SOME VIEWS ON PRICING AND EC COMPETITION POLICY

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1. INTRODUCTION

Ladies and Gentlemen,

I feel very honoured to have been asked to give a speech at this conference. This event recognises the major role that EU competition policy can play in commercial strategies in general, and pricing policies in particular.

I am also delighted that, during this conference, the Commission will not monopolise the presentation of EU antitrust law and practice on pricing and its implications for companies. Some of this morning's speeches and others thereafter will give you a fairly comprehensive view. A number of speakers will also give you advice on some tricky points of Commission concern.

Therefore, within the next twenty-five minutes, I will focus my speech on three major points:

- The way in which pricing information is useful in defining the economic context of a case, within the boundaries of the specific setting of competition policy at EU level.
- Some of the Commission's anti-trust enforcement principles for pricing agreements and practices.
- The main challenges that EU competition policy faces and some implications for pricing policies.

2. INSTITUTIONAL SETTING OF ANTI-TRUST ENFORCEMENT AT EU LEVEL.

I will not devote much time to explaining how the Commission and the Directorate General for Competition (DG IV) are structured. You may know that we are about two hundred officials working amongst the four Directorates concerned with antitrust (DG IV organigramme). EC Antitrust procedures governed are detailed in the documentation provided by the organisers. I would like to stress, for those of you that are not familiar with it, that a number of safeguards exist (Antitrust proceedings I & II). It allows for common discussion and mutual understanding throughout the various stages in the administrative Commission proceedings. Co-operation with companies is central to our activity.

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[1] The opinions expressed are purely personal. They can in no way be attributed to the European Commission or its services, which cannot be held responsible at any title whatsoever.

As for the substance, I will assume that you all know everything about the relevant EC treaty articles which provide the basis for anti-trust, both as regards private companies (articles 85 and 86) and public companies and Member States (articles 90 and 5-3g). It is the Commission's view that pricing activity «is competition in one of its essential forms»[2]. The protection of free price competition is one of the centrepieces of Commission policy, as called for by the express wording of articles 85 and 86. The Commission's enforcement policy has been greatly facilitated by the express prohibitions regarding agreements and abusive practices contained therein.

Two aspects are worth stressing, however:

The Commission can be a somewhat hybrid competition authority compared to other national authorities. Whilst protecting competition, the Commission does not disregard its duty in fostering market integration between different nations. Our situation is not the same as that of American antitrust agencies. It is sufficient to mention the 1918 Webb-Pomerene Act in the USA, which relieves from the Sherman act pricing cartels on overseas markets that would not be tolerated internally. Similar laws in EU Member states would rapidly jeopardise the goals of the EC Treaty. Therefore, some practices that may be disregarded at national level may be found objectionable at EU level. For instance, a dual price system between two Member states, provided that prices are set at a certain level, might be tantamount to an export prohibition.

The broader objectives that the Commission may pursue have also appeared useful to the Member States. Faced with proposals to establish an independent cartel agency during the negotiations on the Amsterdam treaty, Member States have maintained the current status in this area.

The legal community in the UK is well aware of the differences between a « case-law » based legal system versus a regulation-based one. Case-law is predominant in EC anti-trust law. As in other areas of EC law, this fact is due to the central role of the European Court of Justice. Its influence has been significant in the early days of interpretation of the scope of Articles 85 and 86, and often extended beyond the specific case it was to rule about. Most aspects constraining or limiting pricing policies as regards their compatibility with EC law have been clarified through case law.

Today, the Commission's enforcement activity is solidly founded on three grounds: first, a clear set of rules embodied in case-law and relevant regulations. Second, the development of a «culture of competition » in most Member states (adoption of national competition laws, creation of administrative authorities, application of EC treaty articles). Third, the widespread consensus that antitrust action beyond national boundaries is beneficial to the competitiveness of our economies and firms.

3. PRICING AS A TOOL IN ECONOMIC ANALYSIS

Antitrust policy is first and foremost concerned about efficient market functioning, even in cases where pricing itself is not the object of proceedings. It is therefore no wonder that price analysis is embodied as a basic tool in the economic analysis that EU anti-trust law

[2] Wood Pulp OJ 1985 L 85/1 §21.

calls for. For DG IV, there is a trade-off between resources needed for analysis and the economic and legal issues at stake in each specific case.

Under article 85 (1), the appreciability condition on competition and trade between Member States might revert to assessing market power in connection with the effects of the restrictions. Though market power may result from varied factors (market structure, IPR's, essential facility under different degrees of vertical integration), its definition involves the undertaking's ability to raise or to maintain supra-competitive prices. Such ability is always present in case of dominance.

Market delineation might also involve pricing-related information. The Commission's Market Definition Notice[3] spells out the principles applied. This notice is partly built around the demand and price substitutability for the purpose of delineating both the product and the geographic market. Its application is central to Art. 85 (3) (no elimination of competition) and 86.

The reactions to past changes of relative prices in terms of quantities demanded are often crucial in establishing substitutability. DG IV also takes into account pricing-related tests for market delineation: estimates of elasticity and cross-price elasticity, tests based on similarity of price movements over time, the analysis of causality between price series and similarity of price levels and/or their convergence. Reasoned answers of customers and competitors as to the effects of a small but lasting price (5% test) are also taken into account. Caution is needed to interpret actual prices compared to competitive prices (cellophane fallacy).

For a practitioner, pricing is also useful to be looked at in connection with non-pricing related proceedings. Pricing differences amongst geographic areas / market segments may also foster other unlawful agreements or abuses. Overall, pricing-related infringements in specific cases can hardly be separated from other possible anti-competitive practices. Hence the difficulty of extracting simple rules from case-law on pricing, beyond clear-cut cartel cases.

4. PRICE CONVERGENCE IN THE EU

Prices integrate information on other variables on which competition takes place such as innovation, distribution costs, brand image and production efficiency. Furthermore, price divergence is an indicator of both market integration and the strength of competition within the EU.

The share of intra-EU trade as a percentage of total trade reaches now about 70% for Member States. Structural changes in European markets have resulted in increased price convergence across the EU between 1985 and 1996. Most price convergence is observed in consumer and equipment goods, particularly those that are highly traded within the EU and with the rest of the world. The single market has accelerated convergence in consumer goods. In 1996, the price variation of identical products and services in different Member States were: 19.6% for consumer goods, 28.6% for services, respectively down from 22.5% and 33.7% in 1985. However, energy and construction

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3 Commission notice on the definition of the relevant market for the purposes of competition law. OJ C 3/72 of 9.12.1997.

price variations increased respectively from 21.1% and 22.1% in 1985 to 31.7% and 27.4% in 1996.

Some interesting aspects emerge from an EU-wide broad sector-based review over a period of 15 years [4]:

- For certain goods, no additional convergence of prices is expected. Existing levels of price dispersion are the result of structural characteristics. They are fully compatible with the achievement of an integrated market, such as differences in taste and culture, in income levels, etc.

- There is a trade-off for incumbents at national level between accepting lower market share with even prices or accepting price decreases with a similar market share. Over ten years, the average price-cost margin amongst sectors has decreased by 3.9% in the EU. However, capital yields increased in the past five years.

- Price dispersion is inversely proportional to the volume of intra-EU trade and directly proportional to concentration at national level (entry of multinationals favours convergence). Limited convergence experienced in sheltered sectors is to be viewed in this context. The ranking of MS according to price levels is remarkably stable over time for 145 categories of goods & services. The ranking has changed for 18 categories.

Variances are of course higher at lower levels of data aggregation, which may be relevant for anti-trust analysis. They illustrate that arbitrage between national markets remains profitable and needs to be vigorously protected by competition policy. In this sense, the «break-even point» where arbitrage may become profitable varies considerably amongst sectors. For instance, in the car sector, variances of 15 % start to trigger purchases outside national boundaries. Such variations are not unrelated to restrictive practices for which Volkswagen was fined early this year[5].

Price convergence is not an end in itself, and even less so for the purpose of competition. Quite the contrary. I would view perfectly even prices throughout the community with considerable scepticism. In this area, our concern is to remove the barriers which prevent prices from reflecting economic realities, whilst ensuring that efficient competitors and consumers are not harmed by abusive pricing practices.

I will now turn to the status of pricing practices under the Commission's enforcement practice. I will start with pricing restrictions caught by article 85.

5. PRICING IN VERTICAL AGREEMENTS.

Some commentators have noted a sort of obsessive concern on the part of the Commission regarding price restrictions. This does not refer to the need to maintain some

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4 The 1996 Single Market Review. SEC (96), background document to the Commission Communication to the Council and the EP on "Impact and Effectiveness of the Internal Market" (COM (96) 520 final of 30.10.1996.

5 Volkswagen-Audi. OJ L 124 of 25.4.1998.

prices levels or, more precisely, some price-cost margin enabling distributors to provide satisfactory services. Economic theory suggests that other restrictions tolerated at community level or subject to a « rule of reason » in the United States (e.g. territory allocation) can be as harmful as price fixing.

Both the Commission and the Court have stressed that a relaxation of price competition may foster total output and competition based on other factors. However, the Commission and the Court have consistently refused to consider resale price maintenance as a legitimate means to attain such goals.

This attitude is evidenced in all Commission block-exemptions regulations related to vertical agreements[6]. None of them exempt restrictions to dealers' freedom to set their own commercial policy and prices. The scope is broader than mere resale price maintenance (fixed, minimum or maximum prices). It also embraces restrictions on rebates or discounts and any discretion left to the manufacturer with regard to resale prices, whilst not covering merely recommended prices. Such recommended prices however, if agreed by a cartel of producers, may immediately raise Commission concerns.

Pricing restrictions are therefore subject to individual scrutiny and judged on their own merits. Commission enforcement practice reveals that many other less restrictive means than resale price maintenance may be contemplated before the latter may be exempted.

Resale price maintenance systems operating exclusively at national level are, in principle, a matter for national competition law. From an enforcement perspective, national authorities are much closer to specific market conditions. However, such agreements may come under the scope of community law where they would be likely to deflect trade between Member States from its patterns[7].

The circumstances under which the Commission or the national authorities may deal with a national system are also dependent on the enforcement powers of the national authority and the intensity of the effects in inter-state trade[8]. For instance, as regards book pricing, the Court has not considered price-fixing obligations at national level as necessarily incompatible with the treaty. The Commission has made it clear that it does not intend to interfere with such obligations regarding book pricing where their scope and effects are limited to one Member State.

6. HORIZONTAL AGREEMENTS

I will not elaborate very much on the Commission's attitude regarding horizontal price agreements. I think that the legal and economic communities agree in that there are not many redeeming virtues from a price cartel. Such consensus explains that there is little

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6 Commission regulations (EEC) N° 1983/83 (Exclusive distribution) recital §8, 1984/83 (Exclusive purchase) recital §8, 4087/88 (Franchise) recital §13, art.5 e) and 1475/95 (Motor Vehicles distribution) art 6§6.

7 GERO Fabriek OJ 1977 L 16/8 § 11.

8 Commission notice on Co-operation between National Authorities and the Commission in handling cases falling within the scope of articles 85 and 86 of the EC treaty. OJ C/313 of 15.10.1997, p.3 §5.

need in cartel cases to explain their actual or potential economic harm. The leaflet to this conference asks whether companies would risk 10% of their turnover for a breach of competition law. On average, pricing related infringements to article 85 have resulted in fines around more than 3% of the turnover in the affected markets. Price cartels are likely to attract fines whose starting point, whatever their duration and other aggravating circumstances, is likely to be around 14 million pounds, subject to the 10% ceiling[9].

From an enforcement standpoint, price fixing cartels simply raise three issues:

- The standard of evidence necessary to establish the existence and the participants.

- The existing incentives to relinquish cartels. Two years after its Communication on leniency[10], the Commission is satisfied with the number of cases where participants have denounced secret cartels. The theoretical underpinnings of the "incentive to cheat" in cartels[11] have proved fairly real in practice.

- The third aspect is the determination of the Competition authority. The Commission has made clear on several occasions the importance it places on this matter. I would simply quote Commissioner Van Miert commenting on the last price-fixing cartel unveiled in October: " Major industrial groups taking part in secret cartels cannot expect fines to be limited to 10% of their turnover in the particular business"[12].

7. ABUSIVE PRICING.

I will now turn to some aspects of pricing-related abuses of dominant positions. Formal Commission decisions concerning price abuses are rare. One of the main reasons is the fragmentation of European firms compared to American or Japanese ones. Nine years of operation of Merger control at EU level have shown that sectoral market dominance in Europe is more the exception than the rule. At least, insofar as markets that are not sheltered by regulation, are concerned.

The other reason can be found in the practical difficulties of establishing price abuses. I am not sure that every European company active in manufacturing would be able to state precisely what their real production costs are. The difficulty is compounded for the Commission. Expert studies on price and cost-allocation as well as formal requests for information in specific cases may be part of the means by which the Commission follows market prices.

Therefore, I will not argue on the basis of theoretical cases that economic literature is plagued with. I will elaborate on some practical considerations regarding excessive and predatory pricing, as well as one of their possible combinations, cross-subsidisation.

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9 Guidelines on the method of setting fines imposed pursuant to article 15(2) of regulation 17 and article 65(5) of the ECSC treaty. OJ C 9, of 14.1.1998

10 Commission notice on the non-imposition or reduction of fines in cartel cases. OJ C 207 of 18.7.1996.

11 E.J. Green and R H Porter "Non co-operative Price Collusion under Imperfect Price Information". Econometrica 52 (January 1984) 87-100.

12 Press Release, IP/98/917 of 21.10.1998

8. EXCESSIVE PRICING.

As regards excessive pricing in particular, little case law has developed so far. According to the Court of Justice, a price is excessive if it is "excessive in relation to the economic value of the service provided"[13]. One method of establishing a price excess is by comparing the price and the production cost of a product. In United Brands, the Court stated that an 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[14]. A comparison of prices charged for the same product or service on other geographic markets might provide the basis for the assessment[15].

In these cases, the Court stated that when a company holding a dominant position imposes scales of fees for its services, which are appreciably higher than those charged in other Member States, that difference is an indication of an abuse of a dominant position. This holds provided that a comparison of the fee levels has been made on a consistent basis. In particular, a comparison between the prices charged by a dominant company and those charged on comparable competitive markets could provide a basis for assessing whether the prices charged are fair[16]. In such a case, it is for the undertaking in question to justify the difference by reference to objective dissimilarities in the situation among Member States.

Depending on the merits of each individual case, the benchmark for Commission intervention may vary considerably. In a case settled with Deutsche Telekom[17], a difference of more then 100% was found to be unacceptable. In other cases, however, the Commission might intervene even if this difference is significantly smaller.

9. PREDATORY PRICING

In 1966, the Commission gave a first ideas as to the applicability of article 86 to predatory pricing. In the early years of definition of EC competition policy, the Commission already indicated that an abuse of dominant position may involve price competition engaged for the purpose of ousting from the market a competitor who does not have the resources to withstand sales below cost price.

Three elements are worth singling out: the reference to production costs, the purpose of eliminating competitors and the underlying efficiency of competitors which do not enjoy the resources that a dominant position presumably allows for. Such principles remain central in our daily case-handling.

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13 (Case 26/75,General Motors Continental, ECR 1975, p. 1367, § 12)

14 (Case 27/76, United Brands, ECR 1978, p. 207, § 251)

15 (cf. Case 395/87, Tournier, ECR 1988, p. 2521, § 38; and Joint Cases 110/88, 241/88 and 242/88, Lucazeau, ECR 1988, p. 2811, § 25)

16 (cf. Case 30/87, Bodson, ECR 1988, p. 2507, § 31)

17 Press Release IP/96/975 of 4.11.1996

Twenty years elapsed between the declaration and the first occasion where such principles were applied in Akzo. Since then, cases of pure predatory pricing have remained rare. Some landmark cases after Akzo have further refined the standards applicable as for the costs to be taken into account, the relationship between a dominant market and a more contestable one, as well as the links with other exclusionary practices.

The Commission rejects both a purely cost-based rule and a policy of doing nothing. Nonetheless, Commission's practice reveals that such (unfulfilled) criteria are more often used to reject complaints than to pursue real infringements. This is more so when allegations are made about predatory prices in isolation from other restrictive practices. Two main configurations appear.

- Under a first possibility, the alleged predatory pricing is effected in one single product market by a firm mainly active in that market. In such cases, the analysis of the objective structural conditions under which the predator would be likely to recoup short-term losses over time seem necessary as a supplement to cost-based analysis, whatever the benchmark used (MC, AVC, ATC). The Commission has not had so far the opportunity to have this approach confirmed by the CFI or the Court.

- Under a second configuration, the predatory pricing is combined with some sort of cross-subsidisation. This kind of « cheap capital », as defined earlier this morning, raises some complex problems as far as its treatment under antitrust law is concerned.

10. CROSS-SUBSIDISATION.

Market disciplines may be expected to constrain companies from entering unprofitable markets, as recognised by the Commission in Tetra Pak II[18]. Very often, to raise competition concerns cross-subsidisation has to involve a combination of excessive pricing in the geographic or product market where the company is dominant and predatory pricing in the more contestable one.

An examination of recent cases shows that cross-subsidisation is first and foremost a concern for the Commission in those markets where former monopolies or utilities are in a position to exclude new entrants. This has been the case in the telecom markets in the beginning of this year, where price rigidities where observed after the complete liberalisation effective from January the 1st this year.

In this aspect, history shows that a great deal of agreement between Member States is necessary to open up markets to competition by Community directives. In this field, the Commission weighs action by liberalisation directives based on article 90 (3) (telecommunications) of the treaty with possible action within the internal market under article 100(a) (electricity and gas).

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[18] "The pursuit of activities having inadequate profitability to cover all the costs involved may indeed be economically justified in the short term, provided income remains above variable costs and the activities contribute in part to covering fixed costs". Tetra Pak II OJ 1992 L72/1.

In the former case, pricing principles are embedded into legislation to define the compatibility of pricing policies of former monopolies with Article 86. Regulatory authorities at national level have been established which monitor such pricing policies, without prejudice of their ability to set more stringent or precise rules.

In the latter case, the scope of anti-trust law is limited to the extent that some pricing policies (postalisation or nation-wide fares) might be necessary to ensure the continuity of universal service[19]. Such pricing policies might include some sort of cross-subsidisation, amongst the privileges state-owned companies might enjoy. However, this is an area where anti-trust policy needs to be combined with other provisions regarding aid granted by the Member States.

11. FUTURE CHALLENGES AND CURRENT REFORMS IN EC COMPETITION POLICY.

In the last two minutes, I would like to outline some aspects of current steps taken by the Commission to modernise its policy. Changes are needed, among other factors, in response to deeper and broader economic integration caused by the EMU and the enlargement to six new members at least.

Policy proposals are expected for next year as regards procedural substantive rules set forth in regulation 17. Hopefully next year some additional guidance will be given regarding horizontal co-operation agreements. I can say at the outset that none of the pricing practices and agreements I referred to before would be held automatically lawful following such changes.

Regarding vertical restraints, the Commission made earlier in September this year comprehensive and somewhat revolutionary proposals. I have enclosed a copy in the documentation provided to you. If and when adopted, they will greatly modify the current regime applicable to distribution, compared to the current regime at EU level. Three points are worth singling out:

- The use of market share thresholds to automatically exempt agreements from article 85(1) where the parties hold less than 25% of the relevant market, with a possibility of some restrictions being exempted below a 40% market share threshold.

- The existence of a single regulation for all sectors and forms of distribution, excep motor vehicles. It is intended to avoid any bias towards sectors or towards a particular form of distribution because of more favourable provisions in the relevant regulation.

- The express drafting of black clauses which, if present in the agreements, might still need individual clearance. Such list of black clauses includes pricing related restrictions, except real maximum or recommended prices. None of the latter would be subject to any scrutiny, whatever the market shares.

[19] SFEI - La Poste Case C-39/94 §57-8.

12. CONCLUSION

Presenting some principles might look rather authoritative and cold. I would like to stress, as a conclusion, that the Directorate-General for Competition is no more than a public service. Companies are our "main customer" in DG IV. Over the past four years on average, companies initiated 87% of our antitrust cases. One third of such cases were started as a result of complaints.

On the other side of the Atlantic, the Supreme Court has made a clear separation between protecting competition and protecting competitors[20]. In this room, many companies and advisors may find that their business, their shareholders and their customers are also worth protecting. Such protection may be useful when faced with asymmetries of power in vertical agreements, retaliatory measures for not entering a price cartel and exclusionary pricing.

I hope other speakers and legal advisors today will not find my competition unfair if I stress that, thanks to the channel link, Brussels is fairly close if you would need to get in touch with us. For information purposes, our address in the net is also worth consulting at http://europa.eu.int/comm/dg04.

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[20] Brown Shoe & Cie vs. United States. 370 US 294.344 (1962).