilla (2005:119) specifically mention „the firm enjoys a (near) monopoly position in the market, which is not the result of past investments or innovations, and which is protected by insurmountable legal barriers to entry". Evans and Padilla (2005:120) explicitly would not consider it relevant if the company is a former state owned monopolist or not as to them only legal barriers still in place would matter. Past barriers or whether investments were based on public funds do not enter this assessment. In addition to the cumulative conditions they propose as screens, the authors remain critical and suggest that "it remains unclear why it may not be better simply to rely on ex-ante regulation, setting up sector-specific regulatory bodies with more information about the fundamentals of the markets in question and better able to monitor compliance." (Evans and Padilla, 2005:122).

be particularly pertinent also in those Asian countries that have excessive or unfair price provisions in their competition laws (often translated as price abuses there).[123] The threshold to intervene on the basis of "abusive prices" is much lower if the firm was set up as a result of a former government led economic development strategy and their position is therefore due to government intervention rather than market based competition. This also applies to sectors where the industry structure is essentially government induced.[124]

112. So-called "gap" or "mistake" cases are also based on the origin of dominance and have been proposed as they have the direct appeal of linking excessive prices with past exclusionary conduct, thereby avoiding the thorny issue of defining theoretically and operationalising practically what excessive prices are.[125]

113. Gap cases can only exist in jurisdictions that do not have a monopolization offense as they require dominance in order to find an abuse, as for example under EU law. Mistake cases on the other hand are based on a misjudgement of the effects or unawareness of previous exclusionary conduct of the firm.[126] An excessive price case may then provide a possibility of "correcting" for a lacking intervention concerning exclusionary conduct *ex post*.

114. There is a link between such cases and the argument that exploitative cases should only be considered with respect to former government monopolies. While former government monopolies may not have gained their dominant position by exclusion, they did not gain that position in a competitive process either.[127]

### *4.3. Weak or absent sector-specific regulator*

115. Related to the advocacy argument made above is the proposed condition of either a weak or no sector specific regulator.[128] In other words, in the presence of a sector specific regulator it seems reasonable if not necessary to leave the task of addressing the problem to the specific body. This would generally also apply if the sector specific regulator has not (yet) the specific mandate needed to address the excessive price problem. Advocacy on the part of the competition authority may be helpful in allowing the regulator to obtain the required mandate.

116. While advocating in favour of creating a new regulator may also be an option for a competition authority if no regulator currently exists, the likelihood of success within a reasonable time frame is limited

123 For example Korea, China, Mongolia and Chinese Taipei have specific excessive price provisions in their competition laws. These are of course to be distinguished from more general unfair pricing laws covering for example what is often called unconscionable conduct. The laws can be triggered when a company takes advantage of another person's inability to properly protect their own position and are independent of whether the company is in a dominant position or not. On this see section 5 below.

124 On this point see Annex 2 discussing a Korean case.

125 This may be overly optimistic as it can be questioned whether the exclusionary acquisition of dominance for example is sufficient to prove that prices charged subsequently are excessive. The same applies to "second-shot" cases where in addition to this problem, *ne bis in idem* concerns may further complicate things.

126 Again, this could concern both, firms already in a dominant position and firms that monopolize through an exclusionary strategy.

127 Röller (2008:529; 531) would, therefore, include former state owned incumbents in the category of gap cases.

128 See Motta and de Streel (2007:26ff.).

and such efforts should probably then be accompanied by an opening of an excessive price case as set out above. Competition law enforcement action should probably also be initiated in case there are limited grounds for setting up a regulator, for example due to an only occasional occurrence of problems in this area simply not warranting the creation of a regulatory body.[129] It may also simply not be feasible to set up a regulator.

117. A particularly noteworthy situation may exist in countries transitioning from a planned to a market based economy. In these countries former state monopolies may have been privatized in problematic ways and while there may be hope for the market to correct these initial problems, transitory intervention by the competition authority may be preferable to the creation of a new regulator.[130]

118. The issues are thornier if the screen is extended to include the situation of weak regulators.[131] This obviously raises a range of issues including but not limited to the question of the proper allocation of tasks between regulators and competition authorities in case of concurrent jurisdictions and also issues falling into the category of regulated conduct.[132]

119. In particular in recently liberalized sectors, or in the privatisation process of public utilities in some of the new EU Member States, regulators may not have been able yet to establish a firm presence and properly regulate former state monopolies that maintain high level ties with government.

120. Recent EU energy cases point to the fact that quite generally at least the EU Commission will not refrain from enforcing competition rules in regulated sectors. This applies to national regulation that is anyhow subservient to EU competition law but also to regulations on the EU level.[133] This includes instances where a national regulator either decided not to intervene or had endorsed the behaviour of a dominant company.[134]

### *4.4. Additional conditions*

121. A few other screens have been proposed in the literature.[135]

122. In their discussion of appropriate screens, Evans and Padilla (2005:119) propose to also include the risk that the excessive prices prevent the emergence of new goods or services in adjacent markets as a

---

129 In certain circumstances, for example in cases of trans-boundary excessive price problems in EU Member States, without corresponding responsibilities on the European level, it may be extremely difficult to arrange for a regulatory solution. This is particularly the case if the problem does not concern all involved jurisdictions equally or if there are clear winners and losers.

130 Temporary intervention by the competition authority in such situations may also be particularly warranted in light of the high importance of the sectors concerned for consumers and the need to maintain public support for a market based economy.

131 The term weak regulators is used loosely and is meant to encompasses both, regulators that underperform in light of their mandate and regulators that perform well but function on the basis of limited powers.

132 On the latter issue of regulated conduct see OECD (2011a) for an extensive discussion.

133 See for example the EU ENI case described in Maier-Rigaud et. al (2011).

134 Commission Decision 2003/707 of May 21 2003, Deutsche Telekom AG [2003] OJ L263/9 upheld on appeal Case T-271/03 Deutsche Telekom Ag v Commission, judgement of the Court of First Instance of April 10 2008. See also Commission Decision of July 4 2007 Wanadoo Espana/Telefonica, Case COMP/38.784, Case T-336/07 Telefonica SA and Telefonica de Espana.

135 Some of these screens are also discussed in Motta and de Streel (2007) and Motta and de Streel (2006).

necessary condition for conducting an excessive price case and also on a more technical level that prices charged by the dominant firm should widely exceed the firms average total cost.[136]

123. O'Donoghue and Padilla (2006), concerned with possibly negative dynamic effects suggest that as necessary condition for intervention, investment and innovation should only play a minor role in the industry. Similarly it has been argued that "there should be no intervention against excessive prices or an innovative product within that product's patent life"[137].

124. Another condition proposed is indispensability[138], i.e. that the product must be a good that customers cannot afford not to have, as for example food or medical products and as opposed to luxury goods.[139] In addition to the "cannot afford not to have" standard, van de Woude also includes necessary inputs for downstream activities or access to essential facilities.

### *4.5. The potential limits of screens*

125. There may be practical legal problems with exercising restraint by implementing "informal" or even "tacit" screens by competition authorities. These problems exist as long as the screens are not formally integrated into the basic legal provisions or have become part of the case law. As many jurisdictions benefit from a substantial amount of prosecutorial discretion not only in their *ex-officio* case work, i.e. the cases the authority would actively seek and open itself, but also in the treatment of complaints, screens may be easily implemented in the context of the general setting of priorities for the authority. To the extent that the "informal" screens are, however, considered as setting the appropriate enforcement thresholds, such an approach bears the risk of over-enforcement as the screens would at best only be binding for the authority but would not constitute law or accepted policy.

126. In such cases, private litigation could be launched by a plaintiff on the basis of the law itself and would be capable of producing excessive price cases even if the criteria set out in the non-binding screens (possibly not even known outside the authority) are not fulfilled.

127. This problem may be further exacerbated by the fact that such cases would no longer be treated by the competition authority itself.[140] As the difficulties of excessive price cases including the design of appropriate remedies, is already a challenge for competition authorities the problems are likely to be magnified if treated by non-specialized courts that may not fully appreciate the need for detailed economic

---

136 This is actually one of the criteria used in the Australian access regulation provision - there is no intervention unless the intervention can actually promote competition in another market (See Part IIIA of the Competition and Consumer Act available at http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s44g.html).

137 Fletcher and Jardine (2008:542). This of course assumes that the monopoly right granted under patent law, more specifically the width and breadth of the patent, provides for the proper weighing of the benefits of encouraged investment incentives *ex ante* (including risk of failure) and the disadvantage of limiting competition with all its effects for the lifetime of the patent. On the possible systemic conflict between intellectual property law and competition law, see Régibeau (2008:661ff.).

138 van der Woude (2008:620).

139 This has a theoretical grounding in the fact that more inelastic demand (indispensability), implies a higher price. It is, however, not clear what van der Woude has in mind when he writes "the supplier will not lose sales volume when he increases his prices, even beyond monopoly price levels" (2008:620). Clearly, by definition, quantity and price cannot both exceed the monopoly price and quantity.

140 This is of course to some extent already the case for jurisdictions where no administrative law approach is followed and where this problem therefore exists also for "normal" cases.

analysis and the difficulties involved in such cases. However, private litigants would likely be seeking mainly damages and an individualised supply agreement into the future, something that courts should have fewer difficulties with than finding a market wide solution.

128. The reasons set out above have to be seen as a major drawback at least of "unofficial" screens or any explicit or tacit policy of not giving priority to excessive price cases. As noted by Whish (2003:690), "the fact that the European Commission, in its prosecutorial discretion, has decided not to take direct control of prices does not mean that Article 82 (102) is inapplicable". There is also a risk that a prescriptive adherence to informal screens could expose a competition authority who operates in an administrative enforcement system, as opposed to one that must prosecute its cases in court, to administrative review.

## 5. Some legal provisions on excessive price abuses

129. In this section some of the legal bases for competition authorities to act on excessive prices are discussed. The legal provisions and the case law play a much more important role than the screens discussed in the previous section as they represent the binding basis for intervention even if the courts have not had as many opportunities to clarify the issues as they have in other areas of competition law. In addition, also the economic theories put to courts have been less settled, leaving the legal system to arbitrate between often radically opposing economic approaches.

130. European competition law is the main topic discussed here as it has influenced excessive price provisions in many jurisdictions. In addition German competition law, whose excessive price provisions were developed in parallel with EU provisions and are arguably the most developed, is discussed. In addition to these competition law provisions, other regulatory approaches, that typically follow a different public policy rationale such as price gouging and usury laws are discussed. A selection of excessive price cases is discussed in the Annex.[141]

### *5.1. Unfair pricing under European Law*

131. Article 102(a) of the Treaty on the Functioning of the European Union (TFEU) specifies that imposing unfair purchase or selling prices or other unfair trading conditions either directly or indirectly consists in an abuse of a dominant position (see Box 1). The term "unfair" in turn has been considered by the European Courts and the European Commission to encompass excessive price.[142] Following the case law, excessive prices are prices that have no reasonable relation to economic value. What this means remains open to debate and as was recently noted "even after more than 30 years since the prohibition was first recognized, there is still no sufficiently predictable and concrete definition of what constitutes excessive pricing"[143].

---

141 The Annex includes a case from South Africa, a case from Korea, from Albania, from Germany and two cases from the EU. These cases have been selected to give a rough overview of existing decisions and should not be seen as a representative sample of the case law.

142 See for example Sirena vs. Eda [1971] ECR 69, according to Gal (2004:358) the first case where monopolistic prices without harm to competition were found abusive; Case 27/76 United Brands vs. Commission [1978] ECR 207 (on this case see also Annex 4); Case 30/87 Corinne Bodson vs. Pompes Funebres [1998] ECR 2479; Case 110/99 Lucazeau vs. Sacem [1989] ECR 2811 and Commission Decisions COMP/C-1/36915 British Post office vs. Deutsche Post AG [2001] OJ L331/40; COMP/A 36568/D3 Scandlines Sverige AB vs. Port of Helsingborg and Sundbusserne AS vs. Port of Helsingborg [Jul 23, 2004] (on these two cases see also Annex 3).

143 Gal (2004:373).

**Box 1. Article 102 TFEU**

"Any *abuse* by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

132. An important characteristic of many cases on excessive prices conducted by the EU Commission is their link to the single market agenda.[144] More generally it was noted that enforcing excessive price abuses based on a comparative methodology effectively prevents one dominant company in one market from charging substantially different prices from those charged by other firms for comparable goods or services in other markets, also contributing – at least in terms of price equality – to the goal of integration.[145] These factors are of relevance to the discussion of excessive prices as many jurisdictions today[146] either were inspired by these provisions or, as for example Germany, devised their competition law provisions in parallel with EU law and involving a similar set of people.[147]

133. That excessive prices may be abusive was hinted at already prior to the United Brands case (see Annex 4) but it is only in United Brands that the Court became somewhat more specific as to what constitutes unfair prices. [148]

144 See for example Case 26/75 General Motors Continental NV vs. Commission, [1975] ECR 1367 and Case 226/84 British Leyland vs. Commission [1986] ECR 3263 that both involved restrictions on parallel trade.

145 See Gal (2004:362). This goal of integration has also been cited as the main reason for the initial lack of merger control provisions although some merger control took place under Article 102 TFEU prior to the first EU Merger Regulation (Council Regulation (EC) No. 4064/89) that went into force on 21 September 1990. In fact, mergers across EU Member States were expressly welcomed and encouraged and this may also be one of the reasons that until this day the acquisition of dominance (monopolization in the US terminology) is not prohibited in the EU.

146 See for example Israel or South Africa. Concerning South Africa see in particular Annex 1 discussing the Mittal Case.

147 See Maier-Rigaud (2012).

148 The cases prior to United Brands are Sirena S.r.l vs. Eda S.r.l., Case 40/70, 1971, ECR 69, § 17; Deutsche Grammophon GmbH vs. Metro-SB-Großmärkte GmbH, Case 78/70, 1971 ECR 487, § 19. In General Motors Continental NV vs. Commission, Case 26/75, 1975 ECR 1367, §§ 16-20 no abuse was found for charging a fee that was "excessive in relation to the economic value of the service provided" but was charged only occasionally and for a limited duration only.

134. In United Brands, the court established that it is necessary "to ascertain whether the dominant undertaking has made use of the opportunities arising out of its dominant position in such a way as to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition."[149] This is considered to be the case if the dominant company is charging a price that is excessive because it has no reasonable relation to the *economic value* of the product supplied. Establishing that a price bears no reasonable relation to the economic value of the product could, according to the Court, be established by two cumulative conditions. It would first need to be established that the difference between the costs actually incurred and the price actually charged is excessive. If there is an excessive difference between costs and price charged, it would then have to be determined whether the price is unfair in itself or when compared to competing products. The court also emphasized that other methodologies could also be applied for each of the two legs of the test.

135. The latest decisions of the EU Commission, namely the two port of Helsingborg decisions, have renewed the interest in this test. In particular the statement that "economic value must be determined with regards to the particular circumstances of the case and take into account also non-cost related factors such as the demand for the product/service"[150] has been the subject of considerable debate. This statement has led some authors to conclude that "by making the decisive issue whether prices have 'no reasonable relation to the economic value of the product supplied,' the Commission effectively decreed that prices are not unfair if they are aimed at exploiting the willingness of consumers to pay."[151] According to Werden (2009:656) this implies that all prices charged by dominant companies will have "a reasonable relation to the economic value of the product supplied" as even a monopolist does not price independently of demand and its customers will value the products or services they buy at least as much as they pay for them.[152] In other words, all the decisions are presumably saying is that "the price paid reflects the characteristics of the product, and that this determines the economic value of the product"[153] If that were true, this would indeed "open(s) the way to circularity from which there may be no escape"[154].

136. The interpretation that the EU Commission "abolished" unfair pricing as an abuse "en passant" in two decisions rejecting complaints is unconvincing. While the EU Commission certainly has the possibility to interpret the law and can modify its policy as for instance done with respect to exclusionary abuses after a long process involving several consultations, it would likely do so only in the context of a policy debate.[155] In addition, it in any case cannot change the Treaty. As a result, the reference to demand factors that, as emphasized by Werden, are of course crucial to the economic (as opposed to the European Courts') concept of economic value as determined by supply and demand, has to be interpreted differently.

137. Indeed, there is a lot that speaks in favour of an interpretation that would allow capturing those aspects of demand that would have a bearing on prices also in a more competitive (hypothetical)

149 United Brands § 249.

150 See Scandlines §§ 226-228, 232-233 and Sundbusserne §§ 204-208.

151 See Werden (2009:654f.). See also Akman and Garrod (2011).

152 See also Fletcher and Jardine (2008:536) making the same argument and referring to the England and Wales Court of Appeal (Civil Division), judgement of 2 February 2007, Attheraces (UK) Limited vs. The British Horseracing Board Limited, Case No. A3/2006/0126, [2007] EWCA Civ 38.

153 Furse (2008:72f).

154 Furse (2008:73).

155 In fact the decisions to reject the two complaints coincided with the review of Article 102 a period where policy development in individual cases was therefore unlikely. While that review in the end only focussed on exclusionary abuses, this was not clear yet at the time of the two decisions and any policy change would have pre-empted the debate and would therefore have been deferred to a later stage.

benchmark market. The advantage of such an interpretation of the Port of Helsingborg cases is that it would provide a justification of the two-pronged test of the Court in United Brands. Without the second leg it would be possible to establish excessive prices solely on the basis of high profitability as indicated by an excessive difference between costs and price as set out in the first leg of the test. The purpose of the second leg is, however, to try and identify what may be a legitimate cause of the high profitability potentially found under the first leg. A consideration of demand aspects effectively aims at identifying specific properties of the product or service in question that present an "advantage" to the buyer without actually being included in the production cost and therefore may constitute a valid justification for higher prices.[156]

138. The Port of Helsingborg decisions (see Annex 3) in fact do interpret the second leg of the test as allowing other, special aspects of the product or service to play a role in the analysis and render them capable of justifying a higher price. This interpretation allows outcomes in the price cost comparison in the first leg that suggest that prices may be excessive, without finding excessive prices in the end as the product may have specific aspects to it that are not considered on the cost side. Such higher valuations, even if not based on corresponding cost, may exist and should not be confused with the willingness to pay an excessive price. The idea is that a corresponding higher mark-up over costs would also persist under a competitive market structure.[157] In the words of the case handlers:

> *"The Commission considered, however, that the economic value should be determined with regards to the particular circumstances of the case and take into account also non-cost related factors such as the demand for the product/service.*
>
> *In this respect, the two decisions note that the ferry-operators benefit from an excellent location of the port of Helsingborg and that this should be taken into account in the assessment of the economic value of the service provided by the Port and in its price. The fact that the port services are provided by the Port at this specific place allows both passengers and ferry-operators to cross the Øresund in an expeditious way, which is in itself valuable, creates and sustains demand both on the downstream market (the market for transport services on ferries) and the upstream market (the market for the provision of port services to ferry-operators). This specific feature does not necessarily imply higher production costs for the provider of the port services. However, it is valuable for the customer and also for the provider, and thereby increases the economic value of the product/service."*[158]

139. Some evidence of such a line of reasoning is also found in the Albion Water case, although the case introduces a somewhat odd terminology distinguishing between an unproblematic "excessive price" and an abusive "unfairly high price" triggering intervention:

> *"In certain cases 'economic value' may exceed the cost of supply where there are additional benefits not reflected in the costs of supply. An excessive price is therefore a necessary, but not sufficient, condition for an unfairly high price."*[159]

---

156 This is in contrast to for example branded products that while effectively allowing higher prices compared to non-branded products with identical production cost in a narrow sense, do entail higher cost in a broader sense, namely the costs of building up the brand image. This intangible asset should in principle also be included in the cost calculation of the first leg.

157 A way of thinking about this is that in a market with differentiated products but identical costs, prices will not be marginal cost based and may also not be identical.

158 Lamalle et al (2004:42).

159 §7 in Albion Water Ltd. And Albion Water Group Ltd. VS. Water Services Regulation Authority, case no. 1046/2/4/04 [2008] CAT 31.

140. When a company producing multiple products is under investigation, demand side information is required to determine the socially optimal apportionment of joint and common costs across products.[160] The price elasticity of demand is an essential factor that would need to be considered in the supply side cost-analysis.[161] A classic cost analysis not considering demand elasticity may lead to the unjustified identification of excessive prices in a multiproduct firm context.[162]

### *5.2. Excessive prices under German Law*

141. The recent enforcement record of the Bundeskartellamt, similar to the EU's demonstrates that excessive price cases are conducted by authorities with extensive enforcement experience and in countries with a mature competition culture. Under certain circumstances a competition law approach can be more effective in dealing with a well-defined problem of excessive prices and intervention can be much quicker than creating a regulatory authority. The comparative market concept methodology applied in Germany furthermore demonstrates that as long as the method used to determine whether prices are excessive does not come for the standard regulatory toolbox of cost-based or incentive based price regulation, competition authorities may even be better placed than regulators to perform the analysis. The German case presented in Annex 5 relies on a traditional finding of abuse of dominance but bases itself in part also on a special (temporary) legal provision in the German law giving specific powers to the Bundeskartellamt. This is interesting as it may be an example of how legitimacy concerns with respect to "quasi-regulatory" interventions may be successfully addressed.

142. The case presented in Annex 5 concerns the regional supply of natural gas to household customers. In 2007 and 2008 a considerable rise in gas prices and in some cases substantial differences in price between individual suppliers could be observed in Germany. In addition to these price increases and in contrast to the electricity sector, consumers were not everywhere able to switch to another gas supplier. As a result, the Bundeskartellamt together with the competition authorities of the Länder launched a large-scale investigation of 35 gas suppliers in 2008. The cases were opened as the gas suppliers were suspected of charging abusively excessive prices in 2007 and 2008 in the markets for the supply of heating gas to household customers. The proceedings concerning the year 2008 were based on the new Section 29 ARC (See Box 2) which was applied for the first time in these cases.

143. This new Section 29 ARC applies to the energy sector and was introduced in late 2007 and will remain in force until 2012.[163] This provision makes it easier for the competition authorities to prosecute abusively excessive prices in the electricity and gas markets. In particular, Section 29 ARC allows a partial shift of the burden of proof for excessive prices on the companies suspected of the infringement.[164]

---

160 This information is also required for the profit maximization of the firm itself which may or may not coincide with the socially optimal apportionment of cost to the different product lines.

161 So-called Ramsey pricing of course opens up the theoretical question whether cost apportionments in the context of multiproduct firms should follow the cost apportionment used by the firm in devising its "excessive" price strategy or should be assessed considering the socially optimal apportionment.

162 Consider for example a firm producing two products and facing different demand elasticity for these two products. An optimal pricing strategy may require that the price of product x is used to cover costs associated with product y. The price of product y, as it is cross-subsidized by x may not contribute to common or joint cost at all and the price of product x, covering all joint and common cost could be found excessive based on a "traditional" cost analysis.

163 A the time of writing a prolongation is being discussed.

164 See Bundeskartellamt (2011:25).

**Box 2. Excerpt from the German Act Against Restraints of Competition (ARC)[165]**

**Section 19**
**Abuse of a Dominant Position**

[...]
(4) An abuse exists in particular if a dominant undertaking as a supplier or purchaser of certain kinds of goods or commercial services:
[…]
2. demands payment or other business terms which differ from those which would very likely arise if effective competition existed; in this context, particularly the conduct of undertakings in comparable markets where effective competition prevails shall be taken into account;
[…]

**Section 29**
**Energy Sector**

An undertaking, which is a supplier of electricity or pipeline gas (public utility company) on a market in which it, either alone or together with other public utility companies, has a dominant position, is prohibited from abusing such position by

1. demanding fees or other business terms which are less favourable than those of other public utility companies or undertakings in comparable markets, unless the public utility company provides evidence that such deviation is objectively justified, whereby the reversal of the burden of demonstration and proof (Darlegungs- und Beweislast) shall only apply in proceedings before the cartel authorities, or
2. demanding fees which unreasonably exceed the costs.

Costs that would not arise to the same extent if competition existed must not be taken into consideration in determining whether an abuse within the meaning of sentence 1 exists. §§ 19 and 20 remain unaffected.

144. The proceedings concerning the year 2007 were based on the general prohibition of the abuse of a dominant position (Section 19 ARC, Box 2). Following the "comparative market concept", explicitly mentioned under Section 19 ARC, the investigation focused on whether gas prices differed substantially from those of comparable companies. The proceedings concerning the year 2008 were based on the newly acquired powers under Section 29 ARC.

### *5.3. Price gouging and usury laws*

145. In addition to the provisions that are most often thought of as addressing excessive prices, i.e. the German competition law, the Article 102 of the EU treaty and the competition laws modelled thereafter, there are also other laws directed to controlling excessive prices. In addition to classic public utility regulation, there exist price gouging and usury laws that often have different public policy rationales from the excessive price prohibitions found in the competition laws.

146. Price gouging laws aim to protect vulnerable consumers from short term, wind-fall market power in relation to necessities. Interest rate laws also aim to protect poor and uninformed consumers from unscrupulous lenders. This addresses a particular consumer protection concern that can exist in relation to credit provision where a consumer does not understand what is a fair price or is too high a credit risk to be

165 In German: Gesetz gegen Wettbewerbsbeschränkungen (GWB).

accepted by lenders who expect the loan to be repaid (as opposed to lenders who may merely seek to take both high interest payments and foreclose on collateral).

*5.3.1. Price gouging laws in the United States*[166]

147. Price gouging laws in the US have recently received renewed attention in the wake of Hurricane Katrina. In the US, 29 States[167] have laws that prohibit excessive prices of certain commodities during periods of abnormal supply disruption.[168] These laws provide for civil penalties, criminal penalties or both and most of them, although not all are triggered by a state of emergency declared either by the president, the governor or local officials.[169]

148. The basic methodology employed is based on a comparison of a (fictitious) "normal" price with the potentially excessive price in periods of abnormal supply disruptions. In determining the "normal" supply price a variety of definitions are used. While some US States do not define the normal price at all, others use the average price over a specified period or the price immediately prior to the supply disruption or the emergency declaration.

149. Positive deviations from the "normal" price do not automatically trigger sanctions as limited deviations are allowed. For instance, some states allow price increases to match increases in wholesale costs and others restrict price increases to a certain percentage whereas others do not specify the exact level at which prices would become excessive although they all allow a defence based on cost increases.

150. The FTC notes in its report that when the question was presented in court, judges have resorted to a case by case analysis and those decisions "have not been particularly consistent"[170]. It further states that given "the uncertainty about what constitutes an unconscionable, excessive or exorbitant price, and the paucity of decisions on the issue, statutes based on any of these terms are likely to be difficult to enforce"[171]

151. In its report the FTC clearly warns that if "pricing signals are not present or are distorted by legislative or regulatory command, markets may not function efficiently and consumers may be worse off." Despite these concerns, including for instance also the question of "what constitutes a 'reasonable price'" and doubts as to whether a "federal price gouging legislation would produce a net benefit for consumers", the FTC proposes a list of factors that should be considered if Congress nevertheless were to proceed with passing federal price gouging legislation. While the regulatory goal would of course be linked to a relatively short term economic shock in the aftermath of an emergency, the criteria proposed are interesting in the context of excessive prices more generally.

166 See FTC (2006) for a more detailed discussion. This subsection heavily draws from this report.

167 Although 42 states announced independent investigations or participated in a multi-state working group to investigate gasoline pricing shortly after hurricane Katrina according to FTC research (FTC 2006:192).

168 Alternative terms to "excessive" are "exorbitant", "unreasonable" and "unconscionable" as well as "unjustified" prices.

169 Davis (2008) notes that price gouging laws are not symbolic, toothless measures and reports that state officials are apparently devoting significant resources to enforcing price gouging laws.

170 FTC (2006:191).

171 FTC (2006:192).

*"First, any price gouging statute should define the offense clearly. A primary goal of a statute should be for businesses to know what is prohibited. An ambiguous standard would only confuse consumers and businesses and would make enforcement difficult and arbitrary.*

*A price gouging bill also should account for increased costs, including anticipated costs, that businesses face in the marketplace. Enterprises that do not recover their costs cannot long remain in business, and exiting businesses would only exacerbate the supply problem. Furthermore, cost increases should not be limited to historic costs, because such a limitation could make retailers unable to purchase new product at the higher wholesale prices.*

*The statute also should provide for consideration of local, national, and international market conditions that may be a factor in the tight supply situation. International conditions that increase the price of crude oil naturally will have a downstream effect on retail gasoline prices. Local businesses should not be penalized for factors beyond their control.*

*Finally, any price gouging statute should attempt to account for the market-clearing price. Holding prices too low for too long in the face of temporary supply problems risks distorting the price signal that ultimately will ameliorate the problem. If supply responses and the market-clearing price are not considered, wholesalers and retailers will run out of gasoline and consumers will be worse off."*

### *5.3.2. Rate of interest regulation in EU member states*[172]

152. In a recent study conducted for the European Commission[173] on usury and the regulation of consumer credit prices, a comprehensive inventory of the types of interest rate restrictions that exist in the 27 EU Member States was taken and combined with an assessment of the impact of these both on credit markets and (potential) consumers. The particular interest of this study is its attempt to empirically evaluate the effects of the price cap regulation as captured by a set of hypotheses that are classified into the three categories of "plausible", "inconclusive" and "unlikely". Table 3 below presents an overview of the findings.

172 See iff/ZEW (2010) for a more detailed discussion. This subsection heavily draws from this study.

173 See iff/ZEW (2010). While the study focuses on the 27 EU member states it also reviews the literature analyzing the US, but notes that in light of the fact that US interest rate caps are relatively low compared to the frequently much higher caps found in the EU, comparisons are difficult.

**Table 3. Interest Rate Regulation (IRR)- Empirical assessment of hypotheses**

| | |
|---|---|
| **Plausible** | IRR reduces credit access, in particular for low-income borrowers.<br>Without IRR, more product types exist in the market.<br>IRR leads to increased charges as providers will try to compensate the reduced interest revenues by increased charges. |
| **Inconclusive** | IRR leads to credit from non-bank sources, such as paying bills late.<br>IRR leads to a substantial illegal market in lending.<br>The lack of IRR has particularly adverse effects on default rates/overindebtedness in the presence of economic downturns.<br>The average consumer – or even more so: low-risk consumer – would be granted cheaper credit in the presence of IRR.<br>IRR represents barriers to consumer credit market integration.<br>IRR leads to a convergence of all consumer credit interest rates at the level of the interest rate cap. |
| **Unlikely** | IRR leads to a decline in the volumes of consumer credit granted.<br>The lack of IRR leads to a higher level of over-indebtedness.<br>IRR leads to lower levels of competition in the consumer credit industry. |

153. Another interesting example also related to interest rates can be found in Germany, where contracts involving terms including prices or interest rates deemed to be unethical are automatically null and void. Following a decision of the German Federal Court from 1990[174], a difference of more than 12% between the market interest rate and the contractual rate implies that the contract is "sittenwidrig", i.e. unethical, indecent or immoral depending on the preferred translation of the legal term. The court had apparently no difficulty in determining this percentage.

## 6. Methodologies for assessing excessive prices

154. Competition authorities and regulators have used several different methodologies to assess excessive prices and determine price caps. These methodologies can generally be clustered based on how the benchmark is constructed, what type of information is required for the calculation and what is actually being measured.

155. Several different sorts of benchmarks have been used to determine whether a price is excessive. These benchmarks can be geographic, historic (in time) or relate to other companies providing identical or similar products or services. Benchmarks can also involve a combination of these elements or relate to a notion of reasonable return.

174 Federal Court (BGH) decision of March 13. 1990, AZ: XI ZR 252/89.

156. The benchmark is geographic if the comparison is based on similar products or services located in other (similar) geographic markets. The benchmark is historic if the comparison is based on a comparison between current and past variables, possibly of the same company. The benchmark involves other companies if the comparison draws on variables from similar companies active in the same or similar markets offering the same or similar products and services.

157. These benchmarks could be based on a direct comparison of prices, a comparison of profitability or a comparison of price-cost mark-ups.[175] A direct price comparison can, for instance, be based on a price of a company offering similar products in another geographic market that is subject to a higher level of competition. Similarly, profitability analysis or price-cost mark-ups, can use the profitability or price-cost mark-up of firms in other, more competitive geographic markets. Profitability analysis, however, already allows some indication as to the potentially excessive nature of a price in itself as it has a notion of reasonable normal return on capital built in.

158. In the following profitability analysis is discussed first as it is arguably the economically most important albeit most technical concept, followed by price-cost margin analysis and direct price comparisons. The section on direct price comparisons will also return to the question of benchmarks, discussing geographic and historic comparisons as well as comparisons across competitors or similar firms.

159. As all these methods are fraught with difficulties, it has been suggested that all or as many of the methods as possible should be applied in any given case.[176] This "predominance of evidence" approach was applied in the Napp case.[177] Implicit in this approach is that no single test can be considered sufficiently reliable and that increased reliability can emerge from aggregating results from different benchmarking tests. While some have argued that "it is unclear why the answers to several imprecise tests – even if producing mutually consistent results – should be more credible than the answer to one imprecise test"[178], there is in fact no reason to doubt this as long as the tests that are used are not fundamentally flawed, the individual test unreliability is not correlated and the tests in themselves are independent. In that case, the different errors involved in the different methodologies would tend to cancel each other out, increasing the reliability of the aggregate.

### *6.1. Profitability analysis*[179]

160. Profitability analysis is relevant in this context as excessive prices are typically linked to excessive profits.[180] If high prices are considered potentially excessive from a legal point of view even if they do not result in particularly important profits, profitability analysis will not be useful. This is the case if the legal benchmark is given by the cost of an efficient firm and the potential offender is characterized

175 Price-cost mark-ups seem to be one of the most prevalent methodologies. While they are a measure of profitability, they follow a distinct methodological approach compared to profitability analysis.

176 See Röller (2007).

177 This approach seems to have been approved by the CAT (at the time CCAT) writing „those comparisons, taken together, amply support the Directors conclusions that Napp's prices.." §397 in Case No. 1001-1/1/01 Napp Pharmaceutical Holdings vs. Director-General of Fair Trading, UK Competition Commission Appeal Tribunal, 15 January 2002.

178 O'Donoghue and Padilla (2006:633). See also Williams (2007:145) and Evans and Padilla (2005:109).

179 See also the specific methodological companion paper to this one by Alan Gregory.

180 For a discussion of profitability analysis as a useful method for determining market power in particular in industries with high and recurring common sunk or fixed costs, i.e. decreasing average incremental cost, see Baumol and Swanson (2003).

by inefficient production exhibiting much higher cost. More generally the methodology is much more difficult to apply when the costs to be considered are not those of the firm under analysis.[181]

161. Profitability analysis is fundamentally based on the concept of cost of capital and return on capital. There are essentially two approaches that can be pursued in conducting profitability analysis that under certain conditions have also been shown to lead to identical results.[182] Both approaches are based on the fact that any economic activity involves an initial investment that is subsequently followed by a stream of revenues.

162. The accounting approach to profitability calculates a return on capital employed (ROCE). ROCE is a measure of company earnings before interest and taxes (EBIT) divided by the capital employed in a given period of time. ROCE is traditionally used in price regulation in sectors such as gas, electricity, rail or water. It aims at determining a normal return usually equal to the weighted average cost of capital (WACC) on the estimated asset base.

163. The finance approach revolves around the concept of net present value (NPV) and internal rate of return (IRR) to measure profitability.[183] In contrast to ROCE, a calculation of the (truncated) IRR requires cash flow data and estimates of the asset values employed, for both, the beginning and the end of the relevant time period under analysis.[184]

164. Profitability analysis is not straightforward for at least four reasons[185]:

- Accounting profits are often sensitive to different approaches to depreciation
- Cost and revenue allocation for multi-product companies operating multiple lines of business is particularly difficult
- Company accounts of international companies depend on transfer price arrangements
- Risk factors are highly dependent on assessments of investors that can fluctuate substantially over time.

### *6.1.1. The cost of capital*[186]

165. The cost of capital is an estimation of the price a company has to pay in order to raise the capital it employs. Alternatively it could also be viewed as the opportunity cost of the next best investment or the return that would be earned if the capital were invested elsewhere adjusted for the risk of the current

181 This aspect will be discussed in more detail below. It is relevant to the inherent tension between a competition and a regulatory approach.

182 See Fisher and McGowan (1983), Martin (1984) and Salamon (1985) for a discussion of the reliability of accounting approaches to measuring profits.

183 According to OFT (2003:5) citing Graham and Harvey (2001), IRR is the most frequently used profitability measured in the business world.

184 A comprehensive discussion of profitability analysis using IRR and NPV tailored to the needs of a competition authority can be found in OFT (2003). For a discussion of the use and misuse of profitability analysis see Lind and Walker (2004).

185 See for example Williams (2007:133) or OFT (2003:12).

186 See Williams (2007) for a more detailed discussion including examples on the cost of capital and the return on capital. The following two sections heavily draw from his article.

investment. More specifically, the cost of capital emanates from two different sources of capital, debt and equity. The moment the business is started, the capital of the company consists of debt capital, i.e. money from investors that bought the bonds issued by the company and equity capital obtained through the sale of newly issued shares in exchange for money paid by investors. The total amount of capital, i.e. equity and debt combined, is called the capital base. The firm is owned by its share or equity holders, who seek a return on their invested capital. The cost of preventing shareholders from withdrawing equity, i.e. the return on capital needed for equity holders to induce them to hold shares is called cost of equity.[187]

166. The cost of capital is then calculated as a weighted average cost of capital (WACC) and is commonly estimated using the capital asset pricing model (CAPM).[188] The key result of this model is that the rate of return (ROR) for any particular project is given by:

$$ROR = \text{risk free interest rate} + \beta * (\text{market return} - \text{risk free rate}) \quad [1]$$

167. The risk free rate is normally the government bond rate and β is a parameter measuring the non-diversifiable risk of the company relative to the risk of equities in general.[189] The difference between the market return and the risk free rate is usually referred to as the equity risk premium (ERP). As competition authorities will rarely be interested in the company β unless it is a one-product firm, the β will typically have to be derived relative to the product or service.

*6.1.2. The return on capital*

168. As the cost of capital does not readily compare to specific prices charged, a measure for the return on capital such as the ROCE has to be calculated and compared to the WACC. As previously mentioned, the approach of comparing the cost of capital with the return on capital is a standard method in utility regulation. Once a measure of the weighted average cost of capital (WACC) of a company is established, the price the company is allowed to charge is set to generate an expected ROCE equal to the WACC. While this so-called rate-of-return regulation can also be employed in the context of excessive prices, there is an important difference between investments made by state utilities or utilities in protected markets and investments made in a competitive market environment facing substantial *ex ante* risk of failure. While *ex ante* risks can probably be ignored in a utility setting, where monopoly positions may

187 In contrast to bond holders that receive a steady and predetermined interest rate (setting aside the risk of default), shareholders are the residual claimants on profit and their return is therefore more volatile. As portfolio management allows the elimination of diversifiable risk, equity or share holders will require an extra return for the non-diversifiable risk associated with general movement of the stock market.

188 CAPM was used for example by the NMa in KLM (Vereniging Vrije Vogel vs. KLM and Stewart vs. KLM, 8 November 2000. Pijnacker Hordijk (2002) describes the KLM (page 484) and the Schiphol (page 486) cases. He also vehemently criticises the profitability approach noting that CAPM and WACC "are not meant to evaluate the appropriateness, let alone lawfulness, of profits actually made by individual businesses, and they are not capable of doing so. The mere fact that a business or a business activity may be more profitable than a constructed industry or business average, provides as such no valid economic reason to argue that the profits generated are 'excessive'."

189 If $\beta=1$, the share price moves with the stock market overall. $\beta<1$ implies that the stock price under-reacts, whereas $\beta>1$ implies that the stock overreacts in comparison to the stock market generally. For example, producers of luxury goods are typically believed to have a β greater than 1 as consumption of luxury goods is more impacted by general market developments whereas producers of foodstuffs have a β smaller than 1 as people continue to by food even in a recession. See Williams (2007:136f.)

even have been legally granted, any existing *ex ante* risk of failing has to be rewarded *ex post* in a competitive market environment.[190]

169. The required return for shareholders to induce them to continue to hold the company stocks is calculated as a percentage of the stock market value of the company, not the assets actually invested in the company. The relevant measure for evaluating profitability and indirectly assessing prices is, however, the return on the asset base invested in the company, not the current return on its stock market value. Another reason that focussing on the original assets invested in the company is important, is that this effectively prevents "laundering" of excessive prices. When an acquisition price exceeds the asset value of a company, this may be due to many reasons such as brand image, distribution arrangements, business architecture, know how etc. The cost of building up such "intangible assets" is a legitimate factor in the capital base of a firm. The acquisition price may, however, also exceed the asset value of the company for other, less innocuous reasons. It may simply be due to the value of being able to charge excessive prices. In a nutshell, a firm could simply sell its market power and the buyer could no longer be accused of excessive prices as it had to pay for the capitalized value of the market power.

### *6.2. Price-cost comparisons*

170. If profitability analysis cannot be used, price-cost comparisons may be a viable alternative methodology.

171. The price-cost margin is defined as:

$$p\text{-}c/p \qquad [2]$$

172. So if the price is 10 and the cost is 5, the price cost-margin is 1/2 or 50%. While this may appear a simple measure of the mark-up, the difficulties lie not only in the actual calculation of the mark-ups in any particular case but also in the appropriate choice of cost measure.

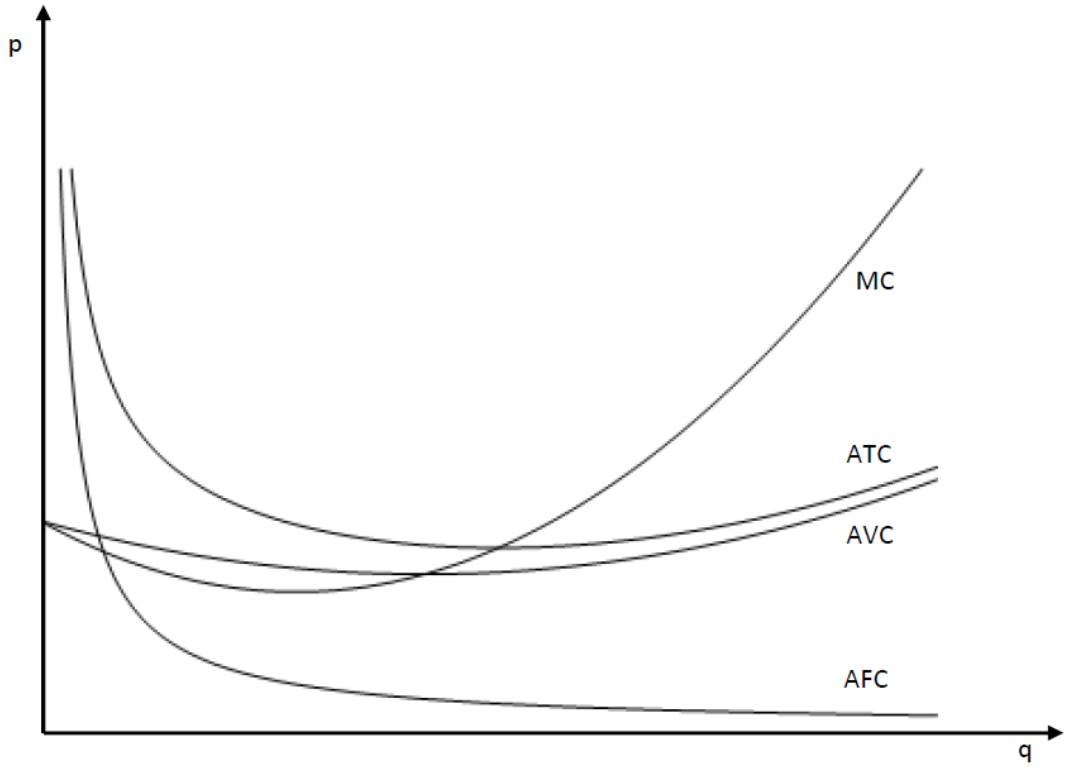
173. The attraction of price-cost margins for measuring profitability and ultimately excessiveness is probably based on the theoretical results presented in Figures 1 and 2 under perfect competition. In this model of perfect competition, firms equilibrium prices are equal to marginal cost, so that deviations from marginal cost pricing as measured by the price-cost margin is considered a direct indicator of market power.[191]

174. In order to be able to properly undertake price-cost margin analysis a certain understanding of cost concepts is required. The following two Figures summarise the commonly used cost concepts.

190 This includes the risk associated with demand uncertainty that has only recently become important also in liberalized but regulated sectors.

191 That this inference is problematic has been shown for example by Baumol and Swanson (2003), who state: "The price-equals-marginal-cost standard is tantamount to a requirement that every firm with scale economies, no matter how competitive the market, commit hara-kiri in order for its prices to be deemed 'competitive'." (682)

**Figure 3. Marginal Cost, Average Total Cost, Average variable Cost and Average Fixed Cost**

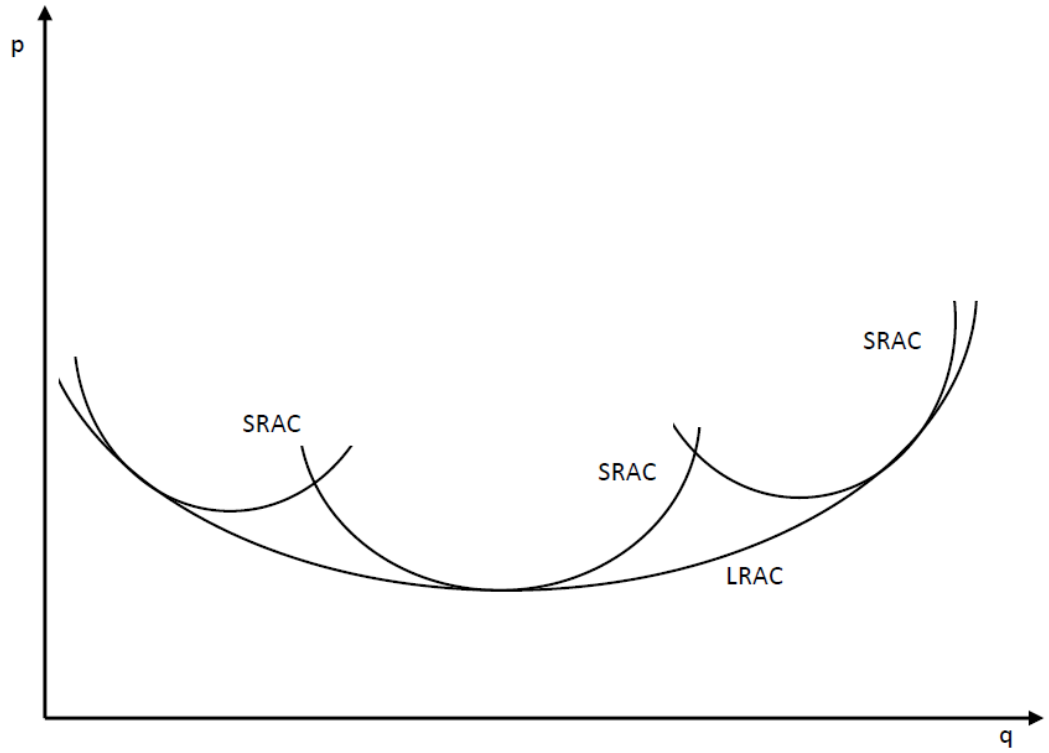



175. The short- and long-run cost curves depicted in Figures 3 and 4 are based on specific assumptions concerning the type of production technology used and will therefore not necessarily always have the shapes depicted here.[192] Fixed costs are the costs that do not vary with the quantity produced, whereas variable costs vary with the quantity produced. Marginal costs (MC) are the additional costs incurred for the production of an additional unit of output.

176. Average fixed cost (AFC) decrease with quantity as they are simply the fixed cost divided by the quantity. Average variable cost (AVC) again depend on the production technology and are defined as the per unit cost of the variable factor(s) of production. The U-shaped average total cost (ATC) curve is simply the product of the AVC and AFC curves. MC intersects both the AVC and ATC curves at their minimum points. Declining ATC is explained as the result of spreading the fixed costs over higher quantities and at lower quantity levels in addition also by increasing marginal productivity. Increasing ATC occurs when the effect of declining marginal productivity, which increases ATC, dominates the effect of spreading the fixed costs.

192 The underlying production technology is typically given by a function with one variable factor of production displaying first increasing and then decreasing marginal productivity. The increasing marginal productivity is directly associated with the negatively sloped portion of the marginal cost curve, while decreasing marginal productivity is associated with the positively sloped part.

**Figure 4. Short Run Average and Long Run Average Total Cost**




177. Figure 4 depicts the long-run average cost (LRAC) curve. LRAC is drawn as an envelope of the short-run average cost (SRAC) curves, exhibiting first increasing and then decreasing returns to scale. It lies below or tangent to the short-run curves.[193]

178. The intuition for LRAC, of particular relevance in the context of excessive price benchmarks, is given by its long-term entry and exit properties. If the price is above LRAC, effective competition will drive the price back to LRAC. If the price is below LRAC, firms will exit the market in the long run. Consequently any price equal or exceeding LRAC will be sustainable for the firm.[194]

179. While these cost concepts are well defined in theory, the application of price-cost margins may be very difficult in practice. Complications are unavoidable when considering pricing strategies designed to maximize the sales of a group of related goods and services rather than a single product or when the product is manufactured by multiple company divisions, possibly across multiple countries, over several years and possibly also relying on IPR based on considerable past R&D efforts related to a different product.[195] The reason for the difficulty lies in the fact that the profit maximizing pricing decisions of such firms involve setting prices such that the overall cost of production including all common or joint costs are covered. This implies different price-cost margins for products facing demands of different elasticities. As

193 The intuition for the relationship between SRAC and LRAC, in particular that the SRAC curves are not tangent to the LRAC curve in their respective minima, is that the short-run constraints of the firm will not allow it to produce at lower cost than in the long-run when there are no constraints.

194 See Annex 1 on the Mittal case and section 2.1 above.

195 See Evans and Padilla (2005:102).

a result, it has been suggested that the pricing policy of a multiproduct firm should be analyzed in its entirety.[196]

180. To avoid the problems associated with LRAC in cases of indirect, joint or common cost, long run average incremental cost are sometimes considered (LRAIC). The long run average incremental cost are the total costs associated with entering a market and begin the supply of a product or service, as an average over total output. The measure excludes common cost as only the costs that are causally related to the product or service in question are included in LRAIC. LRAIC can also be explained with reference to the long run average avoidable cost (LRAAC) and sunk costs incurred upon entry as LRAAC is the total value of costs that are avoided in the long-run if provision of the product or service is ceased, as an average over total output. Whereas LRAC takes all variable and fixed costs into account, LRAIC concerns only the product-specific variable and fixed costs. LRAIC will thus usually fall below LRAC because it does not take into account (non-attributable) common costs but remain above average avoidable cost (AAC)[197] because LRAIC takes into account all product specific fixed costs.[198]

181. An additional question that needs to be addressed once the appropriate measure of cost has been decided upon is who's costs should be used, i.e. the actual cost of the firm under investigation or the cost of an efficient firm or maybe even the cost of the most efficient firm.[199]

182. As costs can easily and artificially be increased – a phenomenon also known as gold plating[200] -, it has been suggested to use a notion of efficient firm cost rather than the actual cost of the dominant company.[201] Furthermore, using the actual cost of the dominant firm would be problematic in case the firm is particularly inefficient as it would allow for a much higher benchmark price.[202] If the cost of an efficient firm is used, this should not necessarily be the most efficient firm, as this would unnecessarily punish a particularly efficient dominant firm (by lowering the benchmark price) and may also lead to the problem that the benchmark price does no longer allow a particularly inefficient firm to cover its cost.

183. There are several options regarding the actual calculation of the cost of an efficient firm. Average supply cost may be a reasonable proxy for efficient firm cost in some instances.[203] An alternative approach that also has the advantage of maintaining dynamic incentives to increase efficiency is to use the cost of

196 Although this has been rejected by the CAT in the Napp case.

197 AAC is the total of all the costs that vary when there is a change in the quantity produced, divided by the quantity produced. It excludes all fixed costs.

198 See for example European Commission (2005) or chapter 4 in Department of Justice (2008).

199 See O'Donoghue and Padilla (2006:616) and the Case 110/99 Lucazeau vs. Sacem [1989] ECR 2811.

200 This question is of high relevance in the regulatory literature and is probably the main reason that the literature has moved away from cost based price regulation towards incentive based regulation and mechanism design. See Laffont and Tirole (1993) and Vogelsang (2002).

201 This is not unusual also in other abuse cases. Note, however, OECD (2000:17) „It is also possible […] that both prices and costs might be excessive, implying inefficiency, hence profits may not be excessive, and that might weigh against finding the price level to be abusive." See also Pijnacker Hordijk (2002:492) claiming that "there is no justification for a competition authority or court substituting its own perception of what 'reasonable' costs should be for the approach by the firm's management."

202 This is essentially the result obtained by Neven, Röller and Zhang (2006) in an analysis of the European Airline industry. Their study is based on data from 1976 to 1994 and suggests that while prices have been close to the monopoly level, price-cost margins were compatible with a more competitive outcome.

203 Average supply cost could be unweighed or weighed by volume as calculated for example in the German regional gas supply case (see Annex 5), where average gas supply prices were used as cost indicator.

the second most efficient firm. Although not always relevant in a one-shot excessive price case context, this preserves the incentives of those firms with higher cost and also maintains the incentive of the two most efficient firms to decrease cost.[204]

### *6.3. Price comparisons*

184. While profitability analysis and also price-cost margin analysis can be used to benchmark the profitability or the price-cost margin of one firm to another in the same market or in other geographic markets and may also be undertaken across time, this type of comparison is typically conducted with respect to direct price comparisons. As a result, this section focuses on the different benchmarks that can be used in price comparisons while similar arguments of course apply when such benchmarks are based on other indicators such as profitability analysis or price-cost margins.

185. It has been argued that it "is possible to object to almost any price comparison, save perhaps those prices charged by the alleged excessive pricer to other customers"[205]. As a result it may be useful to recall and briefly discuss the three main benchmarking methods that have been employed in past competition decisions on excessive prices.

#### *6.3.1. Geographic comparison*

186. The fundamental idea behind geographic comparisons is that the two geographic markets considered are sufficiently comparable so that price comparisons (or cost-price or profitability comparisons) can meaningfully be made.[206] Geographic comparisons have been made for example in United Brands (see Annex 4), the German regional gas price cases (see Annex 5) and in the two Port of Helsingborg decisions (see Annex 3).

187. In 2006 the OECD discussed geographic comparisons in the context of market power:

> *"Using excessive prices as indicator of market power suffers from some of the same problems as profitability measurements. It will typically be difficult to determine a benchmark competitive price level against which the allegedly competitive prices could be measured. One commentator has noted, however, that in some cases it might be possible to find a reasonable benchmark by way of cross-sectional comparison, i.e., when the same product is sold in separate markets and one of the markets appears to be structurally competitive while the other is not. In this situation it might be possible to compare a competitive price with the price charged by a firm in a market where market characteristics suggest that a firm has substantial market power. Such cross-sectional comparison might produce useful evidence of market power where relevant markets tend to be local, such as, for example, retail markets. Simply comparing prices that two firms charge, or that the same firm charges in separate markets, however, will not produce reliable*

---

204 In fact this approach was used in Australia by the regulator in the context of interchange fees. Note, however, that there may be limits to this approach in any industry where relatively high minimum efficient scales exist. While one could argue that this is less of an issue in a multiproduct context if the multiproduct firm would anyhow "cross-subsidize" the particular product or service in question, it certainly is an issue in single line of business cases.

205 Furse (2008:81f.). There is of course a distinction between price discrimination and excessive prices even if both fall in the category of exploitative abuses.

206 SACEM II was the first EU case where it was mentioned that direct price comparisons may be a substitute to a cost-price test. Deutsche Grammophon is an example that the difference between the home and comparator market price may be indicative of price abuse reversing the burden of proof. See also the discussion of the comparative market concept used in Germany in Annex 5.

*evidence of substantial market power. It will not always be obvious whether higher prices in one market can be attributed to the exercise of market power by a firm, or whether they might be caused by other factors as well such as higher costs."*[207]

188. In the Port of Helsingborg cases the Commission suggested that the ports differed substantially in terms of the mix of activities, the volume of assets and investments, how investments are financed, the level of revenues and the cost of each activity. There were also differences with respect to the internal decisions as to how shareholders are remunerated. In addition, as some activities of the port may be loss making, profits of other activities would be masked. All these factors pointed to the difficulty of considering profitability of a port and using other ports as reasonable benchmarks in comparison.

189. Other difficulties in finding comparable geographic markets for benchmarking purposes are differences in tax rates, exchange rates, the general income level of customers and the elasticity of demand. Another important problem may stem from the degree of market penetration of the product or service in question as newly introduced products are likely to be priced differently than the same product in a relatively mature market where the product is widely used. Finally it would have to be excluded that the benchmark prices are either excessive as well or predatory.

*6.3.2. Comparison over time*

190. Another variant is to consider the evolution of profitability, price-cost margins or prices over time. This was the approach of the European Commission used for example in British Leyland and to some extent also in United Brands.[208]

*6.3.3. Comparison across competitors*

191. Similarly to benchmarks established in comparison to other geographic markets, comparisons may be feasible within the same market. While excessive prices typically presuppose high market shares and dominance of the alleged infringer, it is not clear to what extent fringe firms could be used to discover more competitive prices. To the extent that the fringe firm is simply following the pricing decisions of the dominant firm such benchmarking would be futile and if that is not the case, the question remains why there is no effect on market share if there are firms in the same market offering their product or service at substantially lower prices than the dominant firm.

## 7. Abuse shopping and shortcuts

192. Competition authorities will sometimes have a choice of pursuing a given firm or practice under different legal categories. In some cases, excessive price cases may result from an authority having concerns about market conditions or behaviour but finding it easier to deal directly with the consequences than with the behaviour itself. The term "abuse shopping" describes the choice process that competition authorities engage in when it is possible to subsume a particular abuse under different legal categories with corresponding different standards of proof.

193. Of course, authorities can and do legitimately choose from different legal instruments in different cases. From a legal procedural view this need not raise concern. From an economic perspective, however, it may appear strange that the substantive assessment criteria for proving one and the same conduct abusive

207 OECD (2006a:42)

208 See Case 226/84 British Leyland vs. Commission [1986] ECR 3263 and Case 27/76, United Brands Company and United Brands Continentaal BV v Commission [1978] ECR 207, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61976CJ0027:EN:HTML.

vary based on the legal instrument. This also has obvious consequences with respect to the predictability of the competition law.[209]

194. The term "shortcut" is used to describe those extreme instances of abuse shopping that will generally be considered illegitimate.

195. There will be no general agreement on when legitimate abuse shopping becomes a shortcut, but it could be argued that abuse shopping that leads to a reduction in the burden of proof for the authority, should be considered an illegitimate procedural and or substantial shortcut.

196. Faced with apparently large harm to consumers, authorities may be tempted to use excessive price cases as a "universal theory of harm" that can be quickly applied requiring only limited evidence. However, as we have set out, the difficulties and complexities of properly carrying out excessive price cases render this a problematic strategy.

197. As many cases that have been conducted as excessive price cases could well have been characterized and conducted as price discrimination or even exclusionary abuse cases, abuse shopping is a reality that has tended to blur the lines between exploitative and exclusionary cases and led to confusion in the debate on excessive price cases.[210]

### *7.1. Abuse shopping*

198. Abuse shopping allows competition authorities room for strategically choosing the legal category under which the case will be conducted often with substantial consequences. This possibility arises whenever there is no direct mapping of economic effects or even theories of harm into legal qualifications. In such circumstances the right choice, effectively determining the legal requirements that will need to be met and sometimes also the procedure, may make for the difference between successfully concluding a case and losing it.[211] In such instances, competition authorities may find themselves in a situation of "abuse shopping".[212]

199. One way to think about abuse shopping is framing. As has been noted concerning the Napp case: "While the OFT chose to run the case as two separate abuses, this particular instance of excessive pricing could instead have been framed as ongoing recoupment from Napp's predatory strategy, rather than as an abuse in its own right."[213] A similar statement could be made with respect to British Leyland[214] and

---

209 The predictability argument is less convincing as an abuse is supposedly found under both legal characterizations. It may, however, affect the assessment of the firm whether it may get away with an infringement or not as this obviously depends on what the authority will have to prove.

210 Fletcher and Jardine (2008:534) for example state that "in practice many excessive pricing cases are essentially about exclusion rather than exploitation, and moreover the line between the two can sometimes be unclear".

211 Related but not identical to abuse shopping is the strategy to build a theory of harm on separate and ideally fully independent legs or to characterize one infringement of consisting of separate elements. While this strategy will have no impact on the burden of proof for each separate infringement, it allows the case to stand even if one infringement is unconvincing to the court.

212 See OECD (2007:95). The term seems to have been coined by Margaret Bloom, although rather in the sense of a shortcut.

213 Fletcher and Jardine (2008:541).

214 See Case 226/84 British Leyland vs. Commission [1986] ECR 3263.

General Motors[215] as both cases focused on artificial barriers to parallel trade or Albion Water[216] that could have been conducted as constructive refusal to deal case.[217]

### *7.2. Substantive and procedural shortcuts*

200. While abuse shopping has been considered legitimate, the term shortcut is reserved for those cases where abuse shopping would unlikely be considered objectionable. Whereas abuse shopping is about framing the infringement, shortcuts lower the substantive and procedural requirements in proving the infringement.

201. Shortcuts are in particular to be expected in young competition authorities, operating in young legal systems and in environments characterized by a limited competition law experience and a weak competition culture. Shortcuts can be traced to weak internal quality control but also to a weak supervision and control by the courts. Obviously, in such an environment it may sometimes be very tempting for competition authorities to open excessive price cases as shortcut or substitute for harder, more difficult and more involved work.

202. A case possibly falling into this category is discussed in Annex 6. It concerns excessive prices in the mobile telephony market in Albania where the only two operators were found to be collectively dominant. While this case demonstrates how difficult concepts such as collective dominance and excessive prices can be treated in a rather superficial manner to achieve desired results, the case itself is probably not without (regulatory) merit as mobile telephony markets have been regulated in other jurisdictions.[218] The way the mobile telephony problem was tackled by the competition authority in Albania therefore is an example of a substantive shortcut but can also be viewed as a procedural shortcut as it was probably the quickest approach to address the concerns.

203. Shortcuts, to the extent that "the bluff" is not called, may also be used as effective negotiation tool despite strong court supervision. As shortcuts involve less work and a reduced burden of proof, it is relatively easy to open a procedure on the basis of flimsy facts, on which, in the context of excessive prices, some form of price reduction can be negotiated with the dominant firm.[219]

204. Of course the concern with procedural or substantive shortcuts is not about labels. Indeed, there could be no objection (except maybe the confusion caused in an interim period) to relabeling, for example,

---

215 See Case 26/75 General Motors Continental NV vs. Commission, [1975] ECR 1367.

216 See Albion Water Ltd. And Albion Water Group Ltd. VS. Water Services Regulation Authority, case no. 1046/2/4/04 [2008] CAT 31.

217 Examples of abuse shopping not involving excessive prices, are margin squeeze cases that alternatively could be conducted as predation or as (constructive) refusal to supply cases. Both, the refusal to supply and the predation test require a higher standard of proof for the authority than the margin squeeze approach and may therefore rather fall into the category of shortcut.

218 See the EU Roaming cases that in the end were abandoned in light of EU wide price regulation.

219 This is not to question the utility of commitment decisions in general or those obtained for instance in the context of UK market investigations although both have raised procedural questions. UK market investigations in contrast for example to the EU sector inquiry tool, are not pure competition law instruments. They have often been used to efficiently resolve (regulatory) problems, using competition law types of remedies based on a procedure that would be considered a procedural shortcut from a pure competition law point of view. A short commentary on the first 5 years of UK market investigations is given in Oxera (2008). More generally commitment decisions, for example in EU energy cases, have been criticized as the outcome of coercing companies into settlements under the threat of fines. To some, this may also constitute a procedural shortcut.

an exclusionary theory of harm consisting in a constructive refusal to supply access to an essential facility as excessive price case as long as the exclusionary analysis is not dropped from the case.[220] Obviously, a simple re-labelling would not constitute abuse shopping as it would require the authority to go through all the steps usually required in such exclusionary abuse cases.[221] The attraction of shortcuts, as the term implies, is however, that they lower the procedural and/or substantive requirements. If that is not the case, there is no benefit in reframing infringements.

### *7.3. Joint dominance and collusion*

205. In this subsection two different aspects revolving around joint dominance and tacit and explicit collusion are discussed. First, perhaps the most extreme example of a shortcut is discussed, namely running a standard cartel case as joint dominance excessive price case. Second, based on this example, the theoretical possibility of attacking *tacit* collusion as a joint dominance excessive price case is discussed.

#### *7.3.1. Cartel vs. joint dominance excessive price*

206. Probably the most prominent example of a shortcut is to run a cartel case as a joint dominance excessive price case.[222] Competition authorities have traditionally spent and continue to spend substantial time and effort at enforcing competition laws against cartels, arguably the single most uncontroversial competition law infringement in existence and one of the most difficult ones to prove.

207. Dawn raids are conducted to gather evidence, company CEOs are invited for questioning under oath, phones are tapped, sophisticated leniency and whistleblower policies are developed and economic analysis is deployed to detect and prove cartel agreements. All these efforts are costly to the authority and the task of catching cartels has certainly become more difficult with increased sophistication and use of modern technology on the side of the cartelists.

208. In light of these substantial resource costs and the high burden of proof required to successfully prosecute cartels, it may be particularly tempting to shortcut the procedure, fine the cartelists and end the cartel using a joint dominance excessive price theory of harm that requires little else than establishing joint dominance and an excessive price.

209. Besides the negative welfare effects of possible type I errors in enforcing "real" excessive price cases, using excessive price cases as a shortcut to weaken procedural and substantive requirements in other

220 There is some inherent tension though between exclusionary pricing and exploitative prices as the former may exceed the economically rational profit maximizing price that would obtain under exploitation. In a vertical foreclosure case for example one will observe exploitative prices downstream that are based on exclusionary prices upstream.

221 This may also be a way of interpreting the unfair pricing provision in Article 102 TFEU and some of the other legal texts. Although it would probably be deemed inconsistent with existing case law, it would pay tribute to the argument that Article 102 TFEU originally aimed at exploitative abuse. After all, discussing the requirements for demonstrating an abuse is different from the actual label used for the abuse in the end. In light of the fact that all exclusionary abuses entail exploitation, often in the form of higher prices, does, however, not render such a relabeling attractive.

222 Both excessive price cases and joint dominance cases are probably among the most difficult cases to conduct properly. There is for example only limited prior case law on joint dominance and it is therefore far from being a mechanistic exercise. Nevertheless, it is exactly that paucity of clearly established methods and sound approaches that will render them attractive to inexperienced authorities. The relative vagueness allows a very cursory treatment that could boil down to little more than establishing that prices are neither purely cost based nor significantly different between firms – clearly unsatisfactory evidence to find an excessive price abuse and joint dominance.

areas of competition law and therefore substantially increase the probability of type I errors in these areas is a real problems that excessive price provisions can entail in the hands of inexperienced authorities and courts. The high procedural and substantive requirements foreseen for example in cartel cases are deliberately imposed by the legislature and the courts to strike an appropriate balance between the negative economic consequences associated with over-enforcement and the negative economic consequences of under-enforcement.[223] Ultimately shortcuts are undermining the rule of law.

*7.3.2. Joint dominance and tacit or explicit collusion*

210. If a cartel case should not be construed as joint dominance excessive price case, as argued above, the question arises whether excessive price cases based on joint dominance may not be capable of catching tacit collusion.

211. While the enforcement of tacit collusion could be considered an enforcement gap, there are good reasons not to pursue such an approach either. As long as there is no possibility of clearly distinguishing between tacit collusion and (seemingly tacit) explicit collusion in those cases where insufficient evidence to prosecute the alleged cartel is found, such cases only have the potential to exacerbate the problem of shortcuts discussed above.

212. Another, possibly more realistic theory of harm involving joint dominance that may, however, better be caught as anti-competitive agreements are excessive prices charged by patent pools and collecting societies.

## 8. Remedies, fines, disgorgement and private damage claims

### *8.1. Remedies*

213. The design of appropriate and effective remedies is a challenge in all competition cases.[224] The task is particularly difficult in excessive price cases.[225] Ongoing price or profitability regulation is difficult and problematic while finding effective alternative behavioural or structural remedies may be equally challenging.

214. Given the differences in basic approach, timing and frequency of intervention mentioned in section 3, it should come as no surprise that competition authorities and sector regulators display important differences in their approach to remedies.[226]

#### *8.1.1. Price and profitability caps*

215. Since the unlawful conduct concerns the setting of price, the seemingly obvious measure to remedy an excessive price is a price (or corresponding profitability) cap. Similarly to most behavioural remedies, price or rate of return regulation will typically require ongoing monitoring and possibly adjustment and may therefore not be an appropriate choice for a competition authority seeking a one shot

223 This is of course a simplification that ignores issues such as basic procedural rights.

224 On remedies and sanctions in abuse of dominance cases see generally OECD (2006b).

225 As noted by Blumenthal (2008:580) a "remedy that entails ongoing regulation of prices and profits by courts or competition authorities is almost certain to fail".

226 Forrester (2008:566ff) discusses a number of EU exclusionary and exploitative cases where pricing remedies have been employed.

remedy. However, it may be possible to devise more general rules that may be self-enforcing, for example if they can be designed in a way that would allow the supervision by costumers for example.[227]

216. Assuming that it is possible to identify a certain price level above which prices become excessive, a behavioural remedy could be designed that obliges the infringing firm not to offer its products above that price. However, there are certain problems associated with this type of remedy. Firstly, it is difficult to determine in practice above what price level a price becomes excessive. As discussed in section 6, the methodologies available to determine whether a price is excessive or not are all fraught with difficulties and even if a method does seem to yield clear results in detecting whether prices are excessive (for example if they are substantially in excess of any measure of cost), it is harder to determine precisely what the right price level ought to be.

217. Secondly, imposing a *static* pricing remedy is appropriate only as long as the market conditions (such as costs, number of firms, demand) do not change substantially. If any of these parameters change, it is necessary to adjust the price cap. For example, if costs rise, the initial price level that was deemed excessive at the time of the decision may become unproblematic.[228] In that case, the maximum price level would require an upward adjustment in order to avoid the types of negative effects discussed. Conversely, if costs fall, the initial maximum price level may have to be adjusted downwards.[229] While the dominant firm is of course free to pass on the decline in costs to consumers even without a reduction in the level of the price cap it is unlikely to do so. As a matter of fact, an analysis of whether the remedy should be adjusted or not can be almost as demanding in terms of resources as establishing the actual infringement. In that sense changes in costs may even be relatively simple to take into account compared to temporary or permanent shifts in demand for example.

218. Another related problem with respect to simple static pricing remedies is the possibility to circumvent them. Since only one dimension of competition is regulated, a dominant firm can adopt a strategy where it adheres to the remedy but changes its conduct with respect to other dimensions of competition, which in the end can have an equivalent effect to the one deemed unlawful. This is a familiar problem from regulation: price-capped firms have an incentive to reduce quality. Quality can be hard to measure, and reductions in quality are a strategy that will allow the firm to increase the quality-adjusted price without violating the letter of a price cap remedy. As the dominant firm will typically not find it difficult to justify such adjustments evoking all sorts of seemingly benign reasons, the result is that it might be very difficult for the competition authority to prove non-compliance with the remedy.

219. An alternative but even more questionable[230] remedy is a dynamic pricing remedy that has some level of built-in flexible adjustment of the price cap. For example, the maximum price level could be automatically adjusted for changes in costs. Any upward movement of costs would then lead to a higher maximum price level and a downward movement would lead to a lower maximum price. Apart from the practical difficulty that there could be constant dispute between the dominant firm and the competition

---

227 The suggestion that pricing rules may alleviate the ongoing supervision problem is suggested in Paulis (2007:517).

228 This of course tends to result in gold-plating as previously discussed but may nevertheless be a necessary legal consequence depending on the test used to establish the abuse.

229 While one may argue that this may punish firms that decrease their cost, it may follow from the test used to establish that prices are excessive to begin with.

230 The dynamic approach in fact bears the same problems as the static one except that everything is done in advance and the chances for the company to circumvent or manipulate the remedy are higher.

authority whether costs have actually changed or not,[231] it should also be noted that this kind of adjustment ignores shifts in demand. If demand shifts outwards without a corresponding change in the cost function, the firm would not be able to increase its prices.[232]

220. A similar remedy to a dynamic pricing remedy would be the imposition of a rate of return or profitability remedy. The incumbent could be obliged to adjust its prices in such a way that it does not exceed a certain rate of return on investment or on capital employed. In that case, the firm would have to lower its price if costs go down and the virtual cap would increase if costs go up.

221. There are, however, several problems associated with rate of return regulation. Firstly, not only changes in costs but also changes in demand have an influence on the rate of return. In that case, the dominant firm would have to adjust prices in order to maintain the set rate of return. This adjustment may, however, be suboptimal from both, the business perspective of the firm and a welfare perspective. As regulators have increasingly realised, rate of return remedies can lead to perverse incentives. There is no incentive for efficiency. Since the firm is allowed to realise a certain return on investment, it may find it rational to inefficiently over-invest in capital. Apart from productive inefficiencies that are created by such a strategy, this may, if these investments allow the company to decrease its costs in the long run, even lead to increased market power as entry becomes even more difficult.

222. As with price regulation, it is difficult to determine the "right" rate of return, and regulation at levels too high or too low would cause problems. It should also be noted that rate of return regulation can lead to distortions in the allocation of capital if financial markets perceive the imposed rate of return to be too low compared to the risk-adjusted expected return on capital. In that case, the incumbent may find it difficult to raise capital to make further necessary investments. Finally, the imposition of rate of return remedies suffers from the potential problem that interventions on the basis of excessive prices have in general, namely that firms anticipate that successful investments may increase the risk of coming under rate of return regulation *ex-post* resulting in dynamic inefficiencies. In that case, the incentives to invest *ex-ante* are artificially reduced and under-investment is likely to result.[233]

223. Another approach to price or rate of return regulation by a competition authority may be to start off by a relatively light handed price or rate of return requirement combined with a heavy handed information gathering order. This would address the information concern in two ways. First, the light handed price regulation will be less likely to cause harm and second, in case of a repeated offense, the authority could base a new decision on a solid factual background.

224. The difficulties mentioned in particular in a competition law context have been recognized by US courts very early on:

> *"..the subject of what is a reasonable rate is attended with great uncertainty…[E]ven after the standard should be determined there is such an indefinite variety of facts entering into the question of what is a reasonable rate, no matter what standard is adopted, that any individual shipper would in most cases be apt to abandon the effort to show the unreasonable character of a charge sooner than hazard the great expense in time and money necessary to prove the fact… To*

231 As discussed in section 6, accounting provisions allow firms a wide margin of discretion with respect to the ways they allocate costs. Especially where certain services or goods are acquired from another line-of-business within the same undertaking, transfer pricing offers firms many possibilities to legally "manipulate" costs.

232 As discussed in section 2, these effects crucially hinge on the type of production function.

233 This argument was for instance made by RBB (2002:2f.) in the context of the UK Napp case. See also ERG (2004:90).

*say, therefore, that the Act excludes agreements which are not in unreasonable restraint of trade… is substantially to leave the question of unreasonableness to the companies themselves."*[234]

225. The consensus in the literature appears to be that alternative remedies to price or rate of return regulation are more in line with the general philosophy of competition law, and that trying to mimic competitive outcomes directly via price or rate of return regulation is inferior to structural or informational behavioural remedies capable of unleashing competitive forces in disciplining the market.

### *8.1.2. Other behavioural remedies*

226. Another approach to remedies in excessive price cases is to focus on the demand side of the infringement – by reducing entry barriers created by the behaviour of potential customers.[235] These include:

- Difficulty of collecting information on the existence of substitutes (customers find it costly to shop around and learn about alternatives)
- Lack of comparable information across suppliers (difficult and costly to compare products or services across suppliers)
- High switching costs (difficult and costly to switch supplier)[236]
- Asymmetric information between customers and firms (product characteristics are not fully observable increasing the role of past experience with the supplier or supplier reputation)

227. Any remedy capable of addressing these factors increases competition in the market and may also render entry more attractive.[237] Nevertheless, as is clear when considering the monopoly case, in order for such remedies to work, they rely on a minimum of alternative products to be available, something that may in fact not be the case in the more severe potential excessive prices cases.

### *8.1.3. Structural remedies*

228. Structural remedies have been advocated by a wide range of authors. This finding is related to the more general view that it is better to address causes than symptoms.[238] As in all competition cases, it is

234 United States vs. Trans-Missouri Freight Assn., 166 U.S. 290 (1897) cited after Gal (2004:352).

235 A detailed and enthusiastic discussion of such remedies can be found in Fletcher and Jardine (2008:542ff.) They also provide a listing of possible measures capable of addressing the demand side factors identified below.

236 When switching costs are high, these could be reduced, for example by obliging the dominant firm to provide information and prices on alternative suppliers or products. Information remedies were, for example, used in the EU Microsoft case and also the UK store cards case.

237 This approach has also been proposed for sector specific regulators, even in monopoly cases. Forrester (2008:552) argues that "the regulator could compel the monopolist (or holder of significant market power) to practice a policy of *transparency of terms, conditions and pricing*; or a policy of *non-discrimination in respect of commercial terms and conditions offered*; or to apply *separation of cost accounting rules* which accurately reveal the weighting of the various cost elements collectively exploited, thereby facilitating a transparent evaluation of specific cost elements and pricing strategies".

238 Similarly Siragusa (2008:644f) who rightfully emphasizes the need to go to the root of the problem and employ structural remedies. His discussion of excessive network access prices are, however, constructive

important not to confuse the abuse with the remedy and tackling the problem at its source instead of regulating price will always be preferable. According to Siragusa:

> *"If all of the conditions are indeed met for excessive prices to be considered an abuse, .. I would then argue that the firm should not simply be met with merely an order to return to 'normal' pricing, with all the difficulties of determining whatever that may be. As has been a long-standing policy in merger cases, the use of structural remedies should be the preferred option for uprooting the problem of excessive pricing under antitrust law."*[239]

229. In particular in some of the sectors likely to pass at least a subset of the proposed screens discussed in section 4, such as former state owned enterprises, structural remedies will be very much in tune with liberalization and de-regulation efforts as they are based on the "spirit of increasing the role of free markets".[240]

230. Structural remedies to address excessive prices can take two different forms. A horizontal break-up may allow the newly created firms to compete with each other. In contrast, structural remedies could be employed to lower barriers to entry for instance by the separation and subsequent break-up of the crucial bottleneck part of the firm that precluded entry. Vertically restructuring the market, separating the key stages of production with scale economies from the rest and allowing substantial parts of the company to function under competition may also lead to reduced prices.[241] In such a scenario, only the stages of production exhibiting scale economies, for example core network infrastructure (essential facility) would require price regulation. This will of course apply in particular to former government monopolies. Thinking of ways to facilitate entry that ideally attracts a financially well-endowed maverick firm, possibly with a track record in a similar product or neighbouring market (implying knowledge and experience) may be another solution that could be induced by a structural remedy.

231. A general difficulty with divestiture is that there is no clear direct relationship between market share and prices and hence it is not clear what level of assets should be transferred to competitors to achieve the desired downward effect on prices. Generally speaking it may also be difficult to conceive of a market that passes at least some of the screens discussed above where the economies of scale would not be such as to render a long term successful horizontal break-up difficult. As a result it may be more promising to focus on structural remedies capable of lowering entry barriers.

232. While the views of the South African Tribunal in the Mittal case (see Annex 1) were subsequently rejected, they suggest that competition authorities should not try to price regulate but to use instruments from their standard remedy toolbox:

---

refusal to deal cases rather than excessive price cases. Going to the root of the problem may be much more difficult when dealing with "real" excessive price cases. On the possibilities of abuse shopping and framing cases as excessive price cases see section 7 above.

239 Siragusa (2008:645). According to Siragusa the choice of structural remedies would also be consistent with the respective roles of sector-specific regulators and competition authorities. It should be noted that in some jurisdictions there may be proportionality concerns when imposing such remedies in excessive price cases.

240 Siragusa (2008:648).

241 See OECD (2011b). See also the recent EU energy cases such as E.ON discussed in Hellström et al. (2009) or ENI discussed in Maier-Rigaud et al. (2011).

> *"If excessive pricing is to be identified and remedied by a competition authority rather than a duly empowered and appropriately resourced price regulator, then it must do so by recourse to its standard approaches and instruments"*[242]

233. It is in the nature of pure exploitative abuses that clear cut structural remedies, outside of those sectors that would traditionally be subjected to some form of regulation, will be difficult to devise.

### *8.2. Division of tasks*

234. As competition authorities have been deemed to be ill-equipped for specific price regulation on the one hand and sector regulators have been considered too focussed on narrow details and not enough on the broader, more general aim of achieving effective competition in the sector[243] on the other, a combination of both authorities may allow addressing these respective drawbacks.[244]

235. One possible division of tasks is for a competition authority to decide on whether an infringement has been committed, then to hand over to a regulator the design, implementation, monitoring and adjustment of the remedy. In fact there exists at least one instance of a hybrid case involving both, a regulator and a competition authority.[245] While it may not be the best of all possible worlds as there are also costs of setting up the co-operation and co-ordinating the work, there may be instances where the respective specialisation of the different types of authorities can be successfully combined. This would imply that the competition authority, possibly already in close co-operation with a regulator, decides whether a particular intervention is warranted or not. Once this is decided positively, the design of the remedy itself and the ongoing monitoring of the remedy and possible adjustments[246] to it over time could be addressed by the regulator in consultation with the competition authority.[247]

236. In addition, in particular in light of the intricate relation between excessive prices as an antitrust and as a regulatory offense, there may be a substantial role for competition advocacy as remedy. Competition authorities may consider advocating in favour of a regulatory solution or a strengthening of the regulatory authority rather than to intervene on the basis of antitrust. As this often pre-supposes some knowledge of the feasibility of such proposals, a co-operative approach seems to be a warranted basis,

---

242 The summary is due to Lewis (2009:587).

243 See Forrester (2008:574) and more generally section 3 above.

244 As previously discussed, there exits regulators with competition mandate and also competition authorities with regulatory functions where such co-operation may be particularly easy.

245 See the NMa decision of 25 March 2009, Case 6424/427 Ziekenhuis Walcheren – Oosterscheldeziekenhuizen, http://www.nma.nl/images/6424BCV22-154011.pdf. While this case may raise different issues and the remedies may not have been preferable to a prohibition as it concerns a hospital merger where the imposed price supervision remedy was delegated to the Dutch Healthcare Authority (NZa), it demonstrates that co-operation between regulators and competition authorities on a case level is possible. See Canoy and Sauter (2010) for a critical discussion of the case and also the accompanying paper by Misja Mikkers and Wolf Sauter for details on the co-operation between the authorities.

246 There may be legal limitations of implementing "dynamic" remedies, i.e. remedies that are conditional on company internal or external parameters.

247 As argued by Werden (2009:661), however, to avoid being in the role of a regulator it is not enough to reject regulatory remedies or delegate the supervision and design to a regulator, as already the determination of whether prices are excessive can require the development of special expertise.

allowing possibly also the withdrawal of the competition authority at a later stage if a formal division of tasks turns out to be less desirable.[248]

### *8.3. Fines, disgorgement and private damage claims*

237. Some authors have argued that fines should not be imposed and also that private damage claims should not be permitted in excessive price cases.[249] The reasons for this proposal are the possible negative *ex ante* incentive effects of any expected *ex post* transfer from the firm for excessive price abuses that would add to the negative repercussions on investment incentives if prices are capped.[250] However, the advantage of imposing fines instead of a behavioural or structural remedy in these cases is that it may eliminate the need for a bright line test between what is an abusive and what is not an abusive price.[251]

238. In many countries, in addition to fines and behavioural and structural remedies, the enforcement of competition law is significantly supplemented by private actions. Even though regulators often take great care in involving third parties in their decision making, there is typically no equivalent possibility for private action in the regulatory context. To the extent that actions by the competition authority in the area of excessive prices are considered regulatory actions, there is some basis for arguing that this would then also warrant the exclusion of private actions in this area generally or at least for those cases that do not follow in the wake of enforcement actions by the authority. Besides being in line with a regulatory approach to excessive prices, this would have the additional advantage that the competition authority would have to be less concerned about the use of screens that would, as previously discussed, effectively only bind the authority (see section 4.5).[252]

239. While these arguments against the imposition of fines, in particular concerning the negative *ex ante* effects of expected sanctions, are plausible and imply that especially first time offenders should not be fined, they do not apply equally to disgorgement and private damage claims. The reasons are due to the fact that fines must be substantially larger than the illicit gains as they are otherwise not deterrent. The potential negative effects on investment incentives are therefore substantial. Disgorgement and damages will be the same order of magnitude as illicit gains even if the former are by definition larger than the latter. As a result, disgorgement and private damage claims have a substantially lower deterrent effect in contrast to fines and as long as private damage claims simply compensate the victims of the abuse for the damage suffered they seem difficult to deny.[253] So while the imposition of fines may be debated in particular for first time offenders, damages and disgorgement appear fully justified. In particular

---

248 The UK Competition Commission's market investigation regime allow for two types of approaches: Advice to government and regulators and standard remedies imposed on companies.

249 See, however, Elhauge (2009a:513) arguing that private actions may be insufficient for disgorgement so that "another natural remedy" in excessive price cases (if restricted to gap cases) might be to "force the firm to disgorge the price excesses it earned because of its anticompetitive conduct".

250 See Fletcher and Jardine (2008:537) who argue that fines and private damage claims both strengthen "firms` incentives to abide by competition law" and that by "limiting available sanctions, firms are likely to be less concerned about breaching excessive pricing rules, and as such the associated distortions across the economy should be greatly reduced." It seems somewhat paradoxical to advocate a competition rule and at the same time hope for limited compliance.

251 Gal (2004:374).

252 An important caveat here is that if it is possible to make policy changes that indeed would preclude the filing of private damage actions, it would certainly also be possible to formalize the use of screens in the competition law.

253 In fact denying compensation to those that suffered harm is somewhat in contradiction to the finding of an abuse to begin with.

disgorgement may be an appropriate remedy in those jurisdictions where private damage claims are unlikely to exhaust the illicit gains of the infringing firm.

## BIBLIOGRAPHY

Akman, P. and L. Garrod (2011), "When are Excessive Prices Unfair?", *Journal of Competition Law and Economics*, Vol. 7, No. 2, Oxford University Press, Oxford, pp. 403-26.

Areeda, P.E. and H. Hovenkamp,(2002), *Antitrust Law Vol. III*, 2nd edition, Aspen Publishers.

Baumol, W. J. and D. G. Swanson (2003), "The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power", *Antitrust Law Journal*, Vol. 70 No. 3, pp. 661-685.

Blumenthal, B. (2008), "Discussant Comments on Exploitative Abuses under Article 82 EC", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 575 – 580.

Brennan, Tim (2007), "Should Innovation Rationalize Supra-Competitive Prices? A Skeptical Speculation", in: Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p 88-127, available at: http://www.kkv.se/upload/filer/trycksaker/rapporter/pros&cons/rap_pros_and_cons_high_prices.pdf

Breyer, S. (1982), *Regulation and Its Reform*, Harvard University Press.

Breyer, S. (1979), "Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform", *Harvard Law Review*, Vol. 92, No. 3, pp. 547 – 609.

Bundeskartellamt (2011), *Antitrust Enforcement by the Bundeskartellamt, Areas of Focus in 2007/2008*, 2nd edition, available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/TB_Kurzfassung_07-08-GB.pdf

Calcagno, C. and M. Walker (2010), "Excessive Pricing: Towards Clarity and Economic Coherence", *Journal of Competition Law and Economics*, Vol. 6, No. 4, Oxford University Press, Oxford, pp. 891-910.

Canoy, M. and R. Sauter (2010) Out of Control? Hospital Mergers in the Netherlands and the Public Interest, *European Competition Law Review*, 31(9).

Chamberlin, E. (1933/1962), *Theory of Monopolistic Competition: A Reorientation of the Theory of Value*, 8th ed., Harvard University Press.

Church, J. and R. Ware (2000) *Industrial Organization – A Strategic Approach*, McGraw-Hill.

Clark, J. (1940), "Toward a Concept of Workable Competition", *American Economic Review*, Vol. 30, 241.

Crampton, P.S., Jenny, F., Kovacic, W., Lewis, D., Peeperkorn, L., Riesenkampff, A., Werden, G.J. (2009), "Exploitative Abuses" *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law & Policy*, Juris Publishing, Huntington.

Davidson, Kenneth M. (2011) Reality Ignored – How Milton Friedman and Chicago Economics Undermined American Institutions and Endangered the Global Economy, Arlington, Virginia.

Davis, C. W. (2008), *An Analysis of the Enactment of Anti-Price Gouging Laws*, available at: http://etd.lib.montana.edu/etd/2008/davis/DavisC0508.pdf

Denis, H. (1990), *Histoire de la Pensée Economique*, 9th edition, Presses Universitaires de France.

Department of Justice (2008) *Competition and Monopoly: Single Firm Conduct under Section 2 of the Sherman Act*, available at http://www.justice.gov/atr/public/reports/236681.pdf.

Elhauge, E. (2008), "Do Patent Holdup and Royalty Stacking Lead to Systematically Excessive Royalties?", *Journal of Competition Law and Economics*, Vol. 4, No. 3, Oxford University Press, Oxford, pp. 535-570.

Elhauge, E. (2009a), "Disgorgement as an Antitrust remedy", *Antitrust Law Journal*, Vol. 76, Oxford University Press, Oxford, pp. 501-517.

Elhauge, E. (2009b), "Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory", *Harvard Law Review*, 123. 397.

ERG (2004), "ERG Common Position on the approach to Appropriate remedies in the new regulatory framework", ERG (03) 30rev1, April, available at http://erg.eu.int/doc/whatsnew/erg_0330rev1_remedies_common_position.pdf.

Essens, O., Gerbrandy, A. and S. Lavrijssen (2009), *National Courts and the Standard of Review in Competition Law and Economic Regulation*, Europa Law Publishing.

Esteva-Mosso, C. and S. Ryan (1999), "Article 82 – Abuse of Dominant Position", in J. Faull and A. Nikpay (eds) *The EC Law of Competition*, Oxford University Press.

European Commission (2005), *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*; to be found at http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf.

Evans, D.S. and A.J. Padilla (2005), "Excessive Prices: Using Economics to Define Administrable Legal Rules", *Journal of Competition Law and Economics*, Vol. 1, No.1, Oxford University Press, Oxford, pp. 97 – 122.

Ezrachi, A. and D. Gilo (2008), "Are Excessive Prices Really Self-Correcting?", *Journal of Competition Law and Economics*, Vol. 5, No. 2, Oxford University Press, Oxford, pp. 249 –268.

Ezrachi, A. and D. Gilo (2010a), "The Darker Side of the Moon: Assessment of Excessive Pricing and Proposal for a post-entry price-cut benchmark", in: *Article 82 EC, Reflections on its Recent Evolution*, Studies of the Oxford Institute of European and Comparative Law – no. 12, Hart Publishing Oxford.

Ezrachi, A. and D. Gilo (2010b), "Excessive Pricing, Entry, Assessment, and Investment: Lessons from the Mittal Litigation", *Antitrust Law Journal*, 76(3), 873-897.

FTC (2006) *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases*, available at: http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf

Fisher, F. M. and JJ McGowan (1983), On the Misuse of Accounting Rates of Return to Infer Monopoly Profits, American Economic Review, 73, 82.

Fletcher, A. and A. Jardine (2008), "Towards an Appropriate Policy for Excessive Pricing", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 533 – 546.

Forrester, I. (2008), "Sector-Specific Price Regulation or Antitrust Regulation – A Plague on Both Your Houses?", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 547 – 574.

Fox, Eleanor (1986), "Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness", *Notre Dame Law Review*, Vol. 61, pp. 981 – 1020.

Furse, M. (2008), "Excessive Prices, Unfair Prices and Economic Value: The Law of Excessive Pricing under Article 82 Ec and the Chapter II Prohibition", *European Competition Journal*, Vol. 4, No. 1, p.59.

Gal M. S. (2003), *Competition Policy for Small Market Economies*, Harvard University Press

Gal, M.S. (2004), "Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief about Monopoly?", *Antitrust Bulletin*, Vol. 49, Federal Legal Publications, pp. 343 – 384. Also available at: http://ssrn.com/abstract=700863

Geradin, D. (2008), "Abusive Pricing in an IP Licensing Context: An EC Competition Law Analysis", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 671 – 703.

Gewirtz, P. (1996), On 'I Know It When I See It', *Yale Law Journal*, Vol. 105, pp. 1023-1047.

Gorecki, P.K. (2006), "Form- versus Effects-Based Approaches to the Abuse of a Dominant Position: the Case of Ticketmaster Ireland", *Journal of Competition Law and Economics*, Oxford University Press, Oxford , Vol. 2, No. 3, pp. 533 – 548.

Green, N. (2006), "Problems in the Identification of Excessive Prices: The United Kingdom Experiences in the Light of NAPP", in C-D. Ehlermann and I. Atanasiu (eds.), *European Competition Law Annual: 2003 –What Is an Abuse of a Dominant Position*, Hart Publishing, Oxford and Portland Oregon, pp. 79 – 90.

Haucap, J. and A. Uhde (2008), "Regulierung und Wettbewerbsrecht in liberalisierten Netzindustrien aus institutionenökonomischer Perspektive", *ORDO, Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft*, Vol. 59, pp. 237-262.

Haag, M. and R. Klotz (1998), "Commission Practice Concerning Excessive Pricing in Telecommunications", *EU Competition Policy Newsletter*, Vol.2, pp. 35-38.

Hellström, P., Maier-Rigaud, F. and F. Wenzel Bulst (2009), "Remedies in European Antitrust Law", *Antitrust Law Journal*, Vol. 76, pp. 43-63, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1830110.

iff/ZEW (2010), Study on interest rate restrictions in the EU, *Final Report for the EU Commission DG Internal Market and Services*, Project No. ETD/2009/IM/H3/87, Brussels/Hamburg/Mannheim available at http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf or at http://www.responsible-credit.net/media.php?t=media&f=file&id=4103

Jenny, F. (2008), "Discussion on Exploitative Conduct and the Remedies – Panel Discussion", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 477 – 513.

Kuhn, T. (2006) Preishöhenmissbrauch (excessive pricing) im deutschen und europäischen Kartellrecht, *Wirtschaft und Wettbewerb (WuW)*, Vol. 6, pp. 578 – 592.

Laffont, P and J. Tirole (1993) *A Theory of Incentives in Procurement and Regulation*, MIT Press.

Lewis, D. (2009), "Exploitative Abuses – a Note on the *Harmony Gold v. Mittal Steel* Excessive Pricing Case", *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law & Policy*, Juris Publishing, Huntington.

Lind, R. and M. Walker (2004), "The (Mis)use of profitability analysis in competition law cases", *European Competition Law Review*, Vol.25, No.7, pp. 439-446.

Lowe, P. (2003), *How different is EU anti-trust? A Route Map for Advisors*, Speech by Philip Lowe, 16.10.2003, ABA, http://ec.europa.eu/competition/speeches/text/sp2003_038_en.pdf

Lyons, B. (2007), "The Paradox of the Exclusion of Exploitative Abuses", in: Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p 65-87, available at: http://www.kkv.se/upload/filer/trycksaker/rapporter/pros&cons/rap_pros_and_cons_high_prices.pdf

Mackenzie, N. and S. Langbridge (2010), "Excessive Pricing: Guidance from South Africa", *European Competition Law Review*, Vol. 31, No. 9, pp. 354-361.

Maier-Rigaud, F. and Kay Parplies (2009) EU Merger Control Five Years after the Introduction of the SIEC Test: What Explains the Drop in Enforcement Activity? *European Competition Law Review* (ECLR), 2009, 30 (11), p. 565-579

Maier-Rigaud, F., Manca, F. and U. von Koppenfels (2011), "Strategic Underinvestment and Gas Network Foreclosure – the ENI Case", EU Competition Policy Newsletter, 1, forthcoming, to be found at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1903788.

Maier-Rigaud, F. (2012), "On the Normative Foundations of Competition Law - Efficiency, Political Freedom and the Freedom to Compete", in D. Zimmer (ed.), *Goals of Competition Law*, Edward Elgar, forthcoming, to be found at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1829023.

Martin, S. (1984) "The Misuse of Accounting Rates of Return: Comment", *American Economic Review*, Vol.74, No.3, pp.501-506.

May, James (1989), *Antitrust in the formative era: Political and Economical Theory in Constitutional and Antitrust Analysis 1889-1918*, 50 Ohio State L J 258

Motta, A. and A. de Streel (2006), "Excessive Pricing and Price Squeeze under EU Law", in C-D.Ehlermann and I. Atanasiu (eds.), *European Competition Law Annual: 2003 –What Is an Abuse of a Dominant Position*, Hart Publishing, Oxford and Portland Oregon, pp. 91 – 125.

Motta, M. and A. de Streel (2007), Excessive Pricing in Competition Law: Never say Never?, in: Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p 14-46, available at: http://www.kkv.se/upload/filer/trycksaker/rapporter/pros&cons/rap_pros_and_cons_high_prices.pdf

Montgomery, D.W., Baron, R.A. and M.K. Weisskopf (2007), "Potential Effects of Proposed Price Gouging Legislation on the Cost and Severity of Gasoline Supply Interruptions", *Journal of Competition Law and Economics*, Oxford University Press, Oxford, Vol. 3, No. 3, pp. 357 – 397.

Neven D., L.-H. Röller and Zhentang Zhang (2006) "Endogenous Costs and Price-Cost Margins: An Application to the European Airline Industry", *Journal of Industrial Economics*, Vol.54, p. 351.

OECD (1999), *Relationship between Regulators and Competition Authorities*, to be found at http://www.oecd.org/dataoecd/35/37/1920556.pdf

OECD (2001), *Report on Experiences with Structural Separation*, available at: http://www.oecd.org/dataoecd/50/63/45518043.pdf.

OECD (2004), *Access pricing in Telecommunications*, available at http://www.oecd.org/dataoecd/26/6/27767944.pdf.

OECD (2006a) *Evidentiary issues in proving dominance*, available at http://www.oecd.org/dataoecd/42/8/41651328.pdf.

OECD (2006b) *Remedies and Sanctions in Abuse of Dominance Cases*, available at http://www.oecd.org/dataoecd/20/17/38623413.pdf

OECD (2007), *Guidance to Businesses on Monopolisation and Abuse of Dominance*, available at: http://www.oecd.org/dataoecd/50/33/40880976.pdf

OECD (2009), *Two-Sided Markets*, available at: http://www.oecd.org/dataoecd/38/61/44445730.pdf

OECD (2010a), *Competition Assessment Toolkit: Principles*, available at www.oecd.org/competition/toolkit

OECD (2010b), *Competition Assessment Toolkit: Guidance*, available at www.oecd.org/competition/toolkit

OECD (2011a), *Regulated Conduct Defence*, available at: http://www.oecd.org/dataoecd/30/0/48606639.pdf

OECD (2011b) *Recent Experiences with Structural Separation: A Report to the Council on Implementation of the 2001 Recommendation concerning Structural Separation in Regulated Industries*, available on OLIS (DAF/COMP(2011)12)

Office of Fair Trading (2003) *Assessing profitability in competition policy analysis*, Economic Discussion Paper 6, prepared by OXERA, to be found at http://www.oft.gov.uk/shared_oft/reports/comp_policy/oft657.pdf

Office of Fair Trading (2004) *Assessment of conduct, Draft competition law guideline for consultation*, April 2004, OFT414a; http://www.oft.gov.uk/shared_oft/business_leaflets/competition_law/oft414a.pdf.

Office of Fair Trading (2008). *Unfair relationships: Enforcement action under Part 8 of the Enterprise Act 2002*, May 2008 (updated August 2011) http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft854Rev.pdf.

Oliver, P. (2005), "The Concept of "Abuse" of a Dominant Position under Article 82 EC: Recent Developments in Relation to Pricing", *European Competition Journal*, Vol. 1, No.2, pp. 315 – 339.

O`Donoghue, R. and A.J. Padilla (2006), *The Law and Economics of Article 82 EC*, Hart Publishing.

Oxera (2008), *Market investigations: a commentary on the first five years*, to be found at http://www.oxera.com/cmsDocuments/Agenda%20September%2008/Market%20investigations.pdf

Patterson, M.R. (2008), "The Peculiar "New Product" Requirement in European Refusal to License Cases: A US Perspective", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 705 – 721.

Paulis, E. (2008), "Article 82 EC and Exploitative Conduct", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 515-524

Peeperkorn, L. (2009), "Price Discrimination and Exploitation", *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law & Policy*, Juris Publishing, Huntington.

Pijnacker Hordijk, E. (2002), "Excessive Pricing under EC competition law: an update in the light of Dutch developments", in B. Hawk (ed.) *International Antitrust Law and Policy*, Fordham Corporate Law Institute.

Pribram, K.l (1983), *A History of Economic Reasoning*, Johns Hopkins University Press, Baltimore and London.

RBB (2002), "Excess Pricing in the Napp Chapter II case – how much is too much?" RBB Economics Brief 05, September, available at http://www.rbbecon.com/publications/downloads/rbb_brief05.pdf.

Régibeau, P. (2008), "The (Complex?) Relationship between Art 82(a) and Intelelctual Property Rights", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 651 – 669.

Riesenkampff, A. (2009), "Is Article 82 Applicable to OPEC?", *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law & Policy*, Juris Publishing, Huntington.

Robinson, J. (1933/1969), *The Economics of Imperfect Competition*, 2nd revised ed., Palgrave MacMillan.

Robinson, J. (1934), "What is perfect competition?", *Quarterly Journal of Economics*, Vol.49, No.1, pp.104 – 20.

Röller, L-H. (2008), "Exploitative Abuses", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 525-532.

Salamon, G. L. (1985), Accounting Rates of return, *American Economic Review*, Vol.75, No.3, pp.495 – 504.

Schumpeter, J. A. (1954), *History of Economic Analysis*, Allen & Unwin, London, Boston, Sydney.

Siragusa, M. (2008), "Excessive Prices in Energy Markets: Some Unorthodox Thoughts", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 617 – 642.

Terhechte, J.P. (2010) "Excessive Pricing and the Goals of Competition Policy – an Enforcement Perspective". *Social Science Research Network*. Available at: http://ssrn.com/abstract=1696512

Turner, D. (1969), The Scope of Antitrust and Other Economic Regulatory Policies, Harvard Law Review, Vol. 82, p.1207.

van der Woude, M. (2008), "Unfair and Excessive Prices in the Energy Sector", in C-D. Ehlermann and M. Marquis (eds.), *European Competition Law Annual: 2007 – A Reformed Approach to Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, pp. 617 – 642.

Vogelsang, I. (2002), "Incentive Regulation and Competition in Public Utility Markets: A 20-Year Prespective", *Journal of Regulatory Economics*,Vol.22, No.1, pp 5-27..

Wahl, N. (2007), "Exploitative High Prices and European Competition Law – a Personal Reflection", in: Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p 47-64, available at: http://www.kkv.se/upload/filer/trycksaker/rapporter/pros&cons/rap_pros_and_cons_high_prices.pdf

Walker, M. (2010), "Excessive Pricing and Disharmony", *European Competition Law Review*, Vol. 31, No. 4, ESC Pub., Oxford, pp. 143-145.

Werden, G.J. (2009), "Monopoly Pricing and Competition Policy: Divergent Paths to the same Destination", *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law & Policy*, Juris Publishing, Huntington.

Whish, R. (2003) Competition Law, 5th edition, LexisNexis.

Williams, M. (2007), "Excessive Pricing", in: Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p 128-153, available at: http://www.kkv.se/upload/filer/trycksaker/rapporter/pros&cons/rap_pros_and_cons_high_prices.pdf

## ANNEX 1: THE SOUTH AFRICAN MITTAL STEEL CASE

### 1. Facts of the case

1. In 2007, the South African Competition Tribunal found that *Mittal Steel* abused its dominant position by charging excessive prices in the domestic market for flat steel products to the detriment of consumers.[1] At the time, the company's supply of steel exceeded the national demand, and as a result, part of its production was exported. To optimise its export activities, the company chose to merchandise its steel in the international steel market through a special joint venture, Macsteel International, owned jointly by the company itself and Macsteel Holdings. The joint venture purchased flat steel products from Mittal on the condition that it would not be resold in the domestic market. In return, the export price of Mittal steel was set at a lower level than the domestic price.

2. Although in May 2009 the appeal before the Competition Appeal Court was upheld, the case was remitted to the Tribunal, and subsequently settled by the parties, the reasoning presented by the Court is very informative as it lays down the legal test that is to be applied in determining whether a given price is excessive. The case, moreover, is interesting, as the Tribunal, whose judgement was set aside, sought to determine whether price charged by Mittal was excessive without examining the company's costs, pricing structure and without carrying out any price comparison despite the fact that extensive evidence was available.[2] Lastly, it is interesting to note that while the case effectively deals with allegations of excessive prices, the Tribunal refused to declare that Mittal's practice of employing import parity pricing (IPP) constituted the charging of excessive prices. Instead, the Tribunal held that the abuse of a dominant position resulted from the practice of reducing the supply of flat steel on the domestic market through the imposition of a resale prohibition. The Appeal Court explained that in the absence of a finding that the price in question was excessive, the Tribunal would not have been in the position to grant any relief under section 8(a). It is therefore to be understood that the Tribunal's decision characterised the practice of supply reduction by Mittal through the imposition of resale conditions as the charging of an excessive price.[3]

### 2. Legal test

3. Under Section 8(a) of the South African Competition Act a dominant firm is prohibited from charging an "excessive price to the detriment of consumers". Excessive prices are defined in Section 1(1)(ix) of the South African Competition Act as "a price for a good or service which (aa) bears no reasonable relation to the economic value of that good or service, and (bb) is higher than the value referred to in subparagraph (aa)".

---

1 Mittal Steel South Africa Ltd & Macsteel International BV & Macsteel Holdings (pty) Ltd vs. Harmony Gold Mining Company Ltd & Durban Rooderpoort Deep Ltd, Case No. 70/CAC/Apr07, available at: http://www.comptrib.co.za/assets/Uploads/Case-Documents/70CACApr07.pdf. The complaint was lodged in 2002 by Harmony Gold Mining Company Limited and Durban Roodepoort Deep Limited, two gold mining companies which acquire a variety of flat steel products from Mittal Steel.

2 For a more detailed overview of the case see Mackenzie and Langbridge (2010).

3 Competition Appeal Court judgement [2009], para. 8.

4. In its decision the Tribunal approached the prices in question by applying a two-stage test, where the first leg of the test dealt with market structure, while the second with a specific type of conduct. In the Tribunal's view, section 8(a) can only apply where "the structure of the market in question enables those who participate in it to charge excessive prices".[4] This "structural test" in the Tribunal's view requires not just "mere", but rather "super-dominance", approximating a 100% market share. In such a market, moreover, there should be no "realistic prospect of entry". In other words, the power to charge excessive prices according to the Tribunal requires that the market "be both uncontested and incontestable".[5] Once, the requisite of super-dominance has been fulfilled, the authority must establish whether a given firm has actually engaged in conduct designed to take advantage of such structural market features. This, in turn, would require the Tribunal to examine available evidence. The Tribunal, however, emphasized that it

> *"will not approach this enquiry by considering that evidence relating to actual price levels which effectively requires us, first, to identify a particular level as unlawful ('excessive') and then to impose a level of price that would be lawful ('non-excessive'). This, we stress, is an approach consistent with the practice of price regulation – it is not commonly found in the principles and practice of competition law and economics."*[6]

5. By referring to Section 8(d)(iv) of the Act, which explicitly identifies marginal or average variable cost as the cost measurement applicable to the evaluation of predation, The Tribunal further explained that, in its view, Section 8(a) does not refer to the relationship between an excessive price and cost, but rather between price and economic value.[7] The concept of "economic value", however, "has no intrinsic, quantifiable meaning", and as the term "'reasonableness' is also a product of context, and that context is competition".[8] Referring to Evans and Padilla, the Tribunal stated that the price will bear a reasonable relationship to the economic value of the good in question if it is determined by "cognisable competition considerations". In the absence of such considerations, *a contrario*, price will be deemed excessive as "it will not have been determined by the free interaction of demand and supply in a competitive market".[9]

6. The Competition Appeal Court, however, did not agree with the reasoning of the Tribunal and held that it does not find any support in the Act.[10] According to the Court, the determination of excessive prices requires: (1) the determination of the actual price of the good or service in question, (2) the determination of the "economic value" of the good or service in monetary terms, (3) if the actual price is higher than the economic value, whether the difference is unreasonable, and (4) a detriment to the consumers.[11] The concept of "economic value", as interpreted by the Court refers to "the notional price of the good or service under assumed conditions of long-run competitive equilibrium",[12] and as such it cannot

---

4 Tribunal decision, para. 83.

5 Tribunal decision, para. 96.

6 Tribunal decisión, para. 134. Also, in other part of its decision, the Tribunal pointed out that "We eschew the role of price regulator, and so the vast quantum of the evidence and much of the argument submitted to us is simply irrelevant", para. 81.

7 Tribunal decision, para. 146.

8 Tribunal decision, para. 144.

9 Tribunal decision, para. 147.

10 Competition Appeal Court judgement [2009], para. 32

11 Ibid.

12 Competition Appeal Court judgement [2009], para. 40.

be linked to the specific circumstances of an individual firm.[13] The firm's individual cost structure, however, becomes relevant when the price charged exceeds the economic value, and it is necessary to determine whether the relation between the two values is unreasonable.[14]

[13] Competition Appeal Court judgement [2009], para. 43: "[…], in determining the economic value of a good or service, the cost savings to the firm resulting from the subsidised loan or the lower than market rental – or indeed any other special advantage, current or historical, that serves to reduce the particular firm's costs below the notional competitive norm should be disregarded".

[14] Ibid, "It would seem sound, when considering whether the higher price bears a reasonable relation to economic value or not, to take into account the benefits flowing to the firm from the subsidised loan, long-term low rental, or other special advantage which may serve to reduce its own long-run average costs below the notional norm".

## ANNEX 2: THE KOREAN CREDIT CARD CASE

### 1. Facts of the case

1. From the fourth quarter of 1997 to the third quarter of 2000, BC Card Company (with its 12 member banks), LG Capital Company and Samsung Card Company steadily increased their cash advance interest rate, their installment interest rate and the customer default penalty rate. These increases were accompanied with steady decreases in their respective financing and other supply costs.[1]

2. Their interest rates, financing costs and other supply costs for the period were as follows:

**Table 1: BC Card Co.(with its 12 member banks)(%)**

| | January 1997 | February in 1998 | 3/4 quarter in 2000 |
|---|---|---|---|
| Cash advance interest rate | 20.3 | 22.9 | 23.5 |
| Installment interest rate | 12~14.5 | 15~19 | 13.5~18 |
| Overdue payment penalty rate | 23 | 27~28 | 13.5~18 |
| Financing rate(average)<br>(Proportion of overdue payments)<br>(Customer defaults rate) | 9.0~12.37<br>(14.1~30.53)<br>(0.52~7.60) | 9.0~12.75<br>(12.6~24.1)<br>(0.14~12.5) | 7.0~9.25<br>(4.5~8.6)<br>(0.36~2.8) |

**Table 2: LG Capital Co. (%)**

| | 4/4 quarter in 1997 | 1/4 quarter in 1998 | 4/4 quarter in 2000 |
|---|---|---|---|
| Cash advance interest rate | 24.9 | 29.9 | 28.1 |
| Installment interest rate | 12~15 | 16~19 | 14.5~19 |
| Overdue payment penalty rate | 25 | 35 | 29 |
| Financing rate(average)<br>(Proportion of overdue payments)<br>(Customer defaults rate) | 12.1<br>(19.6)<br>(1.1) | 12.6<br>(22.3)<br>(1.0) | 9.4<br>(5.0)<br>(2.6) |

[1] See KFTC decision no. 2001-40, 28/3/2001.

**Table 3: Samsung Card Co. (%)**

| | 4/4 quarter in 1997 | 1/4 quarter in 1998 | 3/4 quarter in 2000 |
|---|---|---|---|
| Cash advance interest rate | 24.48 | 29.47 | 28.16 |
| Installment interest rate | 12~15 | 16~19 | 14.5~19 |
| Overdue payment penalty rate | 25.0 | 35.0 | 29.0 |
| Financing rate(average)<br>(Proportion of overdue payments)<br>(Customer defaults rate) | 12.44<br>(22.5)<br>(2.9) | 15.18<br>(26.46)<br>(3.6) | 9.82<br>(3.61)<br>(1.7) |

## 2. Market structure and governmental regulation

3. Although multiple credit companies operated in Korea in the late 1990ies, the Korean credit card service market exhibited an oligopolistic structure with the three largest firms mentioned above combining a market share of 70.8% and the seven largest companies combining a market share of 93.6%.

4. As government approval is a legal prerequisite for entering the credit card service market, the oligopolistic market structure was considered to be the outcome of government interventions. In fact, there had been no entry for more than 6 years since 1995.

5. In the time period under consideration, Asian economies including the Korean economy were hit by the financial crisis requiring most banks to recapitalize or reduce loans. As the substitutability between bank loans and cash advances and other financial services by credit companies were found to be low, the demand elasticity of credit card based financial services were lower than before.

## 3. Legal test

6. The companies' financing costs decreased significantly during the period and the proportion of overdue payments and customer default rates that influence supply costs also decreased. Despite these cost reductions, the three companies increased the cash advance interest rates significantly and maintained or decreased installment interest rates or overdue payments rates at a lower rate than the decreases in their financing and other supply costs.

## 4. Outcome

7. By administrative order the three companies were forced to readjusted their rates on the basis of a reasonable assessment of the changes in financing costs, proportions of overdue payments and customer default rates during relevant periods. Administrative fines (surcharges) were imposed.

## ANNEX 3: THE EU PORT OF HELSINGBORG CASES

### 1. Facts of the case

1. In July 2004, the Commission adopted two decisions rejecting parallel complaints of Scandlines Sverige[1] and Sundbusserne AS,[2] ferry operators providing services on the Helsingborg-Elsinore route (HH route) between Sweden and Denmark. Both companies claimed that Helsingborgs Hamn AB (HHAB) charged discriminatory and excessive port fees for services provided to ferry operators operating the HH-route, and that such pricing resulted from HHAB's consideration of the port as a whole, single operational and economic unit.

2. In the process of examining whether the submitted allegations were well-founded the Commission carried out a systematic analysis of the analytical framework set out by the ECJ in *United Brands*, and in particular provided some clarification of the concept of the 'economic value' of a service or product. Scandlines lodged an appeal before the General Court claiming that "HHAB has been making returns, on its ferry business, of over 100% the value of the equity employed in this business".[3]

### 2. Legal test

3. To assess whether the port charges were unfair, the Commission embraced the test laid down by the ECJ in para. 252 of the *United Brands* judgement. First, the Commission had to determine the costs actually incurred by HHAB and compare them with the prices actually charged to establish whether the difference between the two values was excessive, and second, if it was, to determine whether the prices were unfair in themselves or when compared to other prices.

4. The Commission found that HHAB's revenues derived from the ferry operations "would seem to exceed the costs actually incurred".[4] To reach this conclusion the Commission first had to determine which costs were to be allocated to ferry operations. As the ECJ pointed out in *United Brands*, cost allocation may involve "considerable and at times very great difficulties […] which may sometimes include a discretionary apportionment of indirect costs and general expenditure […]". In the case at hand, the Commission had to engage in such a complex exercise, as the information provided by the HHAB was in the Commission's view unrealistic.[5]

---

1 Case No Comp/A.36.586/D3 *Scandlines Sverige v Port of Helsingborg*, Commission decision of 23 July 2004 rejecting the complaint of Scandlines Sverige, available at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/36568/36568_44_4.pdf

2 Available at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/36570/36570_39_5.pdf

3 Case T-399/04, *Scandlines Sverige v Commission*, not decided yet.

4 *Scandlines Sverige v Port of Helsingborg*, para. 139.

5 The Commission considered that the allocation of costs presented by HHAB could not be realistic and reflect the level of costs actually incurred since it would imply that the company was actually facing bankruptcy, which according to the audited financial reports was not the case. *Scandlines Sverige v Port of Helsingborg*, para. 108

5. In the absence of reliable information on the actual cost allocation, the Commission could only make an approximate cost allocation. This task was further complicated by the fact that most of the costs were fixed and had to be treated as common or distributed costs.[6] On the basis of its analysis the Commission concluded that the revenues obtained seemed to exceed the costs actually incurred, but that this in itself was not sufficient to conclude that the difference was excessive. It was therefore necessary to carry out the second step of the *United Brand* test and determine whether the price in question was unfair either in itself or when compared to the price of other competing products. To that end, the Commission compared prices in question to (i) prices charged to other port users (i.e. cargo vessels), (ii) prices charged by the port of Elsinore, and (iii) port fees charged in other ports. The Commission pointed out that "a comparison of the prices must be made on a consistent basis", implying that (i) the products/services provided must be comparable, and (ii) the charging systems must allow a meaningful comparison.[7] However, in the present case, such comparisons were not conceivable because (i) most of the services provided to the different categories of port users differed considerably, (ii) the cost structure of the port of Helsingborg and Elsinore were different, and (iii) charging systems in use at each port were different. Despite these difficulties, the Commission nonetheless carried out comparisons, which led it to the conclusion that there was insufficient evidence to support the claim that port fees charged by HHAB were unfair.

### 3. Economic value

6. Focal to the Commission's analysis of the allegedly excessive nature of the port charges was the relation those charges bore to the economic value of the product. The Commission pointed out that the ECJ had not provided further guidance on how "economic value" of the provided product/services shall be calculated. According to the complainant, the economic value should be determined by adding to the cost incurred in the provision of a service, a reasonable profit accounting for a percentage of the production costs. Consequently "any price exceeding the so-determined economic value […] should then be found unfair".[8] While the Commission acknowledged that "the question whether a price is unfair may be assessed within a cost-plus framework",[9] it has nonetheless rejected the complainant's view and held that determination of the economic value must be undertaken on a case-by-case basis and shall take into account other non-cost related, in particular demand-side, factors.[10] Having analysed the relevance of very high sunk costs, opportunity costs, but most importantly an intangible value represented by the excellent location of the Helsingborg port, the Commission concluded that on the basis of the collected evidence it was not possible to determine that port charges had "no reasonable relation to the economic value" of the services and facilities provided by HHAB to the ferry operators.

### 4. Conclusions: outcome

7. While the two-pronged legal test to be used to determine whether prices are excessive was established by the ECJ in the *United Brands* case, the concept of "economic value" and in particular the second leg of the test lacked clarification. In both decisions, having considered that the main question at

6 *Scandlines Sverige v Port of Helsingborg*, para. 118.

7 *Scandlines Sverige v Port of Helsingborg*, para. 175.

8 *Scandlines Sverige v Port of Helsingborg*, para. 219.

9 *Scandlines Sverige v Port of Helsingborg*, para. 221.

10 The Commission explained in para. 227 of the decision that: "The 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".

stake was whether the price bore a reasonable relation to the economic value of the service, the Commission provided guidance as to how an "economic value" of a product or service should be determined and in particular that demand-side factors may be taken into consideration.

## ANNEX 4: THE EU UNITED BRANDS CASE

### 1. Facts of the case

1. In December 1975, the Commission issued a decision finding that United Brands Company (UBC), the largest importer of bananas, who supplied Europe through two main ports – Bremerhaven and Rotterdam, applied various trading and pricing conditions, which fell afoul of Article 102 TFEU (ex. Art. 82 EC). Although the Court of Justice of the European Union (ECJ), annulled[1] the decision in the part concerning excessive prices having found that the Commission's economic analysis was flawed and incomplete, it nonetheless acknowledged that "*..charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied..*"[2] can constitute an abuse. *United Brands* has over time become one of the leading and most frequently cited cases in the EU on excessive prices.

2. The Commission found that United Brands had a dominant position in the relevant market which comprised Belgium, Luxembourg, Denmark, Germany, Ireland and the Netherlands, and that it had violated Article 102 TFEU by (1) preventing its distributors/ripeners from reselling its bananas while still green, (2) charging dissimilar prices for equivalent transaction, (3) imposing unfair, (excessive) prices on its customers, and (4) refusing to supply its bananas to Olesen, one of its customers who also sold bananas from competing brands.[3] UBC appealed the decision before the ECJ challenging the product and geographic market definition and the finding of dominance. It further claimed that it had not charged discriminatory and excessive prices, while its other trading conditions and its refusal to supply were objectively justified. The ECJ upheld the Commission's decision on all grounds except excessive prices, where it found that the Commission had failed to apply appropriate reasoning and analysis. The fine was reduced from 1 million to 850,000 ecus.[4]

### 2. The Commission's reasoning on the imposition of unfair prices

3. In its assessment of excessive prices the Commission looked at price differentials between: branded and unbranded bananas (20-40%), bananas supplied by UBS and those supplied by its competitors (around 7%), and lastly price differentials between EU Member States forming part of the relevant market (15-100%), to which it gave most weight. Having found that the lowest prices were charged for bananas that were to be sold in Ireland, but without analysing UBC's cost structure, the Commission concluded that prices charged to Irish customers were representative, while those charged outside Ireland were excessive as they produced 'a substantial and excessive profit in relation to the economic value of the product

---

1 Case 27/76, United Brands Company and United Brands Continentaal BV v Commission [1978] ECR 207, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61976CJ0027:EN:HTML

2 Ibid, para. 250.

3 Commission Decision of 17 December 1975 relating to a proceeding under Article 86 of the EEC Treaty (IV/26699 – *Chiquita*), 76/353/EEC, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31976D0353:EN:HTML

4 The abbreviation ecu is short for european currency unit, an internal accounting unit used by EU Member States between March 1979 and January 1999 when it was replaced by the Euro (EUR) at parity.

supplied'.[5] In the Commission's view, it was 'the policy of partitioning the relevant market' that allowed UBC to charge excessive prices.[6] In addition to imposing a fine of 1 million ecus, the Commission required United Brands to end the identified infringements without delay. Required to give the firm sufficiently clear indications on how the infringement could be terminated, the Commission informed that reduction of prices outside of Ireland by 15% would be sufficient to comply with the decision.[7] However, there is no reasoning in the published decision that would explain how the Commission arrived at the 15% reduction figure.

4. In its appeal before the ECJ, United Brands disputed the representative nature of the Irish prices on the grounds that the company had actually incurred losses in Ireland. While the Court pointed out that the company's statements were not supported by any accounting documents, it acknowledged that the choice of Ireland as a cost benchmark was open to criticism, especially given that "for nearly 20 years banana prices, in real terms, have not risen on the relevant market".[8] On this last point, it is noteworthy that AG Mayras, whose opinion was, however, not cited by the Court, advised to consider a general proposition that banana prices had actually "dropped compared with what they were ten or twenty years ago".[9] The Advocate General emphasized that to determine whether a given price is unfair, "it is not enough to examine its trend at one particular stage; it is necessary to go further and take into account the trend of costs at the preceding stages". Furthermore, while the decline in retail prices may have been beneficial to consumers, nearly all the profits realised from cost reductions "have maintained if they have not increased the difference between the price paid to the planters and the price charged by United Brands and, have therefore in the end kept up, if they have not augmented, the profits of this undertaking"[10] while the producers/exporters did not gain anything.

## 3. Legal test

5. On appeal lodged by UBC, the ECJ refuted the methodology applied by the Commission, and choose instead to use a two-pronged test to determine whether UBC's prices bore "*no reasonable relation to the economic value of the product*". This, according to the Court, could be done by showing first that the difference between the costs actually incurred and the price actually charged is excessive. If it is, then in the second step it would have to be determined whether a price is unfair in itself or when compared to competing products.[11] The Court also noted that other methodologies could be devised to determine whether prices are unfair. In the case at hand, however, the Commission had clearly failed to prove its case. First, it did not satisfy the first prong of the test as it did not even analyse UBC's cost structure. While the ECJ recognised that in certain circumstances evaluation of production costs is likely to pose considerable difficulties, it pointed out that it was not the case here as "the production costs of the banana

5 Case 27/76, United Brands, para. 239.

6 Case 27/76, United Brands, para. 236.

7 Commission Decision, *Chiquita* [1975], part II.C.

8 Case 27/76, *United Brands*, para. 265.

9 Case 27/76, Opinion of Mr Advocate General Mayras delivered on November 1977, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61976CC0027:EN:PDF

10 Ibid.

11 Case 27/76, *United Brands*, para. 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 […]". Para. 252: "The questions therefore to be determined are 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 competing products".

do not seem to present any insuperable problems". Second, the difference between prices of UBS and of its competitors, which amounted roughly to 7% could not in any case be considered excessive.

**4. Conclusions: outcome**

6. As it turned out the Commission's finding of excessive prices was annulled by the Court since the Commission did not produce sufficient evidence in support of its position. Nonetheless, the judgment of the ECJ in *United Brands* provides the most comprehensive insight into the analytical framework that is to be used by the Court when it comes to the assessment of allegedly excessive prices.

## ANNEX 5: THE GERMAN HOUSEHOLD GAS CASE

### 1. Facts of the case

1. In March 2008 the Bundeskartellamt opened procedures against 35 gas distribution companies based on Sec. 19 ARC and Sec. 29 ARC (on both, see Box 2 in the main text) for alleged abusively excessive gas prices.[1] By the end of 2008, the Bundeskartellamt successfully concluded the proceedings finding that the prices of 30 of the companies were indeed abusively excessive.

2. The relevant product market was defined as the market for delivering natural gas to all standard profile customers as defined in the German gas grid directive[2] buying natural gas for their own use. Geographically, the market was found to be regional and identical to the areas of supply in which the companies assume basic supply functions as determined by law. In these regional markets substantial entry barriers were identified. For example, tenants, a substantial part of all households, were often excluded from switching supplier as the responsibility for doing so resides with the owner who has no incentive to change supplier as he can fully pass on the costs to the tenant. In addition, research referred to by the Bundeskartellamt indicated that at the time of the investigation only 14% of gas customers were willing to switch supplier. It further found that, while a certain degree of substitution between gas, electricity, district heating and oil existed, this did not affect the product market definition.

### 2. The Legal background and methodology used

3. In investigating the practices of the concerned gas distribution companies, two methodologies based on the comparative market concept were used. The concept of quantity weighted net-revenue comparison was employed to analyze the year 2007 and. revenue figures not yet being available, the Bundeskartellamt – based on the newly introduced Sec. 29(1) ARC – compared quantity weighted tariffs for 2008 .

4. The Federal Court of Justice had previously found that a comparison of revenues was an appropriate method in line with Sec. 19(4) no. 2 ARC. In this method, a comparision by way of benchmarking is made between the net revenues of sales to the relevant customer group of the company under investigation and those obtained by a comparable company in another geographic market. This approach allows the Bundeskartellamt to determine how the comparable company would have behaved in the market of the alleged infringer.

5. The comparison of revenues in these specific cases took two separate aspects into account: First of all, each unit of gas sold in 2007 was valued at the price at which it was actually sold. This ensured that any changes in prices were automatically factored in. Second of all, the comparison of revenues allowed

---

1 The decisions of all 30 cases can be found at: http://www.bundeskartellamt.de/wDeutsch/archiv/EntschMissbrauchaufsichtArchiv/2008/EntschMissbrauchsaufsichtW3DnavidW2660.php. An English summary of the case can be found in Bundeskartellamt (2008).

2 § 29 Gasnetzzugangsverordnung (of 25. July 2005, BGBl. I S. 2210).

the Bundeskartellamt to take all tariffs and special contracts and their respective quantities into account as the revenue results from the price and the quantity sold at that price.

6. For 2008 the method mentioned explicitly in Section 29 ARC, namely a comparison of tariffs, was used. The major reason for choosing a tariff comparison was that revenue comparisons were not feasible as the corresponding data had not yet been available.

7. In the tariff comparisons, the tariffs were compared on the basis of 5 consumption patterns considered as typical by the Bundeskartellamt and the regional (Länder) cartel offices. In order to make an appropriate forecast for the year 2008, the prospective gas consumption was calculated (and quantity-weigthed) on the basis of historic monthly temperature dates which then determined the expected amount of gas consumption in a particular month.

8. Further, the Bundeskartellamt subtracted the grid fees from the quantity weighted tariff (net of taxes) calculated over the 5 typical consumption patterns for 2008 and the revenues for 2007 (net of taxes). Subtracting grid fees was considered justified for two reasons. First of all, the grid fees are determined by a regulator in an *ex ante* procedure so that a reassessment of these fees was considered both unnecessary and undesirable. Second of all, subtracting the grid fees eliminated the structural differences between the concerned company and the benchmark company, ensuring the reliability of the benchmarking exercise.[3] As benchmark, the Bundeskartellamtchose two different municipal utility companies[4], one for each year.

9. Finally, the Bundeskartellamt determined a substantiality margin to be subtracted from the established differentials, since the jurisprudence of the Federal Court of Justice provides that only appreciable differences in price between the benchmark company and the targeted company can be considered abusive. The level of the substantiality margin was determined, following the jurisprudence of the Federal Court of Justice, on the basis of the intensity of the residual competition in the relevant regional markets. This intensity of residual competition was measured based on the switching rate of customers in the relevant market. Accordingly, in markets with higher levels of competition, the substantiality margin was increased, resulting in a higher intervention threshold. This was also justified as a possibility to account for the inherent tension between interventions in price abuse cases and the negative impact of such interventions on the incentives of potential entrants.[5] According to the decisions, the average switching rate across all gas distribution companies amounted to approximately 1% in 2007 but was significantly higher in certain areas in 2008.

10. To the benefit of the concerned companies the Bundeskartellamt effectively subtracted this substantiality margin, implying that only revenues or prices that substantially exceed the benchmark company's are to be considered abusive. In the decisions the Bundeskartellamt also mentioned that it had verified that the maximum price or revenue threshold did effectively not lie below the cost of the company.[6] The Bundeskartellamtdistinguished between H and L gas[7] in its decisions and did not accept as

3 Structural differences are essentially given by the particular grid and gridzone.

4 For 2007 the municipal utility company in Jena-Pößneck and for 2008 the municipal utilities company in Stade.

5 See on this point, which cannot be found in the decisions, the report to parliament: Deutscher Bundestag – 16. Wahlperiode, Drucksache 16/13500, page 30.

6 This is in line with the decision of the federal court in BGH, 22.07.1999 - KVR 12/98 – Flugpreisspaltung concerning the route Frankfurt Berlin. It should be noted, however, that this concern expressed in the case law only becomes pertinent if costs have been allocated correctly and possible efficiency reserves have been fully exploited, leaving the Bundeskartellamt with the possibility to adjust costs it considers exaggerated.

cost purchase prices above the average gas prices in the concerned or comparable market areas. The average gas purchase prices of other companies in the market or in comparable markets upstream of the gas distribution business were considered a reasonable benchmark as these costs are independent of the degree of competition in the market for gas distribution itself.

## 3. Remedies and conclusion of the case

11. The remedies consisted in financial commitments to return almost 130 Million Euro to customers via price reductions and deferred price increases. [8] The consumers were also spared approx. 230 million Euros because the gas suppliers subsequently refrained from passing on increased gas procurement costs.[9] Under the commitment, the supply companies were also not allowed to use subsequent price measures in order to compensate for the agreed price cuts.

---

7 H and L stand for different compositions of natural gas where H=High calorific and L = low calorific gas

8 The remedies only concern 30 companies as three procedures were closed as no abuse could be found, one was used as a benchmarking case and another was left to be treated by a regional cartel office.

9 See also the report to parliament: Deutscher Bundestag – 17. Wahlperiode, Drucksache 17/6640, page 120, tob e found at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Taetigkeitsbericht/TB_2009_2010.pdf

## ANNEX 6: THE ALBANIAN MOBILE TELEPHONY CASE

### 1. Facts of the case

1. In November 2007 following a market investigation launched *ex officio* in 2005, the Albanian Competition Authority imposed on AMC (Albanian Mobile Communications) and Vodafone a fine amounting to 454,185,000 Lek (approximately 3.2 million EUR, which equalled to 2% of each firm's annual turnover in the relevant product market).[1] The Competition Commission found that both companies held a jointly[2] dominant position in the mobile telephony market in Albania and that both firms abused their dominant position by applying unfair prices from 2004 to 2005.[3]

### 2. Legal test

2. Article 9(2)(a) of the Albanian Law on Protection of Competition identifies unfair prices as one of the main forms of abuse of dominance.[4] According to the competition authority a price is deemed unfair if it is higher than a price in a competitive market.[5] To decide whether this is the case, it is first examined whether the price charged bears any reasonable relation to the economic value of the product, which essentially means that the price is compared with production costs. Second, where it is impossible to determine the costs, the actual price and the profit rate are compared to price and profit levels of similar products or identical products in other geographical markets. According to the authority, such analysis relies on three different approaches: (i) establishing that the high price bears no reasonable relation to the economic value of the product, (ii) assessing profits, (which led to the conclusion that AMC's and Vodafone's profits would be lower in a presumably competitive market), and (iii) comparing prices of a given product with prices applied in other geographical markets.[6]

3. In the case at hand, the analysis of the relation between the actual price and the economic value of the product was short: the decision itself is 22 pages long. The relation that the price bears to the economic value of the product in question is dealt with in three paragraphs, included in the assessment of the alleged abuse that starts on page 16. The Competition Commission stated that "the service prices applied by [AVC and Vodafone] do not have any reasonable relation with their cost"[7]

---

1 Albanian Competition Authority, Decision No. 59 on abuse of dominant position in the mobile telephony market by Albanian Mobile Communication sh.a and Vodafone Albania sh.a, 9 November 2007, available in English at http://www.caa.gov.al/file/vendimet/Decision%2059%20AMC%20VOD.pdf

2 The Competition Commission did not expressly state that AMC and Vodafone were jointly dominant, but that they occupied 100% of the market.

3 Both firms appealed the decision before the District Civil Court of Tirana.

4 Law No. 9121 on Protection of Competition of 28.07.2003.

5 Decision No. 59, para. 63.

6 Albanian Competition Authority, Annual Report 2007 and Main Work Objectives for the year 2008, available at http://www.caa.gov.al/file/publikimet/English-annual%20rep.2007-08.pdf

7 Decision No. 59, para. 65.

and based this conclusion on the fact that both companies implemented a national termination fee for mobile telephony at a higher level than the threshold recommended by the Albanian Telecommunications Authority.[8] As far as the profits are concerned, the Albanian Competition Commission pointed out that whereas in competitive markets profit rates usually decrease, both firms had "high and increasing EBITDA and profit rates". Also, comparison of ARPU (Average Revenue per User per Minute of Usage) with Western European countries showed that mobile tariffs in Albania were high. Lastly, the comparison of Albanian prices with prices in other geographical markets essentially relied on the conclusion drawn in Cullen Report,[9] according to which "Albania *represents an exception with regard to pricing; she is placed among EU countries that apply the highest prices"*.[10]

## 3. Outcome

4. In the aftermath of the investigation, the Competition Commission adopted decision no. 61, in which it recommended to the Council of Ministers and the Regulatory Agency for Telecommunications that immediate measures (in particular the introduction of the third mobile operator 'Eagle Mobile' and the initiation of licensing procedures for a fourth operator) should be taken in order to effectively liberalise the mobile telephony market.[11]

8 In its decision No. 179, Albanian Telecommunications Authority recommended the threshold of 22 Lek/minute and 28 Lek/minute as a benchmark for 2004 and 2005 respectively for national termination rate.

9 Cullen Reports are published on a regular basis by Cullen International. Reports include benchmarking data on developments in telecommunications, media and electronic commerce regulation across European and non-European countries.

10 Decision No. 59, para. 71, citing Cullen Report 2 – Country Comparative Report (2006).

11 Decision No. 61 *"On Some Recommendations Regarding the Mobile Telephony Market"*. In the Decision, the Competition Commission also suggested to the Telecommunications Regulatory Agency that the national law *On Telecommunications in the Republic of Albania* should be brought in line with the European Union Telecommunications Regulatory Framework 2002, and that Chapter XII (concerning inspection, supervision and administrative procedures) should be revised in order to strengthen sanctions (fines) against violations of administrative procedures by the undertakings. Annual Report 2007, p. 16.