

Chapter 9

The Darker Side of the Moon: Assessment of Excessive Pricing and Proposal for a Post-entry Price-cut Benchmark

Ariel Ezrachi* and David Gilo**

I. Introduction

Excessive pricing by a dominant firm is considered one of the most blatant forms of abuse. It is the dominant firm's simplest possible form of exploitation. Despite this, in many instances, competition authorities refrain from intervening against excessive pricing. Similarly, and to some extent consequently, such cases rarely find their way to the national courts.¹

The recent debate on Article 82 EC has focused predominantly on exclusionary forms of abuse.² That is, it has focused on practices used by the dominant firm to entrench or reinforce its position in the market. On the other hand, the treatment of exploitative abuse has received little attention from the Commission and academics alike.

* Slaughter and May lecturer in Competition Law, Oxford University. Director, The University of Oxford Centre for Competition Law and Policy.

** Associate Professor, Buchmann Faculty of Law, Tel Aviv University. David Gilo wishes to thank the Cegla Center for Interdisciplinary Research of the Law, Buchmann Faculty of Law, for financial assistance.

¹ The small number of cases being brought by the competition agencies influences the number of follow on claims in national courts.

² See eg DG Competition, Communication from the Commission, Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (Brussels, 3 December 2008); DG Competition, Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses (December 2005).

Moreover, in the context of excessive pricing, recent statements from the Commission reflect a lack of enthusiasm in confronting such cases.³

This paper explores the main grounds commonly used to justify non-intervention in cases of alleged excessive pricing. In doing so it questions the weight attributed to some of these grounds. While acknowledging the difficulties at stake, the discussion focuses on one of the grounds for non-intervention - the complexity of evaluating whether a price is excessive. It examines the practical challenges in establishing excessiveness and puts forward a proposal for a *post-entry price-cut benchmark* which may facilitate the finding of excessive pricing.

The benchmark is based on the evaluation of the difference between the price a dominant firm had charged before entry of new firms onto its market, and the price that prevailed after such entry. In discussing the proposal, we highlight the advantages and disadvantages of such a benchmark. We explain why competition agencies have refrained from using this benchmark and consider how such a benchmark could be used by private litigants in national courts.

II. The Main Grounds for Non-intervention

Three justifications are commonly cited to explain competition agencies' reluctance to pursue actions against dominant firms for excessive pricing. The first is that excessive prices attract entry and are therefore self-correcting. The second is that the prohibition of

³ See nn 12 and 13 below.

excessive pricing might chill firms' incentive to innovate or invest ex ante.⁴ The third is the difficulty in determining whether the price is excessive.⁵

These three considerations serve as the main rationale behind US skepticism of the merit of prohibiting excessive pricing. In several instances, the United States Supreme Court has held that US antitrust law does not prohibit the charging of high prices per se.⁶ Accordingly, excessive pricing by a dominant firm is not considered a violation and firms in the US may demand whatever rates they can obtain in the marketplace.⁷ Illustrative in this respect are comments made by the US Supreme Court in the landmark case of *United States v Aluminum Co. of America*. There the Court held that although non intervention may expose the public to the evils of monopoly, US antitrust law will not 'condemn the resultant of those very forces which it is its prime object to foster: finis opus coronat. The successful competitor, having been urged to compete, must not be turned upon when he wins.'⁸

Under European competition law, intervention in cases of excessive prices is not excluded. Article 82 of the EC Treaty targets any abuse by undertakings in a dominant

⁴ See eg Motta & De Stree, *Exploitative and Exclusionary Excessive Prices in EU Law*, available online at http://professorgeradin.blogs.com/professor_geradins_weblog/files/ExcessivePrices18122003.pdf, (2006 p 15); R O'Donoghue & AJ Padilla, *The Law and Economics of Article 82 EC* (Hart Publishing, Oxford and Portland, Oregon, 2006) p 607; M Motta, *Competition Policy: Theory and Practice* (Cambridge University Press, Cambridge 2004) p 69; *Verizon Communications, Inc v Trinko LLP*, 157 L. Ed. 2d 823, 836 (2004)(US).

⁵ See eg O'Donoghue & Padilla (n 4) p 627.

⁶ *Berkey Photo, Inc. v Eastman Kodak Co.*, 603 F.2d 263, 274 n.12 (2d Cir. 1979)(US); *Blue Cross & Blue Shield United v Marshfield Clinic*, 65 F.3d 1406, 1413 (7th Cir. 1995)(US); *Verizon communications Inc. v Trinko LLP*, 157 L. Ed. 2d 823, 836 (2004)(US); See also the earlier case of *United States v American Can Co.*, 230 F 859.

⁷ See eg Areeda and Hovenkamp, *Antitrust law: an analysis of antitrust principles and their application*, (New York, Aspen 2006) para 720a, at 254-55; see also *Chi. Prof'l Sports Ltd. P'ship v NBA*, 95 F.3d 593, 597 (7th Cir. 1996)(US), overturning a decision that the NBA's telecast fees were too high and noting that 'the antitrust laws do not deputize district judges as one-man regulatory agencies'; EM Fox, 'Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness', *Notre Dame Law Review* 61, 981-1020, p 985 and 993; Michal Gal, 'Monopoly pricing as an antitrust offense in the U.S. and the EC: two systems', *Antitrust Bulletin*; Spring 2004, p 343.

⁸ *United States v Aluminum Co. of America (Aloca)*, 148 F.2d 416, 444 (1945).

position and refers to the possibility that such abuse may consist of ‘directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions’.⁹ The wording ‘unfair’ in Article 82(a) EC was held by the European Courts and Commission to encompass excessive pricing.¹⁰ EU jurisprudence generally describes an excessive price as one that bears no reasonable relation to economic value.¹¹

Despite the existence of a provision aimed at monitoring excessive pricing, the three grounds identified above have led to a very limited number of excessive price cases in Europe. The reluctance to engage in price regulation was echoed by the Commission in its yearly reports on competition policy. There the Commission noted that:

(...) 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 behaviour of the dominant company designed to preserve its dominance, usually directly against competitors or new entrants who

⁹ Article 82 EC. In addition the Article targets abuse which involves the limitation of production to the detriment of consumers.

¹⁰ See for example the ECJ decisions in Case 40-70 *Sirena v Eda* [1971] ECR 69; Case 26/75 *General Motors v Commission* [1975] ECR 1367; Case 27/76 *United Brands v Commission of the European Communities* [1978] ECR 207 appeal on Commission decision [1976] OJ L95/1; Also see Commission decisions: COMP/C-1/36.915 *British Post office v Deutsche Post AG* [2001] OJ L331/40; [2002] 4 CMLR 17.

¹¹ Case 27/76 *United Brands v Commission* [1978] ECR 207; Case 26/75 *General Motors v Commission* [1975] ECR 1367.

would normally bring about effective competition and the price level associated with it (emphasis added).¹²

Commenting on the difficulty in measuring excessive pricing, Philip Lowe, Director General DG Competition noted that:

We are ... 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.¹³

In what follows, we critically assess the three grounds for non-intervention that have had such a notable effect on the Commission's enforcement policy.

III. Reflecting on the Non-interventionist Approach

Despite the challenges of excessive pricing cases, it is important to critically assess the three main grounds for non intervention. The assessment questions the weight attributed at times to some of these grounds. While we do not categorically recommend intervention, such examination may widen the range of cases in which the assessment of

¹² XXIVth Commission Report on Competition, Policy 1994, para 207. See also Vth Commission Report on Competition Policy 1975, para 76; XXVIIth Commission Report on Competition Policy 1997, para 77.

¹³ 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.

excessive pricing is merited and possible. At the very least, it should highlight the arguments for non-intervention which should receive the most weight in a particular case.

A. The self correcting nature of excessive pricing

The first ground for non intervention is that excessive prices generate excessive profits and therefore attract entry into the market. The premise is that the regulation of excessive pricing is often redundant because prices would be forced down by a new entrant, induced to enter the market by the possibility of competing with the excessive price.¹⁴ Moreover, it is argued that the mere prospect of new entry would often suffice to prevent excessive pricing as it would deter the dominant undertaking from pricing excessively in the first place. Accordingly, it is claimed that intervention is only merited where significant barriers to entry exist that hinder entry to the market.¹⁵

¹⁴ See Areeda and Hovenkamp, *Antitrust law : an analysis of antitrust principles and their application*, (New York, Aspen 2006) para 720b: '[W]hile permitting the monopolist to charge its profit-maximizing price encourages new competition, forcing it to price at a judicially administered 'competitive' level would discourage entry and thus prolong the period of such pricing.'; *Berkey Photo Inc v Eastman Kodak Co* 603 F.2d 263, 294 (2nd. Cir., 1979)(US); Whish, *Competition Law* (5th ed, LexisNexis, 2003) at 688-689: 'if normal market forces have their way, the fact that a monopolist is able to earn large profits should inevitably, in the absence of barriers to entry, attract new entrants to the market. In this case the extraction of monopoly profits will be self-deterring in the long run and can act as an important economic indicator to potential entrants to enter the market. If one accepts this view of the way that markets operate, one should accept with equanimity periods during which a firm earns monopoly profit: the market will in due course correct itself and intervention by the competition authorities will have the effect of undesirably distorting this process.'; Korah, *EC Competition Law and Practice* (6th ed, Hart Publishing, 1997) p 113: 'The cost price approach ignores the function of pricing as a signal encouraging new entrants. If prices and profits are high, new firms may be attracted into the market over, at least, modest entry barriers.'; O'Donoghue and Padilla (n 4), p 635-636; M Motta and De Streel (n 4), p15; Report by the Economic Advisory Group on Competition Policy, 'An Economic Approach to Article 82,' July 2005, p.11: '...Such a policy intervention [against monopolistic pricing] drastically reduces, and may even forego the chance to protect consumers in the future by competition rather than policy intervention; *Napp Pharmaceutical Holdings Ltd*: 'The Director considers that a price is excessive and an abuse ...where it is clear that high profits will not stimulate successful new entry within a reasonable period.' Decision of the Director General OFT CA98/2/2001 *Napp Pharmaceutical Holdings Ltd*.

¹⁵ See sources cited *ibid*.

Elsewhere, we have shown in detail that the premise that excessive prices are self-correcting does not justify non-intervention.¹⁶ Our principal argument is based on the claim that high prices, in and of themselves, do not attract new entry. It is the post-entry price, and not the pre-entry price, that potential entrants consider when deciding whether to enter. Since the dominant firm can usually cut prices immediately upon a rival's entry, its excessive pre-entry prices do not affect the potential entrants' decision to enter, unless they signal to potential entrants that the dominant firm is relatively inefficient, making entry profitable.¹⁷ Accordingly, if a potential entrant has sufficient information regarding the incumbent's advantages, and particularly the incumbent's marginal costs¹⁸ and the entrant perceives the incumbent to be comparatively more efficient, it is unlikely to enter, even if the incumbent charges an excessive price. Conversely, if a potential entrant perceives the incumbent to be comparatively less efficient, it is likely to enter, but not because of the excessive price. Such an entrant would have entered regardless of pre-entry price levels. We also explore the case in which pre-entry prices could serve as a signal to uninformed entrants and we show that such a signal could be equally clear (or sometimes clearer) in a regime in which excessive prices are prohibited.¹⁹

Subsequently, the alleged self-correcting nature of excessive prices should not be overstated, as by itself it does not justify non-intervention. This shifts the focus from the self-correcting nature of excessive pricing to the other two grounds for non intervention.

B. Chilling effect on investment

¹⁶ See Ariel Ezrachi and David Gilo, 'Are Excessive Prices Really Self-Correcting?' forthcoming, *Journal of Competition Law and Economics* (2009).

¹⁷ *ibid.*

¹⁸ A firm's marginal cost is its cost of supplying one additional unit.

¹⁹ Ezrachi and Gilo (n 16).

The second ground used to justify non-intervention is that the prohibition of excessive pricing might chill firms' incentive to innovate or invest *ex-ante*.²⁰ Such a concern supports a 'hands off' approach in cases in which the court or competition authority hold that prohibiting high profits would harm *ex-ante* investment incentives.²¹

This concern is no doubt a valid one. We wish to stress, however, that it arises only in markets in which competition, as envisioned by the competition laws, fails to provide the desired outcome. These are markets in which, had the dominant firm faced healthy competition enabling it to earn only competitive profits, it would not be induced to engage in presumably valuable investment. In such markets, regulation limiting entry of new competitors and expansion of small competitors could be welfare enhancing, as new entry of viable competitors or expansion of small competitors would erode the dominant firm's supra competitive profits and again harm its *ex-ante* investment incentives.

Examples for such industries are those involving intellectual property protection. In order to encourage innovation and R&D, intellectual property rights help the inventor insulate itself from competition, enabling the inventor to reasonably expect supra-competitive profits.

Note, however, that even in such a market, the argument against intervention loses much of its force once the dominant firm's investment has been recouped, through a

²⁰ See eg Motta & DeStreel (n 4), p 15; O'Donohue & Paddilla (n 4) p 607; M Motta (n 4) p 69; *Verizon Communications, Inc v Trinko LLP* 157 L. Ed. 2d 823, 836 (2004)(US).

²¹ See eg Motta and DeStreel (n 4) p 16, who argue that when such investment considerations exist there should be no intervention against excessive pricing. See also David S Evans and A Jorge Padilla, 'Excessive Prices: Using Economics to Define Administrable Legal Rules' CEMFI Working Paper No. 0416 (September 2004), proposing an interventionist approach only in 'exceptional circumstances' where the firm enjoys near monopoly position, the price charged by the firm widely exceeds its average total cost and there is a risk that the prices would prevent the emergence of new goods and services in adjacent markets.

sufficiently long period of dominance and above-cost pricing. A firm whose patent or monopolistic government license has expired can serve as a good example for such a case. Once a patent or a monopolistic license expires, not only does viable entry by new firms into the market often become plausible, but the assumption is that the dominant firm has already recouped its ex-ante investment.

C. Difficulty in assessment

The third ground for competition agencies' reluctance to attack excessive pricing is the difficulty in determining what constitutes an excessive price.²² The difficulty in determining the competitive price makes the prohibition of excessive pricing complex, cumbersome and inaccurate. A finding of excessive pricing requires the competition agency to establish what the competitive price might have been and whether the difference between this price and the price charged by the dominant undertaking is excessive.²³ This provides two difficulties, first different jurisdictions may have different views as to what amounts to an unfair difference between the competitive price and the price actually charged.²⁴ Second, the difficulties in assessment could result in inconsistency and unpredictability, which could be connected with the second ground for non-intervention concerning the need to stimulate valuable investment. The larger such investment, the more permissible the price difference between the actual price and the 'competitive' price.

²² See eg O'Donohue & Padilla (n 4), p 627; R Whish, *Competition Law* (4th edn, London, Butterworths, 2001) pp 634-35.

²³ The US Supreme Court stressed the practical difficulty in measuring the excessiveness of prices as early as 1897. See *Unites States v Trans-Missouri Freight Assn*, 166 U.S 290 (1897).

²⁴ On the range of approaches to unfairness see: Evans and Padilla (n 21). See also O'Donoghue and Padilla (n 4), p 621-638.

In what follows we focus on this ground for non-intervention and explore the difficulties in establishing excessiveness. To ease some of the difficulties in assessment we put forward a proposal for a ‘post-entry price cut’ benchmark which can in some circumstances alleviate problems of assessment in a welfare-enhancing way.

IV. Evaluating Excessiveness

Article 82 EC stipulates that an abuse may consist of ‘directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions’.²⁵ The wording ‘unfair’ in Article 82(a) was held by the European Courts and the Commission to cover a wide range of pricing practices including excessive pricing.²⁶ EC jurisprudence describes an excessive price as one which ‘has no reasonable relation to the economic value of the product supplied.’²⁷ The court added that 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.’²⁸

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,

²⁵ Similarly, Art 82 targets abuse involving the limitation of production to the detriment of consumers.

²⁶ See for example the ECJ decisions in *Sirena v Eda* (n 10); *General Motors v Commission* (n 10); *United Brands* (n 10); Also see Commission decisions: COMP/C-1/36.915 *British Post office v Deutsche Post AG* [2001] OJ L331/40; [2002] 4 CMLR 17.

²⁷ *United Brands v Commission* (n 10), para 250.

²⁸ *ibid.*, para 251.

whether a price has been imposed which is either unfair in itself or when compared to competing products.²⁹

The UK's OFT indicated as well, that the measurement of supra-normal profit may involve a cost/revenue comparison, return on capital/weighted average cost comparison, or a comparison of the 'certainty equivalent accounting rate of return' (CARR) over a number of years with the risk free rate of interest.³⁰

A crucial problem which transpires from the test described above concerns the finding of the economic value of the product through the assessment of costs. The determination of cost is often prohibitively difficult.³¹ This task is even more formidable when dealing with a multi-product undertaking, where allocation of costs to the different products the firm produces becomes difficult if not impossible.³² Furthermore, cost is not a good approximation of the price that would have prevailed under viable competition. The difficulty arises in at least two respects. First, as is well known, a firm's fixed costs – which are not affected by its level of production – do not affect the price charged in the

²⁹ *ibid*, para 252.

³⁰ OFT 414, 'UK Guidelines on Assessment of Individual Agreements and Conduct', paras 2.1 – 2.23. Also note OFT 657 'Assessing Profitability in Competition Policy Analysis'. See also Martin Graham and Anthony Steele, 'The Assessment of Profitability by Competition Authorities' [1997] OFT research paper No 10.

³¹ Note that the need to evaluate cost within the application of competition law is not unique to excessive pricing and is also conducted in cases of predatory pricing. According to current doctrine in the EU, the low prices of a dominant firm can be condemned as predatory if they are below Average Variable Costs (AVC). When prices are above AVC but below Average Total Costs (ATC) the conduct may be held to be abusive when the undertaking intended to eliminate a competitor. See Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359, [1993] 5 CMLR 215; Case C-333/94 P *Tetra Pak International SA v Commission* [1996] ECR I-5951, [1997] 4 CMLR 662; DG Competition, Communication from the Commission, Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (Brussels, 3 December 2008).

³² See O'Donohue and Padilla (n 4).

market place.³³ Laddie J in *British Horseracing Board v Victor Chandler International*³⁴ stressed this difficulty. In his decision, Laddie J questioned whether in competitive markets prices should end up covering the cost of capital. He noted that:

I do not see that there is any necessary correlation between the cost of production and the cost of capital and the price which can be achieved in the market place. ... this [approach] breaks down as soon as one applies it in the real world. What happens if there are only a few customers? Must the cost of production, including all research and development, be recovered from them? If so, does that mean that the price varies depending on the number of customers one has? Does it also mean that the price must go down once all the research and development costs have been recovered? Does it mean that traders cannot increase the price if they engage in successful advertising campaigns which whet the consumer's appetite?³⁵

The second difficulty is that the price that would have prevailed under viable competition does not even resemble the variable cost – the portion of costs that does depend on the level of production. Even with viable competition, competition is seldom perfect. It typically does not drive prices all the way down to the costs of supplying each unit. The

³³ The reason is that a profit-maximizing firm supplies additional units (and, accordingly, reduces its price) as long as the revenue from supplying the additional unit is greater than the cost of supplying this unit. Only the costs per unit and the demand structure, and not fixed costs, affect this mechanism. See, generally, Jean Tirole, *The Theory of Industrial Organization* (MIT Press, Cambridge, Mass, 1988).

³⁴ *British Horseracing Board v Victor Chandler International* [2005] EWHC 1074 (Ch).

³⁵ *ibid*, paras 47-49.

main reasons are product differentiation (consumers do not see competing products as perfect substitutes)³⁶ and capacity constraints (the competing firms have constraints as to the quantity they can supply, given the size of their plant, distribution and supply networks, etc.).³⁷ Hence, variable cost, or the cost per unit, cannot serve as a proxy to the price that would have prevailed in a competitive market.³⁸

Given that cost is extremely difficult to assess and serves as an imperfect proxy for the competitive price, Community courts have at times considered the question of excessiveness through comparative analysis of prices charged in competitive markets and prices charged by the dominant undertaking.³⁹ It is often possible to look at prices charged in similar industries in other geographic markets, which do seem to enjoy competitive conditions. For example, in *Lucazeau v SACEM* a comparison of prices charged for the same service in different member states was held to form a reasonable basis for establishing excessiveness of price.⁴⁰ The accuracy of such a comparative benchmark may increase when comparing prices charged by the same undertaking in different markets, some competitive, some not. Such comparison eliminates possible differences between undertakings as it focuses on the same dominant undertaking and its pricing strategy in different markets. The dominant firm could only justify the price difference if it faces higher costs in providing the product in the high-priced market. In

³⁶ See Tirole (n 33), chapter 7.

³⁷ *ibid*, chapter 5.

³⁸ See generally n 4 above.

³⁹ See eg *United Brands* (n 11) overruling a Commission holding of excessive pricing due to lack of a cost study, while other benchmarks were available; See also the CAT decision in *Albion Water Limited v Water Services Regulation Authority* [2006] CAT 36, where the CAT required further investigation by the Authority, notably to determine the *extent* to which the price was above cost, while other benchmarks were available.

⁴⁰ Case 110/99 *Lucazeau v SACEM*, [1989] ECR 2811.

Bodson,⁴¹ for example, the excessiveness of price was assessed by comparisons to pricing in other regions where the market was competitive. In this case the ECJ assessed the fairness of the price charged for funeral services in a particular area, by comparing these charges with other areas in which the undertaking did not hold a dominant position. In *Deutsche Post AG* a comparison between price for cross border and domestic mail was used to determine the excessiveness of price.⁴² In *Ministere Public v Jean-Louis Tournier*, the ECJ indicated that when a dominant undertaking charges higher fees for its services in one Member State than in others, then ‘where a comparison of the fee levels has been made on a consistent basis, that difference must be regarded as indicative of an abuse of a dominant position. In such a case it is for the undertaking in question to justify the difference by reference to objective dissimilarities between the situation in the Member State concerned and the situation prevailing in all the other Member States.’⁴³

In the case of *Napp Pharmaceutical Holding*,⁴⁴ the OFT established the excessiveness of Napp’s price by using a double benchmark, which included both a cost-price comparison and a price comparison across markets. Napp appealed the OFT’s decision to the Competition Appeal Tribunal (CAT).⁴⁵ On appeal, the CAT assessed in detail the OFT finding of excessive price and considered that comparisons of ‘(i) Napp’s prices with Napp’s costs, (ii) Napp’s prices with the costs of its next most profitable competitor, (iii) Napp’s prices with those of its other competitors and (iv) Napp’s prices with prices charged by Napp in other markets, were among the approaches that could

⁴¹ Case 30/87 *Corinne Bodson v SA Pompes Funebres des Regions Liberees*, [1988] ECR 2479.

⁴² Case COMP/C-1/36.915 *Deutsche Post AG* [2001] OJ L331/40.

⁴³ Case 395/87 *Ministere Public v Jean-Louis Tournier*, [1989] ECR 2521, para 38.

⁴⁴ Decision CA98/2/2001 of the Director General of Fair Trading, *Napp Pharmaceutical Holdings Ltd*.

⁴⁵ *Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading* [2002] CAT 1.

reasonably be used to establish excessive prices in that case.⁴⁶ The CAT upheld the OFT decision and stated that ‘during the period of the infringement, Napp’s prices in the community segment were significantly higher than would be expected in a competitive market.’⁴⁷

In general, the use of the comparative benchmark resolves the difficulties associated with establishing cost structure and economic value. Such benchmarks aim to identify the competitive price and compare it to the alleged excessive price. Note however the limitation of this benchmark as it compares price between different geographies or different undertakings. Although it offers a valuable proxy of the competitive price, either on its own or in addition to a cost based analysis, it does not provide definitive evidence of the competitive price that would have been charged by the dominant undertaking in the same market.

V. Proposal for a Post-entry Price Cut Benchmark

As noted, a comparative benchmark provides a valuable tool for approximating the competitive price. The court or competition agency can use it to examine whether the price charged by the dominant undertaking is excessively high in comparison to that proxy. However, one notable difficulty with such a benchmark lies in its reliance on certain assumptions. It must either be based on market realities different from that of the dominant firm’s market i.e. where it is comparing prices charged by the dominant

⁴⁶ *ibid*, para 392.

⁴⁷ *ibid*, para 403; more generally note the OFT draft guidelines on Assessment of Conduct, where it provides a list of possible benchmarks which may be used to assess whether prices are excessively high, and these include comparative benchmarks. See: OFT 414 paras 2.7 - 2.15.

undertaking in a different market, or on undertakings different from the dominant firm i.e. where it is comparing pricing by different undertakings in the same market.

At times, it may be possible to improve the quality of the comparative benchmark by comparing different pricing strategies by the same undertaking in the same market. In *British Leyland v Commission*,⁴⁸ the ECJ upheld a Commission decision in which British Leyland was found to abuse its dominant position by charging excessive fees for its services. British Leyland enjoyed a state monopoly for the issuance of certificates of conformity to vehicles in Great Britain. It systematically increased the price charged for issuing the certificates from 1981 to 1983 irrespective of the costs of its activities. Absent justification for the price increase the court found that the fees were fixed at a level which was disproportionate to the economic value of the service provided.⁴⁹

The decision is interesting, in the sense that the comparison of price was conducted in the same market and with reference to the same undertaking. Yet in a case such as *British Leyland*, in which prices had increased over time, it was still open to the dominant undertaking to show that prices had increased due to a parallel increase in costs.

In this section we put forward a proposal for a comparative benchmark which similarly considers pricing by the same undertaking and in the same market. Our proposed benchmark is applied in cases where the dominant undertaking cuts its price due to new entry into the market.

⁴⁸ Case 226/84 *British Leyland Plc v Commission* [1986] ECR 3263, [1987] 1 CMLR 185.

⁴⁹ In its decision, the court cited the *General Motors* judgment (n 10), in which it was held that an undertaking abuses its dominant position where it has an administrative monopoly and charges for its services fees which are disproportionate to the economic value of the service provided.

Suppose that after enjoying several years of dominance, a new entrant, or new entrants, finally enter the dominant firm's market. Naturally, the new entrant or entrants are expected to charge prices lower than those charged by the dominant firm, in order to gain a customer base and market share. The dominant firm, for its part, is expected to react by cutting its own price, in order to try to retain its market share. Absent tacit or explicit collusion between the dominant firm and its new rivals, such competitive tension typically lowers the price down to the competitive price. This competitive price can be a useful benchmark in showing that the dominant firm charged an excessive price before entry.

According to a post-entry price cut benchmark, when a dominant firm significantly cuts its prices upon new entry into its market, it could be found to have priced excessively prior to entry. This will be the case when the difference between the dominant firm's pre-entry prices and post-entry prices exceeds a threshold, defined by the competition authority or court. For such a finding to be made, the low post-entry price would have to persist for a considerable period of time.

As an illustration, suppose that the dominant firm is indeed a former patent holder whose patent had expired or a former government-created monopoly whose market is now opened to competition. Suppose further that this dominant firm had priced at a certain level for several years following the expiration of the patent or the monopolistic license, but then, following new entry into its market, the dominant firm significantly cut its prices in order to defend its market share. We explore whether the price difference between the pre-entry price and the post-entry price can serve as evidence as to the

excessiveness of the pre-entry price in the years following the expiration of the patent or monopoly license.

This benchmark is particularly interesting in that the dominant firm might have relatively few excuses for significant post-entry price cuts other than pricing excessively before entry. It would seem quite a coincidence that the same firm would charge significantly different prices in the same market, where the sudden change in its pricing behavior occurred only after competitive entry into its market. To be sure, in rare cases, the dominant company might be able to justify such behavior. The dominant firm could try to show that an exogenous change other than new competition justified the price drop.⁵⁰

The use of a post-entry price-cut benchmark for showing that pre-entry prices were excessive bears some resemblance to proposals made by scholars in the context of predatory pricing. Edlin, asserted that a dominant firm should be blocked from significantly cutting its price for a period of 12-18 months following substantial entry into its market.⁵¹ Williamson proposed a rule according to which in the post-entry period, the dominant firm should not be able to increase output above the pre-entry level for 12-18 months.⁵² Baumol suggested that if an entrant is driven out of the market following a price cut by an incumbent firm, then the incumbent should not be allowed to raise its price again unless justified by cost or demand changes.⁵³ We, however, do not consider a

⁵⁰ For example, an excessive price difference could be justified by proof of a sudden drop in the dominant firm's costs that occurred at the same time as entry.

⁵¹ Aaron S Edlin, 'Do Guaranteed-Low-Price Policies Guarantee High Prices, And Can Antitrust Rise to The Challenge?' (1997) 111 Harv L Rev 528, p 563. Against see Elhauge, 'Why Above-Cost Price Cuts to Drive out Entrants Are Not Predatory—and the Implications for Defining Costs and Market Power,' (2003) *Yale Law Journal*, 112, 681-827.

⁵² Williamson, 'Predatory Pricing: A Strategic and Welfare Analysis' (1977) *Yale Law Journal*, 87, 284.

⁵³ Baumol, 'Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing,' (1979) *Yale Law Journal*, 89, 1-26.

post-entry price cut by a dominant firm as possible predatory pricing, but rather merely as evidence, among other items of evidence, to support the claim that the pre-entry price was excessive.⁵⁴

A potential problem with using a post-entry price cut benchmark to help reveal excessive pre-entry pricing is that it could alter the behavior of the dominant firm and of new entrants into its market. In particular, if the dominant firm knows that a large difference between pre-entry and post-entry price could be used as evidence of excessive pricing it might not only lower its pre-entry prices but also raise its post-entry prices so as to minimise this difference. Moreover, if the new entrant foresees such behavior, the entrant too could raise the price it charges after entry, compared to the price it would have charged absent the use of this benchmark.

However, this disadvantage of the post-entry price cut benchmark should not be overestimated. First, existing benchmarks which compare the dominant firm's own pricing in several markets share a similar disadvantage. Consider, for example, the widely used benchmark which compares the dominant firm's price in the market in which it is dominant, to its price in another market in which the firm is subject to competition. Knowing that its different prices in both markets could support an excessive pricing claim, the dominant firm may want to raise the price it charges in the competitive market. The firm's rivals in the competitive market too may raise their price accordingly. Second,

⁵⁴ Note, the damages to be calculated in a predatory pricing suit are those of the entrant, harmed by post-entry price cuts. Such damages stem from lost sales. In contrast when the pre-entry price is attacked as excessive, damages equal the difference between the incumbent's pre and post-entry prices, multiplied by the number of units sold under the pre-entry price (admittedly, such a measure of damages is understated, in the sense that it does not grasp the harm to consumers who, due to the excessive price, refrained from buying the product). In any case, calculating damages from excessive pre-entry pricing seems easier than calculating the hypothetical loss of sales of a new entrant under a predatory pricing claim. The former measure also better reflects the social loss (rather than the loss to a particular firm) stemming from the dominant firm's behavior.

if the dominant firm is expected to lower its post-entry price more moderately, this in itself could attract entry of firms that otherwise may have hesitated to enter. More entry could, naturally, benefit consumers.⁵⁵ Third, the post-entry price cut benchmark is typically only one of the potential pieces of evidence that could support an excessive pricing claim. Hence the dominant firm knows that even if it keeps its post-entry price relatively high, its pre-entry price may still be successfully attacked using other benchmarks and methods. Hence reacting softly to entry only in order to weaken somewhat the excessive pricing claim against it may not be worth the significant sacrifice of post-entry profits and market share. Of course, the more numerous the new entrants into the dominant firm's market, the less troubling is the fear of soft post-entry competition. Even if the dominant firm would be reluctant to substantially cut prices after entry, competition among the new entrants would considerably drive prices down.

VI. Enforcement Choices

Having outlined the proposed post-entry price cut benchmark and explained its benefits and limitations, we now turn to explore how it may be used by competition agencies or private litigants. Let us distinguish between public and public enforcement.

A. Public enforcement

By its nature the post-entry price cut benchmark only comes into play following successful entry. Consequently, although the benchmark relieves many of the difficulties in assessment, it does so in circumstances in which the European Commission might

⁵⁵ New entrants attracted by above cost pricing of incumbent firms may be less efficient than the incumbent firm, but even the entry of less efficient firms could promote consumer welfare, which is the main focus of competition law.

deem intervention inappropriate and superfluous. Indeed, we are not aware of EU cases which have used this benchmark. The Commission is unlikely to use a post-entry price cut benchmark in excessive pricing cases, because it is typically expected to intervene in cases which involve *ongoing abuses* of a dominant position, while the benchmark that we explore involves a *former* abuse of a dominant position (namely, the excessive prices the dominant firm had charged in the pre-entry period).⁵⁶ That said, we see no reason why competition agencies should limit themselves to remedying existing infringements. Their expertise and access to relevant market data place them in a superior position to consider cases of excessive pricing and use the post-entry price cut benchmark with the aim of deterring infringements of competition law.

B. Private enforcement

The use of competition law by private parties in national courts may increase social welfare by supplementing public enforcement, enhancing its deterrent effect and by providing a channel for corrective justice through compensation and injunctive relief.⁵⁷ The public value of the complementary role of private enforcement was echoed in *Courage v Crehan*, where the ECJ held that the right to sue for damages against violations of competition law

⁵⁶ Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty OJ L 1/1 - which constitutes the legal basis for the Commission's powers to impose remedies for infringements of Article 82 - provides in Article 7(1) that the Commission 'may impose . . . any behavioural or structural remedies which are proportionate to the infringement committed *and necessary to bring the infringement effectively to an end.*' (emphasis added)

⁵⁷ 'Case 26/62 *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration* [1963] ECR1: 'the vigilance of individuals concerned to protect their rights amounts to an effective supervision in addition to the supervision entrusted ... to the diligence of the Commission and of the Member States.'

strengthens the working of the Community competition rules and discourages agreements or practices, which are able to restrict or distort competition. From that point of view actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community.⁵⁸

In the context of a dominant firm that allegedly charged excessive prices for a significant period (say, a few years), and then ceased to do so when entry occurred, it seems particularly important to enable private action on account of the pre-entry abuse. As noted, competition agencies may lack incentive to act in such cases. Accordingly, absent private enforcement, the dominant firm would have no reason to refrain from pricing excessively, while it can, before entry into its market occurs.

Due to the cost and risks associated with such private actions, and the fact that the victims of abuse are typically dispersed consumers, each of which has a small stake, one would expect such suits to be lead by representative or collective actions. In its White Paper on Damages Actions for Breach of the EC Antitrust Rules the Commission considered the question of collective redress, and suggested two complementary mechanisms:⁵⁹ representative actions, which are brought by qualified entities, and opt-in collective actions, in which victims decide to combine their individual claims for harm they have suffered into one single action. If accepted, these proposals would facilitate private enforcement and may serve as the main vehicle to advance post-entry excessive pricing claims.

⁵⁸ Case C-453/99 *Courage Ltd v Bernard Crehan* [2001] ECR I-6297, para 27.

⁵⁹ http://ec.europa.eu/comm/competition/antitrust/actionsdamages/files_white_paper/whitepaper_en.pdf.

A notable hurdle that a private claimant is likely to face using the post-entry price cut benchmark is the lack of a public investigation on which to base their claim. This can materially impact on the likelihood of such claims reaching the national court. A stand-alone claim requires the claimant to prove all the elements of the infringements and bear the associated costs and risks. The claimant would need to establish the defendant's dominant position in a properly defined market, and that the dominant firm had indeed priced excessively. In order to apply the post-entry price cut benchmark the claimant (say, of a class action by consumers) would need to acquire information as to the quantity the dominant firm had sold for the allegedly excessive price before entry. It would also have to show that the post-entry price is indeed a good proxy for the industry's competitive price rather than a price which is temporarily below the so called 'competitive' price. For example, a new entrant may temporarily charge a particularly low price, below the industry's true competitive price, in order to promote its product and get a foothold in the market.

The national court would have to be persuaded that the difference between the pre entry price and the post-entry ('competitive') price is excessive. This could be a difficult task, particularly when the dominant firm had made significant welfare enhancing investments (such as in research and development) that could justify a relatively high profit margin until entry occurred. Typically, all of the relevant information regarding ex ante investment, cost structure and plausible explanations justifying the post-entry price-cut, are in the hands of the dominant firm. Accordingly, it could be sound policy to shift the burden of proof to the dominant firm once the plaintiff establishes that the difference between the pre and post-entry prices is above a certain threshold.

VII. Conclusion

The recent review of the scope and application of Article 82 has predominantly focused on exclusionary abuse leaving aside the ‘darker side of the moon’, namely exploitative abuse. In this paper we have attempted to shed some light on the most blatant form of exploitative abuse; excessive pricing.

Despite the fact that excessive pricing causes direct harm to consumers, competition agencies have often preferred to limit their intervention in such cases. The most convincing reason for non-intervention is the difficulty of measuring the competitive price and subsequently establishing that the price charged is excessive.

In this paper we have put forward a proposal for a post-entry price cut benchmark which can be used to detect excessive pricing. This benchmark, we believe, can enrich the analytical toolbox available to competition authorities or private plaintiffs and assist in identifying cases of excessive pricing, albeit that there are limitations associated with its use. Moreover it may contribute to deterring dominant companies from pricing excessively in the first place.