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Working Party No. 2 on Competition and Regulation

EXCESSIVE PRICES

-- Hungary --

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1. Introduction

1. Article 21 of the Hungarian Competition Act (similarly to TFEU 102) prohibits the abuse of a dominant position, and explicitly mentions a prohibition to set unfair selling prices.¹ Excessive pricing comes under this heading, and therefore excessive pricing cases are investigated by the Hungarian Competition Authority (Gazdasági Versenyhivatal, GVH).

2. Excessive pricing may be either an exploitative or an exclusionary abuse. In the former case, excessive pricing is a direct exploitation of existing market power, where the dominant firm charges a high price to its customers. In the latter case, the excessive price forms part of an exclusionary strategy, where the dominant firm aims to strengthen or maintain its market power through putting its rivals at a disadvantage.² Exploitative and exclusionary excessive prices are based on different legal and economic principles. In this essay, we focus only on *exploitative excessive pricing*.

3. The following table shows the number of (closed) cases of exploitative excessive pricing where the Competition Council of the GVH made a decision,³ and also the number of cases where the GVH intervened, either through accepting commitments or declaring an infringement.

	2002	2003	2004	2005	2006	2007	2008	2009	2010
# Decisions	6	15	10	14	12	9	2	0	0
# Infringements	1	3	1	1	1	0	0	0	0
# Commitments	0	0	0	0	2	5	3	0	0

4. In our discussion we follow the four main questions posed in the call for contributions.

2. Under what conditions do excessive process require intervention?

5. A certain number of cases of alleged exploitative excessive pricing come to the attention of a competition authority, yet not all these cases are in fact investigated. In turn, not all cases that are investigated eventually lead to intervention – in some cases, it turns out that no abuse has taken place, the alleged abuse cannot be proven, or the firm is not in a dominant position. The decision on which cases

¹ Article 21 reads as follows: "It shall be prohibited to abuse a dominant position, particularly: a) in business relations, including the application of standard contractual terms, to set unfair purchase or selling prices or to stipulate in any other manner unjustified advantages or to force the other party to accept disadvantageous conditions; ..."

² For example, the dominant firm in an upstream (wholesale) market may set the price of its product so high that the margin between its price and the retail price is insufficient for an efficient firm to operate profitably in the downstream market (this is also known as a margin squeeze).

³ This number is lower than the total number of cases investigated, since cases can, under certain circumstances, be closed by the case team, and thus no formal decision is taken by the Competition Council. This occurs, for example, when dominance cannot be demonstrated or excessive pricing obviously cannot be proven.

should be pursued is often based on so-called *screening criteria*.⁴ In this section we describe the GVH's stance towards screening and screening criteria.

6. It is important to acknowledge that exploitative excessive pricing raises many difficulties, conceptual as well as methodological. The investigation of excessive pricing cases is also quite resource intensive. These factors might necessitate the implementation of some kind of screening.

7. Based on Article 21 of the Hungarian Competition Act, the GVH has a duty to investigate cases of possible exploitative excessive pricing. Several possible cases, however, may be minor in the sense that they influence the welfare of only very few consumers, or only to a small degree; furthermore, proving that pricing was excessive may be extremely time-consuming and costly. In these cases the costs of conducting (or completing) an investigation could outweigh the benefits (even taking into account the possible deterrence effect), which means that it may not be in the public interest for the investigation to be launched, or for it to continue. The Preamble of the Hungarian Competition Act acknowledges the significance of the public interest in this way,⁵ and in some exploitative excessive pricing cases, this has been referred to as an important factor.⁶

8. The GVH does not officially use screening criteria *per se*. However, the GVH tends to agree with general view that in the presence of certain factors investigations into excessive pricing are more validated. Specifically, the most often cited screening criteria are the following:

- There should be high entry barriers on the market in question. This is typically regarded as the most important criterion; since in the absence of entry barriers, it can be reasonably expected that exploitative excessive pricing will induce entry and thus eliminate the need for intervention.
- The firm under investigation should have large market power: an especially strong form of dominance should be asserted. It is also more warranted to investigate a firm whose dominant position is not merited by its market conduct (for example, derives from former legal monopoly).
- There should be either no regulation regarding the investigated price or conduct of the firm (or there should be regulatory failure on the market). This leads to the next question: whether excessive prices should be dealt with by competition authorities rather than regulators.

3. Should excessive prices be dealt with by competition authorities or rather by regulators?

9. Two main questions can be posed regarding the relationship between regulators and competition authorities: first, what the allocation of tasks should be between the sector regulators and the competition authorities in regulated markets, and secondly, which markets should be regulated at all.

10. A core difference between dealing with excessive prices by competition authorities or by regulators is the nature of the intervention: competition authorities intervene *ex post*, that is, after an abuse

⁴ Sometimes it is hard to verify whether the criteria are met before a case is actually launched. This means that "screening" can actually take place even after an investigation has started, possibly causing the case to be closed.

⁵ The Preamble states: "The public interest attached to the maintenance of competition on the market ensuring economic efficiency and social progress, the interests of undertakings complying with the requirements of business fairness and the interests of consumers require the state to protect by law fairness and freedom of economic competition. ..."

⁶ Case Vj-156/2005 concerning exploitative excessive pricing by an electricity operator towards one single customer, for example, refers to the public interest and cites the Preamble.

has taken place, whereas regulation takes place *ex ante*, that is, prices are regulated in a way to ensure that abuse does not take place. Both *ex ante* and *ex post* intervention have advantages and disadvantages:

- In general, preventing abuse is preferred to punishing or remedying abuse.
- Furthermore, *ex post* intervention often takes a significant amount of time. By the time the investigation has taken place and all court appeals have been settled, many important factors may have changed on the relevant market. This means that *ex post* intervention may be less than efficient, especially in quickly changing markets.
- On the other hand, *ex ante* regulation is extremely difficult to plan and implement in an efficient way, and also needs to be constantly monitored, which renders it costly. Therefore, price regulation should be used in relatively few markets, specifically those where there is market failure (externalities, a natural monopoly, information asymmetry etc).

11. There is no general rule concerning the allocation of tasks between various regulators and the GVH. In the case of regulated sectors of telecommunications and media, the GVH does not have the mandate to investigate exploitative excessive pricing cases.⁷ In other (partially regulated) markets, such as energy, water etc, the GVH has the mandate to investigate such cases even if regulation exists – although, of course, firms cannot be condemned for simply adhering to regulated prices.⁸

4. What are the different economic methodologies for assessing excessive pricing?

12. Methods for assessing excessive pricing all require a benchmark price with which to compare the allegedly excessive price. Methods differ from each other in the chosen benchmark.

13. Furthermore, in each case it must be decided by how much the price should exceed the benchmark before being deemed excessive, that is, a threshold must be chosen. The choice of threshold is typically dependent on the market in question, can be based on academic papers or case law, but is ultimately always to some degree arbitrary.

14. Before discussing specific methods, we think it is important to acknowledge three general rules.

- In order to show that an abuse has occurred, it is necessary to prove dominance. However, it is important to note that establishing dominance is not sufficient: a dominant firm's prices will naturally be higher than prices under effective competition, but this is not an abuse in itself. In order to establish an abuse, there is a higher standard of proof and a larger deviation needed from the effectively competitive level than what is needed to assert dominance.
- Whenever possible, more than one method should be used in assessing excessive pricing. Firstly, because neither method is perfect, neither is exact enough. Secondly, because it is especially important in exploitative excessive pricing cases to avoid a Type I error. The GVH tends to agree with the view that when the price of the product can be well compared both to its economic value

⁷ For example, termination charges are regulated and thus excessive pricing cases cannot be investigated by the GVH in this market. On the other hand, cable television programme packages are unregulated, and therefore cases can be launched.

⁸ Such investigations, however, are extremely rare.

and to its production costs then both tests should point towards abuse in order for an infringement to be well founded.⁹

- Different tests and different benchmarks typically require different thresholds, depending on the specifics of the case and the industry. For example, if in one test, a 10% threshold is used in a given case then it cannot be assumed that a 10% threshold will be appropriate for a different test in the same case. Also, if a given test is conducted with a 10% threshold in one industry, this does not imply that a 10% threshold is appropriate in another industry.

15. The following is a list of possible methods. In each case, we cite cases investigated by the GVH where the method has been used.

- Comparison of the firm's prices to other firms' prices in the relevant market.¹⁰
- Comparison of the firm's prices to its rivals' prices in other markets.¹¹
- Comparison of the firm's prices in the relevant market to its prices in other markets.¹²
- Comparison of the firm's current prices with its past prices.¹³
- Comparison of the firm's prices with prices on the commercial exchange.¹⁴
- Comparison of the firm's prices to its costs.¹⁵

⁹ The European Commission's assessment of United Brands in the Port of Helsingborg cases is also along these lines: case 36.570 (Sundbusserne v. Port of Helsingborg) and case 36.568 (Scandalines Sverige AB v. Port of Helsingborg), date of decisions: 23 July 2004.

¹⁰ A large number of excessive pricing cases were investigated in markets where the dominant firm was in fact a monopoly, and therefore this method was seldom used by the GVH. However, in cases when there are rivals in the market, this method is typically a starting point. It was used, for example, in the case of the investigation concerning the wholesale prices of MOL, the Hungarian Oil and Gas Company (Vj-152/2000).

¹¹ This method is typically used when there are several local geographic markets within Hungary, for example, in several cases relating to price increases in cable television programme packages. This method was not the primary method used, however.

¹² This method was used in a case against a natural gas distribution service provider (Vj-116/2005), where the firm provided gas to two distinct sets of consumers: to one group, at a regulated level, and to another, in an unregulated market. The unregulated price was deemed excessive, since it was three times as large as the regulated price – and the regulated price had been calculated based on costs, and was therefore itself not an unprofitable price. Similarly, in a funeral service case (Vj-157/2007) the fee for funeral services for foreigners was more than 16 times the price for Hungarians.

¹³ Typically this method is used when the trigger for the investigation is a significant price rise. The GVH investigated a case (Vj-190/2004), for example, where an energy company increased its prices by 76 and 155% (towards two groups of consumers), and then, 6 months later, decreased them, resulting in prices which were 33 and 71% above the original prices. The Competition Council declared the prices excessive over the first 6 months. Similarly, past prices were used as a benchmark in a group of cases focusing on banking fees.

¹⁴ The GVH conducted an investigation into the pricing of MOL, the Hungarian Oil and Gas Company (Vj-152/2000). Among other methods, the GVH compared MOL's pricing with prices on various European stock markets.

- Comparison of the firm's product's profitability with some benchmark.¹⁶

16. In our experience, it is also important to determine *for how long* prices should stay (continuously) above the threshold for pricing to be considered abusive. Although this question is of potentially similar importance as the abusive price level itself (and raises similar issues of arbitrariness and the correct methods), it is seldom addressed in cases or even in the literature.¹⁷ We believe that this time period should be "significant" (encompassing at least a few months), but the exact time period should depend on the industry in question.

5. What could be appropriate remedies in excessive pricing cases?

17. In this section, we discuss the ways in which a competition authority can *intervene* in an excessive pricing case.

18. We believe it is useful to differentiate between three parts of a possible intervention.

- Adherence: any intervention should prescribe that the dominant firm *cease its abusive conduct*. For example, this could mean lowering prices, or ceasing price discrimination.¹⁸ This may be complemented by explicit indications as to "correct" pricing – something close to price regulation.
- Deterrence: a deterrence effect can primarily be achieved through the levying of a fine.¹⁹ The deterrence effect can be further strengthened through private actions or other specific measures.²⁰
- Remedying: we believe that an intervention should only be called a "remedy" in the proper sense if it fixes the root of the problem, ensuring that a similar problem cannot develop again in the market (where this is not only due to the deterrence effect). Examples of such remedies could be

¹⁵ Comparison with costs is used often by the GVH, although typically in conjunction with other methods. For example, the GVH investigated a large number of cases (36 in total) relating to cable television markets; usually the price increases of programme packages at the beginning of the year. As a first step, increases in costs were taken into account (due either to increases in direct costs and inflation). The cases were further investigated if the price rise was significantly above that induced by increases in cost.

¹⁶ In the above mentioned cable television cases, the GVH analysed firms' profitability in those cases where the investigated price increase was significantly above that induced by increases in cost. If profitability was excessively large, the price was deemed excessive. If profitability was large, but did not surpass a 15% threshold, then further tests were implemented: among others, the comparison of profitability with previous years' profitability.

¹⁷ Specifying a too short space of time result in an unwanted increase in Type I errors.

¹⁸ Adherence was the only intervention in the case of the National Office of Translation and Attestation (Vj-141/2007), which committed to decreasing its prices.

¹⁹ Two out of the three cable television cases where an abuse was proven resulted in a fine, and fines have been applied in a few other cases as well.

²⁰ For example, in the banking fee cases (eg. Vj-12/2006) parties offered (committed to) reimbursing customers who had paid the higher price.

structural remedies involving divestitures, or behavioural (sometimes called demand-side) remedies in which key features of the firm's behaviour change.²¹

19. In some cases, major commitments made by firms during the investigation result in a case being closed with commitments rather than resulting in a condemnation.²²

20. Finding effective ways to intervene is of course fraught with difficulties. We list only a few of the concerns:

- When a firm must cease its abusive conduct, the question immediately arises as to what the correct conduct (the correct price) should be. Competition authorities (as opposed to sector regulators) may not have the information or the capacity to determine what a "good" price would be.
- Most modes of intervention require a certain amount of monitoring, which may be very costly.
- If a remedy leads to explicit or implicit price regulation, it could decrease the incentives for entry, or innovation.

21. The adherence requirement is basically automatic; and deterrence might be necessary. But, whenever possible, we believe that the root of the problem should be addressed, through a real "remedy" in the above sense.

22. Competition advocacy is another way to fixing problems on given markets, that applies to an entire market or markets rather than to a given case. Advocacy can take many forms, for example, the competition authority may advocate the implementation of certain regulations (which influences the supply side of the market), it can attempt to decrease search costs and / or asymmetric information in the market (which primarily influences the demand side of the market), or it could conduct investigations into certain industries to assess the possible competition problems present. The GVH participates in competition advocacy in several ways.²³

²¹ No such structural remedies have been implemented by the GVH. For example, a firm could commit to always informing its customers of upcoming changes in its standard contracts. (In the GVH's practice, this took place for example in the banking fee cases.)

²² The banking fee cases were resolved in this way.

²³ For example, the GVH has conducted industry investigations in certain key industries (for example, telecommunications and certain sectors of banking). It has also published leaflets explaining certain financial and banking issues in order to decrease asymmetric information between banks and their customers. The GVH also has the mandate to present its opinion on proposed regulations that may have an effect on competition.