Introduction

1. The Business and Advisory Committee (BIAC) to the OECD appreciates the opportunity to submit these comments to the OECD Competition Committee Working Party 2 on Competition and Regulation for its Roundtable on Excessive Prices.

2. The subject of this Roundtable is both urgent and topical. First, the treatment of excessive prices differs significantly among jurisdictions, particularly the EC and the US, where no comparable cause of action against “excessive prices” exists. ¹ Second, the treatment of pricing policies of both dominant and non-dominant firms under competition law is particularly sensitive as it may have a direct and profound effect on the economic

¹ BIAC notes that apart from the EU and EU member states, countries whose competition agencies have power to prohibit excessive prices by dominant firms include Argentina, Brazil, China India, Russia and Turkey.
incentives of firms and, as a consequence, on consumer benefits. Third, as practice in several jurisdictions demonstrates, the assessment of pricing policies faces numerous conceptual as well as practical difficulties. Against this backdrop, BIAC is highly supportive of initiatives that seek to unveil the underpinnings of national regimes of antitrust law in the field of excessive prices, to discuss the pros and cons of “excessive” prices and antitrust enforcement policy in this field, to discuss the relationship with ex-ante price regulation and to define the circumstances, if any, that may lend themselves for intervention by antitrust enforcement agencies. The OECD Competition Committee can play a very valuable role in this regard.

The Pros and Cons of Excessive Prices

3. The argument in favour of the application of competition law to excessive pricing is straightforward. Markets are most efficient when prices are set at the “competitive” level, optimising consumer welfare and allocative efficiency. When prices are set at higher levels, consumers are made worse off and overall welfare is reduced. Conversely, at prices lower than the competitive level, firms fail to receive an appropriate return on their investments, which results in inefficient entry and/or insufficient entry. This implies that a policy that could identify and punish deviations from the competitive benchmark without error would increase consumer welfare unambiguously.

4. However, there are also several important objections against the application of competition law to excessive pricing. Indeed, in practice it is virtually impossible to determine with any acceptable degree of certainty what the “competitive” market price is, and whether market prices are above or below that level. Therefore the risks of both Type I and Type II errors in this field are significant. In this respect, BIAC is most concerned about situations where market prices are deemed excessive while in reality they are competitive: as a result of intervention by antitrust agencies in those instances, profits of firms risk to be artificially capped, which diminishes the incentives to invest and innovate. This will eventually harm consumers: this harm consists in the foregone

\[ \text{Ex ante is defined as meaning the prescription of prices in advance, as opposed to review and possible adjustment of pricing after the prices take effect.} \]

\[ \text{See for instance Katz and Rosen, Microeconomics, (1998).} \]

\[ \text{This implication is based on a static, single-incident analysis model that disregards innovation incentives.} \]

\[ \text{The difficulty of determining whether a price is excessive may be a factor in itself that contributes to unclear criteria for the standard of proof and therefore legal uncertainty. This legal certainty may in turn discourage investments.} \]
investment and introduction of valuable new products that would have been made had
the agency not intervened. BIAC notes that excessive price actions may undermine both
the investment incentives of incumbent firms and new entrants as (high) prices may no
longer signal to potential entrants that the market is profitable.6

5. It has been argued that the cost of Type I (over-enforcement) errors is likely to be large
in dynamic industries, such as the software and pharmaceutical sectors, where firms
tend to compete for the market, in emerging industries such as the biotechnology sector,
where firms are contemplating whether to start up, and in those mature industries (e.g.,
telecom) where, due to technological change, firms have an opportunity to upgrade their
services. More generally, the cost of this type of enforcement error is large in fields
where trial and error is common, but the return to succes potentially high.7 Antitrust
policy focusing exclusively on keeping down prices can also reduce product quality and
services.8 BIAC concurs with these positions.

6. BIAC does note however that different views exist on the relationship between static and
dynamic effects. For instance, Brennan takes the position that it would not be correct to
allow firms to exploit market power in the short run to stimulate innovation. The reason
would be that it is, at minimum, uncertain whether innovation requires monopoly or
otherwise supra-competitive profits; in his view, too little is known about the relationship
between market power and innovation, hence there is no reason not to intervene in
cases where prices would be “exploitative.”9 BIAC respectfully takes the opposite
position: as many of the markets referred to above in point 5 demonstrate there are
prima facie sufficient reasons to believe that in specific cases investment by dominant
firms does fuel innovation. And it is precisely because one cannot discard the
possibility that high returns are important for innovation that competition agencies should
be reluctant to intervene against “excessive”prices.10 But the second reason why BIAC
believes that agencies should only exceptionally, if at all, intervene against “excessive”
prices, is that it is extremely complicated - and in many cases impossible - to optimise

6 Pursuing an excessive pricing policy in the event barriers to entry are relatively low may prevent market
entry and in the longer run deprive consumers of variety because the signalling function of pricing is lost.
In the case of high barriers to entry, pursuing such a policy may facilitate cartelisation.

7 See for instance Evans and Padilla, Excessive Prices: Using Economics to Define Administrable Legal

8 See Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007), where the lifting of the
ban of resale price maintenance was motivated by economic models showing that maintaining high retail
prices may incentivise dealers to provide promotional services and invest in product reputation.

9 See Brennan, Should Innovation Rationalize Supra-Competitive Prices? A Skeptical Speculation, in:
The Pros and Cons of High Prices, Swedish Competition Authority (2007).

10 See for example Motta, Competition Policy, Theory and Practice (2004), pp 56-57.
(static) efficiency in the first place. As a result, in BIAC's view, there is a significant risk that the intervening agency does not only not “restore” the competitive price, but in addition, creates disincentives for firms to invest in innovative products and services.

7. While BIAC is generally skeptical of general, ex-ante regulation of prices through sector legislation that is enforced by special regulatory agencies, it believes that in specific cases ex-ante price regulation, while still objectionable, may have certain advantages relative to ex-post price control by competition agencies. In particular, (i) ex-ante price regulation may impose specific (separate) accounting and financial reporting obligations that allow the regulator to gain a deeper insight in pricing and costs than a competition agency would normally have, (ii) special regulators enforcing the regulation may generally have a deeper insight in the sector at hand and (iii) may be able to take other policy priorities into account, (iv) sector regulation may be preferable in markets characterised by special types of market failures to address potential “excessive” pricing problems before they actually arise and (v) ex ante regulation may be more conducive to legal certainty and a stable, predictable investment climate.

Excessive Prices and Competition Law

8. There are wide divergences between the treatment under competition law of “excessive” prices from jurisdiction to jurisdiction. In particular, in the EU, under Article 101(a) TFEU, a firm abuses its dominant position if it “directly or indirectly” imposes “unfair purchase or selling prices or other unfair trading conditions.” Importantly, similar prohibitions are included in the competition laws of the UK, the Netherlands and other EU member states, as well as many other jurisdictions. Nowadays, many of the (relatively recent) competition law regimes of developing countries provide for a prohibition of exploitative abuses in the shape of “excessive” prices. In contrast, there is no comparable cause of action against “excessive” prices in the US. It is a fundamental tenet of US antitrust jurisprudence that “the successful competitor, having been urged to compete, must not be turned on when he wins.” Indeed, the view that the ability, if lawfully obtained, to charge whatever the market will bear is an important and beneficial part of the competitive market process. Moreover, a violation of U.S. law requires the presence of more than monopoly power and the ability to charge excessive prices:

11 There may also be significant differences among jurisdictions with respect to the enactment of ex-ante price control regulation.

12 U.S. v. Aluminum Corp. of America, 148 F.2d 416, 430 (1945) (L. Hand, J.)
The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts “business acumen” in the first place; it induces risk taking that produces innovation and economic growth.\textsuperscript{13}

Exclusionary conduct is a requirement of a monopolization offense in the U.S. and excessive pricing, arguably, is the antithesis of exclusionary conduct because it creates both incentive and opportunity for rivals to innovate and enter the market in question.

9. BIAC believes it is important to take account of the different historical background and motives for enacting (or not enacting) competition law provisions on excessive prices, as well as the varying objectives of competition law regimes and the actual enforcement record over the last few years. For instance, one can argue that at least part of the (early) enforcement history in the area of excessive prices in Europe is influenced by the Treaty establishing the European Coal and Steel Community, which preceded the EC Treaty and which had established a strict control of excessive pricing, as well as the EC Commission’s wish to intervene particularly in cases that threatened the establishment of the common European market.\textsuperscript{14} Countries characterised by economies in transition, smaller (isolated) economies, or economies with many formerly state owned monopolies sometimes argue that the specific nature of their economy necessitates intervention against excessive prices and that the risk of Type I errors is relatively small. These are often closely related to decisions that markets themselves must be regulated in order to operate efficiently. Indeed, there is literature suggesting that certain so-called “natural monopolies” require regulatory control. The history of market regulation has revealed, however, that the scope and magnitude of natural monopolies was often over-stated and the increase of internationalization of commerce undermined many of those national “natural monopolies” that remained. Thus, the underlying tenet that lead initially to the use of price regulation is greatly diminished. For that reason, particularly in the US, there has been an evolution away from regulatory price controls and toward the proposition that excessive prices are self-correcting.\textsuperscript{15}


\textsuperscript{14} Obviously, it would then be logical to ask whether the historical reasons would still apply.

\textsuperscript{15} See for instance Verizon Communications inc. v. Trinko 540 U.S. 398 (2004) (\textit{the mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system}).
General Observations on the Treatment of Excessive Prices under EC Law

10. Article 102 (a) of the TFEU provides that a dominant firm may “abuse” its position by charging unfair prices. However, the concept of “unfair pricing” is not well-developed and there remains a large degree of ambiguity regarding the question when a price is "excessive" and therefore “unfair.” The leading case under EC law is United Brands, a case that heavily relied on the dominant firm’s differential pricing across various European countries, and where the Court held that a price is unfair if it bears no relationship with the “economic value” of the product.\(^{16}\) According to United Brands judgment, this can be determined in two ways: (i) either the price-cost margin is excessive, or (ii) the price imposed is either unfair in itself or in relation to competing products.\(^{17}\)

While there have only been few cases under European law dealing with excessive pricing, these precedents make clear that the application of the United Brands test is tainted with a number of difficulties.\(^{18}\) First, the concept of “economic value” itself is undefined and may or may not be held to include various types of costs. This creates particular difficulties when firms are tempted to charge high prices to cover initial investments which, for instance relate to (basic) research and development or fixed installations. Second, while the United Brands judgment mandates an inquiry into the question whether the prices charged are “unfair” in relation to “competing products”, it is silent on how that inquiry should be conducted. In particular, while price-costs comparisons have been performed in several cases, issues are likely to arise in connection with the choice of the appropriate cost measure, the definition of a reasonable profit margin, the comparison with multi-product firms and the provisions of incentives for cost reductions.\(^{19}\) Similarly, comparisons across competitors, between prices charged in different member states, as well as comparisons of prices over time may give rise to methodological issues.\(^{20}\)

11. The lack of clear guidance by the Community Courts and the difficulties involved in devising an effective test that provides sufficient ex ante legal certainty, is relatively simple to implement and does not deter dominant firms from desirable innovative activities have certainly played a role in the EC Commission’s decision to not include

\(^{16}\) Case 27/76, United Brands Company v Commission (1978) ECR 250.

\(^{17}\) Id, paras 250-252.


\(^{20}\) Id, p. 616-620.
excessive pricing in its 2008 Guidance on its enforcement priorities in applying Article 102 (EC) to abusive exclusionary conduct by dominant undertakings.\textsuperscript{21} As a result, under EC Competition law, no effective general policy guidelines exist with respect to this field of the law. Further, the Commission has historically been reluctant to pursue cases that allege “excessive pricing” given the challenges in resolving such allegations, which are greatly magnified in cases involving intangibles such as IPR. In this respect, two influential Commission officials have recently confirmed the EC Commission’s position on excessive pricing:

\textit{It can be argued that absent exclusionary behavior, monopolistic rents should be of no concern to antitrust regulators or courts. Indeed the Commission and the Courts have explicitly stated that it is legal to hold a dominant or monopoly position. A profit maximizing firm in such position can be expected to charge higher than competitive prices. It would appear inconsistent to allow substantial market power but to prohibit its exercise. Not surprisingly, the Commission has been cautious in bringing excessive pricing cases.}\textsuperscript{22}

12. Recently, however, the EC Commission has published new guidelines on the application of Article 101 TFEU to horizontal cooperation (the “Horizontal Guidelines”).\textsuperscript{23} The new guidelines contain a specific section on standardization and address standards that contain technology protected by intellectual property rights. The Commission believed such guidance would be useful partly in view of the theories about “patent hold-up” that have been the subject of recent debate. Importantly, the guidelines emphasize the generally pro-competitive nature of standardization and of the use of IPR in standards. The guidelines also emphasize the availability of contract remedies to address refusals of owners of essential patents, should these occur, to comply with their FRAND commitments.

13. Thus, despite the cautious approach avocated with regard to excessive prices, the Commission concluded in the Horizontal Guidelines that it has the authority to determine whether the prices charged for the use of intellectual property rights in the


\textsuperscript{22} Damien Neven and Miguel de la Mano, \textit{Economics at DG Competition, 2009–2010}, Rev. Ind. Organ, Nov 2010 at 4.1

In the context of standardized products, is “reasonable” under FRAND provisions.24 In particular, the Guidelines stipulate that:

In case of a dispute, the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR [citation omitted]. In general, there are various methods available to make this assessment. In principle, cost-based methods are not well adapted to this context because of the difficulty in assessing the costs attributable to the development of a particular patent or groups of patents. Instead, it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (ex ante) with those charged after the industry has been locked in (ex post). This assumes that the comparison can be made in a consistent and reliable manner [citation omitted].

Another method could be to obtain an independent expert assessment of the objective centrality and essentiality to the standard at issue of the relevant IPR portfolio. In an appropriate case, it may also be possible to refer to ex ante disclosures of licensing terms in the context of a specific standard-setting process. This also assumes that the comparison can be made in a consistent and reliable manner. The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates. These guidelines do not seek to provide an exhaustive list of appropriate methods to assess whether the royalty fees are excessive.

14. In light of the foregoing, BIAC is concerned that the difficulties in establishing “reasonable” prices and the resulting potential chilling effects that can be traced back to the 1976 United Brands judgment are revived and imported into the domain of IPRs, with potentially greater harm given the intangible nature of IPRs and the significant risks that investment in the underlying R&D entails.25 BIAC shares the criticism and concern that this trend has triggered and notes that it is inconsistent that the Commission has been most cautious in expounding an excessive pricing policy in traditional sectors, yet has

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25 The EC Microsoft proceedings also demonstrate the administrability problems associated with the intervention in intellectual property-related cases.
sought to do so in a most sensitive area; one characterised by dynamic markets and covered by intellectual property rights intended to incentivise innovation.  

General Observations on the Different Tests to Prove Excessive Prices

15. The United Brands case illustrates the difficulties involved in establishing the existence of an “excessive” price and methodologies that may be used. BIAC submits that each of these methodologies presents several difficulties. For example, methodologies based on a comparison between production costs and prices necessarily involve an arbitrary view on whether profit margins are “reasonable”. Moreover, the definition, identification and quantification of costs and the proper assessment of risks are often extremely complex, particularly in the case of multi-product firms.

Indeed, there is a real danger that the absence of objective and predictable methodologies for use by agencies in price setting can result in arbitrary considerations other than long-term consumer welfare and allocative efficiency coming into play.

16. Similarly, methodologies based on a comparison between the prices charged by the dominant firm and those charged by other firms in other markets may fail to take account of the fact that markets may operate under very different conditions of costs and demands. Comparisons between firms in the same relevant product and geographical market may overlook the fact that the dominant firm’s products are merely perceived as superior and may therefore command a higher price. This latter type of comparison seems particularly difficult in differentiated product markets.

Remedies

17. While the proper test for establishing excessive prices is in unclear and the proposed methodologies each give rise to a number of problems, intervention by competition agencies in the field of excessive prices gives rise to yet another complication: once it has been established that a given price is abusive, the question arises which remedy should be imposed to resolve the competitive problem. This remedy is likely to be of a behavioural nature. However, these remedies are akin to price regulation, in which case the question can be raised whether competition agencies have the required skills to

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impose that remedy and whether the conduct at hand should not be better regulated by way of general (price) regulation as briefly discussed in paragraph 7 above.

The Case for Antitrust Intervention in Excessive Pricing Cases

18. In light of the above, BIAC submits that competition agencies should be particularly reluctant to intervene in cases of alleged excessive prices. Indeed, intervention in these cases tends to undermine the self-correcting nature of markets, is likely to distort firms' incentives to invest and is fraught with practical difficulties.

19. BIAC believes that intervention may be justified, if at all, only in truly exceptional, narrowly defined cases. First, at a very minimum, the market at hand should be characterised by exceedingly high and non-transitory barriers to entry which protects the dominant company from competition by new entrants. Second, the incumbent company should have a dominant position that it derived from past exclusive or special rights. This second condition is intended to minimise intervention and the accompanying risks of overenforcement in cases where the dominant position is the result of the firm’s own merits. Thirdly, the conduct must not otherwise be subject to specific, sectoral regulation; the role of general competition agencies should be limited if there is a sectoral regulator with adequate power to address the perceived competitive problem. Finally, intervention against excessive pricing should not occur in the field of intellectual property rights. Allowing excessive pricing action would undermine the very object of those intellectual property rights and the incentive schemes created by these laws.