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"Exploitative abuse: When does enforcement make sense?"

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ABSTRACT

Enforcement against the exploitative abuse of a dominant position is not as prominent as other antitrust fields. Although a renaissance of these cases can be experienced in recent years, the evolution is very limited. This editorial discusses the role of enforcement for these practices and aims to sketch a framework for the identification of relevant cases.

La prohibition des abus de position dominante n'est pas aussi proéminente que les actions contre d'autres pratiques anticoncurrentielles. Si l'on reconnaît une renaissance de ces affaires ces dernières années, cette évolution reste limitée. Cet éditorial s'intéresse au rôle de l'application du droit en la matière et tente d'établir une démarche d'identification des affaires pertinentes.

For a long time enforcement against the exploitative abuse of a dominant position appeared to be competition policy's ugly stepchild. US antitrust never saw any merit in this instrument considering it inappropriate price regulation. This view does seem to reflect real enforcement problems. German courts in the 1970s struck down every case brought by the Bundeskartellamt because they were not satisfied about the benchmarks that would prove a price excessive (for a discussion *see* Kai-Uwe Kühn, "Chapter 4: Germany," in: E. M. Graham and J. D. Richardson, *Global Competition Policy*, Institute for International Economics, Washington, D.C., 1997).

The European Commission never issued any guidance or guidelines on exploitative abuses of dominance.

However, in recent years we seem to experience a renaissance of exploitative abuse cases. For example, the standard-essential patent cases and the *Gazprom* case can be viewed as such cases at European Commission. The CMA in the UK has only recently issued high fines in excessive pricing cases in the pharma industry and the German Bundeskartellamt has creatively pursued a case against Facebook—apparently on the basis that violating privacy law can be an exploitative abuse of a dominant position.

The controversy surrounding the latter case reminds us that little has been done to develop limiting principles to determine whether the behaviour of a dominant firm is exploitative and which cases should be prioritized for enforcement. In this editorial I attempt to sketch a framework how relevant cases could be identified. I first review the two main arguments that support a cautious approach. This leads to a set of cases in which competition intervention appears most appropriate. Second, I argue that only such cases should be prioritized where there are simple remedies available that do not require persistent regulatory intervention.

Why does enforcement against exploitative abuse have a bad name?

There are two main objections to interventions against high prices in markets: (1) an economic one based on the function of the price system to steer the efficient allocation of resources; (2) a practical one about efficient regulatory design.

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Are high prices really bad?

Most of the time high prices are good! They steer companies to invest in the right markets. High prices attract entry. This important informational role of prices is lost when firms cannot exercise short-run market power. Disallowing the full exploitation of market power based on a dominant firm's "special responsibility" may eliminate the necessary signals that high prices convey to the market.

What is the "right price" anyway?

The second objection has been that the most obvious remedies for high prices seem inappropriate for enforcement by competition law: the obvious remedy to an excessive price is to set the "right price," i.e., price regulation. But should a competition authority be the default regulator? Competition enforcers generally lack access to rich information about costs and technologies that a regulator needs for setting "the right price" and adjusting it. Pricing remedies also require permanent oversight, which competition authorities are not well equipped to provide in contrast to a regulator.

Criteria for case selection in exploitative abuse cases

Taking this critique of enforcement against exploitative abuse seriously does not exclude all intervention.

Sometimes high prices are definitely bad

There are clear cases in which high prices cannot steer investment or entry. Two fundamentally different cases come to mind: the persistent monopoly case and the case of hold-up.

A monopoly position tends to be persistent when there are economies of scale that generate a natural monopoly. Water utilities, electricity transmission networks, and sometimes gas pipelines are examples. Sometimes persistent monopoly results from a history of central investment planning as in South Africa (creation of the steel industry—Iscor/Mittal) or the transition economies in Eastern Europe. Natural gas supplies in Eastern Europe and the role dominance of Gazprom are an example.

Another second category is hold-up. It arises when relationship specific investments or commitments need to be made before prices are set. Then competition cannot control price setting because at the time price is negotiated, substitution away from the relationship is too costly. Theoretically hold-up can be resolved by contracting before commitments are made. However, writing long-term contracts is often inefficient because price needs to adjust to circumstances that are hard to specify in a contract. For this reason price setting in long-run relationships is often left to yearly negotiations. Parties rely on "implicit contracts." The incentive to maintain long-run relationships then ensures that price adjustments do not exploit hold-up opportunities. Many industries function with implicit contracting because they save on transaction costs.

Hold-up still occurs because incentives may change over time or are misjudged. The supplier may enter bankruptcy proceeding, breaking the long-run relationship and making hold-up more tempting. The breach of the implicit contractual arrangement then could not be anticipated or prevented.

Hold-up has to be seen as a typical excessive pricing problem: The high price cannot steer investment into the industry because the abuse relies on short-run lock-in. And even if hold-up is rare, intervention may have a large efficiency benefit because with a reduced risk of implicit contracts transactions cost savings can be more systematically realized.

The practical implementabilty of competition policy remedies

In addition, intervention should be consistent with a case-by-case approach and appropriate remedies must be available. Competition policy remedies should allow for easy monitoring, be implementable with limited information, and avoid persistent regulation of the industry.

For hold-up these conditions are satisfied. It occurs in unique circumstances where implicit contracting breaks down fitting a case-by-case approach and remedies tend to be easy to apply because they concern specific contractual periods and price benchmarks from other contracts are often available (the case of standard-essential patents is a bit more complicated and is not discussed here due to space constraints).

In cases of persistent dominant positions it is less clear that competition policy intervention is appropriate. Direct price control would need to be imposed for the long run, and pricing requires detailed information on costs and be permanently controlled. This seems to be a poor fit for remedy instruments available to competition policy. However, there are sometimes indirect measures that may work: If a firm has a monopoly in one market, but not in another, disallowing resale restrictions would allow arbitrage to "import" competition into the monopoly market—this was the solution of the Competition Tribunal in South Africa in the *Mittal* case, which was

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later overturned upon review. When there are many monopoly markets, as in water utilities, simple yard sticks can be used as in Germany where suppliers with high prices in comparison with others are forced to adjust the price downwards. Such a measure does, however, have limitations relative to regulation because it does not reduce monopoly power in the lower priced municipalities.

Summary

It therefore appears there is a role for enforcement against exploitative abuse, but it should be narrowly focussed. Only in circumstances where prices do not have an information function to direct investments and entry and where simple indirect remedies are readily available should enforcement be considered. ■

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