The Paradox of the Exclusion of Exploitative Abuse

by

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Abstract: Monopoly pricing is a textbook market failure that is taught in the first year of any economics course. The implied welfare loss (or 'exploitative abuse') justifies a whole range of competition policy towards cartels, mergers and regulated industries. Yet there is widespread hostility to prosecuting the same exploitative abuse in the textbook monopoly case (i.e. under Article 82EC)! This paper seeks to understand this paradox. I conclude that, while there are important problems with prosecuting Article 82 exploitation cases (because of problems relating to measurement, market dynamics, multi-sided markets and remedy issues), it is important to keep open the possibility of prosecution; for example, in the forthcoming Article 82 Guidelines.

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1.1 Introduction

European Commissioner Neelie Kroes kicked off the current major review of Article 82 by saying: '***it is sound for our enforcement policy to give priority to so-called exclusionary abuses****, since exclusion is often at the basis of later exploitation of customers*'.[1] This is a common position to hear in policy circles, but it is inherently paradoxical. *If exclusionary abuses are bad because they ultimately exploit consumers, why should the policy emphasis not be on directly exploitative abuses?* The answer has direct relevance for the current Article 82 review: should exploitative abuses be integrated alongside exclusion in the emerging guidelines?[2]

This may seem like an esoteric debate, but it translates into fundamental guidance for business, as well as competition practitioners, as to what is and is not lawful behaviour for businesses that dominate their markets. I begin by clarifying what is at issue. There are two ways in which a dominant firm might abuse its market position. First, it might directly harm its customers; for example, by raising prices or limiting its effort to lower costs or develop new or better products. This is known as an exploitative abuse. Second, it might adopt strategies that exclude rivals from making an effective challenge to its dominant position; for example, by predatory pricing, product bundling, exclusive contracts or refusal to supply. Collectively, these are known as exclusionary abuse.

The formal EC law covers both types of abuse, and provides little guidance on whether exploitation or exclusion should be the greater concern.[3] The case law, however, has greatly emphasised exclusionary effects, with exploitative effects appearing to be little more than a sideshow.[4] It is in this context that

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[1] 'Preliminary Thoughts on Policy Review of Article 82' [emphasis in original] Speech at the Fordham Corporate Law Institute, New York, 23rd September 2005.

[2] A quite separate historical paradox is that, despite the conventional wisdom, the drafters of Article 82 originally intended it to relate to exploitative abuses and not exclusionary abuses. Akman (2007) examines the travaux préparatoires (preparatory documents) of Article 82EC and finds that it is *not* based on 'ordoliberal' foundations. The drafters were mainly concerned with increasing 'efficiency' and intended to protect the customers, not competitors, of dominant undertakings.

[3] Article 82 of the EC Treaty prohibits the abuse of a dominant position, and highlights: 'unfair' pricing or trading conditions; 'limiting' production or technical development; 'applying dissimilar conditions to equivalent transactions'; and 'supplementary obligations' in contracts.

[4] See e.g. Whish '*Competition Law*' (2004) ch.5.

DG Comp's opening, and so far only, major public contribution to the review of Article 82 has been the much discussed staff paper on exclusionary abuses.[5] There has been no public commitment as to the next stage of review, but it is likely that the working paper will be developed into a set of guidelines.

Exploitation of consumers is the textbook abuse by a monopolist or dominant firm. Because consumers cannot easily switch to an alternative source of supply, the dominant firm can raise price to enhance profits. Consumers lose out by having to pay more and buy less, and there is a consequent distortion in the allocation of resources. All economics students learn this in their first year of study, and it is a major justification for competition policy. High prices are the most direct form of abuse, and are the most frequent in antitrust cases.

In principle, product quality, service levels and product range may also be abused by a dominant firm. Measurement is a problem – it is difficult to measure non-price factors in order to compare them with an appropriate benchmark, but the same, to a lesser extent, can be said of high prices. However, there is a more fundamental problem with trying to appraise non-price exploitation. The current level of our understanding is that it is not always clear even in which direction the abuse will take place. For example, consider the provision of quality. In general, a dominant firm considers the marginal revenue to be gained from spending on a quality enhancing investment, whereas total welfare is maximised by comparing marginal benefit to consumers to the investment. The marginal revenue calculation emphasises only the higher price that can be extracted from existing consumers and any marginal consumers that might be won or lost as a consequence – it ignores consumer surplus. Although there are some reasons to expect any bias to be towards suboptimal quality, it can be shown that the actual balance is highly sensitive to the nature of 'quality', as well as the price

[5] See also the discussion of appropriate economic principles by the EAGCP, published on the DG Comp website.

at which quality is compared.[6] In principle, then, the monopolist might try to save costs by providing a suboptimal quality, but there is no overwhelming economic theory equivalent to the expectation of high prices. In the murky world of exploitative effects, this is probably sufficient to justify the overwhelming emphasis on price exploitation. This is the focus of the remainder of this paper.

1.2 The Paradox

Despite the textbook monopoly abuse being high prices, most competition economists (and probably also most competition lawyers) have a profound distaste for the direct control of exploitative abuse under Article 82. It conjures images of detailed interventions throughout the economy, when most would argue that regulation should be reserved for cases of genuine natural monopoly (e.g. those parts of privatised utilities which cannot be structured competitively due to network economies). The latter require specific, well informed regulators, and these cannot be put in place for all corners of the economy in which a firm may be dominant. Far better, the argument goes, to concentrate on maximising the chances for the competitive process to throw up a new competitor; hence, the focus on exclusionary abuse.

Before assessing whether this should be the end of the story, we take a step back to recall the DG Comp review of exclusionary abuses. The main thrust has been that the key test should be ultimate consumer effects, and not protecting rivals *per se*. This was anticipated by Ms Kroes in her Fordham speech: ‘First, it is competition, and not competitors, that is to be protected. Second, ultimately the aim is to avoid consumer harm. I like aggressive competition – including by dominant companies – and I don’t care if it may hurt competitors – as long as it ultimately benefits consumers.’ Many of the details of the subsequent Commission working paper[7] have been criticised,

[6] At higher prices charged by a monopolist, the customer base is more likely to be those who value quality and so this tends to push up the monopolist’s choice of quality – so one distortion (high prices) can counterbalance another (lower quality).
[7] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses; public consultation, December 2005.

particularly for not achieving this aim, but this main thrust on consumer effects has received almost universal acclaim.

The Commissioner's views are shared by most competition economists.[8] For example, on the purpose of Article 82 being to protect consumers against harm, an eminent panel of academic economists recently wrote:

> An economic approach to Article 82 focuses on improved consumer welfare. In so doing, it avoids confusing the protection of competition with the protection of competitors and it stresses that the ultimate yardstick of competition policy is in the satisfaction of consumer needs. Competition is a process that forces firms to be responsive to consumers needs with respect to price, quality, variety, etc.; over time it also acts as a selection mechanism, with more efficient firms replacing less efficient ones. [EAGCP, 2005, p.2]

So, we have a strong consensus that an exclusionary practice, whereby a dominant firm hurts rivals, is only an abuse when the consequence is that consumers are expected to be harmed.[9]

There is also a strong consensus that Article 82 should be interpreted exclusively in relation to exclusionary effects. For example, the same panel wrote:

> Whenever possible, competition is to be preferred to detailed regulation as the best mechanism to avoid inefficiencies and foster productivity and growth; this calls for a 'non-dirigiste' approach to competition policy that focuses in most cases on entry barriers; in the context of Article 82, it is then natural to focus on competitive harm that arises from exclusionary strategies. Possible exceptions concern some natural monopoly industries which may require ongoing supervision of access prices and conditions by regulatory agencies. [EAGCP, p.3]

The implication is that any regulation of exploitative effects should be through these specialist agencies, and not through Article 82.

The US Supreme Court agrees: 'The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful, it is

[8] E.g. see the EAGCP report, *op cit*. This is not to deny some significant disagreements over consumer versus total welfare as the appropriate standard. This particular dispute has been surprisingly silent in the debate, though it does not make a fundamental difference to the line of argument in this paper.
[9] This is also in line with the modern treatment of mergers, as exemplified by the revised merger regulation moving away from the 'dominance test' in favour of the 'significant impediment to effective competition' test. The latter is usually interpreted as protecting consumer benefits.

an important element of the free market system' [540 U.S. Verizon-Trinko, 2004, p.407].

So, we can summarise on exclusionary abuse: while hurting one or more rivals is necessary for an exclusionary abuse, it is not sufficient: to be an abuse, exclusion also requires an expectation of eventual consumer harm (i.e. exploitation). And on exploitative abuse: many eminent economists and lawyers say that Article 82 should not deal with such abuses.

This results in our paradox: *it is good to prohibit only those exclusionary practices which can be expected to result (indirectly) in an exploitative abuse…but at the same time it is bad to prohibit directly exploitative practices!*

1.3 The Hazards of Identifying and Remedying Exploitation

I do not propose to challenge the first part of the paradox – that exclusionary practices should be seen as abusive only when they harm consumers. Indeed, I see that as a key achievement of the economic approach to competition policy. However, the distaste for prosecuting direct exploitation requires deeper analysis to understand why this position is held and what its limitations are. I group the analysis around: measurement; market dynamics; multi-sided markets; and remedies.

1.3.1 Measurement Issues

European case law suggests that the key question to ask is: has the dominant firm

> made use of the opportunities arising out of its dominant position in such a way as to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition[?] In this case charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied would be such an abuse. This excess could, inter alia, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which would disclose the amount of the profit margin. [United Brands, 19, #249-251][10]

[10] *United Brands v Commission of the European Communities*, Court of Justice of the European Communities, Case 27/76 [1978] ECR 207. More recently, the meaning of 'economic value' has been interpreted more widely, both by the Commission in Swedish Ports and by the UK Court of Appeal in

There are many reasons why cost measurement is easier said than done. Most of these are well known, so I only sketch them here. Identifying costs and attaching them to a particular product is highly complex in most businesses. Firms normally record costs in a way that is most useful for financial purposes, and this can lead to substantial differences between accounting costs and economic cost. Purchase costs often depend on volume or have multiple components, for example, depending on additional services or demand growth. Capital costs require an assumed cost of capital to convert into annual costs, and the cost of capital may depend on the market power of the firm. Many costs are common across a product range, and allocating these costs to specific products is highly controversial. Sunk costs, for example for a facility built years ago, create further problems: either they are ignored as bygones (which would lead to dynamic problems as discussed below) or they need revaluing (and if valued in terms of their economic rents, this means they depend on achievable price and so this does not provide an independent benchmark against which to judge price). The valuation of intangible assets, such as brands, suffers from the same circularity problem. Business is risky and some inevitably fail having incurred unrecoverable costs. In this context, a competitive *ex ante* return will turn out to be much higher *ex post* for those firms lucky or efficient enough to survive – this is sometimes known as the survivor bias. It is a particularly important issue for R&D intensive industries where only a few lines of research pay off and some turn out to be blockbuster successes.[11]

This is a dauntingly long and undoubtedly incomplete list of problems. It suggests we should be extremely careful if trying to measure how high a particular price is in relation to cost. Nevertheless, these problems should not be over-exaggerated. Regulatory agencies have great experience at measuring costs and reasonable approximations can be made. It is, of course, important that cost estimates should be sensitivity tested in the light of

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Attheraces vs. BHB, to include value to the purchaser. See PwC (2007). The cases are *Scandlines Sverige AB v Port of Helsingborg* COMP/A.36.568.D3 and *Attheraces vs. BHB*, 2007, EHCA civ38.

[11] For a large, say, pharmaceuticals company with numerous lines of research, the failed lines may stay within its cost base, albeit in a lumpy fashion over time, but for a specialist company this will not hold.

whichever of the measurement problems are thought to be most important in the case in question.

Furthermore, cost measurement is an important element to understanding some important types of exclusionary abuse (e.g. predatory pricing). Perhaps more importantly, it is crucial to developing appropriate remedies for many exclusionary practices. For example: compulsory licensing will only be effective if supported by an appropriate analysis of a suitable royalty fee; and access agreements need to identify a suitable access price. Put another way, excessively high royalties or access prices can be seen as either upstream exploitative or downstream exclusionary. The Commission needs to understand exploitative abuse in order to remedy exclusionary abuse.

An alternative to using cost as the benchmark for forming a judgement as to whether a price is too high, it may be possible to compare prices in different markets. In this method, it is important to find reasonably competitive comparator markets. These might be found in the form of similar products sold in different geographic markets, where the market structure is not dominated by a particular firm (careful adjustment may be needed for tax or other differences); or it could be in the form of a comparison with other products which have similar cost structures.

A particular example of the former approach is where the dominant firm itself price discriminates between markets according to local conditions. There is no space here to go into details on the pros and cons of price discrimination.[12] Suffice it to say that there are many occasions where price discrimination enhances consumer welfare because it results in more consumers being able to buy the product, while in other situations it may distort the market. The point at issue here is whether the existence of price discrimination should be seen as evidence that there is an exploitative abuse in the high price market. This is dangerous territory because a common price in the absence of discrimination

[12] See the ‘Pros and Cons of Price Discrimination’ (2005) published by Konkurrensverket.

is likely to be much higher than in the low price market under discrimination. In particular, the lowest discriminatory price may well be below average cost.

1.3.2 Market Dynamics

There are two types of dynamic issue. First, there is the role of high prices in the entry process. Second, there is the role of high prices in the investment incentive for a dominant firm (or a potentially dominant firm).

Suppose we have been able to identify a suitable yardstick for comparing prices, either with good cost data or a suitable comparison across markets. When can we say that a price is exploitative? For example, is a margin of 10%, 20%, 50%, 100% or 500% an abuse? Of course, the question is not well posed because it has no element of time. For example, short-term fluctuations in demand when production is relatively fixed leads to large price fluctuations (or rationing or substantial swings in inventories). In fact, periods of high prices alongside periods of low prices are perfectly consistent with a well-oiled competitive market. So we should focus on persistence: how long must a high price continue in order for it to be called an abuse?

In the context of a dominant firm, the answer depends on how long it might take a small rival to expand or a new entrant to enter the market. The height of current prices has a more limited role. In fact, an entrant may have his attention drawn to a potential opportunity by a very high price, so in this sense high prices act as a powerful signal – the higher the better if they advertise opportunities (Hayek, 1968). Once the opportunity is understood, it is more important for the potential entrant to focus on what price would be post-entry. This means that the dominant firm's expected response must be worked out. If he is expected to respond aggressively, then even a very high current price will not attract entry. Of course, this brings us back to exclusionary behaviour. If the dominant firm has a reputation for predatory responses to entry, or if it is expected to adopt a strategy to limit an entrant's options (e.g. exclusivity agreements or inefficient bundling), then this becomes an issue of *expected* exclusionary effects, which may be difficult to prove (i.e. before the persistence of high prices and lack of entry are observed). Potential entrants will be particularly concerned about *ex post* competition if they have to invest in assets that will be at least part sunk (i.e. non-recoverable).

Turning to the incentive for the dominant firm, it is the expectation of high profits that provides the incentive to invest in a whole range of activities, including capacity, process innovation, product innovation, design, branding, marketing activities, distribution network and supply chain. Some of these investments have outputs that would be easily copied if they were not protected by intellectual property rights (including patent, trademark, copyright and database rights). It is long accepted that property rights, including IPRs, are necessary in a market system to create an incentive to invest. In their absence, many easily-copied ideas which are nonetheless valuable would not be developed. Consequently, consumers would be worse off. The effort and inspiration of invention is not usually picked up in cost data, and there is a very large survivor bias, so the price-cost margin on intellectual property can appear to be very high. If the inventor goes on to produce a product on which he holds an IPR, this can make the product price seem extremely high, and if he licenses the right to produce, the royalty payment might seem 'too high'.

1.3.3 Multi-sided Markets

Economists have become increasingly aware in recent years of the importance of multi-sided platforms, more often known as two-sided markets. These are intermediate platforms that provide benefit to more than one distinct group of customers, and where there are significant externalities (often positive) between these groups. A surprising number of markets seem to share some key features.[13] For example, both advertisers and readers derive benefits from a newspaper, and each group derives a benefit from the other (e.g. advertisers benefit from more readers to be influenced by their adverts, and readers may or may not enjoy reading adverts). Payment card systems have similar properties, with shoppers enjoying a convenient means of payment which is more beneficial the more merchants there are who accept a card under that system (e.g. Visa). A port provides its services to a range of

[13] Many emerging markets in the 'new economy' seem to have similar attributes of network and other positive externalities.

different customer groups, including freight and passenger ferries (though it is not obvious that there are externalities between groups of consumers in this case). In some markets, the two types of customer may include the same people in different guises; for example, mobile phone calls benefit both callers and those who receive calls. A final example is horseracing, in which owners, spectators and punters each derive pleasure from participating in their different ways (i.e. entering, watching and betting on races).

In each of these cases, the different groups of consumers contribute financially to support investment in the platform in different ways. The quality of the platform is enhanced by investment, and such endogenous investments tend to create highly concentrated market structures (Sutton, 1991 and 1998). This makes them disproportionately important in antitrust cases. Much recent theoretical work has enhanced our understanding of pricing practices in multisided markets. Outcomes depend on factors such as which group conveys more positive externalities on the other – the former group is naturally subsidised relative to the latter, who may appear to pay disproportionately high prices even when the market is perfectly efficient.

This has resulted in some high profile 'exploitation' cases in recent years, including: the European Commission on Visa and Swedish Ports; the UK OFT on the price BHB charged bookmakers for the pre-race data necessary for bets to be taken; and the UK Competition Commission on mobile phone termination charges.[14] These cases often waver between Articles 81 and 82 because a joint venture is set up (e.g. Visa for card payments with member banks collectively setting interchange fees) or an entity controls the sport as its governing body (e.g. the British Horseracing Board, BHB, in the horseracing case). The legal issues in relation to Articles 81 and 82 may be different, but the economic analysis is similar. These are often complex cases and competition authorities take some time to come to grips with them. The Visa, BHB and mobile phone cases are analysed in depth in Lyons (2008).[15]

[14] Mobile termination charges was a market inquiry, unusual to the UK competition policy system, so no one firm was considered dominant.
[15] See chapters by Rochet on Visa, Lyons on BHB and Armstrong & Wright on mobile phones.

Close examination of such markets shows that a competition agency's first thoughts about the exploitation are often wrong, and apparently very high prices about which some customers complain very loudly may be part of a reasonably optimal payments package when all groups of consumers and investment incentives are properly taken into account.

1.3.4 Remedies and Punishments

It is important not to confuse the identification of an abuse with the choice of remedy. The natural remedy for high prices might seem to be to regulate them, but this is not the ideal option. The fundament source of market power is some form of entry barrier, and the basic principle of intervention should be to remedy the problem at source.

In large industries subject to large economies of scale, price regulation may still be the best option. The classic examples are in the utilities such as gas and electricity. The problems of price regulation are well understood. Once again, problems of cost attribution and incentives to invest are important issues. [16] Access price regulation requires a subtle balancing of long-term incentives against short-term rip-offs. Another issue is the cost of establishing a specialist bureaucracy. This is necessary because a generalist competition agency is unlikely to have the skills and resources to do an effective job – it would do more harm than good by setting inappropriate prices (either too low or too high) and encourage regulated firms to waste resources trying to manipulate a weak regulator. Nevertheless, for a limited number of markets, all this is worthwhile because otherwise consumers would indeed get exploited. Specialist regulators are fully justifiable in key areas of large markets, but they would be disproportionate if set up for all corners of the economy whenever a dominant firm emerges.

Sometimes it is possible to limit the amount of price regulation by vertical restructuring, separating the key stages of production at which scale economies are most marked. This means that large parts of most industries

[16] I do not dwell on the subtle differences between rate of return regulation and RPI-X, etc.

can be left to market forces while core distribution networks, which would be massively inefficient to duplicate, can be subject to price regulation. This form of vertical restructuring can be effective, especially when the firms were created away from the market as in the privatised utilities. Where vertical integration has been created in a relatively competitive market, however, much greater caution is necessary because important efficiencies may be lost. An alternative form of restructuring is horizontal, breaking up a dominant firm, as the US did most famously with Standard Oil in 1911 and AT&T into the 'Baby Bells' in 1984 (and attempted to do with Microsoft in 2000 before it was overturned on appeal). This is a rare and dramatic remedy, and enormous caution is necessary because the efficiency consequences are so hard to predict.[17] Quite generally, it would be far better to facilitate expansion by a small rival or entry by a new firm, preferably one with a track record in a neighbouring market so it has the appropriate experience, financial resources and skills to succeed. This requires a deep analysis of the source of current entry barriers.

It is possible to be more creative in thinking about alternative remedies. In particular, many markets have several alternative suppliers, yet one long-standing incumbent remains dominant despite charging higher prices. This is common in gas and electricity distribution in the UK (see Waddams, 2006). Customer switching would soon encourage a dominant firm to reduce its prices, but domestic customers are remarkably slow to save even substantial sums of money for relatively little switching effort. The reasons for this consumer inertia are only just beginning to be understood, but inasmuch as it is a matter of lack of credible information, this can be remedied in various ways. For example, a utility might be required to print on its customers' quarterly bills the potential cost savings that could be achieved by switching to a lower price supplier. Indeed, a similar remedy was imposed by the UK Competition Commission on store cards, where credit terms are much higher than for other forms of credit. Similar messages advertising the prices

[17] Some of these problems are apparent in divestiture remedies applied in EU merger cases. See Davies and Lyons (2007). Note that there is an important difference between a merger prohibition, where integration has not yet taken place, and a divestiture or break-up where some previously integrated functions have to be replaced.

available at a dominant firm's rivals might be required at the point of sale.[18] Of course, such remedies are not possible if a firm is so dominant that there is no serious alternative supplier (or if tacit or explicit collusion creates collective dominance across all feasible competitors).

We next turn to punishment for exploitative abuse. A breach of Article 82 is subject to a maximum fine of 10% of turnover of the entire firm, not just the abused market. The turnover base means that, although 10% seems small in relation to the sort of margins that might be found to be exploitative, the fine could be very significant for a non-specialist firm. If the threat of a fine is seen as significant, then it may have a deterrent effect on high prices. In some circumstances this may be beneficial, though there is a danger of adverse dynamic effects for the reasons discussed above. More importantly, it would make everyday business life horribly complicated if firms have to consult competition lawyers every time they raise price. This makes it inappropriate to punish high prices with a fine, though private action for compensation would not be inappropriate, but *only* if there has been a prior finding of abuse. The primary sanction should be remedies to limit future exploitation.

Finally, we mention a potential hazard of not tackling exploitative effects under Article 82. If the Commission says that it will not bring cases of exploitative abuse, and if private enforcement continues to be encouraged, there is a serious danger that exploitation cases may end up in the non-specialist courts, where none of the subtle difficulties discussed above are likely to be appreciated and bad decisions will be made. A good example is the UK ATR vs. BHB case which was rightly overturned on appeal.[19]

1.4 Comparison with the Application of Article 82 in Relation to Exclusionary Effects

We can now bring together some themes that underlie the paradox of the exclusion of exploitative effects. Exploitative effects are…

[18] Great care needs to be taken that such practices do not result in coordinated behaviour between firms.
[19] See footnote 9.

a) **Naturally shorter lived and more dangerous to remedy (Type 1 error)**

The fundamental process of competition is that smaller firms expand and new firms are attracted by profitable opportunities. As these minnows grow, a slack incumbent will see its dominant position erode unless it responds positively with a better product offering (including price, quality and variety). In a well functioning market, exploitative dominance is naturally self-limiting. In contrast, price regulation interferes with this process and has the unfortunate side-effect of discouraging entry. Furthermore, there are ever-present dangers of regulators getting it wrong due to asymmetric information and distorted incentives.

By comparison, the remedies for exclusionary abuse tend to be less dangerous to the competitive process. For example, a dominant firm may be required to provide access agreements or not to sign exclusive contracts. Although these remedies might undermine investment incentives if they are wrongly imposed, at least they do not undercut the profitability of entry.

b) **Possibly mainly due to strategic entry barriers**

It is possible to distinguish two generic types of entry barrier: structural and strategic. A structural barrier is created by natural supply and demand conditions in the market; for example, where the technology dictates large economies of scale. A strategic barrier is created by a dominant firm, which deviates from short-term profit-maximising behaviour in order to exclude an existing or potential rival; for example, signing exclusive contracts that do not significantly improve investment incentives. If all barriers to entry were strategic and readily prohibited by a focus on exclusionary effects, then exploitative behaviour could not last long. Of course, the existence of structural barriers in some markets (or unremedied strategic barriers in place now or having established current market structure in the past) means that exploitation may persist.

c) Harder to prove to the standard required by the Court

For reasons discussed above, it is very difficult to prove that prices are excessive, let alone that a dominant firm is falling short in terms of quality, variety or innovation. There is an almost complete lack of easily observable benchmarks for most dimensions of competition, though there may be some loose comparisons to be made with related products, internationally or over time. For price, at least cost or margin benchmarks can be collected, but there is always a problem in deciding what is a reasonable price in relation to costs. This is why it is often argued that price negotiations should be a matter of freedom of contract between buyer and seller.

In contrast, it may be easier to prove that rivals or potential rivals are being harmed by some exclusionary practice *and* to identify the expected direction of effect on customers (and so eventually on consumers). A similar argument can be used in relation to merger appraisal, where the direction of effect is also what is primarily at stake. Furthermore, in seeking evidence for exclusionary effects, DG Comp can rely on the very active help of injured third parties who will normally have much more at stake than individuals from a more dispersed customer base at the wrong end of a directly exploitative abuse.

d) Politically more difficult to deal with

Two examples illustrate this general point. First, US practice has evolved very much in terms of exclusionary effects, which may also reflect section 2 of the Sherman Act which prohibits monopolisation. It might be argued that, with the emergence of global corporations, it would be good to harmonise what competition agencies do. Apart from political benefits of avoiding trans-Atlantic disputes, harmonisation also provides a clearer signal to firms and so may encourage compliance. Second, competition agencies have an important advocacy role: competition is good for both consumers and firms. If they get this message across, they gain valuable allies, creating status and enhancing funding. Firms find it difficult to understand why they should not maximise profits, and an exploitative abuse by one firm is an opportunity for others. Thus, while the business sector gains broadly by ‘exploitation’, rival firms are hurt by exclusionary abuses and so support their prohibition. Although these are important issues for the most senior practitioners, it would be unwise to allow these political side-effects to be an agency’s prime concern.

1.5 The Appropriate Treatment of Exploitative Effects under Article 82

Where does this leave us? Overall, the arguments set out in sections 3 and 4 support the view that there is justification for a continuing focus on exclusionary abuses. However, it would be unwise to dismiss the core paradox I have identified. In the absence of a prospective sanction, there are likely to be some cases of exploitative abuse that can be remedied without fundamentally harming market dynamics. Proof may be difficult, but it is not impossible. Most importantly, some barriers are structural, or the result of a history of unnoticed, unprosecuted or ineffectively prosecuted exclusionary practices. It is for these cases that provision under Article 82 for exploitative abuse should be maintained.

A similar conclusion has recently been articulated independently by Lars-Hendrik Röller (2007) who calls these ‘gap cases’.[20] He goes on to argue that the key analysis should therefore not be on the high prices *per se*, but on how dominance was achieved. Exploitative cases ‘should be based on acquiring a dominant position through exclusionary conduct. In this way, exploitative abuse cases are back to investigating exclusionary conduct, which is in fact the proper way to identify anticompetitive conduct’ (p.9-10). We part company on this point, because I do not think it is feasible to focus entirely on how a dominant position was attained – this is likely to be lost in the mists of history. It would be a substantial distraction, to say the least, if guidelines and case law developed such that the main focus of the competition inquiry was on past history rather than current and continuing exploitation. If the source of dominance could not be *proved* to be past exclusionary behaviour, the

[20] See also Motta and De Streel (2007) in ‘The Pros and Cons of High Prices’; and Vickers (2005).

Commission would not be able to find an abuse that would allow remedies to be put in place, for example by imposing conditions to facilitate entry. The finding of abuse and the choice of remedy should be kept separate.

Another advantage of maintaining exploitative effects under Article 82 is that it is far better to keep the analysis of economic exploitation where it belongs, in a specialist competition agency and not in the hands of private actions in non-specialist courts. Specialist regulators are not the answer because they are not efficient for areas of the economy other than for a few natural monopoly infrastructure industries.[21] Wherever possible, the remedy should be in the form of encouraging expansion or entry to undermine the incumbent dominant. The key idea is to use the market to undermine a dominant firm's incentive to exploit customers. The encouragement of customer switching by providing appropriate information may be a helpful part of a remedy package. Only as a last resort should price regulation be considered. Fines and other punishments should not have a role in relation to high prices (except where they are linked to exclusionary abuse, which is beyond the current topic).

Finally, having established this important niche role, it is then entirely appropriate for exploitative abuses to be included in any Article 82 guidelines. Nevertheless, it must be conceded that the prohibition of exploitative high prices should be undertaken only with great caution. Ms Kroes is broadly right that the implementation of Article 82 should prioritise abuses that affect the fundamental process of competition.

1.6 Wider Consistency of Competition Policy

This paper has been about a paradox relating to consistency within Article 82. While I have highlighted some of the problems of punishing high prices, I have stressed the importance of maintaining the principle that high prices can be an abuse. Only if an abuse has been found can a remedy be applied, and that remedy need not be clumsy regulation. It is not unusual to hear the argument that high prices should not be considered under Article 82, but should be left

[21] In this, I disagree with some colleagues on the EAGCP (see earlier quote from EAGCP, footnote 7).

to specialist regulatory agencies. But on what grounds should sectors be selected for price control? For some sectors, there may be strong *ex ante* grounds for regulation, but other cases will be marginal. It will be less restrictive if the latter are given the benefit of the doubt with the knowledge that they can be picked up *ex post* if prices become exploitative. The alternative might be to set up regulators whenever there is doubt or in response to political pressure.

This issue of consistency goes wider still. The ECMR revisions and guidelines include a more positive attitude to efficiencies. Merger analysis now focuses quite rightly on prohibiting (or remedying) any merger for which there is an expectation of future high prices and other customer detriment. Article 81(3) includes consumer benefit, for example through lower prices, as a necessary condition for the exemption of restrictive agreements. There is an increasing appreciation that state aid rules should be interpreted by the Commission in terms of economic effect.

Overall, there is much at stake in maintaining the sound principle that exploitative high prices are an abuse of dominance under Article 82. They are integral to an economic effects based competition policy but, because of the hazards of identifying and remedying exploitation, they should be prosecuted only with the greatest caution.

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