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# Agenda

## Advancing economics in business

# Excessive pricing: excessively ignored in competition law?

**Competition authorities have historically pursued very few cases against excessive pricing. This seems to be changing. In the past 12 months, the rules on abuse of dominance have been invoked to tackle high prices in a range of markets, including pharmaceuticals, musical works, and patents. Together with increased political calls for fairness to consumers, does this mean a revival of excessive pricing in competition law?**

Excessive pricing is prohibited under competition law in the EU and most other jurisdictions (apart from the USA), but actual cases have been rare. The European Commission's guidance on abuse of dominance does not go into any details on the topic.[1] One reason is that prices play an important signalling function in markets: high prices indicate to entrants that there are profitable opportunities to be had. In the words of Advocate General (AG) Wahl, in an Opinion issued in April 2017:

> Nevertheless, 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.[2]

Yet excessive pricing seems to be back in the spotlight. Several competition authorities have recently tackled 'rip-off' price increases by pharmaceutical companies. In October 2016 the Italian competition authority fined Aspen for increasing the price of its cancer drugs by between 300% and 1,500%.[3] In December 2016 the UK Competition and Markets Authority (CMA) fined Pfizer and Flynn for excessive pricing of an epilepsy drug, following price hikes of more than 2,000% that raised the annual expenditure on the drug by the National Health Service from £2m to £37m–£50m.[4] Other investigations into pharmaceutical pricing are ongoing, including one announced by the European Commission in May 2017.[5]

The rules on excessive pricing have also been invoked in other contexts. One example is disputes around the licensing of standard-essential patents (SEPs). Owners of SEPs have usually made a commitment to license their patents on fair, reasonable and non-discriminatory (FRAND) terms in exchange for being included in the standard. A judgment of April 2017 by the High Court in the UK on a dispute between Unwired Planet and Huawei deals extensively with the question of how the competition rules on excessive pricing apply in a situation where there is already a FRAND commitment.[6] Another context is the charging for copyright on musical works. The Opinion by AG Wahl of April 2017 was on an excessive pricing case before the Court of Justice of the EU (CJEU) that dealt with the rates charged to commercial premises by a Latvian collecting society for the remuneration of composers of musical works.

## What the law says

Article 102 of the Treaty on the Functioning of the European Union states that abuse of dominance may include 'directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions'. In General Motors (1975), the CJEU determined that an abuse might exist if the price imposed is 'excessive in relation to the economic value of the service provided'.[7] This was expanded on in United Brands (1978), where the CJEU related 'economic value' to production costs and prices of competing products:

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

> This excess could, inter alia, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which would disclose the amount of the profit margin…
>
> 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.[8]

The concepts of 'economic value' and 'unfair' have caused a good deal of confusion. In *United Brands*, the CJEU stated that alternative ways might be devised to determine what constitutes economic value or an unfair price (and it added that 'economic theorists have not failed to think up several'). A number of national competition authorities and courts have tried to come up with ways to interpret these concepts. Perhaps the main lesson that can be drawn from these cases is that they have provided greater clarity on what excessive pricing is not than on what it is.

## Analysing excessive prices

As AG Wahl noted on the question of how to analyse excessive pricing, 'at the current stage of legal and economic thinking, there is no single method, test or set of criteria which is generally accepted in economic writings or across jurisdictions for that purpose'.[9]

As regards benchmarking, in a case in 1988 involving funeral services in France, the CJEU accepted price comparisons between French regions as a basis for assessing excessive pricing.[10] AG Wahl considered benchmarking of rates set by collecting societies in different countries to be an appropriate method in the Latvian music copyright case before the CJEU.[11]

The other method set out in *United Brands* is to compare unit prices with unit costs. From an economic perspective it may be more informative to look at profitability over a longer time period. A robust method for analysing economic profitability in competition cases has been developed in the literature, as set out in a 2003 Oxera discussion paper for the UK competition authority at the time, the Office of Fair Trading.[12] This has been applied in a number of excessive pricing cases. The CMA's recent pharmaceutical case also determined excessive pricing with reference to costs plus a reasonable return (adding that the excessive prices were also unfair in light of a range of other factors, including the behaviour of the two suppliers).[13]

With a range of methods available, each with inherent shortcomings, AG Wahl makes an economically sound recommendation:

> Thus, 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 minimize) 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…
>
> Admittedly, the weaknesses of one method are not necessarily remedied by applying another equally weak method. Yet if the methods are applied independently of each other, a given limitation inherent to one of them would not affect the results obtained through the use of other methods. Accordingly, provided that the methodologies used are, in themselves, not flawed, and that they are applied with rigour and objectivity, the convergence of results may be taken as an indicator of the possible benchmark price in a given case.[14]

## Economic value to downstream purchasers

Other cases have rejected price–cost comparisons or profitability analysis as providing too narrow an interpretation of 'economic value'. One example is the case involving the Port of Helsingborg in Sweden in 2004.[15] Ferry operators had accused the port of setting excessive charges. The European Commission rejected the complaint. It concluded that prices did appear to exceed costs by a significant margin, but also took into account the fact that the land used by the port for the ferry operations was highly valuable in itself. It stated that ferry operators 'benefit from the fact that the location of the port meets their needs perfectly', and that 'this represents an intangible value in itself, which could be taken into account as part of the economic value of the services provided.'[16] Hence, the Commission attached weight to the economic value that the product represented to customers, rather than considering the cost to the supplier alone.

This theme was also central in the 2007 *British Horseracing Board* case in the UK concerning the pricing of racing data. The British Horseracing Board (BHB)—then the regulatory authority for horseracing in Great Britain—was accused of charging excessive prices to Attheraces (ATR), a broadcaster. The High Court determined that the competitive price would be one where BHB recouped the cost of producing its database together with a reasonable return on that cost. The Court of Appeal rejected this cost-plus approach to excessive pricing. Following a line of reasoning similar to that in *Port of Helsingborg,* the court took into consideration the value that the product in question represented to the purchaser of the data:

> we conclude that, in holding that the economic value of the pre-race data was the cost of compilation plus a reasonable return, the judge took too narrow a view of economic value in Article 82 now 102. In particular he was wrong to reject BHB's contention on the relevance of the value of the pre-race data to ATR in determining

> the economic value of the pre-race data and whether the charges specified by BHB were excessive and unfair.[17]

In essence, therefore, the dispute was over who would get the bigger share of the downstream profit 'pie'—BHB or ATR—rather than the total size of the pie. Consumers would get the end-service at the same price regardless of how the pie was divided higher up the supply chain (unless ATR decided not to buy the data at all, in which case there would be no more pie). The Court of Appeal considered that in these circumstances the upstream provider was entitled to charge a price that reflected the value to (and willingness to pay of) the intermediary purchaser downstream:

> We appreciate that this theoretical answer leaves the realistic possibility of a monopoly supplier not quite killing the goose that lays the golden eggs, but coming close to throttling her. We do not exclude the possibility that this could be held to be abusive, not least because of its potential impact on the consumer. But Article 82, as we said earlier, is not a general provision for the regulation of prices. It seeks to prevent the abuse of dominant market positions with the object of protecting and promoting competition. The evidence and findings here do not show ATR's competitiveness to have been, or to be at risk of being, materially compromised by the terms of the arrangements with or specified by BHB.[18]

## The role of economics

A prohibition of excessive pricing can be economically sound if there is no prospect of market forces removing or eroding a monopoly position. Economics can assist with identifying the circumstances in which this arises (e.g. does the activity have natural monopoly characteristics; are there significant entry barriers?). Many countries have extensive experience of regulating prices of particular activities, using well-established economic tools.

There is a misperception that excessive pricing cannot be prohibited because it is too difficult to measure. There are conceptual and practical difficulties in measuring economic profits, allocating costs, and determining the competitive benchmark. However, as noted above, a theoretically sound framework for assessing economic profitability in competition law exists, and addresses most of the conceptual and practical problems. In those cases where it is feasible to apply the framework for profitability analysis it can provide useful insight. Interestingly, the CJEU said pretty much the same in *United Brands*:

> While appreciating the considerable and at times very great difficulties in working out production costs which may sometimes include a discretionary apportionment of indirect costs and general expenditure and which may vary significantly according to the size of the undertaking, its object, the complex nature of its set up, its territorial area of operations, whether it manufactures one or several products, the number of its subsidiaries and their relationship with each other, the production costs of the banana do not seem to present any insuperable problems.[19]

It is correct to say that *if* the relevant test for excessive pricing is taken as being 'cost-plus' or profitability in excess of the competitive level, economics provides the relevant tools for applying the test. Yet it should be borne in mind that the method for measuring economic profitability is not meant to determine excessive prices as such, but rather to identify the existence of entry barriers and market power. The method determines profitability with reference to replacement costs and the cost of entry. If profits are found to be higher than the costs that an entrant would face, this indicates that entry barriers exist (i.e. that profitable opportunities are not taken up by entrants). While this can be a powerful tool to assess market power, it does not in itself determine that prices are too high. That ultimately remains a policy or legal judgement.

Nonetheless, economics can help when such judgements are made. For example, when it comes to dividing the pie, economics can inform on how to do this sensibly, taking into account factors such as total welfare, relative profitability of the parties, and static and dynamic market effects. This also applies to broader concerns about fairness to consumers, which are increasingly raised in policy and regulatory contexts (for example, in online markets and financial services). Whether dealt with through competition law, regulatory tools, or simply political and public pressure, companies setting prices that are perceived as unfairly high can increasingly expect to be the subject of close scrutiny.

Economics can provide both a framework and a toolkit to inform an assessment of prices, and product offering more generally. Further debate is required on how to apply the toolkit. But at least the recent excessive pricing cases have stimulated an appetite for this debate.

[1] European Commission (2008), 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings', December, para. 7.

[2] Case C-177/16, Biedrība 'Autortiesību un komunicēšanās konsultāciju aģentūra – Latvijas Autoru apvienība' v Konkurences padome, Opinion of Advocate General Wahl, 6 April 2017, para. 3.

[3] Autorità Garante della Concorrenza e del Mercato (2016), 'Price increases for cancer drugs up to 1500%: the ICA imposes a 5 million Euro fine on the multinational Aspen', press release, 14 October.

[4] The CMA's decision was published in June 2017. Competition and Markets Authority (2016), 'Unfair pricing in respect of the supply of phenytoin sodium capsules in the UK', Decision, 7 December.

[5] European Commission (2017), 'Antitrust: Commission opens formal investigation into Aspen Pharma's pricing practices for cancer medicines', press release, 15 May.

[6] *Unwired Planet International v Huawei Technologies*, [2017] EWHC 711 (Pat), judgment of 5 April 2017. Oxera acted as experts for Unwired Planet on this matter.

[7] Case 26/75 *General Motors Continental NV v Commission* [1975] ECR 1367, para. 12.

[8] Case 27/76 *United Brands v Commission* [1978] ECR 207; [1978] 1 CMLR 429, paras 250–2.

[9] Case C-177/16, Biedrība 'Autortiesību un komunicēšanās konsultāciju aģentūra – Latvijas Autoru apvienība' v Konkurences padome, Opinion of Advocate General Wahl, 6 April 2017, para. 36.

[10] Case 30/87 *Corinne Bodson v SA Pompes funèbres des régions libérées* [1988] ECR 2479; [1989] 4 CMLR 984.

[11] Case C-177/16, Biedrība 'Autortiesību un komunicēšanās konsultāciju aģentūra – Latvijas Autoru apvienība' v Konkurences padome, Opinion of Advocate General Wahl, 6 April 2017, para. 58.

[12] See Oxera (2003), 'Assessing profitability in competition policy analysis', Economic Discussion Paper 6, report for the UK Office of Fair Trading, July, http://www.oxera.com/Latest-Thinking/Publications/Reports/2003/Assessing-profitability-in-competition-policy-anal.aspx. This methodology has been further developed over time by competition authorities and competition economists.

[13] Competition and Markets Authority (2016), 'Unfair pricing in respect of the supply of phenytoin sodium capsules in the UK', Decision, 7 December. The CMA decision also refers to the 2003 Oxera report on profitability analysis in competition policy.

[14] Case C-177/16, Biedrība 'Autortiesību un komunicēšanās konsultāciju aģentūra – Latvijas Autoru apvienība' v Konkurences padome, Opinion of Advocate General Wahl, 6 April 2017, paras 43 and 45.

[15] *Scandlines Sverige AB v Port of Helsingborg* (Case COMP/A.36.568/D3), Decision of 23 July 2004.

[16] *Scandlines Sverige AB v Port of Helsingborg* (Case COMP/A.36.568/D3), Decision of 23 July 2004, para. 209.

[17] *Attheraces v British Horseracing Board* [2007] EWCA Civ 38, para. 218.

[18] *Attheraces v British Horseracing Board* [2007] EWCA Civ 38, para. 217.

[19] Case 27/76 *United Brands v Commission* [1978] ECR 207; [1978] 1 CMLR 429, para. 254.