

Abuse of dominance – when is an ‘excessive’ price ‘unfair’?

Recent developments at EU and member state level

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A number of significant developments took place in 2008 which suggest that, despite the European competition authorities' and courts' historic reluctance to intervene in pure excessive pricing cases, dominant firms can no longer regard a finding of abuse only for unfair pricing as a purely theoretical risk. The decisions in cases such as Microsoft, Scippacercola, Attheraces and Albion Water provide useful guidance as to how competition authorities and courts at both EU and national level will approach investigations into alleged excessive pricing. All the same, this is still a highly complex area of competition law – applying the tests used to determine whether prices are excessive and unfair to actual pricing scenarios remains extremely difficult.

The year 2008 has seen a significant addition in Europe to the body of case-law on unfair pricing, suggesting that unfair pricing can no longer be regarded by dominant firms as a largely theoretical risk. The general reluctance of the regulators/courts to apply the unfair pricing prohibition is unlikely to disappear but the growing case-law may encourage complaints and private enforcement. Traditionally the Commission and national competition authorities in the EU have been reluctant to police high pricing as such under the abuse provision, reflective of: i) the complexity involved in calculating what amounts to an unreasonable high price, ii) the difficulty in establishing accurately what is the relevant competitive benchmark price; and iii) concern that enforcement may disincentivise market entry,¹ and investment altogether.

The resulting relative lack of decisions/judgments has led to uncertainty. The Commission, when it published its 2005 Staff Discussion Paper on exclusionary abuses, stated that it would also review exploitative abuses. However, this has so far failed to materialise. The Commission's November 2008 Guidance on its Article 82 enforcement priorities² is confined to exclusionary abuses. It is to be hoped that the Commission and/or national regulators take steps in the near future to clarify this area. In the meantime, we must make do with the decisional practice of the competition regulators and courts in the EU, to which 2008 has added.

In Scippacercola³ the CFI dismissed an appeal against a 2005 Commission decision rejecting an excessive pricing complaint against Athens International Airport. The complainant provided manifestly incomplete data on AIA's costs and other European airports' charges were not radically

lower. AIA also supplied information which suggested that its prices did not cover its costs. The Court held that the Commission was right in deciding that as the evidence suggested a small likelihood of infringement, the likely complexity of verifying AIA's costs data justified rejecting the complaint for lack of sufficient Community interest.

Another significant case was the Commission's February 2008 decision⁴ to impose a €899m fine on Microsoft for charging unreasonable royalties for licensing interoperability information, contrary to the Commission's March 2004 decision specifying that any remuneration charged should allow rivals to viably compete and should not "reflect the 'strategic value' stemming from Microsoft's market power...". Microsoft had agreed certain pricing principles, namely that royalty rates reflect whether a protocol was Microsoft's creation, was innovative, and by reference to a market valuation of comparable technologies. This test was essentially the same as the 'United Brands'⁵ test for unfair pricing: the concept of 'fair compensation' that would be reaped absent dominance, by reference to royalties for licensing comparable data under competitive conditions.⁶

The Commission only treated novel, non-obvious protocol technology as innovative. Microsoft argued this ignored the commercial value of trade secrets but the Commission said that the 'indispensability' of the protocols meant "its commercial value is not an adequate yardstick to determine a reasonable remuneration". The Commission excluded minor incremental changes of negligible value and novel combinations of protocols viewed as reflecting "ordinary skill and common sense". By this yardstick, nearly all the protocols were found not to be innovative and so

should have been licensed royalty-free. As regards royalty levels for comparable technologies, the Commission noted that Microsoft licenses similar protocols royalty-free and gave examples of other companies licensing comparable protocols for free. Microsoft eventually lowered the royalty from up to 3.87% of product revenues to a flat fee of €10,000. The fine imposed related to June 2006 – October 2007. In March 2007 Microsoft's CEO wrote to the Commission asking for "the exact remuneration rates" Microsoft should set. The Commission replied that "it is not for the Commission to prescribe the precise remuneration rates" but rather to appraise the reasonableness of the remuneration rate set by Microsoft "at its own discretion". Microsoft's appeal against the Commission's February 2008 decision to the CFI is pending.

Finally, it is noteworthy that the Commission is currently pursuing a case against Rambus for charging unreasonable royalties for licensing its technology after an alleged 'patent ambush', providing the Commission with a route to challenge the effects of patent ambush, if not the patent ambush itself (as Article 82 does not prohibit

conduct used to achieve dominance, only abuse once dominance is attained).

The UK has also been the source of considerable clarification of the scope of the unfair pricing prohibition under Article 82 and its equivalent under the UK Competition Act 1998 (the so-called Chapter II prohibition).

In *'Attheraces Ltd –v– British Horse Racing Board'*⁸, Attheraces claimed that the price charged by BHB for 'pre-race data' on horseraces was unfair. Etherton J. accepted this, finding the prices significantly exceeded the economic value in the data, measured by "the cost to BHB of producing its Database...together with a reasonable return on that cost". The Court of Appeal emphasised that the central concept of unfair pricing is "economic value" – while this cannot be "what the market will fetch" (this could reflect dominance rather than value), Etherton J. had failed to consider whether the price, although above cost, was nevertheless reflective of the economic value of the data to Attheraces.

As Attheraces was making 'handsome profits' from its overseas broadcasts and BHB's prices were

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apparently not materially compromising Attheraces' competitiveness, it was perfectly possible that BHB's prices, although significantly above costs, nevertheless reflected the economic value of the data to Attheraces. In other words, the supplier's costs and margins are potentially of less relevance than the buyer's ability to profitably remain in business even paying the allegedly excessive price.

The November 2008 judgment of the UK Competition Appeal Tribunal (CAT) in '*Albion Water –v– Water Services Regulation Authority*'⁹ takes a more interventionist approach, reflecting that the defendant was a monopoly water utility also found to have engaged in exclusionary conduct (margin squeeze). Albion Water wished to supply Shotton Paper Mill with non-potable water but could only deliver via Dwr Cymru's pipe network under a common carriage arrangement. Albion complained to WSRA that Dwr Cymru's access price was unfair and appealed WSRA's rejection of the complaint to CAT.

After an exhaustive consideration by the CAT of Dwr Cymru's costs reasonably attributable to the access service (by reference to various methodologies used by WSRA), the CAT found that the difference between the price charged and Dwr Cymru's reasonable costs was at least 46.8% and that this difference was "material and excessive".

As regards whether this excessive price was also "unfair", the CAT said that Attheraces does not preclude that reasonably incurred costs (plus reasonable return) could represent the "economic value" of supply "in the absence of any relevant non-cost-related factors", i.e. that a price materially higher than costs could, absent non-cost related factors, be excessive as well as unfair. Unlike Attheraces, here Albion was being foreclosed by Dwr Cymru's high prices.

The exclusionary effect of Dwr Cymru's excessively high price removed the "economic value" of access from Albion's perspective (because Albion could not compete viably for customers at such high access prices). Therefore, the judgment indicates that where an excessively high price (compared to reasonably incurred costs) charged by a vertically integrated supplier to a downstream rival has an exclusionary effect, the ability of the dominant supplier to argue that the price is nevertheless reflective of "economic value" will be considerably limited.

There have also been noteworthy precedents in the area of unfair pricing in other EU countries. In Germany, following the introduction in December 2007 of amendments to the law on abusive pricing (new section 29 ARC) which allowed stricter

regulation of energy suppliers, the competition authority opened abuse proceedings in March 2008 against 33 gas suppliers for charging excessive prices to household and commercial consumers in 2007 and 2008. In order to determine whether prices were excessive, the competition authority followed the so-called "comparative market concept", comparing – for 2007 – the turnovers that the companies achieved with that of gas suppliers offering lower prices (in competitive markets) and – for 2008 – the tariffs used by the majority of the customers of the companies concerned with the tariffs used by customers of comparable companies (in competitive markets). By December 2008, 29 of the 33 pending cases had been settled as the companies involved offered compensation to consumers totalling €127m.

In Italy, an abuse case against Acquedotto Pugliese (AQP) was concluded in November 2008. AQP is responsible for the supply of fresh water and the management of waste water in Puglia and neighbouring Italian regions, and was accused of a range of abuses including excessive pricing – imposing charges on consumers that were unrelated to the actual costs of installation and supply. The investigation was closed when the Italian competition authority accepted commitments offered by AQP to change its pricing policy and unbundle installation and supply, allowing consumers to make their own arrangements for connection to the water and waste system without using AQP's services.

While events in 2008 have developed the law on excessive and unfair pricing in Europe, the application of the test to actual pricing scenarios remains extremely difficult in practice. However, while much of the complexity of the decided cases has come from difficulties in identifying cost allocation issues, the recent cases have helped to clarify the scope and purpose of the unfair pricing prohibition and its relationship to exclusionary abuses

Notes:

¹ Therefore the OFT's May 11, 2005 decision to close its investigation into suspected excessive pricing by SSL was on the grounds that "With evidence of emerging competition, any potential remedies such as a price cap could stifle such entry and hinder rather than help the competitive process".

² www.ec.europa.eu/competition/antitrust/art82/guidance.pdf.

³ (Case T-306/05) '*Scippacercola –v– Commission*' (January 2008).

⁴ Commission Decision of 27/II/2008, C (2008) 764 final.

⁵ (Case 27/76) ‘United Brands –v– Commission’ [1978] ECR 207.

⁶ In ‘United Brands’, the ECJ said that unfair pricing arose when a dominant supplier “has made use of the opportunities arising out of its dominant position...to reap trading benefits...” and that a price would be unfair if it bore “no reasonable relation to the economic value of the product supplied” by reference to i) production costs and ii) a comparison to competing products’ prices.

⁷ See: www.europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/330&format=HTML&aged=0&language=EN&guiLanguage=en
⁸ [2007] All ER (D) 26 (Feb).

⁹ [2008] CAT 31.

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