

RESEARCH OUTPUTS / RÉSULTATS DE RECHERCHE

Excessive pricing and price squeeze under EU law

Motta, Massimo; De Streel, Alexandre

Published in:

European Competition Law Annual 2003: What is an Abuse of Dominant Position?

Publication date:

2006

Document Version

Early version, also known as pre-print

[Link to publication](#)

Citation for pulished version (HARVARD):

Motta, M & De Streel, A 2006, Excessive pricing and price squeeze under EU law. in CD Ehlermann & I Atanasiu (eds), *European Competition Law Annual 2003: What is an Abuse of Dominant Position?*. Hart, Oxford, pp. 91-125. <<http://www.crid.be/pdf/public/7351.pdf>>

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal ?

Take down policy

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

IV

*Massimo Motta and Alexandre de Streel**

Excessive Pricing and Price Squeeze under EU Law

A. Introduction

Article 82 of the EC Treaty provides for a condemnation of excessive prices. However, the general concept of ‘excessive price’ may cover two very different realities. An excessive price may be an exploitative abuse, i.e., a direct exploitation of market power. In this case, the dominant firm charges a high price to its customers (either end-users or undertakings with which the dominant firm does not compete). Alternatively, an excessive price may be an exclusionary abuse, aiming to strengthen or maintain the market power of the dominant firm by putting rivals at disadvantage. In this case, the dominant firm in one market, e.g., a market upstream, sets the price of the input so high that the margin between wholesale and retail prices is insufficient for an efficient firm to profitably operate in the downstream market. These two types of excessive prices are based on different legal and economic principles and hence are analysed separately in this paper.

This paper aims to study the current case law of both types of excessive prices, and furthermore aims, on the basis of economic theories and legal reasoning, to propose policy recommendations for antitrust authorities and the courts. This review is timely for several reasons.

First, although the number of excessive pricing cases in the EU has so far been relatively modest (albeit not insignificant), the incidence of such cases may increase in the future due the combined effects of the liberalisation of network industries and the decentralisation of European antitrust enforcement. Indeed, liberalisation opens to antitrust intervention sectors of the economy where prices used to be regulated (albeit with another legal instrument) and where dominant positions are prevalent and not easily contestable. As we show, liberalised sectors are among the best candidates for antitrust price control intervention, in the absence of effective regulation. In addition, the decentralisation of competition law¹ increases the role of national

* Economics Department of the European University Institute, Florence and Universitat Pompeu Fabra, Barcelona; Law Department of the European University Institute, Florence. Thanks to E. Rouseva for helpful discussions and to M. Marquis for insightful comments. The paper states the law as of 1 December 2003 unless indicated otherwise.

¹ Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty, OJ L 1 [2003].

92 1 – Policy Objectives, Enforcement Tools and Actors etc.

competition authorities (NCAs) and national courts in applying Article 81(3) EC, but more generally in the application of all antitrust provisions, including Article 82 EC.² This may in turn increase the number of excessive price actions for two reasons: first, the NCAs are probably more prone to political capture than the Commission and national politicians may desire to see an end put to excessive prices to please their voters; and second, the enhanced role of national courts can increase private actions, and unfair price cases are good candidates for unhappy customers.

Second, the Commission is undertaking a review of its policy on abuse of dominance, and wishes to rely on economic theory to evaluate and refine established practice and develop new enforcement policies where necessary (Lowe, 2003: 5).

Third, at a time when antitrust systems are converging across the world, the treatment of exploitative excessive pricing remains one important difference between the EU and the US. Across the Atlantic, the case law³ and doctrine have consistently held that a competition authority may not condemn exploitative excessive prices. As observed by Areeda and Hovenkamp (1996: paragraph 720b), ‘the Courts correctly regard as uncongenial and foreign to the Sherman Act the burden of continuously supervising economic performance, particularly the firm’s day-to-day pricing decisions’. The US approach has been further explained by Fox (1986: 985 and 993), who notes that ‘US law is not regulatory (in the sense of direct regulation of price and output) but rather concentrates on preserving conditions whereby free market forces constrain price and induce optimal production’ and thus ‘rests on the principle that price should be controlled by [the] free market unless Congress has in effect determined that the market cannot work and has established a regulatory commission’. The extent of control of the US authorities is thus limited to exclusionary excessive prices.

The paper is organised as follows: after this introduction, Section B deals with exploitative prices and Section C deals with the application of exclusionary prices, in particular the practice known as ‘price squeeze’. Each section distinguishes the principles derived from the case law and from Commission practice while proposing certain policy recommendations. Finally, Section D briefly concludes. The paper is limited to the European

² In other words, the impact of the long-established direct effect of Article 82 EC (see Case 127/73 *BRT/Sabam* [1974] ECR 51) will be enhanced.

³ *United States v. Trans-Missouri Freight Ass.*, 166 U.S. 290 (1897); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927): “(. . .) in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organisation and a choice between rival philosophies”; *United States v. Aluminium Co. of America*, 148 F.2d 416 (2d Cir. 1945). For a tentative explanation of the divergence between EU and US, see Fox (1986); Hawk (1988); and Kauper (1990: 655).

Excessive Pricing and Price Squeeze Under EU Law 93

level, and does not cover national practices.⁴ Moreover, the paper concentrates on cases of single dominance, and does not address cases of excessive prices charged by collectively dominant undertakings.

B. Exploitative Prices

1. Principles derived from the case law

1.1 Dominant position

Article 82(a) EC prohibits a dominant firm from ‘directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions’. A firm holds a dominant position if it possesses enough market power to behave to an appreciable extent independently of the competitors, customers and ultimately consumers.⁵ Due to the general formulation of Article 82, every dominant firm, however its market power has been acquired or maintained (Kaufer, 1990: 660), has a ‘special responsibility’⁶ not to set excessive prices. The Court of Justice confirmed this principle explicitly for the first time in *Parke Davis*, and has constantly maintained it ever since.⁷

1.2 Abuse: When is a Price Excessive?

A price is excessive when it is above the competitive level

Joliet (1970: 243) considered that a price is unfair when a dominant firm has actually taken advantage of its dominant position to set prices significantly higher than those which would result from effective competition. Hence, a price is excessive when it is significantly above the effective competitive level.⁸

⁴ For an overview of national practices, see Böge (2003) and Ruppelt (2003, written contribution for this volume) for Germany; Green (2003, written contribution for this volume) for United Kingdom; Conseil de la Concurrence français (2003) for France; and Hordijck (2002) for the Netherlands.

⁵ Case 27/76 *United Brands* [1978] ECR 207, para. 65.

⁶ The reference here is to the general formulation adopted by the Court in Case 322/81 *Michelin* [1983] ECR 3461.

⁷ Case 24/67 *Parke Davis* [1968] ECR 55. More recently, see Case C-323/93 *Centre d'insémination de la Crespelle* [1994] ECR I-5077, paras. 25–6; Case C-242/95 *GT-Link* [1997] ECR I-4449, para. 39.

⁸ This more precise formulation of unfair prices is adopted by the German competition law (§19, Sec. 4, No.2 GWB). From this wording, a price is proved to be excessive by means of the

94 1 – Policy Objectives, Enforcement Tools and Actors etc.

This reasoning was followed by the Court of Justice in *United Brands*,⁹ where the Court held that:

249. 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 to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition.

250. In this case charging a price which is excessive because it has no reasonable relation to the economic value of the product would be an abuse.

Thus, a price is unfair when it is above the economic value of the product, which means above the normal competitive level. In the Guidelines on vertical restraints, the Commission defines a ‘competitive’ price as being equal to minimum average costs.¹⁰ Indeed, a price below average costs would not be viable (and could not be taken as the competitive benchmark), in case of fixed costs. Also, when competition is *for* the market rather than *in* the market (in particular, where the market is dynamic and characterised by high investment and network effects), price may have to be set substantially above the average total cost of the winning firm.

As for the means of proof, the Court was very open as to the methodology to prove an excessive price in *United Brands*:

251. This excess could, *inter alia*, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its costs of production, which would disclose the amount of the profit margin (. . .).

253. *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 (emphasis supplied).

And indeed over time, the Court developed a veritable cocktail of approaches to determine whether a price is excessive, as summarised in Table 1 below (see similarly, although not identically, Lowe 2003: 11). Indeed, an excessive price may be proved by comparing the price under review with different indicators: cost measures of the dominant firm; other prices applied by the dominant firm; or prices of other firms offering products similar to the one of the investigated firm.

so-called ‘as-if competition’ test, whereby a price is unfair if it is significantly above the price prevailing in a comparable but competitive market plus a certain mark-up. Nevertheless, due to the difficulty of finding such a comparable market, the German courts have allowed a second means of proof by comparing the price in question with (efficient) production costs.

⁹ Cited at note 5.

¹⁰ Commission Guidelines on Vertical Restraints, OJ C 291 [2000], para. 126.

Excessive Pricing and Price Squeeze Under EU Law 95

Table 1: Proof of exploitative excessive pricing

	Cost of the dominant firm	Other prices of the dominant firm (Discrimination)	Price of other firms offering similar products
Same relevant market (product and geographic)	United Brands 1978 CICCE 1985 SACEM II 1988 Ahmed Saeed 1989		(Competitor comparison) United Brands 1978 Parke, Davis 1968 Renault 1988
Other relevant market in the same Member State		General Motors 1975 British Leyland 1986	General Motors 1975 Bodson 1988
Other relevant market in another Member State		United Brands 1978 (Benchmarking)	Sirena 1971 Deutsche Grammophon 1971 SACEM I 1989 SACEM II 1989

C. Comparison with Efficient Costs of Production and Profitability Analysis

In *United Brands*, UBC charged different prices for its ‘Chiquita’ branded bananas to ripeners/distributors from different Member States and prohibited the distributors from reselling its bananas, thereby partitioning the common market. Among other abusive practices impeding the single market (resale prohibition, refusal to deal, discrimination), the Commission¹¹ considered that the prices on several continental markets (Germany, Benelux and Denmark) were excessive for three reasons: they were (1) at least 100% higher than the price practised on the Irish market which UBC allegedly admitted not to be loss-making; (2) 20% to 40% higher than the prices of unbranded bananas in the continental countries, even though their quality was only slightly lower; (3) and 7% higher than the price charged by competitors of branded bananas, which were sold profitably. The Commission imposed a fine on UBC of €1 million and suggested that a decrease in price of 15% should remedy the abuse.

¹¹ Commission Decision of 17 December 1975, *Chiquita*, OJ L 95 [1976].

96 1 – Policy Objectives, Enforcement Tools and Actors etc.

On appeal, the Court of Justice held that:

252. The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products. (. . .)

256. The Commission was at least under the duty to require UBC to produce particulars of all the constituent elements of its production costs.

Based on these principles, the Court annulled the Commission Decision on the point of unfair pricing for insufficient proof. First, the Commission did not try to calculate the production costs of the bananas, despite the fact that such a calculation was feasible, as revealed by a 1975 study of the United Nations Conference on Trade and Development.¹² The Commission did even not request UBC to produce its cost data. Second, the use of the Irish price as a benchmark was open to criticism because it was not clear whether this price was profitable. Third, a 7% difference with the main competitors could not automatically be regarded as excessive.

Closely following the wording of the Court, Faull and Nikpay (1999: 192) argue that a twofold test was imposed by the Court's judgment in *United Brands*. According to these authors, the first component of the test is a cost/price analysis, while the second component is an analysis to determine whether the price is excessive, either in itself or by comparison with competitors' products. However, we suggest that both components of the test aim to prove the same thing, i.e., that the price in question is significantly above the competitive level, and that the two components should not necessarily be used cumulatively. We also suggest that the Court in *United Brands* established a priority rule with respect to the different means of proof in favour of a direct cost calculation. Indeed, an antitrust authority should try to get cost data and to compare such data with the alleged excessive price. It is only when it is too difficult to get these data, or in order to complement a cost analysis, that the authority may decide to compare competitors' prices, and more generally to compare the investigated prices with benchmarked prices.

In subsequent cases, the Court refined the price/cost comparison. In *CICCE*,¹³ the Court rejected a complaint against the Commission that had refused to condemn unfairly low prices paid by French television companies (operating at that time as a monopsonist) for broadcasting films. In its analysis, the Commission refused to compare an average production cost for all the films with an average selling price, and instead considered that the analysis should be done for each film separately due to the considerable variance of costs and fees between the films. In its decision, the Court endorsed this

¹² See para. 254: "[Working out] the production costs of the bananas [does] not seem to present any insuperable problems".

¹³ Case 298/83 *CICCE* [1985] ECR 1105, paras. 24–5.

Excessive Pricing and Price Squeeze Under EU Law 97

approach. Thus, in case of similar products having different cost structures, an approach based on the use of averages should be ruled out.

In *SACEM II*,¹⁴ the Court considered that the production costs to be taken into account are those of an efficient firm, and not necessarily those of the investigated firm which may have inflated production costs because of its dominant position (X-inefficiency). Indeed, the Court stated that a firm may not justify its unfair price with high production costs because the possibility may not be ruled out that it is precisely the lack of competition on the market in question that accounts for the high costs.

Finally, in *Ahmed Saeed*,¹⁵ the Court addressed the difficulty of apportioning the common costs among several services. In an *obiter dictum* to a preliminary ruling case on airline tariffs, the Court held that:

43. Certain interpretative criteria for assessing whether the rate employed is excessive may be inferred from [sector-specific regulation], which lays down the criteria to be followed by the aeronautical authorities for approving tariffs. It appears in particular that tariffs must be reasonably related to the long-term fully allocated costs of the air carrier, while taking into account the needs of consumers, the need for a satisfactory return on capital, the competitive market situation, including fares of the other air carriers operating on the route, and the need to prevent dumping.

Therefore, if sector-specific regulation provides accounting rules for the national regulatory authority (NRA) to control prices, the very same rule may be followed by the competition agency to determine if price is excessive.¹⁶

To conclude, a first approach to the assessment of whether prices are excessive consists of computing costs of production and establishing whether the price set by the dominant firm is above a 'reasonable' price. Figure 1 illustrates this method: the price p^n is deemed excessive if it is above the price p^* . Of course, there are at least two problems with this approach. The first is that the method is to a large extent arbitrary, and we will not dwell upon it: what is the margin of profits that the courts should be ready to accept¹⁷; or in other

¹⁴ Cases 110, 241 & 242/88 *Lucazeau/SACEM (SACEM II)* [1989] ECR 2811, para. 29. Similarly, see Case 395/87 *Tournier (SACEM I)* [1989] ECR 2521, para. 42. The Court's approach as described in this paragraph is shared by a majority of commentators (see, among others, Kauper, 1990: 662; Whish, 2003: 692), but not by Hordijk (2002: 471). According to Hordijk, it is only in exceptional circumstances that supposedly inflated production costs should be disregarded.

¹⁵ Case 66/86 *Ahmed Saeed* [1989] ECR 803.

¹⁶ For instance, the Commission recommended the use of a Long Run Incremental Cost (LRIC) methodology for the pricing of fixed interconnection and the unbundled access to the local loop in the telecommunications sector. LRIC consists of evaluating the network elements at the current or prospective value of an efficient operator and allocating them in accordance with the principle of cost causation. See *Commission Recommendation of 8 January 1998 on interconnection in a liberalized telecommunications market (Part I—Interconnection pricing)*, OJ L 73 [1998]; and *Commission Recommendation of 25 May 2000 on unbundled access to the local loop*, OJ L 156 [2000] at Article 1(6).

¹⁷ See, for instance, the profitability analysis referred to by OXERA (2003).

98 1 – Policy Objectives, Enforcement Tools and Actors etc.

words, what is the maximum ‘fair’ price p^* above which the price charged by a dominant firm is excessive? The second concerns the difficulty of computing the level of costs, c .

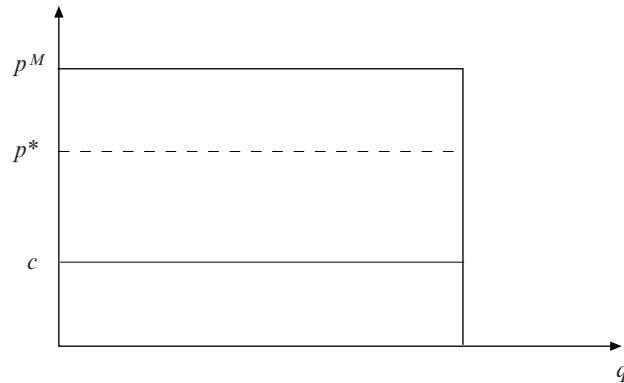


FIG. 1

Comparison with other Prices Charged by the Dominant Firm

A direct calculation of costs, which is already difficult for a sectoral regulator even when firms are subject to an accounting transparency obligation, may be virtually impossible for an antitrust authority. The authority may thus decide to compare more easily observable data, such as two different prices charged by the same investigated firm. The authority may show that the same price is charged for two services having different costs, as illustrated by Figure 2. Alternatively, the authority may show that two different but profitable prices are charged for the same product, and that the price charged to some customer is therefore excessive, as a profitable lower price has been charged to others. This situation is illustrated by Figure 3.

In these cases, the authority shows that both prices are profitable and discriminatory in order to prove that one of them is excessive. This price will be condemned under Article 82(a) EC (unfair price). In addition, the very same prices may also be condemned under Article 82(c) EC (discrimination), and,

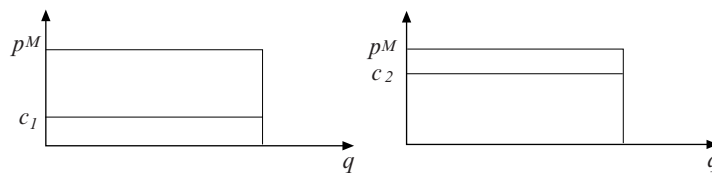


FIG. 2

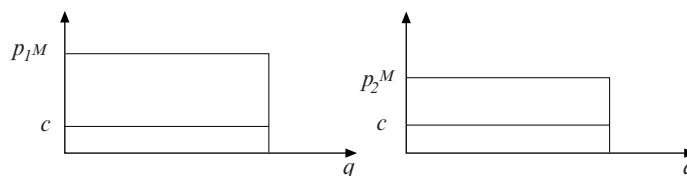
Excessive Pricing and Price Squeeze Under EU Law 99

FIG. 3

in practice, most excessive pricing has tended to be subsumed into price discrimination cases.

To do so, the authority may decide to compare two prices that the dominant firm charges in the same Member State. This approach was applied by the Commission in *General Motors*,¹⁸ its first ever unfair pricing decision. In the beginning of the Seventies, General Motors Continental had been granted the legal monopoly to issue conformity certificates for vehicles used in Belgium. Thus, the cars sold in one Member State but re-imported into Belgium had to obtain this certificate. At first, GMC was charging €146 for this service, but soon afterwards the company decreased its price to €25 for the European models.

The Commission considered that the initial price was unfair, and imposed a fine of €100,000, for four reasons. (1) The price of approving American models imported in Belgium was the same as the price of approving European models, whereas the cost of the former was higher than the latter because more European models were imported, hence the fixed costs were spread among a greater quantity. (2) GMC itself was ready to offer the service at €25 for some clients who were unwilling to pay the full charge. (3) Other Belgian firms acting as authorised agents of other manufacturers carrying out inspections similar to those provided by GMC charged only €70 or less. (4) The price charged by the government testing stations before the legal monopoly was granted to GMC was only €30.

On appeal, the Court of Justice confirmed in principle that an unfair price would be abusive,¹⁹ but did not address the means of proof as it was not disputed that GMC's price was excessive. However, the Court annulled the Commission decision because the issuance of conformity certificate was a new responsibility for GMC transferred from state testing stations, and for which it applied a high rate for an initial period but soon thereafter brought its rates into line with the real economic cost of the operation.

¹⁸ Commission Decision of 19 December 1974, *General Motors*, OJ L 29 [1975].

¹⁹ Case 26-75 *General Motors* [1975] ECR 1367, para. 12: "Such an abuse (of a dominant position) might lie, *inter alia*, in the imposition of a price which is excessive in relation to the economic value of the service provided and which has the effect of curbing parallel imports by neutralising the possibly more favourable level of prices applying in other sales areas in the Community (...)".

100 1 – Policy Objectives, Enforcement Tools and Actors etc.

A very similar case arose ten years later. *British Leyland* also enjoyed a legal monopoly to issue national certificates of conformity. Initially, BL charged £25 for both right-hand drive and left-hand drive cars, then increased the fee for left-hand drive cars to £150 for dealers and £100 for private individuals. Following the opening of a Commission procedure, BL charged a uniform fee of £100, and then reduced it back to £25. The Commission²⁰ considered that these prices could not reflect the cost of the service and were probably aimed at curbing parallel imports. Accordingly, it imposed a fine of €350,000.

On appeal,²¹ the Court upheld the Commission Decision by considering that the only difference in relation to the issue of a certificate for right-hand drive and left-hand drive vehicles was a simple administrative check that could not entail significant costs. Thus the difference in cost between both services could not justify the difference in fees. In fact, the fees did not relate to the costs and were fixed solely to make the re-importation of left-hand drive cars less attractive.

Alternatively, an antitrust authority may decide to compare the prices charged by the dominant undertaking in two different Member States. As seen above, this approach was followed by the Commission and implicitly endorsed by the Court in *United Brands*, which clarified the relationship between unfair and discriminatory prices. To prove unfair pricing, the Commission has to show that the prices are different (without justification) for the same product, and that both prices are profitable. To prove that prices are discriminatory, the Commission has to show that the prices are different (without justification) and that they place buyers at a competitive disadvantage.²²

Comparison with Prices of other Firms Offering Products Similar to Those of the Dominant Firm

The authority may also compare the price under review with the prices of similar products offered by another firm. This method has several variants, depending on the position of the other firm: such other firm may be active on the very same relevant market as the dominant firm (ie, it may be a competitor); it may be active on another geographic market but may still operate in the same Member State as the dominant firm; or it may be active in another Member State.

This first variant (comparison with competitor prices) is illustrated in Figure 4, where p^M is the price of the dominant firm and p^C is the price of the other firm.

²⁰ Commission Decision of 2 July 1984, *British Leyland*, OJ L 207 [1984].

²¹ Case 226/84 *British Leyland* [1986] ECR 3263, para. 28. This is the only European Court case condemning an exploitative excessive price.

²² In *United Brands*, the Court considered that the Commission had sufficiently proved that the prices in question were discriminatory. However, the Court considered that the Commission had not sufficiently proved that the prices were excessive, as it was not clear that the lower Irish prices (used as a benchmark) were profitable.

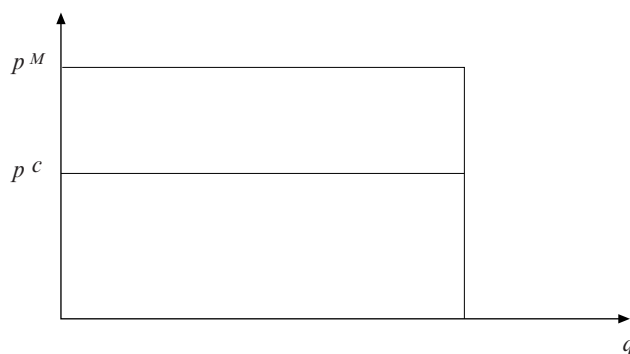
Excessive Pricing and Price Squeeze Under EU Law 101

FIG. 4

This approach was followed by the Commission in *United Brands*, where it compared the price of Chiquita bananas with the prices of branded bananas of similar quality. The Court implicitly endorsed the approach but held that a 7% difference is not enough to automatically be regarded as excessive.²³ However, this is a particularly misleading test, since it risks the finding of excessive pricing whenever there are differences in quality between the products of different firms. If the dominant firm has attained its leadership through superior products, then it will also be able to command higher prices, without this being abusive.

A particular application of this method consists of comparing the price of a patented product offered by the investigated firm with the price of a similar unpatented product offered by competitors.

In *Parke Davis*,²⁴ the Court of Justice was asked by a Dutch tribunal whether the patented holder might charge higher prices than that of a similar unpatented product coming from another Member State.²⁵ The Court replied that the comparison between the prices of a patented product in one Member State and the price of a similar unpatented product in another Member State was not sufficient to prove excessive pricing. But it was not clear at the time of the case whether this insufficiency was due to the fact that two compared prices were between patented and unpatented products, or to the fact that the compared prices were between two different countries. This ambiguity was clarified three years later in *Deutsche Grammophon* (see below), where the Court held that the comparison of prices between two countries might be indicative of an abuse. Thus, the judgment in *Parke, Davis* was explained by

²³ *United Brands*, para. 266.

²⁴ Cited at note 7.

²⁵ There was a clear internal market dimension in this case, as the Court was also asked whether the holder of a patent on a medicinal product issued in the Netherlands might prevent the importation of similar products from another Member State where the medicinal product is not patentable.

102 1 – Policy Objectives, Enforcement Tools and Actors etc.

the fact that the price comparison was between patented and unpatented products.

Indeed, in *Renault*,²⁶ the Court of Justice was asked by an Italian tribunal whether it would be abusive for a car manufacturer to register intellectual property rights in respect of an ornamental design of spare parts for cars and hence to eliminate competition from independent manufacturers of spare parts. The Court replied that the mere fact of securing the benefit of an exclusive right granted by national law could not be condemned, but that the exercise of such a right might be abusive if it led to an arbitrary refusal by the dominant firm to deliver spare parts to independent repairers, excessive prices for the spare parts, or a decision by the dominant firm not to produce spare parts for a particular model even though many cars of that model remain in circulation.²⁷ Then the Court held that:

17. (. . .) a higher price for the [registered component sold by the car manufacturer] than for the [unprotected component sold by independent producers] does not necessarily constitute an abuse, since the proprietor of protective rights in respect of an ornamental design may lawfully call for a return on the amounts which he has invested in order to perfect the protected design.

Therefore, a comparison between the price of a product protected by an IPR and the price of a similar unprotected product is not sufficient to prove that the former is unfair because investment incentives in intellectual property need to be safeguarded. As noted by Gyselen (1990: 605), the Court implicitly accepted that an inventor must be given the opportunity to objectively justify its higher price as a means to recoup its extra costs and prevent third parties from taking a free ride on its efforts to innovate.

The second variant of the test (comparison with firms active in another geographic market situated in the same Member State) is illustrated in Figure 5, where the comparison is made between the price p^M of the dominant firm under investigation and the market price p^B arising in another market B.

This second variant was explicitly endorsed by the Court in *Bodson*.²⁸ In this preliminary ruling decision on the legality of public exclusive concessions to provide the external services for funerals, the Court stated in an obiter dictum that:

31. (. . .) it must be possible to make a comparison between the prices charged by the group of undertakings which hold a concession and prices charged elsewhere.

²⁶ Case 53/87 *Renault* 53/87 [1988] ECR 6039, paras. 16–17.

²⁷ One may question whether there is a secondary market for spare parts for each car type. If potential buyers of cars are able to take into account the cost of after-sales services, including spare parts, such secondary market would not exist (Motta, 2004: chapter 3).

²⁸ Case 30/87 *Bodson* [1988] ECR 2479. Note that this second variant had previously been applied by the Commission in *General Motors* when it compared the charges of GMC with the charges of the agents of other manufacturers. The Commission compared in this case the prices of different monopolists, without any reference to a competitive price.

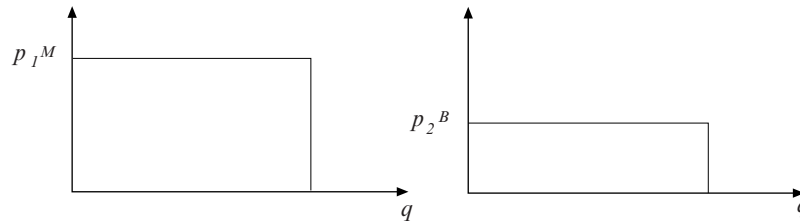
Excessive Pricing and Price Squeeze Under EU Law 103

FIG. 5

Such a comparison could provide a basis for assessing whether or not the prices charged by the concession holders are fair.

In this case, the Court rightly suggested comparing the price on a market which is not competitive (the one covered by the public concession) with the price of a competitive market (the one not covered by the public concession).

The third variant (comparison with firms active in another Member State, sometimes called ‘benchmarking’), has been endorsed by the Court, and indeed was often referred to in preliminary ruling cases as it carries with it an internal market dimension.

In *Deutsche Grammophon*,²⁹ the Court of Justice was asked by a German Tribunal whether a German manufacturer of sound recordings would abuse its exclusive right of distribution by imposing a selling price in Germany that is higher than the price of the original product sold in France and re-imported in Germany.³⁰ The Court held that:

19. The difference between the controlled price (ie, in Germany) and the price of the product reimported from another Member State (ie, France) does not necessarily suffice to disclose an abuse; it may however, if unjustified by any objective criteria and if it is particularly marked, be a determining factor in such abuse.³¹

In this case, and in contrast to *Parke Davis*, the sound recordings were protected by IPRs in both Member States, and the Court concluded that the comparison of prices might be relied upon to show that the prices were unfair.

This third variant was confirmed and refined in *SACEM II*.³² The Court of Justice was asked by a French court whether the rate of royalty charged by a French musical copyright management society to French discotheques, which was substantially higher than those applied by identical societies in other

²⁹ Case 78/70 *Deutsche Grammophon* [1971] ECR 487.

³⁰ The Court was also asked whether a German undertaking manufacturing sound recordings may rely on its exclusive right of distribution to prohibit the marketing in Germany of sound recordings which it has itself supplied to its French subsidiary.

³¹ See similarly, albeit less clearly, Case 40/70 *Sirena* [1971] ECR 69, para. 17: “Although the price level of the product may not of itself necessarily suffice to disclose such an abuse, it may, however, if unjustified by any objective criteria, and if it is particularly high, be a determining factor”.

³² Cited at note 14.

104 1 – Policy Objectives, Enforcement Tools and Actors etc.

Member States, was to be deemed excessive. In practice, SACEM was charging a fixed rate of 8.25% of the turnover of the discotheques, which was revealed by a Commission study (cited in OECD, 1996: 129) to be more than four times the European average. The Court replied that:

25. When an undertaking holding a dominant position imposes scales of fees for its services which are appreciably higher than those charged in other Member States and where a comparison of the fee levels has been made on a consistent basis, that difference must be regarded as indicative of an abuse of a dominant position. 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.

Thus, if there are substantial price differences between Member States, the burden of proof shifts from the competition authority to the dominant firm which has to show that its price is not excessive. It is interesting to note that, in this case, the Court did not stipulate that the benchmarked market (ie, the compared Member State) had to be competitive. Hence, an antitrust authority may compare the prices of two markets, each of which is monopolised by a different player. In practice, following the Court's judgment, SACEM reduced its royalty in 1991 from 8.25% to 7.18% of the discotheques' turnover. Following an opinion by the French Conseil de la Concurrence,³³ it further decreased the rate to 4.39% in 1993.

D. Recent practice of the European Commission

In more than forty years of competition practice, the Commission adopted only four formal decisions condemning excessive prices. The first three cases (General Motors in 1974, United Brands in 1975, and British Leyland in 1984) have been discussed above.

In the most recent case, *Deutsche Post II*³⁴ of 2001, DPAG (which enjoyed at the time a legal monopoly for internal mail) considered that any mail coming from abroad but containing a reference to Germany—usually in the form of a German reply address—had a German sender, regardless of where the mail was produced or posted.³⁵ DPAG considered that this mail circum-

³³ Conseil de la Concurrence, Opinion 93-A-05 of 20 April 1993.

³⁴ Commission Decision of 25 July 2001, *Deutsche Post II*, OJ L 331 [2001], paras. 159–67. The Court of Justice had previously decided that DPAG was allowed to charge internal tariffs for truly circumvented domestic mail to safeguard general interest objectives. See Cases C-147 & 148/97 *Deutsche Post* [2000] ECR I-825, para. 61.

³⁵ This sort of mail is becoming increasingly common for commercial mailing companies. These companies centralise their mail distribution by sending mails from one distribution point to addressees in a number of countries, but they provide the possibility for the addressees to reply to an address in their own country to increase the response rate.

Excessive Pricing and Price Squeeze Under EU Law 105

vented domestic mail, and consequently applied the domestic tariff (ie, €0.51).

First, the Commission investigated the identity of the sender of the disputed mails. It found that they did not have German senders but on the contrary were posted from the UK. Hence, the mail did not circumvent domestic mail and should be treated as normal international mail. Second, the Commission determined that charging domestic tariffs to disputed pieces of mail was above cost. The Commission could not make a detailed analysis of DPAG's average costs, as there were no reliable accounting data for the relevant period,³⁶ nor could the Commission compare DPAG's prices with those of competitors, as DPAG was a monopolist. Instead, the Commission estimated the cost of delivering of incoming international mail on the basis of DPAG's own estimate. Indeed, in its notification of the REIMS II agreement,³⁷ DPAG had submitted that the cost related to distribution of international traffic was only 80% of the cost of processing domestic mail (as there is no need to collect the mail all over the country). Thus, the Commission estimated that the cost of the disputed pieces of mail was at least 20% lower than the charged tariffs. Accordingly, it imposed a fine, but only of the symbolic amount of €1000 due to the legal uncertainty at the time. Contrary to the previous Commission decisions on unfair prices, Deutsche Post did not appeal because the main point of the case was more related to the determination of the sender of the mails than to the level of the prices. Once it was established that the disputed mail was not circumvented internal mail, even DPAG did not really challenge that a lower tariff should have been applied.

The above mentioned four cases are only the visible tip of the iceberg. The Commission initiated several other cases that did not lead to formal decisions but nevertheless resulted in price decreases. Most of the cases related to the recently liberalised network industries, such as airlines,³⁸ electricity,³⁹ and, in particular, telecommunications.⁴⁰

³⁶ Postal Directive 97/67/EC (OJ L 15 [1998]) imposes the introduction of a transparent internal cost accounting system, but this was not yet in place when the alleged abuse was committed.

³⁷ Commission Decision of 15 September 1999, *REIMS II*, OJ L 275 [1999], para. 88; Commission Decision of 23 October 2003, *REIMS II Extension*, OJ L 56 [2004].

³⁸ In *Sterling Airways*, the Commission considered that the high fares on the Copenhagen-London route of the then-legal monopolist airline SAS could be abusive due to very high profitability (price above costs). However, the case was closed when the fares dropped considerably in comparison to the other SAS international routes. See European Commission (1980: *Xth Report on Competition Policy*, para. 137.

³⁹ *Electricity transmission tariffs in the Netherlands*, in European Commission (1999): *XXIXth Report on Competition Policy*, p. 165, where the Commission found that charges for electricity transmission must always be linked to actual cost in order to avoid abuse within the meaning of Article 82 EC.

⁴⁰ Excessive prices in the telecoms sector are dealt with in the Commission Notice on the application of competition rules to access agreements in the telecommunications sector, OJ C 265 [1998], paras. 105–9.

106 1 – Policy Objectives, Enforcement Tools and Actors etc.

With regard to the telephone calls on a fixed line, cases were opened in several Member States in 1998 against excessive prices for international calls, and their related wholesale charges paid between foreign operators.⁴¹ The Commission proved its cases using the discrimination method, and progressively closed the cases when the prices decreased (by 26% to 28%), sometimes due to the intervention of the national regulatory authorities (NRAs).

With regard to the calls on a mobile line, several cases were opened for excessive prices for fixed-to-mobile calls, and their related wholesale charges.⁴² In 1998, proceedings related to unfair fixed termination charges (proved with discrimination and benchmarking), unfair fixed retention charges (proved with benchmarking), and unfair mobile termination charges (proved with discrimination and benchmarking).⁴³ The cases were passed to NRAs when they had jurisdiction to intervene under national telecommunication law, and otherwise were closed after the operators agreed substantial reductions of their charges (from 30% to 80%). The issue of excessive mobile termination charges arose again in 2002 in the Netherlands on the basis of a complaint of WorldCom, but the Commission decided this time to treat the case as a form of abusive price squeeze.⁴⁴

In 1999, and again in the mobile sector, the Commission investigated the high prevailing international roaming prices,⁴⁵ relying on the very rarely used ‘sector inquiry’ provision, which allows the Commission to carry out an investigation into a whole market rather than specific companies. No formal case has been opened yet, but in an interim report, the Commission identified several possibilities of excessive prices on the basis of discrimination, benchmarking, and an analysis of the pattern of changes of the price over a four years period.

⁴¹ IP/97/1180 of 19 December 1997; IP/98/763 of 13 August 1998; IP/99/279 of 29 April 1999. These cases related to the so-called “accounting rates”, which are the charges agreed between the telecom operator of the country where the call originates and the telecom operator of the country where the call terminates for carrying a call of a duration of one minute from its origin to its destination. Each of the two companies involved receives a share—usually half—of this accounting rate.

⁴² IP/98/141 of 9 February 1998; IP/98/707 of 27 July 1998; IP/98/1036 of 26 November 1998; IP/99/298 of 4 May 1998.

⁴³ In the case of mobile-to-fixed calls, the fixed termination charge is the fee paid by the mobile operator to the fixed operator for terminating the call. In case of fixed-to-mobile calls, the mobile termination charge is the fee paid by the fixed operator to the mobile operator for terminating the call, and the fixed retention charge is the fee kept by the fixed operator for originating the call.

⁴⁴ IP/02/483 of 27 March 2002. The case is still pending before the Commission.

⁴⁵ IP/00/111 of 4 February 2000; Commission services Working Document on the initial findings of the sector inquiry into mobile roaming charges, 13 December 2000, available at http://www.europa.eu.int/comm/competition/antitrust/others/sector_inquiries/roaming/; MEMO/01/262 of 11 July 2001. International roaming tariffs are the charges that a mobile customer has to pay while giving and receiving calls abroad using a network other than the one to which he is affiliated.

Excessive Pricing and Price Squeeze Under EU Law 107

With regard to leased lines, which are an important building block of the Information Society, the Commission in 1999 launched another sector inquiry⁴⁶ into the conditions under which such leased lines are provided. Relying on benchmarking, the Commission identified several possible instances of excessive pricing of national and international leased lines and decided to open five cases for unfair international leased line prices. The inquiry, and most of the cases, were closed in December 2002 due to a significant drop in prices (by 30% to 40% on average).

This brief overview shows that, although in law every dominant firm may be liable for unfair prices, in practice the Commission has used this power sparingly. As the Commission has itself noted, it does not want to behave as a price regulator.⁴⁷ It has initiated very few cases and has adopted even fewer formal decisions.⁴⁸ Most cases involved a dominant position protected in varying degrees by government action and, in most instances, special circumstances applied (Gyselen, 1990: 613; Kauper, 1990: 659). Two streams of cases may be distinguished. In the first, the dominant undertaking enjoyed a legal monopoly (*General Motors, British Leyland*) and the abuse created serious impediment to the internal market. The Commission was more concerned with the freedom of circulation than with the anticompetitive exploitation of end users and the associated allocative inefficiencies (Martinez, 1998: 2).

In the second stream of cases, the dominant undertaking was active on markets recently opened to competition (*Deutsche Post*, telecommunications cases) and any pricing abuse may have weakened the political momentum for the liberalisation program. As noted by a senior Commission official (Ungerer, 2001: 11), ‘the procedures aimed particularly at passing on rapidly the advantages of liberalisation in terms of price reductions and service developments to consumers—a major objective in order to show as rapidly as possible the effective consumer benefits and to secure sustained public support for liberalisation’. Moreover, the Commission relied as much as possible on

⁴⁶ IP/99/786 of 22 October 1999; Commission services Working Document on the initial results of the leased lines sector inquiry, 8 September 2000, available at http://www.europa.eu.int/comm/competition/antitrust/others/sector_inquiries/leased_lines/; IP/00/1043 of 22 September 2000; IP/02/1852 of 11 December 2002.

⁴⁷ European Commission (1975): *Vth Report on Competition Policy*, para. 76; European Commission (1994): *XXIVth Report on Competition Policy* (1994), para. 207: “(. . .) 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 would normally bring about effective competition and the price level associated with it” (emphasis supplied); European Commission (1997): *XXVIIth Commission Report on Competition Policy*, para. 77.

⁴⁸ Note also that most of the Court cases have been due to preliminary ruling questions rather than to appeals against Commission Decisions.

108 *1 – Policy Objectives, Enforcement Tools and Actors etc.*

national regulators, limiting its intervention to situations in which sectoral regulators either had no legal power to intervene (mobile termination rates, roaming charges, or international leased lines tariffs) or were not intervening appropriately (international accounting rates, fixed retention or termination charges, national leased lines tariffs).

With regard to the means of proof, the Commission relied on different comparative indicators, often using them cumulatively. In particular, it relied extensively on the discrimination and the benchmarking methods.⁴⁹ In addition, most of the interventions were based on prices 100% above the comparators (Hordijk, 2002:474), even though in some cases, it has relied on a much smaller spread (Haag and Klotz, 1998: 38; Martinez, 1998: 8).

E. Policy recommendations

Arguments against antitrust control of excessive prices

The main arguments against applying competition law to instances of excessive pricing cases in competition law are the following.⁵⁰ First of all, it is useful to recall the difference between sectoral regulation and competition law. While the former pertains to markets where there are legal barriers to entry and/or significant market failures, the latter generally applies to markets where competitive forces are in principle free to operate. In such markets, the general presumption should be that market forces will, over time, reduce the market power of a dominant firm, or at least oblige the firm to reduce its prices so that its customers will not switch to competitors. In other words, exploitative practices are self-correcting because excessive prices will attract new entrants.

In such markets, the use of excessive price actions to increase consumer welfare might help in the short run, but it is likely to have serious negative effects of a longer duration. If firms anticipated that an antitrust authority were ready to cap their prices when they are so successful as to become dominant and enjoy high profits, then their incentive to invest and innovate would be substantially diminished. The threat of excessive price actions that 'expro-

⁴⁹ Benchmarking was also extensively used in the early phase of telecoms liberalisation. Benchmarking was intended to ensure that the prices of incumbents fulfilled cost-orientation obligations applying in the telecoms sector at a time when no cost-transparency accounting was in place and when there was therefore significant information asymmetry between the regulator and the operators.

⁵⁰ See, among others, Areeda and Hovenkamp (1996: 720); Gyselen (1990: 600); Hordijk (2002: 475); Korah (2000: 147); Whish (2003: 688).

Excessive Pricing and Price Squeeze Under EU Law 109

priate' from firms the fruit of their investments would diminish the expected returns and thus discourage them from investing. Indeed, if the charging of monopoly prices were prohibited, then in fact monopoly itself would be prohibited, since a monopolist must be entitled to maximise profits.

Things are made worse by the fact that establishing the 'excessiveness of prices' is a very complex operation whose outcome is necessarily hard to predict. Indeed, in many situations even computing the relevant measures of costs would be a complex exercise: How does one allocate common costs to different products (long-run incremental costs, stand-alone costs)? How does one choose between different accounting methods (historic costs, current costs)? Which measure of costs should be adopted to measure profits in industries where there are important fixed costs? All these difficulties are underlined by the fact that a competition authority may not have as a deep a knowledge of the sector being investigated as an industry regulator.

Furthermore, and unlike an industry regulator, a competition authority's role is not to set prices, whereas an excessive pricing action amounts *de facto* to telling a firm that a price above a certain level would not be acceptable. On top of that, the intervention occurs only at a given point in time, and leaves open the issue of how prices should evolve over time. Unless a structural remedy is imposed (a measure which might have other important drawbacks), the antitrust authority would have to impose behavioural remedies, or continue to monitor prices over time, therefore converting itself into a regulator of the industry.

Antitrust control of excessive prices is justified only in specific cases of dominant position

All the reasons listed above suggest that excessive pricing is a very dangerous instrument to use in competition law. Yet there might be exceptional circumstances justifying the use of such a theory of liability. We believe in particular that the following conditions must simultaneously arise to justify an action against excessive pricing (as an exploitative abuse).

The first necessary (but not sufficient) condition is static and relies on the presence of *high and non-transitory barriers to entry*. In such a case, it is extremely unlikely that market forces would be able to challenge the dominant firm and that the abusive practices would be self-correcting. In practice, the investigated firm should enjoy a monopoly (or near monopoly), or control an essential facility whose position may not be contestable.

This approach is consistent with some recent statements by NCAs. For instance, the French Conseil de la Concurrence (2003: 67) intends to impose cost-orientation only exceptionally, in particular where a dominant firm controls essential facilities. It also notes that it is not an appropriate tool to

110 1 – Policy Objectives, Enforcement Tools and Actors etc.

remedy a competitive problem, but should mainly be used to support a liberalisation process and to facilitate entry of new firms in the markets. The British Office of Fair Trading (1999: 6) will only intervene if: (i) the price in question is higher than would be expected in a competitive market; and (ii) there is no effective market pressure to bring the price down to a competitive level (and this is unlikely to change). Like its French counterpart, the OFT notes that excessive pricing cases are particularly relevant where a dominant undertaking exploits an essential facility.⁵¹

The second necessary condition is dynamic and limits intervention to monopoly (or near monopoly) that is *due to current or past exclusive or special rights*.⁵² Considering that every incontestable monopoly may be condemned would be justifiable in a static setting looking at the market situation *ex post*. However, in a more dynamic setting, taking into account the effect of the intervention on investment incentives, this simplistic argument is no longer valid because fear of antitrust intervention may undermine investment incentives. There is thus a trade-off between static short-term considerations (which would imply that only the first condition should be met for intervention to take place) and dynamic long-term considerations (which would call for additional conditions). Due to all the drawbacks of antitrust excessive price actions, we suggest that the balance should tilt in favour of dynamic consideration. Hence, interventions would only be justified if they have no effect on investment incentives, or in other words, if the monopoly (or near monopoly) in question was due to current or past legal protection.

Thus, if the dominant position has been attained in a market where entry was unrestricted (through investments, innovation, or simply business luck), then competition law should not intervene. More likely than not, firms had anticipated that the winner would have enjoyed such a strong position and heavy investments have probably been made to obtain it. High prices are likely to be the reward for past investments.⁵³ For instance, many network markets are characterised by such a situation, where there is competition *for*

⁵¹ In addition, the OFT (1999: 6) recognises three situations where a price that appears to be above cost is not abusive: (1) high prices may occur for short period within a competitive market; (2), high prices may reflect superior technology/products; and (3) prices may be high in markets with continuous innovation that should be rewarded.

⁵² Note that the above two conditions justifying antitrust control of excessive prices are close, but not identical, to the conditions justifying sectoral regulation. According to the Commission, telecoms regulation is justified mainly when there are high permanent entry barriers and when behind the barriers, the structure of the market is not conducive to competition. However, these two conditions for sectoral regulation are broader—and easier to meet by the authority—than the ones we propose for exploitative abuse. Indeed, the sectoral conditions cover all cases of natural monopoly (however acquired), as well as cases of tight oligopoly leading to tacit collusion: Recitals 9 to 16 of the Commission Recommendation of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation, OJ L 114 [2003].

⁵³ A particular example of this category would be a monopoly position obtained through intellectual property rights protection, such as patents (of course, IPRs must be worth protecting, but this is another matter . . .).

Excessive Pricing and Price Squeeze Under EU Law 111

the market rather than competition *in* the market. Conversely, if the dominant position has been obtained through past or current legal barriers, intervention may be justified. In such a case, high prices are not the reward for past efforts and investments, but simply a rent due to reasons not related to market competition.

Cases in point are most of the industries formerly dominated by public monopolies in Europe. Telecommunications, energy and postal services are all industries where the former incumbent monopolists enjoy dominant positions in the national markets, and where—due to a combination of network effects, switching costs, exclusionary practices, and regulatory mistakes—competition does not work properly despite the fact that, nominally, entry is free.⁵⁴

Interestingly enough, these two conditions are broadly consistent with the Commission's practice. Indeed, it has intervened mainly in cases of legal monopoly not justified by investment (eg, General Motors, British Leyland, SACEM), or in newly liberalised sector (like telecom industries). It is also the view recently advocated by the Director General of DG Competition who stated that:

There can moreover be a legitimate interest to prosecute exploitative practices at least where they are not self-correcting, namely where entry barriers are high or even insuperable. In particular in newly liberalised sectors, entry barriers remain high and above-competitive profits will therefore not automatically attract new entrants. Moreover dominant firms in those sectors often obtained their position not through superior efficiency, but through State intervention. (Lowe, 2003: 9)

Moreover, two additional conditions related to the institutional issues may have to be fulfilled for the antitrust action to be justified. First, there *should not be an effective means for the competition authority to eliminate the entry barriers*. Indeed, when the dominance is due to current legal barriers, it may be more cost-effective for the authority to lobby the government to lift the barriers and liberalise effectively the sector than to open several exploitative abuse cases. As noted by Fingleton (2003), 'Advocacy may be more effective in that a decision by the State to liberalise a sector (and even better to implement liberalisation with enthusiasm) and pro-consumer focus may be a faster remedy to develop competition than a long and expensive court case' (see also Amato and Laudati, 2001).

Second, there should be *no sector-specific regulator*. Indeed, a specific regulator usually has better knowledge of the sector, and usually has the right to intervene with a lower burden of proof. Hence, the regulator should be able to police exploitative abuses much more efficiently than an antitrust authority would. However, the intervention may also be justified if the regulator is

⁵⁴ See Motta (2004: chapter 2) for a thorough discussion of the several reasons why markets in which there is free entry in principle are not necessarily markets where competition works in practice, with dominant positions persisting over time.

112 1 – Policy Objectives, Enforcement Tools and Actors etc.

doing poorly and if the antitrust authority would correct the regulatory failure. This hypothesis is particularly relevant in the diagonal relationship between the European antitrust authority (DG Competition) and the national regulators. In practice, many cases opened by the Commission in the telecoms sector were intended to correct a failure to act on the part of the NRAs. Admittedly, this entails a value judgement on the performance of the regulator and might lead to some institutional conflicts.

Proof of the abuse

Using economic theory we may now screen the Court's cocktail of approaches to proving that a price is excessive.

First, the antitrust authority may show that the price under review is above the production costs of an efficient firm. However, contrary to the predatory pricing cases,⁵⁵ the Court did not go into much detail on the type of cost to be taken into account (marginal cost, long term average cost, total cost, . . .). This uncertainty is regrettable, particularly in oligopolistic or multi-services industries with important common costs where the effective competitive price does not equal the marginal cost and where the allocation of these common costs raise difficult issues. Moreover, the Court did not clarify what level of profit may be acceptable,⁵⁶ that is, by which degree prices should be above costs in order for them to be gauged excessive (in other words, in terms of Figure 1, it is not clear at which level p^* is).

Second, as production costs are not easily observable, particularly for antitrust enforcers who face important asymmetric information, the authority may compare different prices of the investigated firm and show some discrimination (across customers in the same country or across countries). Although this means of proof is relatively straightforward and has been used extensively by the Commission, it raises difficult issues (Varian, 1989). Indeed, it would be tantamount to prohibiting price discrimination across markets (which might be different for reasons of demand, costs and market structure), a prohibition that cannot be justified on efficiency grounds. Economic theory shows that price discrimination may be an efficient way to recoup costs. Disallowing price discrimination might have adverse welfare

⁵⁵ Case 62/86 *Akzo* (1991) (ECR I-3359, paras. 69–74; Case T-83/1991 *Tetra Pak II* [1994] ECR II-755, paras. 144–9; Cases C-359 & 396/96 P *Compagnie Maritime Belge* (2000) (ECR I-1365. A price is deemed to be predatory if it is below the dominant company's average variable costs, or if it is below average total costs and part of an anticompetitive plan. At least so far, the case law has not imposed any requirement according to which it must be shown that the losses sustained through the application of predatory prices will be recouped by the dominant firm.

⁵⁶ In Case 247/86 *Alsatell/Novasam* [1988] ECR 5987, para. 10, the Court of Justice provided some limited and qualified guidance, stating that a price increase of more than 25% might be abusive.

Excessive Pricing and Price Squeeze Under EU Law 113

effects, for instance by discouraging investments and innovations, and by pushing a firm not to serve some markets at all (Motta 2004: 7.4).

Third, the antitrust authority may also compare the investigated price with the prices of other firms offering similar product. The first variant is to look at the price of the competitors of the dominant firm. We are puzzled by a rule considering that a dominant firm's price above competitor prices would be automatically unlawful. This higher price may cover lots of different situations, the majority of them being compatible with a competitive outcome. First, it may indicate that the products are not in the same relevant market, and that the market was thus wrongly defined (and the compared firms are not competitors). Second, it may indicate that the products are part of the same market, but the product of the dominant firm has a superior quality that justified a premium price. Moreover, the very presence of competitors is a strong (albeit not absolute) indication that entry is possible and that the dominant firm's position can be contested. In short, a mere comparison with competitors' prices gives much too little indication to infer anticompetitive behaviour on the part of the dominant firm. Such a comparison should be supplemented by additional elements.

The antitrust authority may also compare the investigated price with the prices of other firms active on relevant markets other than that on which the dominant undertaking operates (whether in the same or in another Member State). Here as well, a simple rule should be avoided and two important elements should be kept in mind. Firstly, it is preferable to ensure that the compared market is a competitive one, as the comparison between two monopolised markets gives very little indication as to the level of the competitive price. Secondly, price discrimination between markets may be justified on efficiency grounds. Hence, a mere difference of price between markets should not be deemed to constitute an exploitative abuse.

To conclude, the proof of an excessive price, or in other words the search for the competitive price, may be like a quest for the Holy Grail. Even if the authorities had perfect knowledge of costs, questions related to the allocation of common cost would arise and involve difficult policy choices. Most of the time, these authorities do not know these costs, and would guess competitive price using other observable but imperfect price indications. However, economic theory teaches us that a mere comparison of price should not suffice to prove an abusive practice. The comparison should always be complemented by a detailed assessment of market characteristics and a thorough economic analysis of the rationale, if any, explaining the divergence in prices.

F. Exclusionary Price

In the previous section, we dealt with the case where the dominant firm whose pricing policy is under investigation sells its product or service to final consumers or firms with which it does not compete (see Figure 6a). Now we are considering a setting where the dominant firm is vertically integrated. Its upstream affiliate produces an input that is used by its downstream affiliate as well as downstream independent firms for the production of a final good. Figure 6b illustrates this situation in the simple example where there is only one downstream rival.

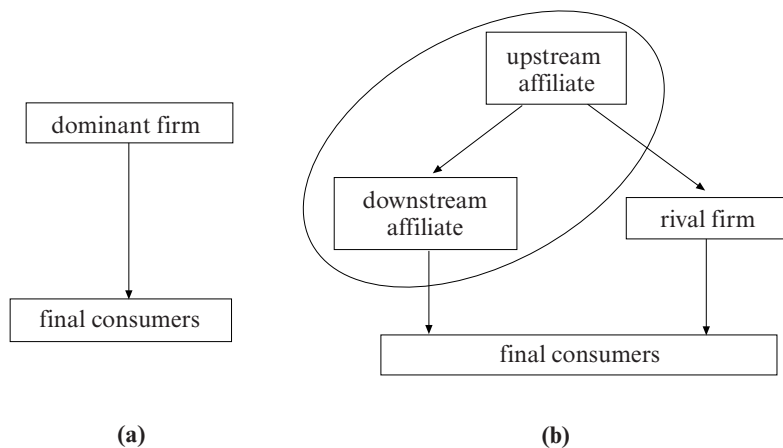


FIG. 6

In this situation, if the dominant firm charges an excessive price for the input sold to the downstream rival, the latter would suffer a competitive disadvantage with respect to the dominant firm's downstream affiliate, and might end up being excluded from the market. This type of excessive pricing, which is generally referred to as a price squeeze, amounts to an exclusionary abuse. It is one of the many foreclosure strategies (like refusal to deal, tying, predatory prices, . . .) that may be used by the investigated firm to create, maintain or strengthen a dominant position on the downstream market.

1. Principles derived from the case law

Although the case law on foreclosure devices is fairly extensive (for an overview, see Bellamy and Child, 2001: 724–56; Whish, 2003: 653–32), there

Excessive Pricing and Price Squeeze Under EU Law 115

is only one decision by the Court of First Instance on the particular strategy of price squeeze.⁵⁷ Moreover, this judgment only slightly touched on the issue when upholding the Commission's rejection of a complaint concerning vertical price squeeze. A much more articulated decision is expected in the forthcoming *Deutsche Telekom* case.⁵⁸

1.1. Dominant position: which firms are subject to antitrust control?

As two markets (upstream and downstream) are involved, it should be determined whether, for antitrust intervention to be justified, the investigated firm would have to be dominant on both markets or only on one of them. The doctrine seems to consider that a 'double dominance' is required (Faull and Nikpay, 1999: 174; Bellamy and Child, 2001: 730). Nevertheless, in *Poudres sphériques* the Court of First Instance held that:

178. (. . .) Price squeezing may be said to take place when an undertaking *which is in a dominant position on the market for an unprocessed product* and itself uses part of its production for the manufacture of a more processed product while at the same time selling off surplus unprocessed product on the market, sets the price at which it sells the unprocessed product at such level that those who purchase it do not have sufficient profit margin on the processing to remain competitive on the market for the processed product (emphasis supplied).

Thus, the court did not require a dominant position on both markets, but only on the upstream market. That makes sense because a price squeeze is a strategy to leverage the upstream market power elsewhere (similarly, see Crocioni and Veljanovski 2003: 39).

In addition, and as in the case of exploitative abuses, due to the general formulation of Article 82 EC, every dominant firm—however its market power has been acquired or maintained—has the 'special responsibility' not to apply abusive exclusionary prices.

1.2. Abuse: what is a price squeeze?

As with every exclusionary practice, in the case of price squeeze a distinction must be made between competitive and anticompetitive margin squeeze. Indeed, Article 82 EC does not prevent a company (even a dominant one) from competing on the merits, and a mere insufficient margin for a competitor to enter should not always be considered abusive. Thus, only a margin

⁵⁷ Case T-5/97 *Poudres sphériques* [2000] ECR II-3755, para 178. Note that the US case law is a bit more extensive, and started with *Alcoa*, cited at note 3.

⁵⁸ Commission Decision of 21 May 2003, *Deutsche Telekom*, OJ L 263 [2003].

116 1 – Policy Objectives, Enforcement Tools and Actors etc.

squeeze that excludes a competitor that is more efficient than the vertically integrated firm would be anticompetitive and should be condemned. More precisely, according to Crocioni and Veljanovski (2003: 30):

an anti-competitive price squeeze arises when a vertically integrated undertaking, with market power in the provision of an ‘essential’ upstream input, prices it and/or its downstream product service, in such way and for a sufficiently long period of time to deny an equally or more efficient downstream rival a sufficient profit to remain in the market.

An anticompetitive margin squeeze may have several causes. It may be due to an excessive price upstream (understood as above) that may or may not be discriminatory.⁵⁹ It may also be due to a downstream predatory price (in the sense of the AKZO case law referred to above).⁶⁰ Thus, in *Poudres sphériques*, the Court of First Instance held that:

179. (. . .) In the absence of abusive prices being charged by the [dominant firm] for the raw material or of predatory pricing for the derived product, the fact that [a new entrant] cannot, seemingly because of its higher production costs, remain competitive in the sale of the derived product cannot justify characterising [the dominant firm’s] pricing policy as abusive.

However, we suggest that this apparently limiting statement was linked to the facts of the case and does not imply that the Court of First Instance considered that price squeeze might not be an abuse independent from excessive or predatory pricing. Indeed in *Continental Can*, the Court of Justice considered that Article 82 covers all types of anticompetitive exclusionary practices.⁶¹

26. The (Article 82) is 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 competition structure, such as is mentioned in (Article 3(g)) of the Treaty. Abuse may therefore occur if an undertaking in a dominant position strengthens such a position in such a way that the degree of dominance reached substantially fetters competition, i.e., that only undertakings remain in the market whose behaviour depends on the dominant one.

⁵⁹ Note however that every anticompetitive margin squeeze that is due to upstream, non-discriminatory excessive prices will necessarily lead to a cross-subsidisation of the retail division by the wholesale division of the vertically integrated undertaking. Indeed, due to the insufficient margin, the retail division is making a loss that is compensated by the excessive profit in the wholesale division.

⁶⁰ Two sorts of predatory prices downstream may be distinguished. The downstream price may be predatory *independently of the level of the upstream price*. In this case, the price does not cover the wholesale and the retail costs. Alternatively, the downstream price may be predatory *only if the level of the upstream price (supposed to exceed costs) is taken into account*. In this case, the downstream price covers the wholesale and the retail costs, but does not cover the upstream price (supposed to be excessive) and the retail costs. If the upstream price is regulated on a cost-orientation basis (as it is often the case in regulated industries), only the first type of predatory downstream price may arise (see Bouckaert and Verboven, 2003).

⁶¹ Case 6/72 *Continental Can* [1973] ECR 215. Similarly, see Case 85/76 *Hoffman-La Roche* [1979] ECR 461, para. 91.

Excessive Pricing and Price Squeeze Under EU Law 117

There are two reasons why a price squeeze may be anticompetitive even though excessive or predatory prices may not be proven. First, the price squeeze may be due in practice to excessive or predatory prices as defined by the EU case law, but the authority may be unable to establish that the prices are excessive or predatory due to a lack of data and may rely instead on the proof of an exclusionary margin. In this case, the proof of a margin squeeze is an indirect way to show other prohibited pricing practices. Second and more importantly, the price squeeze and the elimination of efficient competitors may happen without the presence of excessive or predatory pricing as defined by the EU case law.⁶² In this case, it would be impossible for the authority to show any excessive or predatory price and yet intervention would be appropriate. For both reasons, authorities should be able to condemn margin squeeze independently, but only under very strict conditions. Similarly, Faull and Nikpay (1999: 174) argue that ‘even if neither the upstream nor the downstream price is in itself abusive (ie, excessive or predatory) the combination of the two (the squeeze) is contrary to Article 82’.

So far, there has been no case dealing with how price squeeze may be established independently of other abusive practices. As we suggest below, any standard of proof should: (1) consist of a rigorous comparison between the appropriate upstream and downstream prices; and (2) be complemented by an economic analysis of the possibilities and the incentives to foreclose entry.

2. Practice of the European Commission

In more than forty years of practice, the Commission has adopted only three formal price squeeze decisions, using three different techniques to prove the margin squeeze.

In *National Carbonising*,⁶³ NCB had a virtual monopoly (95% market share) on the wholesale market for coal and, via its subsidiary NSF, a very strong dominance (85% market share) on the retail market for domestic hard coke. NCC, one of the downstream competitors, complained that due to several increases of the wholesale price, the margin between coal and hard coke

⁶² Suppose, for instance, that for the vertically integrated firm, the cost of producing the input (in respect of which the upstream affiliate has a monopoly) is 10, that the cost of producing the final good is 5, and that one unit of input is needed to produce one unit of the final good. Suppose also that the marginal cost of producing the final good is 5 for the rival firm as well. Consider now a situation where the vertically integrated firm sells the input to the rival at a price of 13, and where it also sets the price of the final product at 17. In this case, an excessive price action is unlikely to be successful (as the upstream firm is earning a 30% margin, which is probably not excessive). A predatory pricing action would not be justified either, since the vertically integrated firm is making profits of 2 (its total costs being 15). However, the rival will only be able to sell below cost, as its total costs are 18, which is higher than the final price charged by the vertically integrated firm.

⁶³ Commission Decision of 29 October 1975, *National Carbonising*, OJ L 35 [1976].

118 1 – Policy Objectives, Enforcement Tools and Actors etc.

had become insufficient to allow domestic coke producer to operate economically. In an administrative letter,⁶⁴ the Commission services considered that

An enterprise in a dominant position may have the obligation to arrange its price so as to allow a reasonably efficient manufacturer of derivatives a margin sufficient to enable it to survive in the long term.

Thus, the Commission services considered that the squeeze might be proved by calculating that the margin is insufficient to cover the costs of an efficient new entrant on the retail market. Due to the facts of the case, the Commission services held the preliminary view that no price squeeze had been committed. However, as NCC was questioning this appraisal before the Court⁶⁵ and since there was a risk that NCC would go bankrupt during the Court proceedings, the Commission ordered NCB to decrease the price charged to NCC to allow it to break even during the likely duration of the appeal. Subsequently, the appeal was withdrawn.

In *British Sugar*,⁶⁶ BS held a dominant position on both the market for industrial non-packaged sugar and the market for retail packaged sugar. Moreover, due to the Common Agricultural Policy Sugar Regime, the UK sugar market was not flexible and entry was substantially limited. Napier Brown, one of the competitors just entering the retail market, complained that BS was pursuing several strategies (refusal to supply, undercutting retail prices, discrimination, loyalty rebates) to drive out Napier Brown from the market. On the pricing policy, the Commission found that:

66. A company which is dominant in the market for both a raw material and a corresponding derived product may not maintain a margin between both prices which is insufficient to reflect that dominant company's own costs of transformation with the result that competition in the derived product is restricted.

Thus, the Commission proved the squeeze by calculating that the margin was insufficient to cover the retail costs of the dominant firm. With regard to the facts of the case and in particular the other obvious exclusionary practices adopted by BS, the Commission considered that BS's pricing policy was predatory and imposed a fine of €3 million.

In *Deutsche Telekom*,⁶⁷ DTAG held a nearly monopoly position on the wholesale market for fixed telephone local infrastructure, and a strong dominant position on the retail market for local telephone lines (ie, access to analogue lines, ISDN, ADSL). Moreover, this strong market power resulted from previous monopoly rights. In the context of the telecommunications regulation, the German NRA, the RegTP, controlled each wholesale price individually and the retail tariffs with a price cap on a basket of services.

⁶⁴ Cited in the Commission decision referred to above.

⁶⁵ Case 109/75 R *National Carbonising Company/Commission* (1975) ECR 1193 and (1977) ECR 381.

⁶⁶ Commission Decision of 18 July 1988, *Napier Brown-British Sugar*, OJ L 284 [1988].

⁶⁷ Cited at note 58.

Excessive Pricing and Price Squeeze Under EU Law 119

However, the new entrants on the German telecommunications market were unhappy with this regulation, and complained to the Commission that DTAG was practising margin squeeze such that entry on the retail market had been rendered uneconomic.

In its decision, the Commission held that:

107. (. . .) there is an abusive margin squeeze if the difference between the retail prices charged by the dominant undertaking and the wholesale prices it charges its competitors for comparable services is negative, *or* insufficient to cover the product-specific costs to the dominant operator of providing its own retail services on the downstream market (our italics).

As the wholesale access to the local loop might be used to provide several types of retail access, the Commission compared the wholesale charge of the local loop access with the price of a basket composed of three retail services (namely analogue, ISDN and ADSL connections) weighted according to the consumption pattern of DTAG's customers for the different services. It found a negative margin for several years, and then an insufficient positive margin afterwards. Accordingly, it imposed a fine of €12.6 million.

This case was difficult for at least two reasons. Firstly, different types of access to the local loop may be given at the wholesale level and different services may be offered at the retail level. To address this problem, the Commission chose to compare the price of one type of wholesale access with the price of a weighted basket of retail services. Both choices are subject to criticism, in particular the composition of the basket. Secondly, any condemnation of DTAG's tariffs was an indirect critique of the German regulator's policy. To address this problem, the Commission carefully noted that within the borders of the regulatory obligations (in particular the price cap basket), DTAG enjoyed some discretionary power regarding the prices of each specific service that would have enabled it to alleviate any price squeeze, either by reducing the wholesale charges and/or by increasing the retail subscriber fees.

Again, the three formal decisions discussed above represent only the tip of the iceberg, as several other procedures were opened, particularly in the telecommunications sector.⁶⁸ In 1995, the Commission⁶⁹ issued a Statement of Objection against Belgacom regarding unfair prices related to access to

⁶⁸ Telecom Access Notice, cited in note 40, paras. 117–19. Also relevant are the Guidelines issued by certain national regulators. In the United Kingdom, see OFTEL, *The Application of the Competition Act in the Telecommunications Sector*, January 2000. In the Netherlands, see OPTA/NMa, *Price Squeeze Guidelines*, February 2001. At the European level, see European Regulators Group Common position of April 2004 on the approach to appropriate remedies in the new regulatory framework ERG (03) 30MX1.

⁶⁹ IP/97/292 of 11 April 1997; Case T-111/96 *ITT Promedial/Commission* ECR (1998) II-2937. See also Haag and Klotz (1998). More generally, for the price squeeze action in directory services, see P. Richards (2003).

120 1 – Policy Objectives, Enforcement Tools and Actors etc.

subscribers' data for the publication of telephone directories, which had the effect of excluding competitors on the directory market. After a detailed cost analysis, Belgacom settled the case with the Commission in 1997 and agreed to substantially reduce its tariff (by more than 90% of the original price). In 1996, the Commission⁷⁰ opened a procedure against Deutsche Telekom regarding its new retail business tariffs on the ground that such tariffs discriminated in favour of business customers *vis-à-vis* residential customers, produced price squeezing effects in relation to competitors, and constituted undue bundling of monopolised and competitive services.⁷¹ To close the file, the Commission required the opening of the infrastructure market (thereby enhancing the liberalisation process) and obliged the Federal Minister of Post and Telecommunication (the telecoms regulator at that time) to ensure a fair access price for the DTAG network. As a result, DTAG agreed to reduce substantially its access price (from 38% to 78%).⁷² As already mentioned, in 2002 the Commission opened a case against KPN for setting excessive mobile termination charges which, *inter alia*, gave rise to price squeezing effects. However, no formal decision has yet been adopted.

From the foregoing it can be seen that most of the cases related to firms enjoying a near monopoly position on the wholesale market and an already strong dominance on the retail market. The foreclosure strategies were aimed at reinforcing or maintaining this dominant position on the retail market. In addition, and similarly to exploitative abuses, the cases mainly related to newly liberalised sectors with the goal of ensuring the success of the liberalisation programme and condemning any strategic impediment to market entry. With regard to the means of proof, the Commission considers that price squeeze may be condemned as such, without having to show an excessive or predatory price. Indeed, it has relied on three tests, depending on whether the margin is: negative; positive but unprofitable for the dominant vertically integrated firm; or positive but unprofitable for an efficient operator. Unfortunately, the assessment is often only complemented by an overly superficial analysis of the possibilities and incentives for the dominant firm to foreclose entry with a price squeeze.

⁷⁰ IP/96/543 of 25 July 1996; IP/96/975 of 31 October 1996; Haag and Klotz (1998: 37).

⁷¹ In particular, the Commission determined that the wholesale access price was excessive as it exceeded the prices found on comparable competitive markets by more than 100%.

⁷² Moreover, in 1997, the Commission opened another case against Deutsche Telekom regarding excessive prices for carrier pre-selection and number portability, which had the effects of increasing end users' switching costs, thereby rendering entry less attractive. The case was pursued further by the German NRA, and the fees were reduced considerably by DT (by almost 50%). See IP/98/430 of 13 May 1998.

G. Policy recommendations

Economic Incentives to Foreclose

Although the logic of the argument according to which a vertically integrated firm will set the input price so high as to disadvantage and even exclude downstream competitors might seem compelling at first sight, economics teaches us that such a firm will not necessarily have an incentive to exclude rivals.

Indeed, the influential Chicago School argued that anticompetitive exclusion was not rational, and that every exclusion would therefore be based on efficiency grounds. The Chicago School economists argued that when a firm enjoys substantial market power, there is only one monopoly rent to be gained and that there is usually no need to use vertical integration and foreclosure strategies to reap this rent. This claim was based on a model in which an upstream monopolist sells to perfectly competitive firms. In such circumstances, the upstream monopolist is able to extract all the profits from the market (since there is no problem of double marginalisation). Hence, a vertically integrated firm would not gain anything from discriminating against or excluding downstream rivals.

It is only recently that economists have rigorously shown that under certain circumstances a vertically integrated firm does have an incentive to exclude rivals, resulting in anticompetitive outcomes. A full account of the different situations where foreclosure arises is beyond the scope of this paper, but such situations include the use of different instruments. For instance, refusal to supply (which is just the extreme case of an excessive price for an input, and therefore equivalent to it) can allow a firm enjoying an upstream monopoly to solve commitment problems that would otherwise erode its profits (Rey and Tirole, 2003). Tying two goods together⁷³ might in some circumstances allow a firm to exclude rivals (Whinston, 1990), although one should expect that this operation is more likely to be profitable when the goods are independent than when they are vertically related, i.e., complementary. In network industries, a dominant firm might have the incentive to make it difficult for rival firms to interoperate with its own products⁷⁴ (Katz and Shapiro, 1985).⁷⁵

⁷³ Note that when a vertically integrated firm is the monopolistic producer of a necessary input, committing to tying implies selling only the final good, thus denying the input to downstream rivals. Therefore, tying is similar to a refusal to supply (and excessive pricing of) the input.

⁷⁴ Making it very costly (or impossible) for rivals to interoperate with an input is similar to charging a very high price for (or refusing to supply) it.

⁷⁵ For a comprehensive analysis of various foreclosure practices, see Motta, 2004 (Chapters 6 and 7).

122 1 – Policy Objectives, Enforcement Tools and Actors etc.

More generally, recent economic models allow us to analyse situations where there are several downstream and/or several upstream firms, and enable us to show that in certain cases a vertically integrated firm *might* create foreclosure (and that such foreclosure is welfare-detrimental).

These analyses show that the vertically integrated firm would seek to continue to supply the independent downstream firms in several instances. First, ceasing to supply (or setting an excessive price of the input) downstream rivals would not be profitable when the latter serve an at least partially different market than the integrated downstream firm. Second, even if the upstream integrated firm ceases to supply (or sells at higher prices to) the downstream rival firms, the cost of the input for the latter will not increase if: (i) there are other upstream firms which are ready to increase their supply of the input; and (ii) the lower demand for the input (caused by the withdrawal from the market of the downstream affiliate of the integrated firm) will tend to reduce input prices. Therefore, foreclosure (in the sense of an increase in the prices of the input available to independent firms) will occur only if there are no other upstream producers that sell close enough substitute inputs (or if the capacity of such upstream producers is constrained).

Therefore, it is appropriate to keep in mind that a number of conditions must hold for a vertically integrated firm to engage in anticompetitive foreclosure. In particular, theory suggests that one should expect this to arise only in those cases where the vertically integrated firm enjoys a monopoly (or a near monopoly) of an input for which there is no good substitute.

Antitrust control of price squeeze is justified only in specific cases of dominant position

Similarly to what we did for exploitative excessive prices, we may now propose some conditions for opening a price squeeze case. Although there is very little economic literature on this topic (a welcome exception is Choné, 2002), as price squeezing is one of the many different foreclosure strategies, the principles developed above apply.

Hence, the first condition is static and relies on the presence of high and non-transitory barriers to entry. In other words, the investigated firm enjoys a monopoly or quasi-monopoly at one stage of the production.

However, this condition may not be restrictive enough, as the same conflict between static and dynamic objectives underlined above apply equally here. Indeed, condemning a monopolist that tries to reap its rent through exclusionary behaviour may have negative effects on investment incentives. Condemning a firm for excessive pricing of inputs, and obliging it to reduce that price, is similar in its effects to obliging the owner of infrastructure to grant rivals access to it. Both types of actions impinge upon the property

Excessive Pricing and Price Squeeze Under EU Law 123

rights of the owner of the asset, and likely to trigger a fall in its profits. In turn, and to the extent that the monopoly over the input is the fruit of investments, this reduces the remuneration from the investments made in the past, and has the additional effect of discouraging further investments by this and other firms (as other firms will observe the action taken against the input monopolist and will expect similar actions in case it too has monopoly over an input which turns out to be ‘essential’).

Should we then conclude that a second condition related to the way monopoly has been acquired should be added, and that price squeeze action should be limited to cases where monopoly is due to current or past legal entry barriers? Although in general the numerous drawbacks of antitrust actions against exploitative prices clearly tilt the balance in favour of very strict conditions to intervene, this is relatively less the case for exclusionary prices. Thus, we would advise the authority to take into account the effects of its intervention on investment incentives, but would not go as far as requiring that monopoly resulted from current or previous legal monopoly to justify intervention. In other words, if the monopoly was not the result of investment in a (*ex ante*) competitive market, but rather the inheritance from the past of a legal monopoly, then the case for an excessive pricing action (or compulsory access or licensing) would be much stronger, as this would not be a situation where the antitrust authorities would deprive the firm of the fruit of its investments. Finally, the two additional institutional conditions related to the efficient means for the antitrust authority to remove the legal entry barriers and the presence of an efficient sectoral regulator would equally apply.

3. Proof of the price squeeze

To prove a price squeeze, an antitrust authority may show that the upstream price is excessive, or that the downstream price is predatory, as understood above.

The authority may also show that there is an insufficient margin between wholesale and retail prices to cover the retail costs of a firm that is at least as efficient as the dominant firm. This comparison may be complex, in particular in multi-services industries where fixed costs have to be allocated to different services and where a dominant firm may benefit from important economies of scope (Crocioni and Veljanovski, 2003; Grout, 2001). As a general rule, the antitrust authority should avoid a test which is too lax and which would favour entry of a less efficient firm than the dominant one. In addition, the margin calculation should always be complemented by a rigorous analysis of the ability and incentive of the dominant firm to foreclose entry with a price squeezing strategy. This additional economic analysis is

124 1 – Policy Objectives, Enforcement Tools and Actors etc.

indispensable, as it is always very difficult to distinguish between competitive and anticompetitive margin squeeze, and since there is therefore a high risk of false condemnation (type I errors). Thus, the authority should show why the monopolist has to reap or protect its monopoly rent by excluding its rivals.

Without such a strict burden of proof, we may end up with multiple, unjustified price squeeze actions, as was the case in the US electricity sector in the Seventies. As noted by Joskow (1985: 174), ‘the great quantity of litigation motivated by concern about price squeezes in particular, and retail market competition in general, has had no positive efficiency consequences; it is at best a waste of time and litigation expense and at worst a source of inefficiency’.

H. Conclusion

Fifteen years ago, Fox (1986: 992) noted that, ‘the Common Market law on excessive pricing has profound implications. It assumes that high pricing is unfair, it assumes that unfairly high pricing can be identified by courts, and it implies that courts are better mechanisms than markets to correct unfairly high pricing’. Indeed, the EC Treaty gives competition authorities very broad powers to intervene against excessive prices (whether exploitative or exclusionary), that may embody a form of price regulation that the authors of the Treaty may not have excluded at the time. However, this regulatory conception is not in line with the insights of current legal and economic thinking. It is nowadays generally accepted that antitrust authorities should not aim to directly regulate firms’ prices, access and output, but instead should focus on preserving structures and conditions whereby market forces constrain price and increase output (see Hawk, 1988: 81). Obviously, the Commission and the Courts can not change the Treaty, and the types of practices that are expressly mentioned therein must at least in certain circumstances be regarded as abusive. Therefore, we suggest that the Commission uses its power with great restraint and that the Courts set a high standard of proof.

With regard to *exploitative excessive prices*, we suggest that the Commission should only intervene in cases of very strong dominance (confined to a monopoly or near monopoly) that are caused by past or current legal entry barriers, whenever market forces alone are unlikely to lead to a competitive result. With regard to *exclusionary excessive prices* (in particular, price squeeze), we suggest that the Commission should intervene only in cases of very strong dominance (confined to a monopoly or near monopoly), and that it should focus (but not necessarily limit) its activities on monopolies that are due to past or current legal entry barriers. Moreover, the means of

Excessive Pricing and Price Squeeze Under EU Law 125

proof should be elaborated and predicated on a thorough analysis of the market characteristics and the economic incentives of the undertakings.

Thus, excessive price actions should mainly be concentrated on monopolised sectors, or recently liberalised ones (such as telecoms, post, railways, . . .). In other words, competition law applied to some sectors may be different (and more interventionist) than in others (see Larouche, 2000). Similarly, Hancher and Buendia Sierra (1998: 943) have proposed a less strict test—more easily met by the authority—for predatory prices in some sectors and noted that ‘competition rules cannot be applied in newly liberalised markets in exactly the same way as they have been applied in “normal” sectors because the market structures and the risks for competition are substantially different’. At a more general level, we suggest that the mere dominance concept as interpreted by the Court in *United Brands* is too generic to lead to appropriate public policy towards firms with market power. In fact, intervention against specific behaviour should depend on the level and the cause of market power, or in other words, dominance should be differentiated according to the abuse to be condemned.⁷⁶

⁷⁶ Readers can find a similar argument, i.e., that antitrust intervention should be linked not only to the existence of a dominant position, but also to the source of such a position, in Motta (2004: 2.5.2 and 2.5.3), as well as Vickers (2003, written contribution for this volume).

