THE COMPETITION POLICY FRAMEWORK FOR EXCESSIVE PRICING

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Abstract: *The paper introduces the concept of excessive pricing within the framework of the competition policy. Charging high prices by an undertaking is a natural freedom in the context of a market economy. Still, a company that detains an important market power has a special economic and social responsibility to ensure that its conduct does not distort competition or negatively affect the consumers' welfare on that market. A company in such a position is deemed to poses a dominant position on the market. Specifically, in regard with the notion of excessive pricing, a dominant undertaking should not make use of the opportunities arising out of its special market power in such a way as to gain trading profits which it would not have benefit if there had been sufficiently competition. The paper briefly analyzes the method used when establishing dominance, as well as various forms of abuse of a dominant position on the market, finally focusing on the evaluation of excessive prices. Relevant excessive pricing cases are presented, covering 45 years of European experience, since 1975 to the present day. In regard with the evolution of the methodology for analyzing potential excessive prices by the competition authorities, the cost/tariff comparison as part of the United Brands test is a cornerstone in the European jurisprudence. The notion of 'economic value' is for the first time used in 1978 and criteria set in the United Brands case provide for a 2 steps approach to the assessment of excessive prices. Other ways of assessing excessive pricing are dealt with, as the European Court of Justice observed that economic theorists have not failed to think up several methods to deal with the issue. Yardstick competition and the elimination of the excessive costs from the evaluation are examples of such alternative methodologies used when analyzing excessive prices. The paper concludes with the presentation of the recent European Commission investigation into excessive pricing in the pharmaceutical sector, and proposes the idea that monopoly companies' tariffs might be easier to evaluate in the context of excessive pricing.*

Keywords: *abuse of dominant position; competition policy; excessive prices.*

JEL Classification: *K21; L41.*

1. Brief introduction to the notion of abuse of dominant position within the framework of the competition policy

1.1. The implementation of modern competition rules

Modern competition rules, or the antitrust rules, were established in 1890 in the United States (US) with the enactment of the Sherman Antitrust Act, named after its promoter, Senator John Sherman. Sherman Antitrust Act is referred to as *the constitution of the competition system* (Heyne, 1991, as cited in Dodescu, 2000).The

law was intended to prevent the practices of monopolization and the restriction of competition by large US companies that cooperated to set prices, production levels, or market shares. Still, the Sherman Antitrust Act did not prohibit the holding of a monopoly, considering that a law intended to promote competition must allow the possibility of obtaining a monopoly as a result of higher efficiency (Dodescu, 2000).
After World War II, European antitrust rules were initially introduced in the European Coal and Steel Community Agreement in 1951. Article 65 of the agreement prohibited cartels, and article 66 established provisions for economic concentrations and for the abuse of a dominant position held by companies. Subsequently, the Treaty of Rome of 1957, or the EC Treaty, which established the European Economic Community, included these competition rules in article 85 and article 86 (Papadopoulos, 2010).
Today, article 101 and article 102 of the Treaty on the Functioning of the European Union (TFEU) establishes, at Community level, the general framework for the pursuit of economic activities in accordance with competition principles, by prohibiting certain types of agreements between undertakings and by prohibiting certain abusive practices of dominant undertakings.
Briefly, the antitrust rules prohibit two major types of business practices, namely *(i)* anticompetitive agreements between multiple undertakings (e.g price fixing, market sharing, bid rigging) and *(ii)* the abuse of a dominant position detained by a single undertaking on the market (e.g discrimination, excessive pricing).

1.2. Examples of abuses of dominant position in the market

Antitrust rules prohibit abusive conduct by undertakings that have a dominant position on a particular market.
Being dominant on a market presumes that an undertaking has such an important market power that is able to commercialy behave independently of the actions of the competitors. The extreme case of a dominant position is a monopoly, where the undertaking in concern faces zero competition.
To be in a dominant position is not in itself illegal and a dominant undertaking is entitled to compete on the merits as any other company. However, because of its special market power, a dominant undertaking has a special responsibility to ensure that its conduct does not distort competition on that market or on other markets. Examples of behaviour that may amount to an abuse include: *(i)* requiring that buyers purchase all units of a particular product only from the dominant company (exclusive purchasing), *(ii)* setting prices at a loss-making level (predation), *(iii)* refusing to supply input indispensable for competition in an ancillary market, *(iv)* charging excessive prices (European Union, 2013).
Abuse of a dominant position by excessive pricing is a direct way of affecting the interests of final consumers. If a large part of the anti-competitive practices implies an indirect affectation of the consumers, by distorting the competitive environment, the unilateral imposition of excessively high tariffs implies the direct affectation of the economic well-being of the clients. This is also the reason why the prohibition of such practices was included in the European regulations from the beginning. Moreover, it is important to note that not only monopoly companies are likely to impose excessive prices, but also companies active in competitive markets, but in those markets where

competition is substantially diminished by the existence of a key player, with a special market power.

2. Assessing dominance

The abuse of dominance antitrust rules that are laid down in the TFEU are enforced by the European Commission (Commission). At the level of each European Union Member State the competition authorities apply the national antitrust rules. Antitrust rules at the national level are similar with those at community level (Scurt, 2020).
In order for an undertaking to be in the situation of abusing a dominant position, it is necessary that a competition authority establishes that the respective company is dominant. Defining the relevant market is a technical instrument that allows competition authorities to determine the position of an undertaking on a certain market. The competitive constraints have to be analyzed, respectively the substitutability at the level of demand and supply of a certain product/service, as well as the potential competition (Wish; Bailey, 2015).
In accordance with the legal provisions in the field of competition, when assessing dominance a competition authority will define *(i)* the relevant product market and *(ii)* the relevant geographic market.
The relevant product market is made of all products/services which the consumer considers to be a substitute for each other due to their characteristics, their prices and their intended use. The relevant geographic market is an area in which the conditions of competition for a given product are homogenous.
Establishing the market shares is very useful when assessing the importance of each undertaking on the market in comparison to the others. The competition authorities' economic view and practice is that the higher the market share, and the longer the period of time over which it is held, the more likely it is to be a preliminary indication of dominance. In general, as historically data of the European jurisprudence shows, if an undertaking has a market share of less than 40%, it is unlikely to be dominant. Therefore, a market share over 40% represents a solid indicator of a potential dominant position. This indicator does not represent in itself a proof of a dominant position, subsequent analysis being needed. The competition authorities also take other factors into account in their assessment of dominance, including *(i)* the ease with which other undertakings can enter the market – whether there are any entry barriers on the market, *(ii)* the existence of countervailing buyer power, *(iii)* the overall size and strength of the undertaking, its resources and the extent to which it is present at several levels of the supply chain, or vertically integrated (European Union, 2013).

3. Excessive pricing - cases and methods of evaluation

An excessive price is a price set by a dominant undertaking excessively above the competitive level in order to exploit its customers. The evaluation of the excessive character of the prices enforced by an undertaking in a dominant position may encounter certain difficulties in practice even if the evaluation is performed *ex post*.

The main difficulty that arises is establishing an adequate benchmark (what the price might have been in a more competitive market).
The antitrust rules concern the possible ability of an undertaking to exploit consumers by imposing unfairly high prices. Consumer protection is a legitimate objective of antitrust rules, which is particularly evident where markets are characterized by structural problems and require the intervention of competition authorities.
If a dominant company receives excessive profits, it can send an important signal in attracting new players to the market. In the absence of substantial barriers to entry, any intervention that would reduce the profits of the dominant undertaking could be unnecessary and could lead to the blocking of effective market signals for potential competitors. Therefore, a prudent approach to intervention against high prices would be needed, when new market entrants are expected to be stimulated within a reasonable period of time.
On the other hand, where barriers to entry are very high, the interest of competition authorities in protecting consumers is fully justified. Thus, although the competition rules should not restrict the undertaking's ability to succeed in the market, it is legitimate for those rules to prevent the improper exploitation of market power. It should also be added that in some cases, the dominance of a company is the result of forces other than competitive ones (OECD, 2011).

3.1. The United Brands case and the 'economic value' concept
One of the most relevant European case regarding excessive pricing dates from 1978 - the *United Brands case*. United Brands Company (UBC) was the main supplier of bananas in Europe, using mainly the *Chiquita* brand. In *United Brands* the Commission condemned UBC for charging excessive prices for Chiquita bananas in Germany, Denmark and Benelux countries. It compared the prices with those of competitors' unbranded bananas and with the price of Chiquitas in Ireland. The Commission sustained that the prices were "excessive in relation to the economic value of the product supplied". The European Court of Justice (ECJ) annulled the Commission's decision that excessive prices had been charged (Case 27/76 *United Brands v. Commission*, 1978).
The ECJ judgment in *United Brands* represents an important standard for most of the cases of excessive pricing that the competition authorities have pursued since.
According to Jones and Sufrin (2004), the Commission decision "was quashed because the Commission had failed to do its work properly. It had not presented sufficient evidence and had not analyzed UBC's costs. The Court accepted that excessive prices can constitute an abuse and that charging a price which has no relation to the 'economic value' would be excessive. But what is the economic value of a banana other than what a customer is prepared to pay for it?"
In order to answer the last question it is necessary to appeal to the text of the ECJ judgment.
In *United Brands* the ECJ used the concept of 'economic value' as following: "charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied" would be an abuse when „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”.
Next, the ECJ judgment specifies the criteria needed to be taken into account when assesing excessive prices: “The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products”.
Basically, the criteria set in the *United Brands case* provide for a 2 steps approach to the assessment of excessive prices:

- cost vs. tariff comparison - in the situation of an excessive difference being noted the next evaluation step should be approached, respectively
- comparison of allegedly excessive tariffs with tariffs charged by other competing undertakings.

As the ECJ judgment states, other potential ways of evaluating and determining excessive tariffs are also accepted in practice: “Other ways may be devised - and economic theorists have not failed to think up several - of selecting the rules for determining whether the price of a product is unfair”.
Historically, the Commission has not dealt with numerous excessive prices cases, appearing to agree with many economists’ view that interference with high prices and profits *per se* is a disincentive to innovation and investment (Jones; Sufrin, 2004).
One of the Commissions’ excessive pricing decision that has been upheld by the ECJ is *British Leyland*, where the Commission determined that British Leyland undertaking had charged higher prices for bestowing certificates of conformity for left-hand drive cars than for right-hand drive cars. In 1985, ECJ stated that an abuse of dominance violation occurs when the fee charged by an administrative monopoly is disproportionate to the economic value of the services rendered (Case 226/84 *British Leyland v. Commission*, 1985).

3.2. Yardstick competition

As it results from the United Brands case, the cost/tariff analysis is not the only way to assess potentially excessive prices. Another method of analyzing the potential excessive character of some prices is the so-called yardstick competition.
In the case *Corrine Bodson v Pompes Funebres*, a question to the ECJ was whether Pompes Funebres, which was granted the exclusive right to provide "external services" for funerals in a city in France, is guilty of imposing excessive prices. The ECJ has ruled that, given that more than 30,000 localities in France have not granted such exclusive rights, leaving the domain unregulated or operating on the market themselves, it must be possible to make a comparison between the prices charged by the companies benefiting from concessions and other undertakings: such a comparison could provide a basis for assessing whether the prices charged by concession holders are fair (Case 30/87 *Bodson v Pompes Funebres* ECR 2479, 1988).
Such a technique can be described as a *yardstick competition*: comparing the performance of one enterprise with the performance of other enterprises (Wish; Bailey, 2015).

3.3. Eliminating the excessive costs

In the case *Ministere Public v Tournier*, a case concerning the level of royalties levied on dancing public places by a French copyright company, the ECJ ruled that excessive or disproportionate expenditure should not be taken into account in determining the reasonableness of the price. The company in question had a de facto monopoly, and the ECJ suggested that the very lack of competition led to high administrative costs: the company had no incentive to keep costs down (Case 395/87 *Ministere Public v Tournier* ECR 2521, 1989).
The elimination of unjustified expenditure is a method which does not take into account those cost elements which mask the profitability of a dominant undertaking, in the present case of a monopolistic undertaking, where that undertaking becomes inefficient due to a lack of competitive pressure (Wish; Bailey, 2015).

3.4. Other relevant cases

European case law shows that European courts and the Commission have addressed the issue of excessive prices, especially in markets with a deep-rooted dominant position, where the entry and expansion of competitors is not expected to ensure effective competition in the near future.

3.4.1. General Motors case

In 1974, the Commission sanctioned General Motors for charging a high fee, for a period of four months, in regard with the compliance inspections of 5 types of vehicles manufactured in another Member State and imported into Belgium. The fee was considered excessive by the Commission, which established that art. 102 of TFEU had been infringed. In essence, General Motors' fee for inspections was similar in amount to the amount charged for inspecting the conformity of US cars, although the inspection of European cars had lower costs.
According to the Belgian regulatory framework, the inspection of conformity for each vehicle brand is carried out only by the manufacturer or by an exclusive agent. Practically, the state delegated the task of carrying out inspections to private enterprises, but without imposing maximum limits on tariffs for the services provided by them. Because General Motors practically had a legal monopoly and because it had an unrestricted right to set tariffs, the Court agreed with the Commission's position that the company held a dominant position. The Court did not rule out the possibility that an undertaking in such a situation might abuse by applying excessive prices in relation to the economic value of the service provided and which has the effect of reducing parallel imports (*General Motors Continental NV v Commission* Case 26/75, 1975).
However, the Court upheld General Motors' arguments and held that the company did not abuse its dominant market position. General Motors pointed out that the activity in relation to the tariffs incriminated by the Commission was an occasional activity, the company was not used to performing the service for imported vehicles, and the activity was started shortly before the alleged abusive behavior. In addition, the Court took into account the fact that General Motors very quickly brought its rates to the level of the real economic cost of the operation and reimbursed sums to those

who complained about the unfair price. The Court concluded that the Commission's intervention was unjustified in the temporal and factual circumstances in which it took place (OECD, 2011).

3.4.2. SACEM case

In this case, Societé des Auteurs, Compositeurs et Editeurs de Musique (SACEM) is an authors' association, which has a dominant position in France and is bound by contracts of mutual representation with copyright companies in other regions of the EU. In 1989, the ECJ ruled on the question: does SACEM violate art. 102 of the TFEU if it imposes global royalties on the basis of 8.25% of the gross turnover of a nightclub and if this rate is obviously higher than the rate applied by identical copyright companies in other Member States?
According to the ECJ, art. 102 of the TFEU must be interpreted as meaning that a dominant undertaking imposes unfair conditions when the fees charged for discotheques are considerably higher than those charged in other Member States and where the rates are compared consistently. However, there would be no abuse if the copyright management company concerned could justify such a difference in relation to objective and relevant differences between the management of copyright in the Member State concerned and the management of copyright in the other Member States (*F. Lucazeau v Societé des Auteurs, Compositeurs et Editeurs de Musique* Cases 110/88, 241/88 & 242/88, 1989).
SACEM tried to justify the difference described by the ECJ. The authors' association argued that the difference was due to the high prices of nightclubs in France, the high level of copyright protection in France, the characteristic features of French law and the common methods of collecting royalties used in France. The ECJ was not convinced by the arguments presented and considered that the factors mentioned could not cause a considerable difference between the rates of fees charged in the various Member States. The ECJ has indicated that the prices charged by a monopolist in one Member State will be excessive, as long as they are significantly higher than the prices charged by another monopolist in another Member State (OECD, 2011).

3.4.3. Deutsche Post case

In 1998, the public postal operator of the United Kingdom (UK), The British Post Office, filed a complaint with the Commission which alleged that Deutsche Post had frequently intercepted, surcharged and delayed international mail from the UK arriving in Germany. The dispute between the British Post Office and Deutsche Post resulted from a disagreement over how to identify the sender of international correspondence.
In 2001, the Commission found that Deutsche Post abused its dominant position on the German market for international postal delivery in multiple ways: (i) discrimination, (ii) refusal to supply, (iii) impeding the development of markets and (iv) excessive pricing. Basically, the price charged by Deutsche Post for the delivery service was found to be excessive and unfair (Commission decision COMP/36.915 - *Deutsche Post AG*, 2001).

In regard with the excessive pricing issue, in the case the Commission established that the price charged exceeded the economic value by at least 25%. The economic value was calculated as the average cost including a reasonable profit margin (OECD, 2011). Specific to this case, the service in question was the delivery of incoming cross-border, compared with the domestic mailing service. Deutsche Post identically priced the two services. As Hou (2011) analyzed, the two services were supposed to share the same delivery channel, and the cost for delivering cross-border mails should have been less than that for domestic mails since in the former activity a postal office could have saved costs in collecting mails. Deutsche Post did not dispute the facts and affirmed that the costs of forwarding cross-border mail might have been approximately 80% of the domestic tariff. Therefore, the Commission found that art. 102 was infringed as Deutsche Post couldn't provide satisfactory explanations regarding the similar pricing of the two services.

4. Recent developments and conclusions

The historical data shows that it is difficult to decide what constitutes an excessive price. Ascertaining what the price might have been in a more competitive market is rarely possible in practice, therefore the seek for other potential yardsticks may arise. However, in regard with the control of monopoly positioned companies' tariffs, a proper solution for highlighting excessive prices would be the comparison made with other monopolists, from similar markets, as well as the elimination of excessive costs. A monopoly undertaking tends to discretionary behave when setting tariffs, which is easy to understand, given that it is not subject of the competitive process. Thus, for various reasons, such as the inertia for tariff increases or the desire to realize over-profits, certain costs included in the internal tariff assessments may be oversized. A direct analysis of the actual costs of a monopolist, carried out by competition authorities, could highlight the lack of justification for certain costs, as well as the imposition of excessive prices.
In the recent years, national competition authorities and the Commission vigorously restarted to analyze cases of potential excessive pricing. In May 2017, the Commission launched an investigation into excessive pricing in the pharmaceutical sector, targeting several Aspen generic oncology products. The investigation covers the entire EU with the exception of Italy, where Aspen undertaking was fined more than €5 million in 2016 for price hikes of between 250% and 1,500%, by the Italian competition authority (Global Competition Review, 2017). In July 2020, the Commission invited comments from all interested parties on commitments offered by Aspen to address the Commission's concerns over excessive pricing. Aspen proposes to reduce its prices in Europe for six critical cancer medicines by 73% on average. Taking into account all comments received, the Commission will then take a final view as to whether the commitments sufficiently address competition concerns. At the moment of this paper the case is still in progress.

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