HD **Excessive pricing: Will antitrust authorities intervene?**

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It is an oddity of antitrust and competition law that - although one of the main benefits of competition, and of competition laws, is supposedly to keep prices down - in reality competition law is very rarely deployed to combat excessive pricing by businesses with monopolistic or dominant market positions. Just recently, however, in 2013, there have been two significant cases of interventions against excessive pricing - by competition authorities in **China** and in South Africa.

Context

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Competition is supposed to benefit consumers by keeping prices down - that is, as low as possible consistent with a reasonable rate of return for the businesses supplying the goods or services concerned. Although it is clearly in the interests of any business to make as much money as possible, and although this might be thought to involve the business charging its customers as much as possible, the fact that the business faces competition acts as a constraint on overcharging its customers. Where there are effective competitors, the business dares not keep its prices too high, because it fears it would then lose customers to its competitors, which could reduce its profits. It is this "competitive constraint" - the fear of losing customers to competitors - that keeps prices down where there is effective competition.

Antitrust and competition laws intervene where the competitive constraint is weakened. This will arise where competitors collude with each other, rather than competing with full vigour - at which point antitrust prohibitions on agreements restrictive of competition "bite". Similarly, where there is a merger of businesses that had previously been significant competitors of each other (e.g., by way of **M**&A transactions or joint ventures), antitrust authorities will apply merger control law to examine whether there is a significant reduction in competition that would weaken the competitive constraint. The point is that where competitors enter into an agreement or a merger that restricts competition, the competitive constraint is weakened, the businesses concerned are therefore no longer so worried about losing customers to competitors if they raise their prices, and accordingly there is a concern that prices will go up (to the detriment of consumers).

In addition, even without an agreement or merger between competitors, antitrust laws will intervene in a third situation where the competitive constraint is weakened. This is where the business concerned has a monopoly or dominant position in a market, often also called "market power" - i.e., the business is so strong in the market that, when it sets its commercial strategy (including pricing decisions), it is not constrained by the fear of losing customers to its competitors. The weakness of the competitive constraint removes or lessens the deterrent to putting prices up too high (i.e. higher than is consistent with a reasonable rate of return), and that is detrimental to consumers.

To combat this, antitrust laws around the world have rules to control businesses with monopolistic or dominant market positions - for example, in the United States, Section 2 of the Sherman Act controlling "monopolisation", in Australia the prohibition on abuse of market power, and in the European Union and its member countries the Article 102 prohibition on abuse of a dominant position.

Strangely, however, there is a reluctance to deploy these antitrust laws against abuse of dominance or monopoly or market power to intervene where the business possessing the monopoly or market power or dominance (and therefore not subject to the competitive constraint that would deter it from raising prices) actually does abuse that power to raise prices. In other words, antitrust authorities rarely intervene against excessive pricing. The US and Australian prohibitions on conduct by businesses with monopolistic or market power tend to focus more on "exclusionary" conduct (i.e., using market power to reduce competition still further) than on exploitation of market power to impose high prices.

In the EU (and in the national competition laws of EU member countries, which typically reflect EU competition law), there is no doubt that the prohibition on abuse of a dominant position can in principle be invoked to combat excessive pricing. Article 102 of the Treaty on the Functioning of the EU, which sets out the prohibition, specifically states that the prohibition covers "directly or indirectly imposing unfair... selling prices". Indeed, the EU's Court of Justice explicitly confirmed, in the 1976 United Brands case, that a business having a dominant market position abuses that position where it is

In practice, cases where the EU prohibition on abuse of a dominant position has actually been deployed to combat excessive pricing are few and far between. It should be noted, however, that direct intervention against excessive pricing does often occur in the context of the special regulatory regimes that apply to utility services - such as gas, electricity, water and telecoms - which are often natural monopolies or quasi-monopolies, and which are subject to price caps and price controls imposed by sector regulators. This is less a matter of antitrust and competition law, and more a matter of direct State controls of pricing.

So we have a paradox. On the one hand, competition is considered beneficial largely because the resultant fear of losing customers to competitors has the effect of deterring excessive pricing. At the same time, antitrust and competition laws (against anti-competitive agreements, abuse of monopolistic or dominant market positions, and anti-competitive mergers) are designed in large part to protect consumers from a weakening of competition that would result in excessive pricing. On the other hand, businesses having market power operate with less fear of losing customers to their competitors, but antitrust and competition laws are reluctant to intervene to combat excessive pricing.

Why is this?

In practice - what constitutes an excessive price?

A large part of the answer lies in the difficulty of determining what constitutes an excessive price.

Case law on excessive pricing by dominant undertakings - particularly where, as in the EU and its member countries, the prohibition on abuse of a dominant position is (at least in principle) designed to cover excessive pricing - suggests that there are broadly three classes of evidence that a price charged by a dominant business is "excessive" and hence unlawful:

first, where the price of the product very significantly exceeds the cost of producing it (this applies to services as well as goods);

second, where the profit margin on sales of the product is exceptionally high; and

third, where the price is significantly higher than the price for comparable products ("benchmarks") either in the same country or in other countries.

The practical problems of determining excessive pricing

Each of the above classes of evidence of excessive pricing has its difficulties - and these difficulties have often inhibited the application of antitrust and competition law to excessive pricing.

First, it is difficult to establish whether price vastly outstrips production costs, in large part because it is difficult to measure production costs. For example:

If the costs were incurred a considerable time before the product is sold (e.g., in the case of investment in plant and machinery, or in the purchase of raw materials that take a long time to convert into the finished product), it is hard to know whether the relevant cost is the historic cost (i.e. the cost actually incurred at the time) or the cost that would be incurred for the same inputs at current prices.

Where a business produces a range of different products, it is often hard to determine how to apportion "common" costs that are relevant to all products (e.g., the cost of its premises, machinery, and so on) - and therefore hard to determine the cost of the particular product concerned.

Second, the difficulty of declaring a profit margin (or rate of return) to be excessive lies in the fact that high profits are sometimes perfectly explicable as a result of good competitive behaviour, rather than the abuse of a dominant position. For instance:

A higher profit margin on sales of a product might reflect increased efficiency, rather than excessive pricing - and increased efficiency is a commendable outcome in a competitive market, which antitrust authorities should not be constraining; and

Likewise, where innovation is a feature of the market concerned - as is typically the case in sectors such as technology, pharmaceuticals and life sciences - high profits might be necessary to finance (and to give incentives for) the research and development investment necessary to innovate. As the UK's competition authority, the Office of Fair Trading, put it in its draft guideline on assessing conduct under the prohibition on abuse of a dominant position:

It would be perverse if antitrust law were deployed to inhibit innovation, which is one of the outcomes that competition is supposed to promote. Indeed, in the UK, similar concerns have arisen in the context of recent increases in consumer prices for gas and electricity, where the opposition Labour Party has proposed a "freeze" on these prices, but critics have warned that such a freeze could inhibit investment in security of supply of **energy**.

Third, there are real problems in determining that a price is excessive by comparison with "benchmarks" in the same country or internationally.

Within a country, an obvious problem is that, because the business concerned has a monopoly or dominant market position, there are few if any competitors in the same country to compare it with.

Internationally, the difficulty is that competitive conditions in other countries are often so different as to make any benchmarking meaningless.

For all these reasons, antitrust authorities have often been reluctant to intervene against excessive pricing. But that does not mean that businesses with market power need not worry about price levels. And this point has been reinforced by two new cases - in **China** and in South Africa - that show that, whatever the practical difficulties, concerns about excessive pricing have not gone away.

China - Guangdong river sand

In September 2013, companies controlled by a single individual together accounting for 75 per cent of sales in the Qujiang district of Shaoguan City were fined over 500,000 **Chinese** yuan renimbi (about GB £55,000 or €65,000 or US $85,000) - 2 per cent of their annual turnover - for excessive pricing in the **sale** of river sand, on the grounds that this was an abuse of dominance in violation of Article 17 of **China**'s Antimonopoly Law and Article 11 of **China**'s Regulation prohibiting Monopolistic Pricing.3

There was no doubt that the relevant companies had a dominant position; because of the high cost of transporting river sand, the market was local, and a 75 per cent market share is clearly a dominant position.

As for the excessive pricing, the authority relied on the fact that the prices (or, at least, the price increase) was vastly disproportionate to the production cost (or, rather the production cost increase). The companies had faced a production cost increase of 20 per cent - but implemented pricing increases of about 50 per cent.

By way of remedy, the companies were ordered to sell all the river sand that they had hoarded within six months of the decision and to do so below a specified price ceiling.

South Africa - polypropylene and propylene

South Africa's Competition Tribunal is hearing a case against the chemicals producer Sasol, which is accused of excessive pricing in breach of the country's Competition Act, which includes a prohibition on the abuse of a dominant position. This is only the third case of excessive pricing that the Competition Tribunal has heard in the 14 years since its inception. South Africa's Competition Commission is asking the Tribunal to impose a fine of 10 per cent of Sasol's turnover.

The claim relates to pricing on the domestic markets for polypropylene and propylene. There are essentially two grounds for the claim of excessive pricing:

The profit margins involved were an average of 162 per cent a year from 2004 to 2008, which the Competition Commission described as an "astonishing average return on capital"; and

The price vastly outstrips comparable prices - in particular, Sasol's price for the product on domestic markets was 30 per cent higher than the prices for the products sold to international customers.

What do we learn from the two cases?

In practical terms, a number of lessons can be learned from the **China** and South Africa cases.

First, and most obviously, the two cases show that, in spite of the difficulties, antitrust and competition authorities are prepared to take action against excessive pricing. Businesses with market power need to bear this in mind in setting their prices.

Second both cases arose in emerging markets. It may be that, in countries where competition (and competition law) is less developed, there will be greater readiness to take direct action against excessive pricing.

Third, both cases concern the pricing of goods sold to business customers (rather than to consumers); in the **Chinese** case, river sand is used for major infrastructure projects while in the South African case, the chemicals concerned are used for plastics. Clearly, when the products that are excessively priced are inputs into other goods, the excessive pricing has a multiplier effect across a wider range of products, and is therefore (arguably) more damaging.

Footnotes

1 Case 27/76 United Brands v Commission [1978] ECR 207.

2 UK Office of Fair Trading, Assessment of conduct - draft competition law guideline for consultation, OFT 414a, April 2004, paragraphs 2.18 and 2.20.

3 Guandong Price Bureau press release of September 4, 2013.

"charging a price which is excessive because it has no reasonable relation to the economic value of the products supplied".1 "Prices and profits may be high in markets where there is innovation. Successful innovation may allow a **firm** to earn profits significantly higher than those of its competitors. However, a high return in one period could provide a fair return on the investment in an earlier period required to bring about innovation. These costs include investment in research and development and should take into account the risk at the time of the investment that the innovation might have failed. ... In particular, competition law should not undermine appropriate incentives for undertakings to innovate."2

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