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Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief About Monopoly?

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Monopoly pricing as an antitrust offense in the U.S. and the EC: two systems of belief about monopoly?

BY MICHAL S. GAL*

I. Introduction

Basic economic theory contrasts two industry structures and their outcomes: a competitive, atomistic structure, comprised of many similar firms, and a monopoly structure containing but one firm. The competitive model denies any firm the power to affect price, as all firms are price takers. Price equals marginal costs of production and the social optimum of price and output is reached. By contrast, the textbook monopoly model conveys complete control over price to a

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single firm, which is constrained in its pricing and output decisions only by the costs of production and the elasticity of demand. A monopolistic firm that cannot discriminate will raise its price until its marginal revenue equals its marginal costs.

This increase in price creates a wealth transfer from the consumers to the monopolist. The more inelastic the demand and the higher the entry barriers, the larger the monopolist’s portion of the total welfare created and the larger the wealth transfer. Monopoly pricing also creates a deadweight loss in societal resources due to the fact that consumers are willing to buy additional products or services at a price below the monopolistic one and above the competitive one. Similar effects, although to a lesser extent, are obtained with above-cost pricing by a firm that dominates a market but does not operate in it alone, or by oligopolists enjoying joint dominance.

These costs of monopoly are independent of the manner in which the monopoly was historically achieved or of its engagement in predatory or exclusionary conduct. Even an innocently obtained or maintained monopoly can and likely will engage in monopoly pricing. The textbook model thus applies regardless of the way in which monopoly power was acquired and maintained; neither does it seek to analyze the effects of monopoly pricing on the erosion of monopoly power.

The problem with the above analysis is that it is a static one: it analyzes a situation at a given point in time and disregards the dynamics that led to that situation or that are created by it. Dynamic models recognize that efforts to become a monopoly and enjoy high prices are the fuel of the competitive process of innovation, of the wish to get ahead of rivals, although such efforts might sometimes be wasteful. Monopoly profits are also an important signaling device that spurs competition, as the higher the price, the stronger the incentive of rival firms to take part in the profits to be had by undercutting the monopolist. Thus economic theory has shown that monopoly pricing is not necessarily inefficient. Yet we also know that the efficacy of the market mechanism depends on the existing market

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conditions. Asymmetric information, network effects, scale economies and strategic behavior are only some of the factors that may retard the entry or expansion of firms, thus enabling monopoly pricing to be exercised, at least in the short run.

Monopoly pricing is a major concern of antitrust: if firms seek to raise their profits through merger, they must attain governmental approval; when several manufacturers of similar products reach an agreement to raise prices, such contracts are not only unenforceable, but also subject to criminal charges in many jurisdictions. In short, a wide array of conducts that enable firms to raise prices above competitive levels are constrained by antitrust law. Why then not tackle monopoly pricing directly?

Monopoly pricing per se, that is without need of proof of anticompetitive conduct or intent, is regulated very differently on both sides of the Atlantic, at least in theory. U.S. antitrust law sets a straightforward rule: monopoly pricing, as such, is not regulated. In contrast, under European Community (EC) law excessive pricing is considered an abuse of dominance and is punishable by fine and subject to a prohibitory order. These approaches fit the divide between the regulation of exclusionary and exploitative conduct: whereas exclusionary conduct is an offense against antitrust law on both sides of the Atlantic, exploitative conduct generally only breaches EU law.

This article analyzes these regulatory approaches, their historical and theoretical roots, as well as the differences that exist in practice between the two systems. As will be shown, the divergent legal rules reflect different ideological goals and different assumptions about how markets operate. The U.S. views the unregulated economy as essentially competitive, if the creation of artificial barriers is prohibited. This approach places significant emphasis on the workings of the market and considers monopoly created by means other than

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2 The article does not deal with prices that apart from being exploitative are also part of an anticompetitive scheme. Such might be the case, for example, when an owner of an essential facility charges an excessive price for granting access to the facility. Such price, apart from being exploitative, can also be exclusionary. See, e.g., Napier Brown/British Sugar, 1988 O.J. 284/41, [1990] 4 C.M.L.R. 196.
artificial barriers to be relatively unimportant. It also reflects the limited role granted to government in regulating markets directly and the social, moral and political values attributed to the process of competition. EC law reflects a lesser belief in the ability of market forces to erode monopoly and a stronger belief in the ability of a regulator to intervene efficiently in setting the business parameters of firms operating in the market. It also reflects a stronger emphasis on distributional justice.

The importance of the analysis lies beyond antitrust intervention in monopoly pricing, as it opens a window to much broader themes that underlie the competition policies of both jurisdictions and enables us to exemplify and contrast the foundations of both regulatory systems. The regulation of excessive pricing encapsulates issues such as the goals and underpinning of EC and U.S. antitrust systems; the equilibrium point that was adopted to balance between the forces of Darwinian capitalism and those of social justice; the role of government regulation; the balance between practical problems and theoretical principles; and the assumptions regarding the relative administrability of various types of regulation. Monopoly pricing regulation is thus, in many ways, a microcosm of competition policy.

The article proceeds as follows. The next two sections analyze and contrast the U.S. and EC approaches. The last section attempts to reconcile the two apparently conflicting approaches in order to find some common ground that might serve as a basis for the harmonization of competition policies on a global basis, a process that is currently underway. Many believe that given the reticent approach of the EC Commission toward the application of the excessive pricing rules, harmonization of the two different approaches is feasible. In my view this is not necessarily true.

II. U.S. approach: no prohibition of monopoly pricing

U.S. competition law does not prohibit monopoly pricing, as such. The main antitrust statute, the Sherman Act, was early on interpreted as prohibiting only exclusionary conduct that created or maintained a monopolistic position, rather than the monopolistic status or its exploitation. Even the Federal Trade Commission Act, which
incorporates the notion of fairness into the antitrust arena, relates to "unfair methods of competition" only. The Supreme Court stated that "size and power, apart from the way in which they were acquired or the purpose with which they are used, do not offend against the law."3 Nor do related phenomena, such as large market share, monopoly pricing and restricted output, which were not achieved by anticompetitive means.4 Modern American antitrust has not challenged this view and continues to leave monopoly pricing, as such, unregulated.

This section seeks to explore the historical and ideological roots of the American rule, but does not stop there. It also asks whether this rule is grounded in current U.S. antitrust paradigm, rather than just "tagging along" for historical reasons. I focus both on the economic reasoning that dominates much of modern antitrust law and on the law’s much broader ideological basis.

A. The development of the rule against monopolization

U.S. antitrust law originated from the need to limit the consequences of size and power. Why, then, did it not limit the most obvious form of exercise of monopoly power? To answer this question, we must consider the history of U.S. antitrust. The Sherman Act, adopted in 1890, was based in some part on common law rules regulating restraints of trade. Indeed, the principal sponsor of the Act, Senator John Sherman, declared that it "does not announce a new principle of law, but applies old and well-recognized principles of the

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4 For a modern statement of this rule see, e.g., Berkey Photo v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP (S.Ct., January 13, 2004). See also Eleanor M. Fox, Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity and Fairness 61 Notre Dame L. Rev. 981 (1986). It should be noted, however, that cost/price differences are sometimes calculated in private damage suits, based on allegations of monopolization.
common law." The common law did not generally regulate monopoly, as such. Rather, it set rules that limited the ability to establish state-created or quasi-public monopolies and it prohibited some forms of conduct of such monopolies, once created. Yet the Sherman Act did not simply enact the common law, as it applies to all monopolies regardless of their origin. Courts were thus inevitably required to interpret and create a new set of rules for monopolies.

The U.S. approach must therefore be understood in light of the socioeconomic philosophy and suppositions that were prominent at that time. One of the most important assumptions on which the rule against the regulation of mere monopoly was based was the belief in the strength of market forces. It was widely believed that if the law will prevent artificial barriers to entry, then the self-correcting forces of the marketplace will generally prevent the attainment and maintenance of monopoly power. This rule was informed by the classical economic conviction that to assure common welfare, markets should remain open and competitive. The force of the self-correcting tendency was suggested by the relative rarity of persistent single-firm domination in the major national markets that was not the result of exclusionary conduct. Perhaps this strong faith in the market also reflected the optimism of the frontier spirit that markets will eventually work to the general benefit.

Accordingly, early antitrust cases placed significant emphasis on the ability of the market's invisible hand to deal effectively with monopolies. The Court's reasoning in Standard Oil is a telling example:

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5 21 Cong. Rec. 2456 (1890).


9 Standard Oil Co. v. United States, 221 U.S. 1 (1911).
By the omission of any direct prohibition against monopoly in the concrete, [the Sherman Act] indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted.

Note the extremity of the argument: the freedom to contract will inevitably prevent the creation of monopolies.

This "why fix what ain't broken" approach is also mirrored in another early decision, *American Can*, in which the Supreme Court stated that perhaps the framers of the Anti-Trust Act believed that, if such illegitimate attempts were effectively prevented, the occasion on which it would become necessary to deal with size and power otherwise brought about would be so few and so long postponed that it might never be necessary to deal with them at all.

Indeed, congressional debates prior to the enactment of the Sherman Act reveal that the perceived strength of the market to prevent monopoly was an important basis of the rule against antitrust intervention in monopoly pricing. As Thorelli observes:

Congress believed in competition. . . . As a general rule, business operated best when left alone. The government's natural role in the system of free private enterprise was that of the patrolmen policing the highways of commerce. . . . Translated in to the terms of commerce this means that occupations were to be kept open to all who wished to try their luck . . . and that hindrances to equal opportunity were to be eliminated. Government intervention should remove obstacles to the free flow of commerce, not itself become an additional obstacle.

Still, the belief in the market's invisible hand alone cannot explain the rule against intervention. Despite the Court's statement in *Standard Oil*, even at the twilight of the 19th century it was clear that the market alone cannot prevent all forms of monopoly and some firms succeeded

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10 *American Can*, supra note 3.
11 Id.
12 THORELLI, supra note 8, at 226–27.
in gaining size and power without resorting to exclusionary techniques, although theories of market failure were much less developed than they are today. The roots of this rule ran deeper, to the ideology that stood at the basis of antitrust law and the rights it sought to protect.

U.S. antitrust has its genesis as a social response to industrial development and change. During the second half of the 19th century new industries underwent ambitious expansion, both horizontal and vertical, in the form of large industrial combinations—trusts—that dominated many important markets. While economic growth was generally valued, the conduct of some of these trusts was seen as challenging the economic, political and social order. The trusts, by creating artificial barriers to free and open competition, were achieving large scales that threatened to dominate markets, frustrate the ability of new entrepreneurs to enter the market and compete on merit, and achieve political power. They provoked a strong social response that led, eventually, to the enactment of the Sherman Act. 13

Much ambiguity remains with regard to the intentions of the framers of the Sherman Act. 14 Yet they all shared a common belief in the importance of competition as the mainspring of American progress and prosperity. 15 Competition, it was believed, safeguarded the social

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14 Some historians maintain that the Act was a fraud, contrived to soothe the public without injuring the trusts, as Congress was itself dominated at the time by many of the very industrial magnates most vulnerable to real antitrust legislation. See, e.g., Merle Fainsod & Lincoln Gordon, *Government and the American Economy* 450 (1941). Others argue that it was a special interest legislation, designed to favor the coalition of small businesses. See, e.g., *The Causes and Consequences of Antitrust: The Public Choice Perspective* (Fred S. McChesney & William F. Shughart II eds., 1995); Thomas DiLorenzo, *The Origins of Antitrust: An Interest Group Perspective*, 5 Int’l Rev. L. & Econ. 73 (1985). Bork argued that its main goal was efficiency. Robert Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & Econ. 7 (1966). For criticism of this approach see, e.g., Herbert Hovenkamp, *Federal Antitrust Policy* 48–49 (2d ed. 1999).
15 Hovenkamp, *supra* note 14, at 50–51.
goal of free economic opportunity. America was thought to have been made possible by the particular type of character that was forged by competitive individualism, by the sight and pursuit of business opportunity and by the incentives of consumers for productiveness created by the wish to afford high-priced goods. For this process to continue it was necessary that newcomers be able to become entrepreneurs on reasonably equal terms. Competition was also valued for psychological and moral reasons as a disciplinary value for character. It was not merely an apparatus for the production of goods and services; it was a set of rules for enhancing good conduct. Antitrust thus reflected a vision of society and of the individual’s participation in the economic enterprise. Accordingly, it focused mainly, when dealing with monopolies, on wrongs of exclusion.

Competition was also valued for safeguarding the political process from capture by private economic power. The threat that a trust-of-trusts would one day be stronger than civil government itself, haunted the minds of many in the industrial era. This threat was likened to political domination. In the words of Senator Sherman: “if we would not submit to an emperor we should not submit to an autocrat of trade.” The hostility toward bigness thus focused on its political and social harms, rather than on allocative efficiency. Only a few statements in the congressional debate can be associated with efficiency or with the distributional effects of monopoly pricing.

This conception of the role of free competition is directly linked to the then dominant liberal, constitutional tradition. As May argues, at the Act’s inception the Constitution was attuned to protect economic opportunity, property, contract and political liberty from the excesses

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19 21 Cong. Rec. 2460 (1890).
of governmental power. Antitrust, it was believed, would protect these same values from the new "autocrats of trade."\textsuperscript{20} At the same time, it also followed the separation of powers principle by limiting the direct regulatory role of the government in the market.

The Sherman Act thus sought to advance a variety of libertarian economic, social and political values, and to achieve that by neither mandating nor constraining the end results of business activity, but rather by assuring that the market remained competitive. It was a process-based, rather than an end-state approach. The main focus of the Act was thus not on price levels themselves, but rather on the preservation of the competitive functioning of the market, since the goals which the Act sought to protect were not directly harmed by monopoly pricing. In addition, as Hovenkamp points out, the decade before the enactment of the law was one of rapid economic growth and declining prices, even in those industries dominated by trusts. It is thus unlikely that the U.S. Congress would have picked that time to intervene in the economy by way of directly regulating high prices.\textsuperscript{21}

In addition to this ideological underpinning of the Sherman Act, early Court decisions recognized the pragmatic and practical difficulties in setting a "correct" price level. As early as 1897, the U.S. Supreme Court held with respect to a defense that allegedly illegal shipment contracts set reasonable rates, that:

\begin{quote}
[T]he subject of what is a reasonable rate is attended with great uncertainty. . . . [E]ven after the standard should be determined there is such an indefinite variety of facts entering into the question of what is a reasonable rate, no matter what standard is adopted, that any individual shipper would in most cases be apt to abandon the effort to show the unreasonable character of a charge sooner than hazard the great expense in time and money necessary to prove the fact. . . . To say, therefore, that the Act excludes agreements which are not in unreasonable restraint of trade . . . is substantially to leave the question of unreasonableness to the companies themselves.\textsuperscript{22}
\end{quote}


\textsuperscript{21} HOVENKAMP, \textit{supra} note 14, at 50.

\textsuperscript{22} United States v. Trans-Missouri Freight Assn., 166 U.S. 290 (1897).
This reasoning is indicative of the recognition of the practical difficulties of price regulation. Other decisions stress that supervision of economic performance which requires constant scrutiny and adjustment is foreign to the Sherman Act.\textsuperscript{23}

Later opinions recognized the importance of monopoly pricing for the dynamics of the market mechanism. Judge Learned Hand is famous for his opinion in the \textit{ALCOA} case, in which he stated that

\begin{quote}
    a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: \textit{finis opus coronat}. The successful competitor, having been urged to compete, must not be turned upon when he wins.\textsuperscript{24}
\end{quote}

Judge Learned Hand seems to recognize the importance of monopoly profits as part of the engine that makes markets work. Monopoly pricing creates incentives for firms to compete and invest in cost-reducing or welfare-enhancing products, services or processes that might enable them to gain a comparative advantage and achieve a monopoly position to enjoy its fruits. Limiting the profitability of monopolists that achieved their position solely by fair competition distorts the incentives of firms to become more efficient. The effect might be impaired innovative performances, low levels of research and development, and productive inefficiency. The question is, of course, how significant this disincentive effect is likely to be. The \textit{ALCOA} decision does not attempt to raise this question. Nor do other decisions from that time.

\textit{ALCOA} can also be understood as making an argument about fairness: once we view competition as a process in which firms are urged to take part and compete, regulation of monopoly pricing may also be seen as an unfair denial of earned rewards. Assuming that exclusionary conduct is prohibited—that is, antitrust laws actually succeed in preventing the conduct of the monopolist or the would-be monopolist that creates artificial barriers to entry—monopoly is a

\textsuperscript{23} See, e.g., United States v. Trenton Potteries Co., 273 U.S. 392 (1927) ("The reasonable price today may through economic and business changes become the unreasonable price of tomorrow.").

\textsuperscript{24} United States v. ALCOA, 148 F. 2d 416 (2d Cir. 1945).
result of the market mechanism. The law should thus not condemn the
"natural behavior of the monopoly." 25 This is strengthened by the fact
that "monopolizing" is a crime as well as a civil wrong and "persons
may unwillingly find themselves in possession of monopoly." 26
Interestingly, we shall see that EC law also rests on a fairness
argument, but one that focuses on consumers rather than on producers.

Let us consider this last argument more carefully. Considering that
the monopoly has a property right over its assets, which were gained
legally, does it follow that it has the right over the fruits of these
assets, that is, monopoly profits? Alternatively, can we base this right
on the freedom to trade—the right to profit from one’s position in the
market, which was gained or maintained without resort to
exclusionary conduct? In my opinion the answer must be negative.
These rights do not stand on their own. Rather, they must be balanced
against the harm to consumers. It is thus doubtful that the U.S. rule
against intervention in monopoly pricing can be explained by a
simplistic property or freedom of trade argument, as it would lead to
an outright annulment of the antitrust laws.

In sum, the U.S. approach resulted from a combination of factors,
most pointing strongly in the same direction. At its core is the strong
belief that unrestrained interaction of competitive forces will yield the
best allocation of economic resources, while at the same time
providing an environment conducive to the preservation of democratic
and social institutions. The remedy for infringement—treble damages
or even a criminal prosecution—may have also encouraged a
narrower interpretation of the antitrust laws.

This section would not be complete without mentioning several
suggestions that have been made over the years to regulate mere
monopoly. The proposals were seen as an attempt to fill what was
perceived to be a gap in the law dealing with monopolies and other
concentrated market structures that the market does not succeed in
eroding in due time and that have adverse consequences. These
proposals reject the argument that structure will take care of itself as

25 Id.
26 Id.
based on average tendencies. The proponents raise the argument that although the market can correct dominance in most cases, aberrations can and do appear, and the implied time horizon for self-policing to be efficient may be unacceptably long. None of these proposals were ever adopted.

B. Modern day paradigms

Interestingly, making the argument that monopoly pricing regulation by the antitrust laws is not in society's favor still seems grounded in U.S. modern-day antitrust paradigm. The preferred rule toward intervention in monopoly pricing is the same as in the past, but the analysis and the balancing of considerations is more complicated. Again we see a process-based approach, but for different reasons. The modern antitrust debate is generally dominated by economic reasoning and a libertarian approach. According to this view, market conduct should not be regulated unless it can be shown that regulation improves economic performance sufficiently to offset its costs. I thus attempt to test the U.S. rule within this paradigm.

Even today, the belief in the self-correcting tendencies of the market is still one of the main bases on which the legal rule against antitrust intervention in monopoly pricing rests. But the argument is a much more subtle one: it is no longer believed that the market will "inevitably prevent" all instances of monopoly, but that monopoly that exists over long periods of time will be relatively rare. Where competitive conditions may develop, high prices tend to attract new


Parts of this section are based on Michal S. Gal, Competition Policy for Small Market Economies ch. 3 (2003).
firms into the market that seek to enjoy the high profits attainable. Such new entry, or the fear of it, constrains the monopolist’s power to raise prices. Competition is thus regarded as a dynamic process that may sometimes contain the seeds of its own short-termed destruction but also for the revival of competition in the long run.

At the same time, modern economics recognizes many market failures that may not allow market forces to perform their self-correcting task efficiently and expeditiously. There are several reasons, other than superior performance, for the persistence of market power. Furthermore, dominance does not necessarily imply prior or existing superiority on any absolute scale. For instance, in the presence of network externalities the attainment of monopoly power may result from first-mover advantages rather than from superior efficiency. While these exceptions might be relatively rare, they may exist for long periods of time and reduce allocative efficiency significantly.

Yet even if market forces cannot efficiently erode existing market power, U.S. current thinking recognizes several factors that counsel against antitrust intervention in monopoly pricing. Most important is the reduction of the incentives to invest in efficiency-enhancing products or processes in order to gain a comparative advantage and possibly become a monopolist that may result from such intervention. This consideration was strongly emphasized by the Supreme Court in its recent *Trinko* decision, as follows:

> 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.29

The question is, of course, how significant this disincentive effect is likely to be. The answer depends primarily on the nature of the market and the position of the firm in it at the time highly successful competitive strategies are identified or implemented. Generally, the more likely that the competitive conduct would lead to a dominant position, the greater the disincentive to engage in such conduct. But

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29 *Trinko*, supra note 4.
even if the competitive move were to subject the firm to regulation, deliberate reduction of research and development might enhance the risk of an even greater loss in market position.30

The above considerations could still justify regulation of monopoly pricing where market forces have very limited power to erode a monopoly position due to significant and long-term market failures. The main factor, which has led to the rejection of the regulation of monopoly pricing even in such situations, is the strong skepticism toward the efficacy of government intervention. Arguments center on the theoretical and practical difficulties in determining what is a "reasonable" price, especially when cost, demand, and technological functions are constantly changing. A prohibition not based on a manageable, understandable, and reasonably administrable set of rules would create a high level of uncertainty. Another consideration focuses on the ability of an outside body to regulate efficiently the decisions of a private firm. In a simplified way, regulation can be viewed as a game between the firm and the regulator, in which the firm is intent upon profit maximization while the regulator seeks to maximize social welfare. One of the main difficulties that the regulator faces in achieving optimal regulation is asymmetric information. The fact that the regulator is one step removed from the operations of the productive entity necessarily limits his access to the required information and his ability to evaluate such information.

In addition, the institutional features of the courts, on which the task of regulation is placed, are ill-fitted to perform that task. As Turner has argued, courts that would attempt to prevent monopoly pricing by ordering lower price levels would be forced to act as public utility commissions.31 An injunction that would simply prohibit the defendant from further charging monopoly prices would be too vague. It would not give an efficient indication for the correct set of prices that would be deemed lawful. An order requiring the monopolist to set price equal to marginal cost would also be very hard to enforce, given all the factors that affect the cost function of the firm, and would have

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30 Areeda & Hovenkamp, supra note 7, at 58–62.

to be constantly adjusted to changes in that function. Moreover, the specialist knowledge and the steep learning curve needed to regulate pricing of each specific firm or industry is likely to be sufficiently important to justify a hands-off approach. Accordingly, such an order cannot be effectively enforced with good prospects for materially solving the resource allocation problems without involving the courts in an ongoing and complicated regulatory function. It is thus argued that antitrust litigation, already costly and complex, would become unworkable, and the instability caused might result in an outcome worse than the currently existing one. Such regulation is also inherently contradictory to the notion of antitrust, because it involves the perpetual monitoring of prices.

In sum, the rule against antitrust intervention in monopoly pricing survived different stages in U.S. economic thinking, influenced by the judicial attitudes and the theoretical knowledge (or belief) prevailing at the time. The hands-off approach was based, at its inception, on the belief in the self-correcting tendency of the market and the limited role of government in regulating markets. The modern paradigm is based on a dynamic analysis of the market and the economic effects of monopoly pricing regulation. The basic premise still remains that most markets are competitive and monopoly tends to be self-correcting. But even when markets are not competitive, it is believed that the costs of regulation are likely to outweigh its benefits.

III. EC: excessive prices as abuse of dominant position

EC law prohibits some types of monopoly pricing. Article 82 of the Treaty of Rome contains a nonexclusive list of abuses of dominance, which includes both exclusionary as well as exploitative conduct. In particular, subsection (a) prohibits “directly or indirectly imposing unfair purchase or selling prices . . .” by a dominant firm. This provision has been interpreted as proscribing high monopolistic prices, with no need to prove that competition has been harmed. This possibility was first acknowledged by the European Court of Justice (ECJ) in Sirena\textsuperscript{32} in 1971.

Monopoly pricing was first squarely considered by the ECJ in *General Motors*.\textsuperscript{33} Belgian authorities had delegated to all automobile manufacturers' representatives the duty to inspect and issue certificates of conformity to all vehicles of their respective trademarks entering the country. General Motors (GM) charged a very high fee for this service. The Commission found that GM had a dominant position in granting certificates of conformity for its automobiles crossing the Belgian border\textsuperscript{34} and that the high fee constituted an abuse of dominant position. GM sued for annulment. Although the Court found no abuse on the facts before it in view of GM's explanation and its immediate refunds to customers once the inquiry commenced, it recognized that, in principle, an abuse could include "the imposition of a price which is excessive in relation to the economic value of the service provided."\textsuperscript{35} This rule was reiterated in several other decisions.\textsuperscript{36} It is thus established law that, at least in theory, monopoly pricing might constitute an abuse of dominance. Following the *General Motors* decision, this prohibition has come to be known as the rule against excessive pricing.

The objection to excessive pricing is that the monopolist is using his monopoly position to "reap trading benefits that [he] would not have reaped if there had been normal and sufficiently effective competition."\textsuperscript{37} It follows that the monopolist bears special duties not to fully exploit his monopoly power and not to create too great allocative inefficiency in the market. The prohibition against


\textsuperscript{34} The Commission arguably erred in its market definition in *General Motors*, id. The definition disregarded the effects of interfirm competition on intrafirm competition. The following discussion takes this market definition as given, as the correct one is irrelevant to the substantive tests established for excessive pricing once market dominance is established.

\textsuperscript{35} Id. ¶ 12.

\textsuperscript{36} See cases cited below.

excessive pricing is based on the assumption that there is some "fair" price that is exogenous to the circumstances of the specific trade, and that such a price could be established by the Commission or by the courts. Accepting monopoly pricing implies accepting the existing distribution of wealth and power;\textsuperscript{38} regulating monopoly pricing implies its rejection.

This section seeks to analyze the historical and theoretical roots of the rule against excessive pricing, as well as its application in practice. It is argued that the rule has very little practical value in Community institutions. Yet it may still be alive and kicking due to the diffusion of EC law to member states and, possibly, due to potential private enforcement of the Treaty.

A. \textit{Historical and ideological roots of the rule against excessive pricing}

In what paradigm is the rule against excessive pricing grounded? Let us first ask whether the condemnation of "unfair" high prices is an inevitable interpretation of the law, or whether it might have been interpreted instead as prohibiting only low, predatory prices, designed to eliminate or weaken a competitor. Section 82(a), standing alone, does not mandate the former interpretation. "Unfair" prices do not necessarily imply that high prices must be included. Yet the latter interpretation is strengthened by the next subsection, which defines "limiting production . . . to the prejudice of consumers" as an abuse. Subsection (b) is, in fact, a reflection of subsection (a), as limiting production is another way to ensure that high prices prevail. The focal point of subsection (b) is harm to consumers, rather than to competitors or to competition. While it is true that harm to competition may result in harm to consumers, the legislator has specifically indicated that a practice that is harmful to consumers can be abusive, notwithstanding that it is not harmful to competition. It is also interesting to note that while the authentic English text of the Treaty uses the word "abuse," most other languages use the double concept "abusive exploitation," which

might be thought to forbid the exploitation of those with whom the dominant firm deals.\textsuperscript{39}

Why did the signatories of the Treaty of Rome seek to prohibit "unfair" monopolistic prices? As a great deal is still unknown about the genesis of the Treaty since the discussions surrounding its enactment are not yet unveiled, one must explore the historical and ideological underpinnings of EC law. The six original members of the European Community all had strong protectionist and prescriptive traditions. These member states were much less skeptical than the U.S. about the efficiency of direct regulation of the market. In fact, Germany, which had the strongest antitrust tradition of the six signatories, prohibited the earning of "monopoly rents." It might also be that the rampant inflation after World War II experienced by many European countries naturally led to a strong interest in an economic policy that ensured lower prices. The fact that many dominant firms were created, controlled or protected by national governments might also have played a role, as such monopolies were not likely to be eliminated by market forces.

But more fundamentally, the excessive pricing prohibition should be understood in light of the basic aim of the European Community, which was to open markets all across the Community and to create a single common market. The driving paradigm behind the Treaty was the substitution of age-old rivalries with the merging of essential interests, to create, by establishing an economic community, the basis for a broader and deeper understanding among countries and peoples long divided by bloody conflicts.\textsuperscript{40} Accordingly, article 2 of the Treaty sets forth the principles that must ultimately guide the Commission and the courts in the application of the Treaty, as follows:

\textsuperscript{39} \textit{Competition Law of the European Community} 3-29 (Valentine Korah ed., 2002).

\textsuperscript{40} From the preamble of the Treaty Establishing the European Coal and Steel Community 1951. \textit{See also} David J. Gerber, \textit{The Transformation of European Community Competition Law?}, 35 \textit{Harv. Int'l L. J.} 97, 101–03 (1994).
To promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of standard of living and closer relations between the States belonging to it.\textsuperscript{41}

EC policy is thus based on broad, and sometimes conflicting, aims that are concerned not only with promoting economic efficiency and a free market economy, but also with achieving broader social and political goals, most notably the creation of a single, integrated European market.\textsuperscript{42} The excessive pricing prohibition must be analyzed in light of these goals. Although there is very little analysis of how this prohibition furthers the goals of the Treaty, some observations are analyzed below.

At first blush, the regulation of excessive prices might seem contrary to the basic goal of establishing an integrated common market. Regulation of price levels, as such, does not reduce barriers to trade between member states. On the contrary: it might slow down the natural self-correcting tendency of market forces if incentives to enter new markets and gain high profits are weakened.

Yet the rule against excessive pricing might be understood in a broader context, as increasing the level of trade between member states and advancing the goal of a “harmonious development of economic activities” by reducing significant price disparities among consumers in different member states. Accordingly, the rule furthers the goal of integration by artificially creating relatively similar conditions in all member states: it prevents a dominant firm in one market from charging prices significantly different from those charged by other firms for comparable goods or services in other markets; it might also reduce the differences in prices charged by a dominant firm to different consumers, even if such prices do not place consumers at a “competitive disadvantage,” as the rule against price discrimination requires.\textsuperscript{43} The excessive pricing prohibition thereby broadens the goal of

\textsuperscript{41} Article 2, Treaty of Rome 1957. See also the preamble to the Treaty.

\textsuperscript{42} SIR LEON BRITTAN, EUROPEAN COMPETITION POLICY: KEEPING THE PLAYING-FIELD LEVEL 3 (1992).

\textsuperscript{43} Article 82(c) of the Treaty of Rome 1957.
nondiscrimination to markets that are not in direct competition, to ensure
that all consumers and input-buyers in the Community are equally
served. It should be noted, however, that this possible reasoning does not
explain the potential breadth of the rule against excessive pricing, which
does not differentiate between firms that supply comparable goods or
services to those supplied elsewhere in the Community and those that do
not; it deals with all monopolies equally. Equal levels of prices among
member states, high as they may be, do not, in themselves, create
obstacles to the harmonization of economic activities. Such an
interpretation is also limited by the Treaty's requirement that for unfair
pricing to be an offense it must affect trade between member states.

The position adopted by the EC toward excessive pricing can
alternatively be explained by the fact that the signatories of the Treaty
recognized that the emerging common market needed companies of
bigger size than those prevailing. Large firms would be needed to
achieve optimal scales once barriers to trade between member states
were reduced. Yet the signatories may have been less confident than
their U.S. counterparts that high prices will attract sufficient entrants
to lead to lower prices. Accordingly, price regulation was seen as
necessary to protect customers until competition develops more fully.
This need was strengthened by the fact that the Treaty does not apply
to the acquisition of a dominant position, thereby justifying a stricter
policy toward the consequences of market power, once achieved,
including monopoly pricing.

Still, the EC rule against excessive pricing is based not on purely
economic arguments, but on fairness, as indicated in the language of
the law itself ("unfair prices"). The question to be asked is thus: Unfair
in what way? To answer this question one must apply a different
conceptual lens and engage in a normative analysis that focuses on
conceptions of fairness and how they apply to monopoly pricing.

Monopoly pricing may cause harm (at least in the short run) to
final consumers who pay more, to producers who use the monopolist's
products or services as inputs and to society, as it creates a deadweight

44 2 BARRY HAWK, UNITED STATES, COMMON MARKET AND INTERNATIONAL
loss. The question is on what grounds such harm is "unfair," and even if there is no harm, whether monopoly pricing, in itself, breaches notions of fairness.

Let us focus on consumers. One might argue that the consumer has a right to enjoy some part of the total welfare created by the trade. This argument assumes that the seller has a right to profit, but only to a certain "fair" limit. Beyond that limit, the monopolist is extracting profits to which he does not have a right. The question still remains, on what such a right is based, especially if the high price is a result of natural market forces rather than a state-created or a state-protected monopolist.

At its inception and during the first two decades of its application, the Treaty of Rome was strongly influenced by the Ordoliberal ideology developed by the Freiburg School of German academics before and immediately after the Second World War. Against the backdrop of economic and social chaos and amassed power, the Ordoliberals attempted to create a tolerant and humane society that would protect human dignity and personal freedom while creating a framework for the well-functioning of the market. The Ordoliberal ideology stressed the need for an economic constitution that would limit the convergence of private economic power in the interest of a free and fair political and social order. To achieve this goal, it posited the need to regulate the conduct of dominant firms by requiring them to act in a manner consistent with a competitive economic model. It also stressed the goal of fairness, which was understood as protecting the individual’s economic freedom of action as a value in itself against any impairment of market power.

45 Some parts of the discussion of fairness build on Adi Ayal (S.J.D. thesis, Bar Ilan University).


47 Id. at 240.

48 Id. at 244–51.

49 Werhard Moschel, Competition Policy From an Ordo Point of View, in German Neoliberals and the Social Market Economy 142 (A. Peacock & H. Willgerodt eds., 1989).
Accordingly, excessive pricing was regarded as abuse of market power as it created an inequitable distribution of the benefits of the market.

Ordoliberalism still influences EC law today, although to a smaller extent. Still, a fairness argument can also be made on other grounds. A possible argument is that of an implied social contract between all market players (including producers, consumers, and the public authorities) regarding the “rules of the game” in the marketplace. According to this argument, any producer knows that he is allowed to become a monopolist, but is not allowed to enjoy profits beyond some preset limit. The State creates a setting for the game by creating and enforcing property rights and contractual obligations and by limiting the creation of artificial barriers to competition, at the price for the producers of limiting monopoly profits, once a monopoly position is achieved. On what basis could such a social contract be justified? One possible basis, following Rawlsian theories, is an agreement between all relevant players prior to the beginning of the game and before each player knew what role it would be playing in it.50 To justify the excessive pricing rule one must therefore assume that even a successful monopolist might have chosen to prohibit excessive pricing, if asked ex ante, before he knew whether he would be a producer, and if so how successful, or a consumer.51

The social contract may alternatively be based on the maximization of social goals. The framers of the Treaty, as delegates of a democratic system, set the market rules that will further the welfare of all involved, even if not all market players might have


51 Rawlsian theorists also require that the rule also justify the positive requirement, known as the Maximin principle, that the least well off would get the largest (maximum) allocation of resources, compared to other allocations. Applying such a rule is, however, contextual, as it depends on the relative wealth of consumers and producers, which is not similar under all conditions. Yet it might still be argued that as a general proposition producers are better off than consumers. For criticism of the Maximin principle see, e.g., Kenneth Arrow, Book Review: Some Ordinalist Utilitarian Notes on Rawls’ Theory of Justice, 70 J. Phil. 245 (1973).
agreed to them if given a choice. One possibility is to justify the rule against excessive pricing as maximizing total social welfare. While monopoly pricing might be necessary in order to fuel the competitive process, beyond a certain level its harm to total social welfare might be larger than its benefit. Also, once market failures are taken into account, social welfare in the form of productive and dynamic efficiency is not necessarily maximized by enabling the monopolist to charge any price it wishes.

An alternative or cumulative argument focuses on distributive justice principles that stand at the basis of the social contract. Such principles can be grounded in moral argument or explained as based on the risk aversion of those setting the rules of the game, who will also later participate in it: as one does not know whether one would be a future winner or loser of the market game, a risk averse rule setter would limit the harm to the game’s losers—those that will not be able to afford high priced goods. Yet a simple distributive argument is problematic, as the excessive pricing rule adopted in the EC does not necessarily distribute the surplus created by the trade equally among all the game’s losers, as consumers have different elasticities of demand for different products. Also, reducing the cost of a product or a service does not necessarily protect the game’s losers, as it does not differentiate between products according to their consumers. A monopolist setting high prices for luxury hotel rooms and low prices for regular ones and one setting high prices for regular rooms are treated in the same way by the law. Antitrust is thus a crude tool to achieve distributional goals. This might justify a policy that maximizes aggregate welfare, to be redistributed by other means, such as tax policy. At the same time, a rule against excessive pricing might still be justified on distributive grounds as in many cases it does achieve its goal, albeit crudely, and it might also create a stronger perception of distribution and of social justice in the eyes of consumers than other tools do.

The rule against excessive pricing may also be justified by the concern with the social conditions for moral, political, and economic autonomy. In this view, the concentration of extensive and largely

52 I was introduced to this important insight in my discussions on fairness with Eli Salzberger.
unregulated private property rights in the hands of a minority might
deprive many individuals of the prerequisites for the realization of an
autonomous life: a basic income, education, etc. Regulation of the
exploitation of private property rights is thus justified if excessive
pricing would be harmful to the basic purpose of society, perceived as
the moral autonomy of the individual, gained through self-realization
rather than self-reliance.\textsuperscript{53} The problem with such justification is that
excessive pricing rarely produces such extreme results. It also does
not differentiate between those whose basic rights would be affected
by the monopolistic price and those who would not, and thus control
of excessive pricing is not necessarily an efficient tool for achieving
this goal.

Finally, one might argue that the prohibition against unfair pricing can
be based on communitarian notions of fairness.\textsuperscript{54} Similar to other notions
of fairness analyzed above, this approach also rejects utilitarianism as the
basis of social, or public justice. Under this approach a constitutive
conception of community describes a framework that is distinguishable
from, and in some sense prior to, the dispositions of individuals within it.
Enabling all members of the community to purchase similar goods or
services is then regarded as part of the communitarian ethos. Of course,
equal opportunity depends on much more than regulating excessive
prices, but it is a step in the right direction.

Thus, strong theoretical grounds might exist for a rule against
excessive pricing, at least one that is applied selectively. Yet the
question remains whether antitrust is an appropriate instrument for
achieving fairness. This question is the focus of the next subsections.

\textbf{B. What constitutes an “unfair” price?}

Once established that monopoly pricing can amount to an abuse,
the essential issue becomes at what point a price is so high that it
becomes abusive. The challenge then becomes drawing a clear line
between monopoly pricing that is “unfair,” and that which is not.

\textsuperscript{53} \textit{Trebilcock}, \textit{supra} note 6.

\textsuperscript{54} For the communitarian approach in general \textit{see}, \textit{e.g.}, \textit{Michael J. Sandel, Liberalism and the Limits of Justice} (1982).
The EC’s condemnation of monopoly pricing illuminates the practical problems involved in regulating the pricing decisions of dominant firms. The legal standards applicable to unfair prices are not defined by the law and have been left to judicial interpretation. The test adopted by the ECJ in General Motors,⁵⁵ which defined a price as abusive when it has no reasonable relation to economic value, is still the basic definition of unfair pricing today.⁵⁶ This laconic statement, however, does not give any indications as to the “reasonableness” of profit.

United Brands⁵⁷ was the first case in which the ECJ gave some insights into the character of the prohibition and the tests for its applicability. The case focused on the prices charged by United Brands for Chiquita brand bananas in several EC countries. The Commission found, inter alia, an abuse of dominance by way of excessive pricing. It reached its decision by using the prices United Brands charged its consumers in Ireland as a benchmark to evaluate its prices in other states which were considerably higher, sometimes as much as 100%.⁵⁸ Its reasoning was that the price in Ireland can be used as a reference point, since it could be assumed that United Brands would not sell at a loss. The Court annulled the Commission’s decision as being too simplistic. While it recognized that excessive prices can amount to an abuse, it found that the Commission did not meet the burden of proof, as it did not consider all objective justifications for price differentials between different markets, such as production costs, distribution costs and marketing. Nevertheless, the Court laid down the standard for finding excessive pricing as follows:

⁵⁵ General Motors, supra note 33, ¶ 12.
⁵⁷ United Brands, supra, note 37.
⁵⁸ Id. The Commission’s analysis is based on the assumption that price discrimination among customers is, of itself, an abuse of monopoly power. If, for example, the criterion for abuse was a reduction in output or in total welfare, then price discrimination would not have necessarily been considered an abuse, and the Commission could not have based its decision on it.
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.59

The decision, while leaving the door open to other methodologies, endorsed a cost-price test as a first step toward a finding of abuse. Such a test requires the Commission to make a comparison between the selling price of the product in question and its costs of production. A comprehensive cost analysis is therefore fundamental to determining whether a price is excessive. Yet the court itself acknowledged the difficulties in determining cost-price differences. Production costs are especially difficult to determine when long-term investments are made, when risk-factors should be assessed, when production costs of complex corporate structures with a wide product range or multinational production facilities must be apportioned, or when intellectual property is involved.60 But even if costs could be determined, the United Brands decision, and others that follow, provide no clear guidance as to the permissive scope for profits. It is unclear where to draw the line between high and excessive price, and what margin of profit a dominant firm should be allowed.

The next case that reached the ECJ was British Leyland.61 The case involved prices charged for the issuance of type-approval certificates for cars, much alike the General Motors case.62 The ECJ affirmed the

59 Id. ¶ 250–52.
62 General Motors, supra note 33.
Commission's finding of abuse, without a close scrutiny of the cost-price differentials. It did not engage in a comprehensive comparison of the service fee to the cost of the "simple administrative check" for which it was paid. Rather, it based its decision on the fact that importers of left-hand-driven cars had to pay six times the amount paid for right-hand-driven cars. The discriminatory nature of the charge emphasized its excessiveness, as it was charged in order to make intrabrand competition between British Leyland suppliers difficult.

An alternative test used by the ECJ to determine price excessiveness is the comparative market test, which compares the performance of one undertaking with that of another operating in a different geographic market, where a suitable comparator can be found. The test was first specifically applied by the ECJ in its Societe des Auteurs, Compositeurs et Editeurs de Musique (SACEM) decisions. There, the operators of French discotheques complained that SACEM, the French copyright collecting society, was charging more for licenses of performing rights than were similar collecting societies located in other Member States. The cases were referred to the ECJ for a preliminary ruling on whether the prices charged by SACEM qualified as "unfair trading conditions" if "that rate is manifestly higher than that by identical copyright societies in other Member States." The Court answered this question in the affirmative, stating that:

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 dominant position. In such a case it is for the undertaking in question to justify the difference in reference to objective dissimilarities between the situation in the member state concerned and the situation prevailing in all the other member states.

The SACEM judgments stand for the proposition that an objective comparison of price levels between comparable markets may serve as an alternative basis to a cost-price analysis for reviewing excessive

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64 SACEM II, id. ¶ 25.
Monopoly pricing

pricing allegations. In fact, in SACEM it was recognized that a cost-price comparison would be impossible, given the nature of the product—the creation and protection of a musical piece. Yet a comparison to prices charged by other firms may also not be easy, as one must objectively account for all the factors that affect cost levels in different markets.

The case also stands for the proposition that when a dominant firm’s charges are appreciably higher than corresponding charges in other Member States, and where a comparison of the fee levels has been made on a consistent basis, that difference will be regarded as indicative evidence of abusive conduct, thereby reversing the burden of proof. This rule is converse to the one applied in United Brands. There, it was decided that if cost-price differentials are high, the Commission, not the defendant, must prove that such a differential is excessive in comparison, inter alia, to prices in other member states.

SACEM is also interesting for its treatment of inefficiencies. In United Brands the Court stated that the basis for calculation would be costs, including a reasonable profit on the capital used. But in SACEM the Court stated that if a dominant firm’s costs were higher than those of firms providing the same service elsewhere, prices might be excessive, even if profits were not. Notably, the Court rejected an argument raised by the collecting society that differences arose as a result of a higher level of operating expenses. The Court stated that the possibility cannot be ruled out “that it is precisely the lack of competition on the market in question that accounts for the heavy burden of administration and hence the high level of royalties.” It follows that an investigation into excessive prices may sometimes extend to a critical analysis of the underlying cost structure of the dominant firm, in order to verify whether the excessive level of prices may be attributed to excessive costs. Such an analysis is economically justified as it might increase the incentives for dominant firms to reduce their inefficiencies. How wide this inquiry should be—

66 United Brands, supra note 37, ¶ 251.
67 SACEM II, supra note 63, ¶ 42.
whether, for example, it should include costs incurred in order to
preserve or create government-made barriers to entry that protect a
monopolistic position—is an interesting question that has yet to be
addressed.

The comparative market method to determine price excessiveness
was also recognized in Bodson,68 which involved allegations of
excessive prices by French providers of funeral services. The ECJ, in
a preliminary ruling, pointed to the comparative market test as a
possible method to determine the issue of excessiveness. As Pijnacker
Hordijk observes, Bodson seems to signal a more fundamental
departure from the cost-price approach than SACEM, since although
in SACEM it was not possible to carry out the cost-price analysis, this
is not necessarily true of funeral services.69 Notably, the price
comparison test might be preferable to the cost-price comparison if
the goal of the Treaty is the limitation of inefficiencies. It might also
be preferable for furthering the goal of integration.

Bodson is also interesting because it compares the monopolistic
price to price levels in competitive markets, a benchmark that is
debatable. It is noteworthy that both SACEM and Bodson were
preliminary ruling cases, in which the ECJ was not required to set the
exact level of price that would not be deemed excessive, but only set
general principles, to be later applied by the referring national court.
In both cases, as in the few other cases that reached the ECJ, the level
of difference deemed "unfair" was never clearly determined.

Nor do Commission decisions espouse a clear rule for
excessiveness. Apart from the cases cited above, there are only a few
other cases in which the Commission reached a formal decision on
price excessiveness, none of them providing clear guidance. The
recent case of Naloo70 is an especially interesting example. The case

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4 C.M.L.R. 984.

69 Erik Pijnacker Hordijk, Excessive Pricing Under EC Competition
Law: An Update in the Light of Dutch Developments, in INTERNATIONAL
ANTITRUST LAW AND POLICY (Barry Hawk ed., 2002).

focused on the Commission's decision not to bring a suit of excessive pricing against British Coal Corporation (BCC), which enjoyed a statutory monopoly over the extraction and the licensing of the extraction of unworked coal in the U.K. In so doing, the Commission rejected the complaint brought by Naloo, a BCC licensee. The test for excessiveness adopted by the Commission was that "the royalty will not prevent efficient companies [downstream] from making a profit [or] impose a significant competitive disadvantage." This test focuses on the effects on competition and competitiveness downstream, rather than on the profits of the dominant firm. It is essentially similar to that adopted for access to essential facilities, which focuses on nondiscrimination rather than on excessiveness, and is thus a more economic-oriented approach to monopoly pricing. Although Naloo was not based on article 82 of the Treaty of Rome 1957 but rather on similar prohibitions in the European Coal and Steel Community Treaty, it is still indicative of the Commission's approach.

There are also a handful of cases in which the Commission never reached a formal decision, after they were settled between the Commission and the alleged abuser. In Deutsche Telekom, for example, the Commission performed a cost-profit analysis and an international price comparison, which demonstrated that price levels were 100% higher than in comparable competitive markets. The statement released by the Commission indicated that tariffs were lowered by 38% for access to the local network and by 78% for access to the long-distance network. It failed, however, to give a theoretical underpinning for the price levels agreed upon.\(^7\)

As the foregoing demonstrates, even after more than 30 years since the prohibition was first recognized, there is still no sufficiently predictable and concrete definition of what constitutes excessive pricing.\(^7\) While the sparse case law on the subject has established

\(^7\) See also Commission, Tenth Report on Competition Policy §§ 136–37 (1980).

\(^7\) For practical problems of regulating prices through the Courts and setting the correct price see also the New Zealand case of Telecom Corporation of New Zealand Ltd. v. Clear Communications Ltd., [1995] 1 N.Z.L.R. 385 (PC).
some methodological tools to determine cost-price differences, it remains vague and unclear with regard to the tests for appraising price levels. In fact, only in British Leyland the ECJ found an actual abuse of dominance by way of excessive pricing. Most additional cases in which it acknowledged the possibility that such an abuse could be found on the facts—including SACEM, Bodson, Ahmed Saeed\(^{73}\) and GT-Link\(^{74}\)—were preliminary ruling cases in which it did not have to decide itself whether charges were unfair. In Naloo\(^{75}\) it sent the case back to be determined by the Commission on the facts.

The problem is, of course, that the imprecision of the legal criteria runs the risk of discouraging legitimate and desirable competition of dominant undertakings.\(^{76}\) This would particularly be the case were the Commission to adopt a more rigorous enforcement policy than the one currently adopted, as elaborated below. At the same time, it should be noted that establishing a bright line between abusive and nonabusive price might not always be necessary. Rather, in cases in which the remedy is a fine for abusive behavior what needs to be established is that prices are way above their competitive level. The fine might then be based on an external criteria, such as the turnover of the dominant firm.

\section*{C. Current state of enforcement: is free competition replacing unfair competition?}

These formidable problems of identification and delineation of excessive pricing have led the Commission to devote only minimal resources to such cases. The Commission has acknowledged the difficulty of ascertaining in any given case whether an abusive price has been set, for “there is no objective way of establishing exactly

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\(^{75}\) Naloo, supra note 70.

what price covers costs plus a reasonable profit margin." Prohibiting excessive pricing would also require it to act as price regulator, with the task of second-guessing the market as to what should be the correct price level and to monitor compliance with the standards set, tasks for which it is not fit. Consequently, since United Brands the Commission has been reticent about taking decisions on unfair prices per se, and most of the cases that came before the ECJ on issues of abuse were cases referred to it by national authorities for preliminary rulings. Interestingly, the reasons provided for the Commission’s approach are of a pragmatic rather than a fundamental nature. That is, if there existed precision in legal criteria—i.e. if the line between unfair and fair pricing was easily discernible and would not create any uncertainty—there would still be justification for applying the prohibition more determinedly under the Commission’s reasoning.

The reticent approach of the Commission toward the enforcement of the excessive pricing prohibition has been applauded by many prominent European scholars, who have voiced arguments against direct control of prices which go beyond practical problems of legal precision and the lack of competence of courts, to the importance of price signaling and the natural self-regulating tendencies of the market.

Accordingly, the Commission has focused primarily on facilitating market entry rather than on regulating “unfair” prices per se. Most of the cases brought by the Commission on grounds of excessive pricing were essentially of exclusionary rather than of exploitative nature and involved a second legal objection that centered on barriers to entry or

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77 Commission, Fifth Report on Competition Policy (1975), point 3: “measures to halt the abuse of dominant positions cannot be converted into systematic monitoring of prices.” See also Commission, XXIV Report on Competition Policy (1994), at point 207: “The Commission in its decision-making practice does not normally control or condemn the high level of prices as such”; and Commission, XXVII Report on Competition Policy (1997), at point 77.

to market integration. General Motors and British Leyland, for example, focused on artificial barriers to parallel trade in cars. In recent years the Commission has been vigilant in investigating allegedly high prices charged by dominant firms that control essential facilities, and thus involve access issues. Many of these cases can be solved through the prohibition against price discrimination, as usually the pricing of the dominant firm is discriminatory. Emphasis is thus shifting from “fair” competition to free competition, although some cases are still based on exploitative abuse allegations, especially when price differences perpetuate market divisions.

Interestingly, an overview of the Commission’s practice reveals that allegations and findings of excessive pricing are in fact confined to those situations in which prices are found to be grossly exorbitant when compared to underlying costs or to price levels prevailing in comparable markets. As Pijnacker Hordijk indicates, only margins in the range of 100% or more have given rise to interventions in excessive pricing, and even following the Commission’s intervention, considerable margins are still allowed to exist.79 The ECJ has indicated that even lower price differentials might constitute an abuse, but still the profit margins it allows are high. The following is an indicative table of cases brought by the Commission or decided by the ECJ.80

In sum, the Commission’s practical treatment of excessive pricing is much closer to that of the U.S. than a simple linguistic comparison would suggest. Still, there is a significant conceptual difference between the two approaches because in the EC the reticence to intervene is based on practical reasons, while in the U.S. it is based on theoretical and ideological ones.

D. Application of the prohibition by national authorities: a revival?

Yet the EC rule against excessive pricing cannot as of yet be laid to rest. While the Commission has been reluctant to apply it, national

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79 Pijnacker Hordijk, supra note 69.
80 Part of the table is based on Pijnacker Hordijk, id.
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10. Deutsche Telekom in XXVII REPORT, id. § 77.
authorities have not necessarily adopted a similar approach. Under the regulatory system of the EC, national competition authorities may generally apply national competition laws—which largely follow the EC laws—in cases that involve an anticompetitive conduct that affects the member state. The formal legal EC rule, which still prohibits excessive pricing, enables national authorities and courts to take a different stance with regard to its practical application. As a result, the rule against excessive pricing may be awakened from its dormant state. In fact, some authorities have adopted a much more interventionist approach than the Commission. The Dutch, in particular, seem to largely reject the self-restraint practiced by the European Commission, thereby adopting tools and practices usually used by direct regulators. The British experience is also interesting in that it attempts to infuse the prohibition with modern economics. I briefly explore both.

In 1998 the U.K. enacted the Competition Act which is closely modeled on the competition provisions included in the Treaty of Rome. The Act requires that as far as possible and appropriate, it is to be interpreted and applied in a manner consistent with the principles of EC law regarding competition. Shortly after, the Office of Fair Trading (OFT) issued guidelines for the application of the new prohibitions.\(^\text{81}\) Interestingly, the guidelines state that "perhaps the most obvious form of abuse is where a dominant undertaking charges prices higher than it would do if it faces effective competition."\(^\text{82}\) At the same time, it recognized that\(^\text{83}\)

There may, however, be many objective justifications for prices that are apparently excessively high. First, in competitive markets prices and costs vary over time and there are likely to be periods when high profits can be earned. This is an important part of the competitive process since it can encourage increased output or entry to a market. Secondly, undertakings in competitive markets might be able to sustain high profits for a period of time if they are more efficient than their

\(^{81}\) OFT Guidelines in Relation to Chapter II Prohibition Under the UK Competition Act 1998 (OFT 402, March 1999).

\(^{82}\) Id. ¶ 4.7.

\(^{83}\) Id.
competitors. This might occur if an undertaking has developed lower-cost techniques of production, supplies higher quality products or is more effective at identifying market opportunities. . . . To be an abuse, prices would have to be persistently excessive without stimulating new entry or innovation.

The U.K. approach thus attempts to inject the excessive pricing prohibition with dynamic elements. In fact, the justifications for high prices focus on market stimulation and leave to be regulated only dominant firms that are so secure in their position that market forces cannot erode them in the foreseeable future. This approach resembles that on which British law has been based before 1998, under which the competition authority could intervene and even regulate prices when market imperfections could not be remedied by the market in due time.

The guidelines adopt both the price-cost and the market comparison test. They also go a step beyond the current EC test and use the cost of capital as the benchmark for calculating reasonable profits. The cost of capital is calculated as the return that would be earned by investing elsewhere, having regard to the risks incurred by investing in the particular company. When the profits of a dominant firm consistently and significantly exceed its relevant cost of capital, this might indicate that its prices are excessive.

The Dutch experience has gone down a different path. The Dutch enacted a prohibition on excessive pricing modeled on the EC Treaty in 1998. In the years since, the Dutch Competition Authority has taken an interventionist stance in various cases and has set several detailed principles for the determination of whether prices were excessive or not. These principles go beyond those set by the Commission or the ECJ. The decisions taken by the Dutch authority raise fundamental issues for setting clear, predictory economic principles that limit excessive pricing while at the same time not

84 Id. ¶ 109.

85 For the only case to date that put the prohibition to the test see Napp Pharmaceutical Holdings Ltd. v. Director General of Fair Trading (Competition Commission Appeals Tribunal, January 15, 2002). Napp involved both exclusionary and exploitative behavior.
significantly harming the incentives of firms to invest in becoming monopolists.  

Pijnacker Hordijk argues that Dutch case law stands for the proposition that dominant firms should as a general rule offer their products on the basis of costs plus a modest markup for profits. In *KLM*, for example, the Dutch authority introduced a “normative” framework to assess price levels: it defined the normative weighted average costs of capital (WACC) for KLM. The WACC represents the return of investment private investors may require given their appraisal of the risks inherent in the business concerned. To calculate the applicable WACC for use of internal capital, the authority used the capital asset pricing model, which quantifies the risks that may be relevant to a shareholder. For the purposes of the investigation the normative rate of return was calculated by setting a market risk premium and a nonsystematic rate for the industry.

This approach was further developed in *Schiphol*, where it was stated that in principle tariffs should be based on the “total economic costs that an (efficient) undertaking may attribute to the provision of its services. Economic costs are defined as the sum of capital costs, depreciation, operational costs and taxation. This means that a reasonable rate of return on invested capital may be included in the cost price.” The reasonable rate of return consisted of a base rate plus a risk markup. The base rate was set equal to the interest on long-term state issued bonds. The risk markup depended on the degree of

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86 Pijnacker Hordijk, *supra* note 69.

87 *Id.*

88 *Vereniging Vrije Vogel v. KLM and Stewart v. KLM* (Dutch Competition Authority, November 8, 2000).

89 The inquiry into Schiphol airport’s costs was prompted by a request of the Ministry of Transportation, with a view to the intended privatization of the airport. The Dutch Competition Authority was requested to assess Schiphol’s tariffs under the provisions of the Competition Act. *REPORT ON SCHIPHOL’S TARIFFS* (Dutch Competition Authority, 2001).

90 *Id.*
risk of the specific business activity. Similar principles were applied in several additional cases.91 The Dutch Competition Authority thus considers a price excessive in case either costs or profits are excessive, or both.

These principles are problematic, as they significantly limit the prices that can be charged by a dominant firm. Also, risk factors are highly dependent on temporary insights of investors of a given sector and may significantly fluctuate over time. Moreover, the focus on industry-wide parameters and on "normative costs" may not allow an inefficient dominant firm to recoup its real investment. Yet in the recent case of Voorburg,92 which involved the pricing of cable TV services, the Dutch Competition Authority stated that if the actual return on investment is smaller than the WACC, the tariff should, in principle, not be excessive.

As these examples show, excessive pricing prohibitions have been revived by some national competition authorities, although most still follow the EC Commission's reserved approach. The approach adopted by the Dutch Competition Authority indicates a much less self-restrained approach to pricing regulation. Significant differences of enforcement might interfere with the basic goal of the Treaty, which was market integration. It will also be interesting to see which approach will be adopted by the new EC member states.

IV. Summary and conclusions: how to reconcile the two systems of belief?

The rules regulating monopoly pricing reflect two systems of belief and divergent goals of antitrust. The U.S. rule, which leaves monopoly pricing unregulated, is based on a strong belief in the self-

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91 To date, there are at least ten cases dealing with excessive pricing issues. Other major cases include Essers/NV Telekabel (Dutch Competition Authority, April 13, 1999) on the pricing of cable TV services and PTT Post (Dutch Competition Authority, November 11, 1998) on the pricing of postbox services.

92 Gemeente Voorburg en Gemeente Wassenaar/Casema (Dutch Competition Authority, June 12, 2003).
correcting powers of the market and is a process-oriented rather than an outcome-oriented approach to competition. Emphasis is placed on the creation of conditions for competition, which is perceived to be socially and politically essential for the U.S. governmental system and national ethos, rather than on the direct outcomes of monopoly. The EC rule, which regulates excessive pricing, indicates a lesser belief in the market and an equitable emphasis on outcomes. Interestingly, both jurisdictions support their rules on fairness arguments, although in the U.S. the focus is on fairness to producers whereas in the EU it is on fairness to consumers.

In their practical application the rules are significantly closer. The EC Commission has recognized the practical problems involved in ex post regulation of the consequences of market power, and is more focused on the creation of market power itself. Most member states have followed in the Commission’s footsteps. Yet the proliferation of antitrust enforcement to national authorities might enliven this prohibition again widen the gap. This process is made possible by the fact that, despite the Commission’s reluctance to apply it in practice, in theory the rule against excessive pricing is still an integral part of Community law.

Let us now take a broader view of these divergent rules in light of the recent attempts to bring competition laws closer together on a global scale. Should such attempts go forward, the inevitable question would be how these divergent systems can be reconciled on a global basis. Such reconciliation of differences might be especially important in light of the proliferation of the excessive pricing rule to many jurisdictions around the world.

One option is for all jurisdictions to adopt a rule that regulates monopoly pricing. In light of the underpinnings of U.S. law and other jurisdictions that adopted a similar approach (e.g., Canada), this option does not seem realistic. Another option is to abolish excessive pricing regulation altogether and focus on the prevention of the creation of artificial barriers to competition. Such a solution might also be difficult to agree upon. While most jurisdictions recognize its difficulties of enforcement, a rule prohibiting excessive pricing is an important part of their regulatory system. As noted above, the rule is
often grounded in fairness considerations that are fundamental to the ideology on which the law is based. It might also serve to increase support of consumers for competition policy, if only by creating a public perception that monopolists are directly prohibited from charging excessively high prices. This is especially important in transition economies, in which the market is often dominated by a few large private enterprises and the belief in the market’s invisible hand has yet to be established. Small size might also affect the inclination to abolish a rule regulating excessive pricing. In small economies entry barriers are high and the natural conditions of the market make it easier to gain and to preserve monopoly power for long periods. Thus, a firm might remain dominant for long periods despite the lack of continuing superior performance and ex post regulation of excessive prices might be deemed necessary, at least in some cases. In addition, the regulation of excessive pricing, especially where prices on basic products are significantly reduced, might strengthen the public support and political power of the regulator.

It thus seems that complete convergence of the rules regulating monopoly pricing is not a realistic option. Nonetheless, the gap between the rules should be minimized as much as possible and clear guidelines should be set as to how the regulator should use its powers, as elaborated elsewhere. Most importantly, regulation should be limited to cases in which the inefficiency created by the dominant firm is significant and there is no possibility for reviving competition in due time. While none of the laws specifically differentiate between monopolies that can be eroded by market forces and those that cannot, the discretion granted to the regulator should be interpreted as disallowing it to intervene when the market is not permanently or at least significantly disabled. Otherwise, such regulation is likely to further remove the possibilities for the natural operation of the self-correcting market mechanism.

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93 Small economies are defined as jurisdictions that can support only a limited number of firms in most of their industries. See GAL, supra note 28, Introduction.

94 Id., chs. 1 & 3.

95 Id. at 79–81.
Harmonization of the rules regulating monopoly pricing, at least on a theoretical level, is thus a difficult endeavor. It will have to reconcile not only the beliefs in the way markets work and the rules of the market game, but also a history of divergent enforcement. This is since the law, as Oliver Wendell Holmes noted in his first *Lowell Lecture* (Nov. 23, 1880), "embodies the story of a nation's development through many centuries and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics."