EXPLOITATIVE PRICES IN EUROPEAN COMPETITION LAW

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I. Introduction.

Undertakings may restrict competition in two ways: (1) cooperating with their competitors (collusive practices) and (2) interfering with their ability to compete (exclusionary practices).[2] In both cases, their ultimate goal is to raise the price they charge to their customers for their products or services.[3] Therefore, the main concern about collusive and exclusionary practices is that they enable firms to profitably raise prices over their marginal costs; in short: they create market power.[4]

In European competition law it has been considered that, under certain circumstances, practices which, without creating it, represent a mere exercise of the (substantial) market power already enjoyed by the dominant firm, should be prohibited as well. The

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[2] However, the doctrine about exclusion is viewed with deep degree of skepticism by commentators associated to the Chicago School, and collusion is nowadays the main concern of competition agencies. See J. B. Baker: "Exclusion as a core competition concern", 78 *Antitrust Law Journal* (2013), pp. 527-529.

[3] R. BORK: *The Antitrust Paradox. A Policy at War with Itself,* p. 134-160. R. POSNER: *Antitrust Law*, 2nd edition, Chicago-London, 2001, pp. 40 -43.

[4] *"The term "market power" refers to the ability of a firm (or a group of firms, acting jointly) to raise price above the competitive level without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded"* (W.M. LANDES, R.A. POSNER, "Market power in antitrust cases", *Harvard Law Review,* .vol. 94, n. 5, 1981, p. 937.

concept of *"exploitative abuse"* was formulated in *United Brands* in the following terms:

> *"The imposition by an undertaking in a dominant position directly or indirectly of unfair purchase or selling prices is an abuse to which exception can be taken under Article 86 of the Treaty. It is advisable therefore 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."*[5]

Among these exploitative practices, the most obvious example is the direct imposition of excessively high prices. However, European competition legislation does not refer to exploitative prices. The legal basis to intervene against them is found in Article 102 (a) TFEU, which states that an abuse may consist in *"directly or indirectly imposing unfair purchase or selling prices or other trading conditions."*

In my view, it is not obvious why *"unfair price"* means *"excessive price",* and even less *"exploitative excessive price"*. Any price increase may reduce the consumer surplus, but that does not suffice to label it as exploitative; at least, not mainly or exclusively: high prices may have as object or effect the exclusion of competitors. Thus, high prices may arise when the dominant undertaking competes on the downstream market with the buyer whom it charges them (as it is the case of margin squeeze or some cases of constructive refusal to deal). In these cases, the loss of welfare of the intermediate customers is just a by-product of the mainly exclusionary effects of the adopted pricing policy (which, in turn, is aiming to the acquisition of market power in the downstream market). To prevent them, are those exclusionary effects that must be demonstrated, rather than the mere exercise of market power.

To be purely exploitative, high prices have to be directed to the mere exploitation of the buyers (whatever this concept means), rather than to the foreclosure of some descendant market. However, to prevent purely exploitative prices, competition authorities must face significant conceptual and institutional problems. The aim of this paper is to demonstrate that, in light of such problems, it seems advisable to prohibit high prices

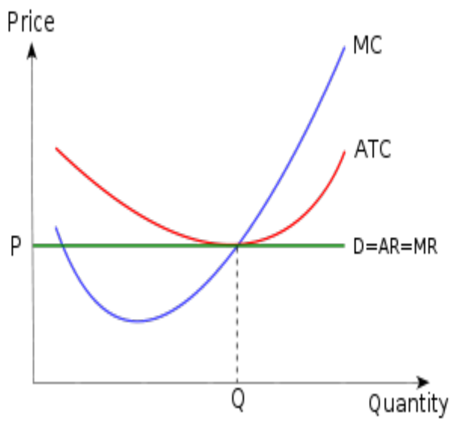
[5] Judgment of the European Court of Justice of 14 February 1978, case 27/76, *United Brands v Commission,* paras. 248-249.

only in very limited circumstances, and even requiring the proof of exclusionary effects (section II). This approach is compatible with the decisional practice of the European Commission (section III). However, the vagueness and inconsistency of the case-law allows competition authorities to adopt a less stringent test, thus assuming a price control function that the Treaty does not grant them and that may adversely affect the efficient operation of the market (section IV). Section V concludes.

II. Conceptual and institutional issues related to the prohibition of exploitative prices.

There is disagreement among economists about whether the goal of competition law should be the protection of consumer or total welfare, and whether competition policy should focus on allocative or productive (including dynamic) efficiency. But according to mainstream economics the promotion of economic welfare should be the lodestar of competition law.[6]

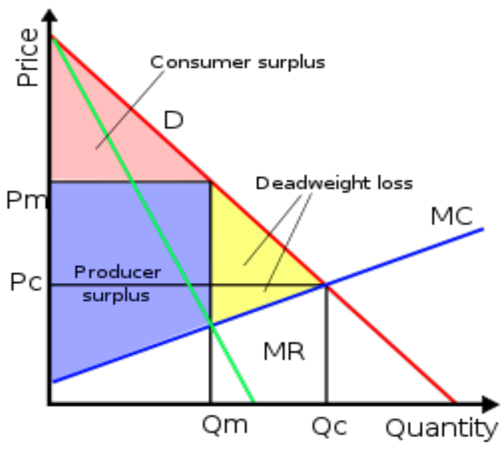
As we all know, in competitive markets, the price of a good or service tends to equal the marginal cost of production. As production represents consumer preferences, firms in perfectly competitive markets are said to produce at an allocative efficient level. *(figure 1)*.



(Figure 1)

[6] J. D. Wright & D. H. Ginsburg: "The Goals of Antitrust: Welfare Trumps Choice", *Fordham Law Review,* vol. 81, 2013, p. 2046

On the contrary, in markets where one firm enjoys substantial market power (i.e. a dominant position),[7] the equilibrium price (monopoly price) tends to equal marginal revenue, exceeding the marginal cost, and thus leading to allocative inefficiency (deadweight loos represented in Figure 2 by the yellow triangle), and a wealth transfer from buyers to the dominant firm (producer surplus represented by the blue rectangle).[8] Dominant firms do not maximize output, thus impairing allocative efficiency. However, due to productive and dynamic efficiency (i.e. economies of scale, technological developments that reduce costs or produce better quality products, etc.) the profit maximizing level of output might be set by the dominant firm at a lower price (and a higher level of output) than perfectly competitive firms.



(Figure 2)

In support of the prohibition of exploitative prices, it has been said that, if the central goal of competition policy is to promote consumer welfare, it would be strange to protect them only indirectly, by intervention against exclusionary conduct capable of granting market power (i.e. power over price), and not also directly by intervening

[7] *"Dominance entails that [...] the undertaking in question enjoys substantial market power over a period of time" (Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings,* para. 10).

[8] Consumer surplus is the difference between what consumers are willing to pay for a good or service relative to its market price. Producer surplus is the difference between the price received by the producer and the minimum amount that he/she would accept for the good.

against the exercise of significant market power (and the concomitant allocative inefficiency and wealth transfer) once it has been achieved.

However, the prohibition of exploitative prices does not necessarily protect consumers, as customers might not be consumers in the sense of final users of the product or service. And, even if competition law should promote consumer welfare rather than total welfare, dominant firms should be free to charge prices at the level they choose, as supra-normal profits will attract new competitors. Excessive price actions may undermine the investment incentives of incumbent dominant firms and potential new entrants, reducing mid and long-term consumer welfare. High prices convey signals indicating that a market is profitable and trigger investment and entry into the industry.[9] Focusing in allocative efficiency in the short term (i.e. intervening against the exercise of significant market power forcing prices down towards marginal cost) may reduce the scope for investment, impairing productive and dynamic efficiency to the ultimate detriment of consumers.[10] This is the main reason why US antitrust law does not regulate high prices. In the words of Justice SCALIA*:*

> *"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- is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth"*[11]

Therefore, when dominance has not been achieved through the market being a natural monopoly or through state-granted monopoly rights,[12] in the absence of proof of unlawful (i.e. exclusionary) practices the actual structure of the market is presumed to

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[9] M. MOTTA AND A.. DE STREEL, "Excessive Pricing in Competition Law: Never say Never?", in SWEDISH COMPETITION AUTHORITY, *The Pros and Cons of High Prices,* 2007, pp. 17-18 (available at http://www.kkv.se/globalassets/english/research/the-pros-and-cons-of-high-prices-14mb.pdf).

[10] L. LOVDAHL GORMSEN, *A Principled Approach to Abuse of Dominance in European Competition Law,* Cambridge University Press, 2010, p. 27.

[11] *Verizon Communications Inc. v. Law Iffices of Curtis V. Trinko, LLP.* In this, sense, it has been previously stated that *"(t)he successful competitor, having been urged to compete, must not be turned upon when he wins"* [United States v. ALCOA, 148 F.2d 416 (2nd Cir., 1945)]

[12] See E. M. FOX, D. HEALY, "When the state harms competition – The role for competition law", *Antitrust Law Journal,* vol. 73, 2014, p. 769 seq.

be the most effective.[13] Thus, a dominant position reflects the success of the dominant firm in satisfying the needs of consumers more efficiently than their rivals. In HAYEK's words:

> *"Where the source of a monopoly position is a unique skill, it would be absurd to punish the possessor for doing better than anyone else by insisting that he should do as well as he can".*[14]

Indeed, it is widely accepted that determining the level at which a price is *"unfair"* and designing an appropriate remedy is a very difficult task in real-life circumstances. It is unclear what would be the most appropriate competitive benchmark, and, even if it could be determined, in practice it would be very costly and uncertain to find out where prices are exactly in relation to that competitive benchmark. In this sense, it has been said that there is no benchmark that can be used without error. Any pricing rule is bound to cause errors: mistakenly finding antitrust liability *("false convictions"* or type I errors) or clearing conducts which are anti-competitive *("false acquittals"* or type II errors). As profits attract entry, usually type II errors can be corrected by the market. On the contrary, type I errors are *"especially costly",* as long as they can disincentive the very conducts the antitrust laws are designed to promote: entry and aggressive competition. Thus, a *per se* legality rule is the most appropriate for excessive prices.[15]

In addition, the very existence of *"exploitative prices",* as a category prohibited under the label of *"unfair prices",* might be inconsistent with the wording and goals of Article 102 TFEU. Indeed, a purely *"exploitative price"* should not exceed the *"monopoly price"*.[16] However, Article 102 TFEU does not prevent monopoly pricing. The concept

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[13] MCGEE, "Efficiency and Economics of Size", in GOLDSCHMID *et al.* (eds.), *Industrial Concentration: The New Learning,* Boston, 1974, pág. 93; EASTERBROOK, ""Workable Antitrust Policy", *Michigan Law Review,* 1986, vol. 84, pp. 1700-1701.

[14] F. HAYEK, *Law, Legislation and Liberty*, vol. 3, Chicago, 1979, p. 72.

[15] D.S. EVANS & A.J. PADILLA, "Excessive Prices: Using Economics to Define Administrable Rules", CEPR Discussion Paper No. 4626, 2004.

[16] *"[O]ne would expect that the prohibition against excessively high prices in Article 82 would refer to prices in excess of the competitive price but less than, or equal to the monopoly price. However, if the prohibition would catch also monopoly prices it would seem clear that Article 82 would be concerned not only with abuse of a dominant position, but also with the fact of someone being in a dominant position as such. If it is logical and expected from an economic point of view that the market conditions, that is the competitive conditions, have an influence over the market price it would seem natural to expect a monopolist to charge the monopoly price. Interfering with such a pricing policy would be tantamount to interfere with dominance as such"* (N. Wahl, "Exploitative high prices and European competition law – a

of dominance relates to a position of economic strength which enables the dominant firm to behave independently of its competitors, its customers and ultimately of the consumers.[17] This independency implies that the dominant firm has substantial market power and, thus, the monopoly pricing is inherent to the concept of dominance.[18] As the mere possession of a dominant position (i.e. substantial market power) is not prohibited, *"unfair price"* cannot correspond to *"monopoly price":* an *"unfair price"* is, then, a *"supra-monopoly price".*[19] However, by setting a price higher than monopoly price the dominant undertaking would not be maximizing its profits. This could be explained because it aimed to recoup those losses in a descendant market,[20] but in this case such a price would be exclusionary rather than exploitative.

Therefore, the term *"unfair prices",* as it is used in Article 102 (a) TFEU, should be interpreted as referring to excessive (too high or too low) prices with exclusionary effects, and are those effects what should be demonstrated;[21] so called *"exploitative prices"* are just maximizing-profit prices (i.e. monopoly prices), and, as long as they are inherent to the possession of a dominant position (i.e. substantial market power) should not be prohibited.

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personal reflection", in SWEDISH COMPETITION AUTHORITY, *The Pros and Cons of High Prices,* 2007, p. 51).

[17] Judgment of 14 February 1978, case 27/76, United Brands v. Commission.

[18] The substantial market power enjoyed by the dominant firm *"means that the undertaking's decisions are largely insensitive to the actions and reactions of competitors, customers and, ultimately, consumers (...) The Commission considers that an undertaking which is capable of profitably increasing prices above the competitive level for a significant period of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant" (Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings,* para 10-11).

[19] M. VAN DER WOUDE, "Unfair and excessive prices in the energy sector", in C.D. EHLERMANN AND MEL MARQUIS (eds.), *European Competition Law Annual 2007: A Reformed Approach to Article 82 EC,* Hast Publishing, Oxford/Portland, Oregon, 2008, p. 619.

[20] In my view, contrary to N. WAHL's claim, this might be an economic reason *"for a monopolist or any dominant firm to charge a higher price than the monopoly price"* ("Exploitative high prices and European competition law – a personal reflection", p. 51).

[21] In a similar line of reasoning, it has been said that *"'unfairness' is a broad enough concept to cover harm to competitors and harm to consumers. Thus, it can cover both 'exclusionary' and 'exploitative' conduct, in line with one of the main thesis of this book that these should both exist for there be an abuse"* (P. AKMAN, *The Concept of Abuse in EU Competition Law. Law and Economic Approaches,* Hart Publishing, Oxford-Portland, Oregon, 2012, p. 149), and that *"exploitation would need to be coupled with harm to competition which can demonstrate itself as 'exclusion' to breach Article 102"* (ibid, p. 184)

Even in the very exceptional cases where the market will not self-correct excessive prices, competition authorities are not well-suited for setting the *"fair"* price. When dominance has been achieved through the market being a true natural monopoly or through state-granted monopoly rights, the task of regulating the prices of monopolists – or removing such a legislative privileges- should be done *ex ante* and left to government or sector-specific regulators.[22]

In light of the above mentioned problems, there is a strong consensus among scholars on the convenience of limiting the application of Article 102 (a) TFEU to excessive prices to very exceptional circumstances. In this sense, different screening tests have been proposed. Some conditions seem to be present in most of them: (1) very high and non-transitory barriers to entry leading to a monopoly or near monopoly in the market; (2) this monopoly results from current or past exclusive rights, and not from past investments or innovation. Furthermore, it has been proposed as additional conditions that: (3) there is no effective means to eliminate the entry barriers; (4) there is no sector regulator being competent to regulate excessive prices; (5) the excessive prices charged are likely to prevent the launching of new products or the emergence of adjacent markets.[23]

Therefore, it seems fair to conclude that mainstream economics is against the prohibition of merely exploitative high prices as it may impair the efficiency of markets. Therefore, it proposes to limit the application of Article 102 (a) to very exceptional circumstances, including the presence of exclusionary effects -as suggests the requirement that the excessive prices charged are likely to prevent the launching of new products or the emergence of adjacent markets-, in which case are these, and not the exploitative ones, which should to be demonstrated.

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[22] M. MOTTA AND A. DE STREEL, "Excessive Pricing and Price Squeeze under EU Law", C.D. EHLERMANN and MEL MARQUIS (eds.), *European Competition Law Annual 2003: What is an abuse of a Dominant Position?,* Hart Publishing, Oxford/Portland, Oregon, 2004, p. 109.

[23] See D.S. EVANS & A.J. PADILLA, "Excessive Prices: Using Economics to Define Administrable Rules", CEPR Discussion Paper No. 4626, 2004, p. 3. M. MOTTA AND A. DE STREEL, "Excessive Pricing and Price Squeeze under EU Law", pp. 109-110. A slightly modified test is proposed in M. MOTTA and A. DE STREEL, "Excessive Pricing in Competition Law: Never say Never?". pp. 14-46.

III. Exploitative prices in the case-law of the European Court of Justice and the decisional practice of the Commission.

European competition law does condemn high prices. This was already implicit in *Parke, Davis,*[24] where the Court stated that the sale price of a product may be regarded as a factor to be taken into account in determining the possible existence of an abuse. And it was made explicit in *Sirena v. Eda,*[25] where it was established that the price level of a product may determine an abuse of a dominant position when it is particularly high. But, at which level the price becomes "particularly high" (i.e., unfair)?

According to the predominant view, the prohibition would be in line with some of the proposals of the Ordoliberal ideology which strongly influenced the Treaty of Rome. Specifically, Article 102 TFEU was based on *"ordoliberal foundations"*.[26] The main objective of ordoliberal competition policy was the protection of the *"economic freedom"* of market actors, so it stressed the need to limit the private economic power. From this point of view, it has been said that *"fairness"* requires that the economic power of dominant firms is not used to disadvantage other market participants, whether competitors, providers or customers; in particular, where a firm uses its market power to raise prices above competitive levels, *"this is often referred to as unfair to purchasers"*[27] or even *"expropriation by way of (...) dominance"*.[28] According to Ordoliberal competition law, the very existence of undertakings with substantial market power distorts the competitive order; they should be prohibited and broken-up where possible, and, where not, regulated to force them to behave as if they were subject to competition. Therefore, competition law requires that dominant firms act *"as if"* they did not possess that power, and that may include fixing the price in such a way that

[24] Judgment of the Court of Justice 29 February 1968 (Case 24/67).

[25] Judgment 18 January 1971 (Case 40/70).

[26] See D. GERBER, Law and Competition in Twentieth Century Europe Protecting Prometeus, OUP, Oxford, 2011.

[27] D. GERBER, "Fairness in competition law: European and U.S. Experience," *Presentation at a Conference on Fairness and Asian Competition Laws,* held on March 5, 2004, in Kyoto, Japan. Available at http://archive.kyotogakuen.ac.jp/~o_ied/information/fairness_in_competition_law.pdf.

[28] D. ZIMMER, "On Fairness and Welfare: The Objectives of Competition Policy (Comment)", in C.D. EHLERMANN AND MEL MARQUIS (eds.), *European Competition Law Annual 2007: A Reformed Approach to Article 82 EC,* Hast Publishing, Oxford/Portland, Oregon, 2008, pp. 106.

marginal costs are just covered.[29] Article 102 (a), according to this view, would deem as excessive any price above marginal costs.

These ideas seemed to be supported in *United Brands*, where the ECJ formulated the concept of *"exploitative abuse"*. According to it, the price might be deemed too high when permits "*to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition."* That might be interpreted as a prohibition for charging a price which exceeds marginal cost (plus a reasonable benefit), i. e. to exercise market power when it becomes substantial, even if legitimately acquired.

However, that would be erroneous. That interpretation would have empowered competition authorities as price regulators and led to a frequent application of the prohibition. On the contrary, relying on a rather inconsistent case-law, the Commission have taken a much more cautious approach. It first limited the scope of Article 102 (a) TFEU to very exceptional cases and, ultimately, adopted an even stricter view that, in practice, has led to its inapplication to exploitative excessive prices.[30]

The landmark case still is *United Brands*, where the Court ratified a qualified definition of unfair high price previously established in *General Motors,*[31] as a *"a price which is excessive because it has no reasonable relation to the economic value of the product supplied"*.[32] For determining whether a price is excessive the ECJ adopted a two-stage approach that requires assessing: (1) whether the difference between the costs actually incurred and the price actually charged is excessive; and, if the answer to this question

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[29] W. EUCKEN, "The Competitive Order and Its Implementation" (Translated by C. Ahlborn and C. Grave) reprinted in *Competition Policy International, n. 2,* 2006, pp. 219-45, at 241-243.

[30] This reinforcement has coincided with the attempted transit *"from fairness to welfare", i.e.* from an ordoliberal point of view focused on the competitive process to a (supposedly) welfare approach expressed in the *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*. *See* C. AHLBORN and J. PADILLA, "From Fairness to Welfare: Implications for the Assessment of Unilateral Conduct under EC Competition Law", in in C.D. EHLERMANN AND MEL MARQUIS (eds.), *European Competition Law Annual 2007: A Reformed Approach to Article 82 EC,* Hast Publishing, Oxford/Portland, Oregon, 2008, pp. 55 *et seq.* As this approach has been apparently rejected by the ECJ, it may be questioned whether this tacit derogation will be uphold in subsequent cases. However, as discussed below, even from an ordoliberal point of view, Article 102 TFEU was primarily directed against the further restriction by dominant firms of residual competition by means other than competition on the merits.

[31] Judgement 13 November 1975, *Case 26/75: "a price which is excessive in relation to the economic value of the service provided"* (para. 12).

[32] Judgment of 14 February 1978 — Case 27/76, United Brands v. Commission, para 250.

is in the affirmative, (2) whether the imposed price is either unfair in itself or when compared to competing products.[33] The Court, however, did not provide further guidance on the meaning of the inherently vague conditions comprised in this test. Thus, according to the first limb, a price-cost comparison is needed to reveal the profit margin of the dominant firm; however, calculating production costs –and even just determining which costs must be taken into consideration- may be extremely difficult.[34] Only when that profit margin is found to be *"excessive",* the price should be further investigated in order to determine whether it is *"unfair"*. To that end, the second limb suggests the need of benchmark prices,[35] but no further guidance is provided.

In addition, the Court recognized that *"other ways may be devised –and economic theorists have not failed to think up several- of selecting the rules form determining whether the price of a product is unfair"* (para 253). Thus, in subsequent cases the ECJ seemed to accept other benchmarks, as the prices of equivalent firms active on neighboring geographic markets,[36] or the prices charged by the same dominant firm to other customers or over time.[37] Apparently, in doing so it skipped the price-cost

[33] *"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; however the Commission has not done this since it has not analysed UBC's costs structure. The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, it 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"* (paras. 251-252).

[34] D. GERADIN, *"The necessary limits to the control of "excessive" prices by competition authorities – A view from Europe",* Tillburg University Legal Studies Working Paper, No 2007-032, p. 7. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1022678&download=yes

[35] D. GERADIN, *"The necessary limits to the control of "excessive" prices by competition authorities – A view from Europe",* p. 10.

[36] *"When an undertaking holding a dominant position imposes scales of fees for its services which are appreciably higher than those charged in other Member States and where a comparison of the fee levels has been made on a consistent basis, that difference must be regarded as indicative of an abuse of a dominant position"* (Judgments of the Court, 13 July 1989, Cases 110/88, 241/88 and 242/88, *Lucazeau and others v. SACEM and others*, at §25, and 395/87, *Ministère public v. Jean-Louis Tournier,* at §46). *"[I]t must be possible to make a comparison between the prices charged by the group of undertakings which hold concessions and prices charged elsewhere"* (Judgment of the Court, 4 May 1988, Case 30/87, *Corinne Bodson v. SA Pompes funèbres des régions libérées).*

[37] See Judgment of the Court 11 November 1986**,** Case 226/84, *British Leyland Public Limited Company v. Commission*, paras. 27-28, where the Court concluded that the prices were excessive because the price differential between the various services offered by the dominant firm was disproportionate in relation to the minimal cost differences between them.

comparison (first limb of the *United Brands* test) and directly undertook a comparison between the dominant firm price and other benchmark prices (which could constitute the second limb of the *United Brands* test). When the difference between them is *"appreciable",* the dominant firm needs to provide an objective justification for the established price differential. This second test seems to be applicable only when it is impossible to perform a cost calculation;[38] however, the ECJ has neither stated it explicitly nor explained the conditions under which each of them is applicable.

Although it is therefore difficult to find consistency in the standards relied on by the ECJ, some results may be derived from the case-law and, specially, from the decisional practice of the Commission:

1. The residual character of exploitative abuses and the rejection of the *"as if"* standard.

The prohibition of the abuse of a dominant position is mainly (if not exclusively) concerned with exclusionary practices. Article 102 (a) TFEU is not addressed to monitor the pricing policy of dominant firms, and do not require them to behave *"as if"* they lack market power, so the Commission will intervene in very exceptional circumstances in relation to it.

Even from an ordoliberal point of view, Article 102 was primarily directed against the further restriction by dominant firms of residual competition. The main concern of the drafters was the need to prevent the strengthening of dominant positions by means other than competition on the merits.[39] Thus, the legislative intent was not framing the

[38] According to the Joined Opinion of Mr. Advocate General Jacobs delivered on 26 May 1989 on *Lucazeau* and *Tournier* cases, *"[t]here is a consensus in the observations made to the Court in these cases that the test laid down in Case 27/76 United Brands v Commission [1978] ECR 207 for determining whether a price is excessive in relation to the economic value of the benefit conferred is inapplicable in the present context [...] It is pointed out that it is inappropriate in the present context to proceed on the basis of a comparison between the costs of production and the selling price because it is impossible to determine the cost of the creation of a work of the imagination such as a musical work"* (para 53). See also J. STEERBERGEN, "(Excessively) High Pricing: What's the role for Competition Authorities?", *Lithuanian Presidency. European Competition Day, 3 October 2013,* p. 5. Available at http://www.eu2013.lt/uploads/documents/Prezentacijos/Jacques%20Steenbergen_Excessively%20High%20Pricing.pdf

[39] Certainly, it was even said that Article 102 TFEU was restricted to the pursuit of the exploitation of those who dealt with dominant undertakings. See R. JOLIET: *Monopolization and Abuse of Dominant Position. A Comparative Study of the American and European Approaches to the Control of Economic*

provision of abuse as a regulatory scheme. The concrete meaning and practical application of the prohibition established in Article 102 (a) TFEU was not much discussed, but it was seen as applicable only in exceptional circumstances to self-evident excesses. The concept of *"as if"* competition was only proposed for the narrow case of regulating infrastructure monopolies, and was not uniformly accepted by ordoliberals.[40] In this sense, the prohibition of exclusionary abuses was confirmed in *Continental Can*, where the Court of Justice established that Article 102 TFEU *"[i]s not only aimed at practices which may cause damage to consumers directly, but also at those which are detrimental to them through their impact on an effective market structure, such is mentioned in Article 3 (f) of the Treaty."*[41] And, according to the subsequent case-law, the protection of the competitive process (competition as such) is the main goal of European Competition Law, so the main focus of Article 102 was not on exploitative, but on exclusionary abuses.[42]

Power, Martinus Nijhoff, 1970, pp. 127-131; "*Monopolisation et Abuse de Position Dominante", Revue Trimestrielle de Droit Européen, 1969, pp. 679-82.* However, in this respect former Judge Joliet "explicitly rejected the findings of a similar comparative study by Ernst-Joachim Mestmäcker –an author affiliated with the ordoliberal school- who had argued that Article 82, like Section 2 Sherman Act, was primarily directed against the further restriction by dominant firms of residual competition" (H. SCHWEITZER, "The History, Interpretation and Underlying Principles of Section 2 Sherman Act and Article 82 EC", in C.D. EHLERMANN AND MEL MARQUIS (eds.)*, European Competition Law Annual 2007: A Reformed Approach to Article 82 EC,* pp. 119-120).

[40] H. SCHWEITZER, *"The History, Interpretation and Underlying Principles of Section 2 Sherman Act and Article 82 EC",* p. 134-140.

[41] Judgement of the Court of Justice 21 February 1973 (Case 6/72, *Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities,* para. 26).

[42] H. SCHWEITZER, "The History, Interpretation and Underlying Principles of Section 2 Sherman Act and Article 82 EC", p. 140. Some commentator, after studying the preparatory works of the Treaty of Rome, have denied that Article 102 was envisaged as an ordoliberal provision: the legislative intent was to promote "efficiency", and specially "productive efficiency". That is the reason why the Treaty did not contain rules on merger control and Article 82 EC does not prohibit the dominant position itself, as a classical ordoliberal rule would have done. The drafters intended to prohibit merely exploitative abuses by dominant undertakings and not exclusionary abuses, as the wording of the French and German versions of the Treaty supports (P. AKMAN, "Searching for the Long-Lost Soul of Article 82DC", *Oxford Journal of Legal Studies,* Vol. 29, No. 2, 2009, pp. 267-303). However, *"even if Article 102 TFEU does not embody the model of direct intervention against market power advocated by ordo-liberals, the distinctive features identified above can nonetheless be traced back to ordo-liberal thought. Such is certainly the case for the focus on the protection of the competitive process, the insistence on competition on the merits and the special responsibility of the dominant firm"* (P. LAROUCHE and M.P. SCHINKEL, "Continental Drift in the Treatment of Dominant Firms: Article 102 TFEU in Contrast to § 2 Sherman Act", p. 12, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2293141).

This residual character of exploitative abuses was reinforced in its *Guidance on the enforcement priorities in applying Article 82 of the EC Treaty,* where it stated that:

> *"Conduct which is directly exploitative of consumers, for example charging excessively high prices or certain behavior that undermines the efforts to achieve an integrated internal market, is also liable to infringe Article 82. The Commission may decide to intervene in relation to such conduct, in particular where the protection of consumers and the proper functioning of the internal market cannot otherwise be adequately ensured. For the purpose of providing guidance on its enforcement priorities the Commission at this stage limits itself to exclusionary conduct and, in particular, certain specific types of exclusionary conduct which, based on its experience, appear to be the most common"* (para. 7).

Therefore, it can be said that the Commission limits the scope of exploitative prices to the very exceptional cases where most of the structural conditions already proposed by various commentators as screening tests are present. Thus, *"the protection of consumers and the proper functioning of the internal market cannot otherwise be adequately ensured"* when, at least, (1) there are very high and non-transitory barriers to entry leading to a monopoly or near monopoly in the market, (2) there is no effective means to eliminate the entry barriers, and (3) there is no sector regulator being competent to regulate excessive prices.

In addition, the conclusion that Article 102 (a) TFEU do not require dominant firms to behave *"as if"* they lack market power could be already derived from two-stage test established in *United Brands.* As we already know, in order to distinguish excessive prices, it requires to determine (1) 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, (2) whether the imposed price is either unfair in itself or when compared to competing products. Consequently, for Article 102 (a) TFUE applies, it does not suffice that difference between costs and price is excessive and, therefore, it does not require dominant firms to set prices in relation with any level of costs.

This was explicitly confirmed in *Scandlines,* where the Commission recognized that *"the assessment of the reasonable relation between the price and the economic value of the product/service must also take into account the relative weight of non-cost related* *factors"*,[43] so proof of an *"excessive"* profit margin did not suffice to establish an abuse.[44] Thus, Article 102 (a) TFUE does neither prohibit that a dominant firm exercise its market power, nor requires that they act "as if" they did not possess that power.

2. An excessive price has to produce exclusionary effects for the Commission to intervene in relation to Article 102 (a) TFEU.

If Article 102 (a) TFUE does not prohibit dominant firms to exercise their market power, monopoly prices have to be considered lawful. Therefore, an exploitative price has to be a supra-monopoly price.

The definition provided by the ECJ already suggested that an unfair high price should be higher than monopoly price: this tends to equal marginal revenue, which is determined by demand curve's shape and height. Thus, monopoly price may be considered as having more than a *"reasonable relation to the value of the product supplied",* unless only cost-related factors could be taken into account to determine that value. Otherwise, a price that results of the free interaction of demand and supply will not be deemed unrelated to the economic value of the product, as *"the economic value of something would rather seem to be decided by the market".*[45]

As already stated above, the Commission considered in *Scandlines* that, in assessing the *"economic value of the product supplied"* account must be taken not only of the costs of production, but also additional factors, *"especially as regards the demand-side aspects of the product/service concerned"*. Thus, high prices imposed by a dominant firm may simply reflect the value that the product or service has for its customers: *"[t]he demand-side is relevant mainly because customers are notably willing to pay more for something specific attached to the product/service that they consider valuable. This*

[43] See Commission Decision, 23 July 2004, Case COMP/A.36.568/D3 – *Scandlines Sverige AB v. Port of Helsingborg,* para. 228.

[44] *"It is important to note that the decisive test in United Brands focuses on the price charged, and its relation to the economic value of the product. While a comparison of prices and costs, which reveals the profit margin, of a particular company may serve as a first step in the analysis (if at all possible to calculate), this in itself cannot be conclusive as regards the existence of an abuse under Article 82"* (para. 102)

[45] N. Wahl, "Exploitative high prices and European competition law – a personal reflection", in SWEDISH COMPETITION AUTHORITY, *The Pros and Cons of High Prices,* 2007, p. 53. See also D.S. EVANS & A.J. PADILLA, "Excessive Prices: Using Economics to Define Administrable Rules", p. 3.

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" (paras 226-227); more simply put: *"[t]he 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."* (para 232).

Therefore, *"the demand-side aspects of the product/service concerned"* has to be taken account to determine its economic value. As the shape and height of the demand's curve determine the marginal revenue, and firms with monopoly power set the price where marginal cost equal marginal revenue, the equilibrium price (i.e. the monopoly price where the firm maximize its profits) has obviously a *"reasonable relation to the value of the product supplied."* Thus, an unfair high price has to be necessarily higher than monopoly price. However, as already stated, by setting a price higher than monopoly price the dominant undertaking would not be maximizing its profits, which could be explained because it aims to recoup those losses in a descendant market. However, such a price may be exclusionary rather than exploitative.

In this sense, the Commission had already suggested that it will not enforce Article 102 (a) to prevent the exercise of market power if legitimately acquired, but only to the exclusionary conduct leading to it:

> *"(...) the existence of a dominant position is not in itself against the rules of competition. Consumers can suffer from a dominant company exploiting this position, the most likely way being through prices higher than would be found if the market were subject to effective competition. The Commission in its decision-making practice does not normally control or condemn the high level of prices as such. Rather, it examines the behavior of the dominant company designed to preserve its dominance, usually directed against competitors or new entrants who would normally bring about effective competition and the price level associated with it.*" [46]

[46] XXIVth Report on Competition, 1994, p. 207. See also the Vth Commission Report on Competition Policy 1975, para 76; XXVIIth Commission Report on Competition Policy 1997, para 77. In this respect, Philip Lowe, then Director General of DG Competition, indicated that *"(...) 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*

In fact, the formal decisions condemning a dominant firm for charging excessive prices *(General Motors, United Brands, British Leyland and Deutsche Post II)* are related with exclusionary conduct. In *General Motors* and *British Leyland* the Commission was concerned not with the exploitation of a dominant position, but with the hindering of freedom of circulation between Member States. In *United Brands* it dealt with discriminatory conduct coupled with measures also preventing parallel trade. Finally, *Deutsche Post II* was not just exploiting its market power, but preventing re-mailing practices in order to exclude foreign operators from the market of domestic mail. All of them were concerned about exclusionary conduct capable of partitioning the internal market.[47]

3. <u>The criteria formulated in *United Brands* remains the relevant test for assessing whether a price is excessive.</u>

In *Scandlines,* the Commission relied exclusively on the two-stage test set in *United Brands* to assess whether the price bears a reasonable relation to the economic value of the product supplied, and in *Dublin Airport,* it stated that this is the relevant test *"[a]ccording to settled case law".* [48] Moreover, the Commission recalled in *Scandlines* that the two conditions for a finding of abusive excessive pricing were cumulative. If proof of an *"excessive"* profit margin does not suffice to establish an abuse, neither proof of the existence of an *"unfair"* price pursuant to the second limb of the *United Brands* test, through a comparison with other prices (be prices of equivalent firms active

by changing the competitive structure or process of the market…..And in my view, we should continue to prosecute such practices where the abuse is not self correcting, namely in cases where entry barriers are high or even insuperable" (Philip Lowe, Director General DG Competition 'How different is EU anti-trust? A route map for advisors – An overview of EU competition law and policy on commercial practices' [Speech] ABA 2003 Fall Meeting).

[47] Although concluded by settlement, the competition concerns in *Rambus* arose *"from the fact that Rambus may be claiming abusive royalties for the use of its patents at a level which it would not have been able to charge absent its conduct"; this conduct amount to "patent ambush"* (Commission Decision of 9.12.2009 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement Case COMP/38.636 – RAMBUS). This is intentional deceptive conduct in the context of the standard-setting process by not disclosing the existence of the patents and patent applications which it later claimed were relevant to the adopted standard, thus forcing its competitors to accept higher licencing fees than those which could have been negotiated at an earlier stage before the adoption of the standard and putting them in a competitive disadvantage in relation to the standard finally adopted.

[48] EC Decision of 17 October 2013, Case No COMP/39.886 – Ryanair/DAA-Aer Lingus, para 82.

on neighboring geographic markets, or the prices charged by the same dominant firm to other customers or over time).

This approach seems to have been confirmed by the Court in *Scippacercola,* where, relying on the *United Brands* test, it stated that an infringement of Article 102 (a) TFEU cannot be established on the basis of a simple comparison of levels of charges payable at different geographic markets.[49] Thus, benchmarks other than the dominant firm own costs (i.e. prices of equivalent firms active on neighboring geographic markets, or the prices charged by the same dominant firm to other customers or over time) would be acceptable only in exceptional circumstances.

IV. Recent decisional practice of the Spanish Competition Authority.

It is fair to conclude that the Commission, partially supported by the ECJ and in line with mainstream economics, has placed on itself a very difficult burden to prove the existence of excessive prices in future cases, leading in practice to the derogation (or, at least, the non-application) of Article 102 (a) TFEU as a measure to control exploitative abuses. However, the inconsistency of the criteria laid down by the ECJ enable national authorities to establish a less stringent test and even to adopt the role of price regulator.

This might be the case of the Spanish *CNMC-Comisión Nacional de los Mercados y de la Competencia* (National Commission of Markets and Competition). The three-stage test established in its Resolution in the *Explosivos* case[50] has been uphold by the Spanish Supreme Court.[51] Although apparently reflecting the European case-law, the test features some qualifications entailing a very different outcome. Specifically, it requires to employ structural and comparative criteria, and to assess the presence of an objective justification:

(1) First, the existence some structural criteria is needed for the abusive character of high prices: persistent high entry barriers, monopolistic or near monopolistic market, and a relatively inelastic demand. Thus, the Spanish Supreme

[49] Judgment of the CFI 16 January 2008, Case T-306/05, paras. 100-104.

[50] Resolution of 12 February 2008, Expte. 626/, *Canarias de Explosivos.*

[51] Judgment of the Supreme Court of 29 May 2013.

Court adopts some of the conditions proposed as a screening test by the scholars mentioned above.

(2) Second, some comparative criteria are employed, but the price-cost comparison is not always needed, as other prices set in more competitive markets (prices of other products, prices of the same product in different geographical markets or the price of same product across time) are accepted as benchmarks; the two-stage test set in *United Brands* is not the only valid test for assessing whether a price is excessive. Moreover, those comparative criteria are employed aiming to determine, not whether the price has a reasonable relationship with the economic value of the product (which is the definition of *"unfair price"* established *in United Brands,* 250), but whether the dominant firm is *"reaping trading benefits which it would not have reaped if there had been normal and sufficiently effective competition"* (which is the definition of *"exploitative abuse"* established in *United Brands,* para 249). Thus, the Spanish case-law adopts a definition of *"unfair price"* which, as we have seen above, could be interpreted as a prohibition to exercise market power when it becomes substantial -even if legitimately acquired-, apparently endorsing the *"as if"* standard.

(3) When the two precedent conditions are met –as it would be the case in most markets where a super-dominant firm is present- the burden of proof shifts to the firm, in order to demonstrate the existence of an objective justification. The implicit endorsement of the *"as if standard"* already mentioned is confirmed by the Court as long as it explicitly rejected as a valid objective justification the intention of the dominant firm to maximize its profits. And, if monopoly price is certainly an unfair price, the prohibition targets exploitative rather than exclusionary abuses.

Relying on this lenient test, during the last economic crisis the CNMC has adopted an aggressive application of the prohibition of unfair prices -at least when compared to its previous decisional practice-, thus risking to become a price regulator.[52]

IV. Conclusion.

[52] See CNMC Resolutions of 28 December 2006 (602/05,Viesgo Generación), 8 Mars 2007 (601/05, IBERDROLA CASTELLÓN), 14 February 2008 (624/07Gas Natural), 25 April 2008 (625/07, Gas Natural) 19 December 2012 (S/0248/10 MENSAJES CORTOS), 10 July 2014 (S/0446/12 ENDESA INSTALACIÓN), 6 November 2014 (S/0460/13, SGAE-CONCIERTOS).

According to mainstream economics the prohibition of exploitative prices may impair the efficiency of markets. Therefore, some screening tests have been proposed to limit the application of Article 102 (a) to very exceptional circumstances, including the presence of exclusionary effects.

The Commission, seemingly in line with those ideas, has placed on itself a very difficult burden to prove the existence of excessive prices in future cases, leading in practice to the non-application of Article 102 (a) TFEU to control exploitative abuses. However, the inconsistency of the criteria laid down by the ECJ enable national authorities to establish a less stringent test to determine whether a price is excessive and, thus, to adopt the role of price regulator. This might be the case of the Spanish *CNMC,* which in recent years has taken a particularly aggressive approach in relation to excessive prices.

Article 3.2 of Regulation 1/2003 allows national authorities and national courts to apply on their territory stricter national laws which prohibit or sanction unilateral conduct, but not so in cases where they apply Article 102 TFEU. Therefore, it would be desirable for the Court to rule on the issue. For this it is only necessary that a court -for example, the Spanish Supreme Court in some of the cases pending before it- asks the right questions and refers the matter to the European Court of Justice for a preliminary ruling.