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Excessive prices

Excessive Prices: An overview of EU and national case law

UNILATERAL PRACTICES, ABUSE OF DOMINANCE, EXCESSIVE PRICES, PRICES, ALL BUSINESS SECTORS, FOREWORD, UNFAIR COMPETITION, EFFECT ON COMPETITION

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e-Competitions Special Issue Excessive prices

One fundamental difference between the European and American approaches to unilateral conduct relates to the treatment of exploitative conduct, including *excessive* prices. While the mere charging of monopoly prices is not unlawful under US antitrust law, which recognizes high prices as an important element of the free-market system that rewards innovation, [*1*] exploitative practices by a dominant company are in principle considered abusive under EU law, even if the exploitative conduct is not accompanied by other anticompetitive practices. Notably, article 102 TFEU explicitly considers that an abuse of dominant position may in particular consist in "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions".*

The classic European case on excessive prices is of course United Brands, which established the standard test used by the Commission and European competition authorities when investigating excessive prices. The United Brands test has two limbs, consisting in determining i) "*whether the difference between the costs actually incurred and the price actually charged is excessive*" and ii) "*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*". [*2*]

From the outset, it is important to recall that in United Brands, the Court annulled the Commission's finding of excessive prices, on the ground that the Commission had not analysed United Brands' costs to determine whether prices where excessive. Instead, the Commission had relied on the observation that prices in Germany, Denmark, The Netherlands, Belgium and Luxembourg were significantly higher than in Ireland. However, the Commission's reliance on the Irish price as a benchmark, without assessing the profitability of Irish prices and United Brands' cost structure, was found to be misguided by the Court. This made sense from an economic standpoint since, in addition to the obvious possibility of different variable costs across countries, it is entirely rational for a profit-maximizing company to recover its fixed costs from its least price-sensitive customers, which would justify higher prices in richer countries.

The United Brands test has often been misunderstood, largely because the test itself, while clearly pointing out why the Commission's evidence in United Brands was insufficient to establish an abuse, leaves many unanswered questions on how to positively establish an excessive pricing abuse. Indeed, United Brands provides one relevant question for determining whether prices are excessive (i.e. is the price excessive in relation to cost, and if so can it be objectively justified?), but does not provide sufficient conditions for establishing an abuse. Indeed, intervention for excessive prices, even if the United Brands test is passed, would arguably require very specific market conditions to be justified. United Brands thus left many ambiguities as to what may constitute an excessive price under EU competition law.

Following United Brands, the European Commission and national competition authorities have not actively been pursuing exploitative cases. The rare exceptions appeared to concern cases when there is another form of abuse (typically exclusionary) combined with the exploitative conduct, [*3*], [*4*] and regulated industries. As explained by Advocate General Wahl, *"[...] in its practice, the Commission has been extremely reluctant to make use of that provision against (allegedly) high prices practiced by dominant undertakings. Rightly so, in my view. In particular, there is simply no need to apply that provision in a free and competitive market: with no barriers to entry, high prices should normally attract new entrants. The market would accordingly self-correct. It may however be different in markets with legal barriers to entry or expansion and, in particular, in those in which there is a legal monopoly. Indeed, there may be markets which, because of their particular features, are not run efficiently when open to competition."* [*5*]

The limited intervention by the Commission and European competition authorities on the basis of excessive prices is economically justified. Indeed, there is generally little reason, from a welfare point of view, for a competition authority to pursue excessive pricing cases. While from an ex-post perspective, enjoining a dominant company to reduce its prices may appear to benefit consumers, from an ex-ante perspective it is dubious that such intervention would generally be beneficial. Indeed, high prices are necessary to reward investment, and act as a signal to attract further investment and entry. Limiting dominant firms' ability to extract the market power that they have lawfully obtained through their past investment, risk taking and business acumen would thus stifle investment and innovation, which would be economically inefficient.

As part of the modernization of European competition enforcement, the Commission rightly decided to focus its enforcement priorities on exclusionary rather than exploitative practices, [*6*] and an interesting debate took place among economists and policymakers to determine under what specific circumstances excessive price cases could be justified. The consensus achieved at the time among economists is clearly spelled out in Motta and de Streel, [*7*] who explain that intervention would require the following conditions to be met. First, the market must be characterised by high and non-transitory barriers to entry leading to a super dominant position. Second, the super-dominant position must be due to current/past exclusive/special rights or to un-condemned past exclusionary anticompetitive practices. Third, no sector-specific regulator has jurisdiction to solve the matter.

The cumulative nature of these three conditions is essential: high barriers to entry and the unlikely prospect of market self-correction are a necessary but not sufficient condition to justify intervention. The restriction to cases where dominance was not obtained on the merits (legal monopoly or past exclusionary behaviour) is also necessary to ensure that excessive pricing cases do not reduce the incentives to invest and innovate, and so is the absence of (a more efficient) regulatory solution. Except if these specific conditions are met, it is thus not socially optimal from an economic point of view for a competition authority to intervene in order to curb what may otherwise be seen as excessive prices. [*8*]

While these conditions reflect an economic rather than a legal consensus, the lack of any enforcement focus by the Commission and European competition authorities in the area of excessive prices, could be read as a signal that such a view of very cautious intervention - in particular outside of regulated industries and in the absence of other abusive conduct - has generally been validated by European competition enforcers.

The relative European stand-still on pursuing excessive pricing cases now seems to have been called into question. Both national competition authorities and the European Commission have recently shown a renewed interest in pursuing excessive pricing cases, in particular in the pharmaceutical sector. [*9*] The European Commission's launch of an investigation into the pricing of five cancer drugs by Aspen pharmaceuticals is the most recent case in this area. [*10*] But there are also a number of prominent recent or on-going national cases. In particular, the UK Competition and Markets Authority (CMA) has fined Pfizer and Flynn Pharma a total of £89.4 million for excessive pricing of anti-epilepsy drug phenytoin sodium. [*11*] The CMA also has a pending investigation against Actavis on the pricing of hydrocortisone tablets, [*12*] while the Italian Competition Authority has already fined Aspen for excessive prices. [*13*]

In the Pfizer/Flynn Pharma case in particular, the CMA applied the first limb of the United Brands test by comparing Pfizer' and Flynn Pharma's return on sale for phenytoin sodium to a return on sales threshold of 6%, considering that returns above this number would constitute an excess. In determining the excess, the CMA did not consider any benchmark comparison, but simply observed that the return on sales for phenytoin sodium was above the 6% return on sales threshold, and decided that this excess was not justified under the second limb of the United Brands test.

In my view, [*14*] what the CMA should have done to properly apply the United Brands test, would have been to compare the return on sales for phenytoin sodium to the return on sales for similar drugs, using a variety of possible benchmarks. Rejecting any possible benchmark comparison with other products, and determining excessiveness on the basis of an arbitrary return on sales threshold of 6%, as the CMA did, does not seem appropriate. The CMA decision was appealed by both Pfizer and Flynn Pharma, and the decision of the UK Competition Appeal Tribunal on this case is currently pending. [*15*]

An important, and unrelated, development on excessive prices also took place at the European level, as several questions on how to assess excessive prices have recently been addressed by the European Court of Justice in a preliminary ruling. [*16*] The questions were raised in the context of the appeal of a fine that had been imposed on the Latvian collecting society "AKKA/LAA" by the Latvian Competition Council, which had found that the collecting society had applied excessively high rates. In particular, the Latvian Competition Council had found that the rates in Latvia were appreciably higher than in neighbouring countries, and were between 50% and 100% higher than the average rates in the European Union (adjusting for purchasing power parity).

The request for the preliminary ruling included questions (among others) on whether comparisons with neighbouring States as well as comparisons with other Member States can constitute valid benchmarks for determining excessive prices, and queried above what threshold the difference is to be regarded as appreciable and hence indicative of an abuse of dominant position.

Remarkably, the Court had the benefit of being informed on these questions by the Opinion of Advocate General Wahl. In particular, Advocate General Wahl insisted on the necessity to rely on a *variety* of benchmarks, and explained that there is no single method, test or set of criteria which is generally accepted, since each method reveals inherent weaknesses and cannot be used in all circumstances (because of either conceptual or data availability reasons). [*17*] On this basis, Advocate General Wahl concluded that "*[...] in the absence of an ubiquitous test and given the limitations inherent in all existing methods, it is in my view crucial that in order to avoid (or, more correctly, to minimise) the risk of errors, competition authorities should strive to examine a case by combining several methods among those which are accepted by standard economic thinking and which appear suitable and available in the specific situation.*" [*18*]

The added value of relying on a variety of methodologies derives from the fact that, while no method is perfect, if the methods are applied independently of each other, limitations of one method should not necessarily affect other methods. Their convergence therefore provides a useful indication of the benchmark price, provided of course that the methods "*are, in themselves, not flawed and that they are applied with rigour and objectivity*". [*19*]

The Court followed the Advocate General's opinion in this respect, and confirmed that *"[...] it is appropriate to compare its rates with those applicable in neighbouring Member States as well as with those applicable in other Member States adjusted in accordance with the PPP index, provided that the reference Member States have been selected in accordance with objective, appropriate and verifiable criteria and that the comparisons are made on a consistent basis."* [*20*]Furthermore, the Court rightly agreed with Advocate General Wahl that no minimal number of comparators is required, and that the choice of appropriate comparators depends on the specificities of each case. [*21*]

As regards the *appreciable* nature of the difference between the investigated price and the benchmark prices, Advocate General Wahl rightly explained that the authority should intervene "*only when it feels sure that, regardless of the limitations and uncertainties surrounding the calculation of the benchmark price, the difference between that price and the actual price is of such a magnitude that almost no doubt remains as to the latter's abusive nature."* [*22*]The Court also followed the Advocate General on this point and considered that two conditions need to be fulfilled to show that the difference is appreciable: the observed price on the investigated market needs to be first, *significantly* and second, *persistently* above the benchmark price. [*23*]

In its Opinion, Advocate General Wahl also made it clear that unfair prices under article 102 TFEU should be limited to regulated markets, [*24*] and set out additional indicators that are relevant to establish an infringement for excessive prices. First, the market must be characterised by high barriers to entry. Second, there must be no sector-specific regulator, as sectoral authorities are better equipped to oversee prices and remedy abuses (or there is regulatory failure, i.e. the sectoral regulator should have acted but failed to do so). Third, the level of buyer power must be considered. Finally, Advocate General Wahl stressed that additional factors may be relevant depending on the specificities of the case. [*25*]

In its decision, the Court confined itself to answering the specific questions that were raised in the request for the preliminary ruling, and hence does not address these three points explicitly. The importance of high barriers to entry however was acknowledged indirectly by the Court since, as mentioned above, the Court emphasized the need for the price difference to be persistent, which can only be the case in the presence of high barriers to entry.

The recent judgment of the European Court of Justice in AKKA/LAA, which was inspired by the insights provided by Advocate General Wahl in its Opinion, has provided welcome clarifications on how to apply the United Brands test. In particular, it is now clear not only to economists, but also from a legal perspective, that consistent benchmark comparisons are essential to establish excessiveness, and that a variety of such benchmark comparisons should be used to reliably reach a conclusion that prices are excessive.

In its judgment, the Court also recognised the need to establish the persistent nature of excessive prices, which implicitly implies that excessive prices can only be found in markets characterised by high barriers to entry. This requirement has clear and practical implications. Consider for instance the hypothetical case of a short-sighted company increasing prices to high levels, and triggering entry by new competitors as a result. Such a conduct could not be qualified as constitutive of an abuse for excessive prices, even if it passed the original United Brands test, as long as the entry of competitors would render the initial price increase temporary. The Court's persistence requirement does make sense, as this example is just a sign of markets self-correcting, and for which antitrust enforcement is thus not needed.

Still, it remains that the United Brands criteria, even as clarified by the Court in AKKA/LAA, provide an incomplete test to positively establish an infringement for excessive prices. Indeed, excessive pricing cases only make sense if a very specific set of market conditions are present. Unlike Advocate General Wahl in its Opinion, the Court did not explicitly address such questions of principles in its judgment and confined itself to more narrowly address the questions raised in the preliminary ruling request.

However, it is clear from the past practice of the European Commission and the economic consensus expressed at the time of the modernization of EU competition law that excessive pricing cases should be limited not only to markets with high barriers to entry, but (cumulatively) to cases where the dominant position was not obtained on the merits (such as in regulated industries), and where no sector-specific regulator would be better placed to address the issue.

It is thus to be hoped that the on-going investigations into excessive prices, in particular in the pharmaceutical sector, will properly take these considerations into account, and that the Commission and European competition authorities will not succumb to the temptation of reducing pricing ex-post to the detriment of ex-ante efficiency. Otherwise, further clarifications from the courts on the specific market conditions required in excessive prices cases will be needed, in order to more firmly align the competition authorities' practice with the economic consensus.

The Advocate General Wahl's Opinion would provide a useful blueprint in this regard.

Note from the Editors: although the e-Competitions editors are doing their best to build a comprehensive set of the leading EU and national antitrust cases, the completeness of the database cannot be guaranteed. The present foreword seeks to provide readers with a view of the existing trends based primarily on cases reported in e-Competitions. Readers are welcome to bring any other relevant cases to the attention of the editors.

[*1*] See e.g. Judgment of the US Supreme Court in Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP (02-682) 540 U.S. 398 (2004). See ***James E. Scheuermann, William D. Semins****, The US Supreme Court introduces a new method for regulatory antitrust analysis (Trinko / Verizon), 13 January 2004, e-Competitions Bulletin January 2004, Art. N° 43984.*

[*2*] Judgment of 14 February 1978, United Brands and United Brands Continentaal v Commission, 27/76, EU:C:1978:22, paragraph 252.

[*3*] For example, in the *Napp* case, where Napp was accused of charging excessively low (exclusionary) prices in the hospital segment and excessively high prices in the community segment for its sustained release morphine tablets, Vickers explained that "*the OFT explicitly viewed Napp's pricing policy as a whole and in the appeal case went on to say that it would not wish to maintain excessive pricing abuse if the pricing to the hospital segment was not judged to be exclusionary.*"

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J. Vickers, How Does the Prohibition of Abuse of Dominance Fit With the Rest of Competition Policy?, Paper for the eighth annual EU competition law and policy workshop at the European University Institute, Florence, 6 June 2003. See ***Derek Ridyard***, *The UK OFT and CCAT held abusive below-cost pricing in the pharmaceuticals sector (Napp), 15 January 2002, e-Competitions Bulletin January 2002, Art. N° 21109*.

[*4*] At the European level, Rambus would constitute such an example. In this case, the Commission was concerned that Rambus may have committed an abuse due to excessive royalties combined with a deceptive conduct consisting in not disclosing standard-relevant patents and patent applications during the standard setting process (patent ambush). See the Commission's Commitment Decision of 09/12/2009, available at:
http://ec.europa.eu/competition/antitrust/cases/dec_docs/38636/38636_1203_1.pdf ↗. See ***Ruben Schellingerhout, Piero Cavicchi***, *The European Commission renders legally binding commitments offered by US software undertaking to lower memory chip royalty rates (Rambus), 9 December 2009, e-Competitions Bulletin December 2009, Art. N° 35010*; ***Peter L'Ecluse***, *The European Commission closes an investigation on a chip manufacturer for abuse of dominant position (Rambus), 9 December 2009, e-Competitions Bulletin December 2009, Art. N° 41679*.

[*5*] Opinion of Advocate General Wahl, delivered on 6 April 2017, following a request for a preliminary ruling by the Latvian Supreme Court on the conditions under which the rates set by the Latvian collecting society AKKA/LAA are excessive under Article 102 (hereafter, "AG Wahl's Opinion of 6 April 2017"). See ***Tim Kasten***, *EU Court of Justice Advocate General Wahl offers guidance on the criteria to identify excessive prices in abuse of dominance case (AKKA / LAA), 6 April 2017, e-Competitions Bulletin April 2017, Art. N° 83821*.

[*6*] Communication from the Commission – Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009.

[*7*] M. Motta and A. de Streel (2007), Excessive Pricing in Competition Law: Never say Never?, in Konkurrensverket – Swedish Competition Authority (ed.), *The Pros and Cons of High Prices*, p. 14.

[*8*] Even in cases where dominance was not obtained on the merits, but through historical state intervention, excessive pricing intervention is not automatically justified. As Evans and Padilla point out in 'Excessive Prices: Using Economics to Define Administrable Legal Rules', *Journal of Competition Law and Economics*, 2005, pp. 97-122, many incumbents in the telecoms and energy sector in Europe invest significant amounts on infrastructure in competition with entrants. They find that consumers are generally better off without intervention in industries where innovation and investment play a key role.

[*9*] See e.g. Commissioner Vestager's speech, "Protecting consumers from exploitation", Chillin' Competition Conference, Brussels, 21 November 2016 available at:
https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/protecting-consumers-exploitation_en ↗.

[*10*] European Commission's press release of 15 May 2017, available at:
http://europa.eu/rapid/press-release_IP-17-1323_en.htm ↗. See ***European Commission***, *The EU Commission opens formal investigation into a pharmaceutical company pricing practices (Aspen Pharma), 15 May 2017, e-Competitions Bulletin May 2017, Art. N° 84199*.

[*11*] CMA decision of 7 December 2016, available at: *https://www.gov.uk/cma-cases/investigation-into-the-supply-of-pharmaceutical-products* ↗. See ***Ajit Kainth, Nathdwarawala Shachi***, *The UK Competition and Markets Authority publishes full decision on excessive pricing and focuses on intention and evidence (Pfizer/Flynn), 15 June 2017, e-Competitions Bulletin June 2017, Art. N° 84760*.

[*12*] See the CMA's press release of 3 March 2017, available at: *https://www.gov.uk/government/news/cma-alleges-anti-competitive-agreements-for-hydrocortisone-tablets* ↗.

[*13*] Italian Competition Authority, A480B – *Incremento Prezzo Farmaci Aspen-Inottemperanza*, decision No. 26432, published in Bulletin No. 10/2017. See ***Michele Giannino***, *The Italian Competition Authority fines a generic manufacturer of drugs for excessive pricing (Aspen), 29 September 2016, e-Competitions Bulletin September 2016, Art. N° 81747*.

[*14*] Disclaimer: I acted as Flynn Pharma's economic expert during the CMA investigation and the appeal in front of the UK Competition Appeal Tribunal.

[*15*] For a further discussion of the practical difficulties of establishing excessive prices in the pharmaceutical industry, see ***Raphael De Coninck, Alessandra Tonazzi, Mélanie Thill-Tayara, Elina Koustoumpardi***, *Recent developments in pharma antitrust, September 2017, Concurrences Review N° 3-2017, Art. N° 84663*. Following completion of this Foreword, the Competition Appeal Tribunal (CAT) gave on 7 June 2018 its judgment on the appeal of the CMA's decision regarding phenytoin sodium (*1275/1/12/17 Flynn Pharma Ltd and Flynn Pharma (Holdings) Ltd v Competition and Markets Authority* ↗). Importantly, the CAT set aside the CMA's finding of abuse as it found that the CMA erred in its reliance on the Cost Plus approach and misapplied the United Brands test by not sufficiently taking into account meaningful comparators.

[*16*] Judgment of the Court (Second Chamber) of 14 September 2017. Autortiesību un komunicēšanās konsultāciju aģentūra / Latvijas Autoru apvienība v Konkurences padome. Request for a preliminary ruling from the Augstākā tiesa. Case C-177/16, ECLI:EU:C:2017:689 (hereafter "Judgment of the Court of 14 September 2017"). See ***Michele Giannino***, *The EU Court of Justice accepts an alternative to the United Brands test to establish excessive pricing (AKKA / LAA), 14 September 2017, e-Competitions Bulletin September 2017, Art. N° 84866*; ***Kevin Coates, Siobhan Kahmann***, *The EU Court of Justice clarifies the concept of unfair price under article 102 TFEU (AKKA / LAA), 14 September 2017, e-Competitions Bulletin September 2017, Art. N° 85306*; ***Fevzi Toksoy, Hanna Stakheyeva***, *The EU Court of Justice delivers a ruling on excessive pricing in a case involving a copyright management association (AKKA / LAA), 14 September 2017, e-Competitions Bulletin September 2017, Art. N° 86151*.

[*17*] In particular, in the case at hand, Advocate General Wahl found that cost-price comparisons are not appropriate in the case of intangible goods, such as copyrighted musical work. AG Wahl's Opinion of 6 April 2017, paragraph 37.

[*18*] AG Wahl's Opinion of 6 April 2017, paragraph 43.

[*19*] AG Wahl's Opinion of 6 April 2017, paragraph 45.

[*20*] Judgment of the Court of 14 September 2017, paragraph 51.

[*21*] Judgment of the Court of 14 September 2017, paragraphs 40-41.

[*22*] AG Wahl's Opinion of 6 April 2017, paragraph 112.

[*23*] Judgment of the Court of 14 September 2017, paragraph 61.

[*24*] AG Wahl's Opinion of 6 April 2017, paragraph 48.

[*25*] AG Wahl's Opinion of 6 April 2017, paragraphs 49-51.