Tel Aviv University Law School
Tel Aviv University Law Faculty Papers

Year 2010 *Paper* 118

EXCESSIVE PRICING, ENTRY, ASSESSMENT, AND INVESTMENT: LESSONS FROM THE MITTAL LITIGATION

David Gilo*

*Tel-Aviv University, gilod@post.tau.ac.il

EXCESSIVE PRICING, ENTRY, ASSESSMENT, AND INVESTMENT: LESSONS FROM THE MITTAL LITIGATION

David Gilo

Abstract

The role of antitrust in curtailing excessive prices has long been a contentious area. Consequently, the charging of excessive prices has been subjected to diverse levels of enforcement across the world. U.S. antitrust law, for example, does not encompass the charging of high prices as such, and was held not to "condemn the resultant of those very forces which it is its prime object to foster: finis opus coronat." By contrast, competition laws in other jurisdictions provide for the condemnation of excessive or unfair pricing. Such is the case under EU competition law, the competition provisions in the European Member States, and in other jurisdictions across the world. But even among those competition regimes which do intervene against the charging of excessive prices as such, one may identify different levels of enthusiasm for doing so. In Europe, for example, recent years have witnessed a restrained approach by the European Commission but a more proactive approach by some of the competition authorities of the Member States. Varying levels of intervention reflect a controversy as to the merit of prohibiting excessive pricing. Three main grounds are often used to justify non- or limited intervention: (1) intervention is not necessary, as high prices would be competed away by new entry, attracted by the excessive price; (2) there are practical difficulties in speculating what a price would have been had there been competition and in determining the excessiveness of the prices actually charged; and (3) enforcement which targets excessive prices may chill innovation and investment. To illustrate the difficulties of assessment and to question some of the justifications that are used to rationalize non-intervention, this article reviews the recent litigation in South Africa related to alleged excessive pricing by Mittal Steel. We use

the decisions of the South African Competition Tribunal and the South African Competition Appeal Court as a case study to highlight both the complexity of, and possible merit in, antitrust intervention against excessive pricing.

Our analysis focuses on the three grounds for non-intervention. First, with respect to the self-correcting nature of excessive prices, we illustrate how excessive prices, in and of themselves, do not attract new entry when potential entrants are either informed or uninformed about their post-entry profits. Referring to our previous work on this subject, we question the South African Competition Tribunal's holding in the Mittal case with respect to the prerequisite conditions for intervention against excessive pricing. Second, we consider how the difficulties of assessing what is an excessive price affected the outcome in the Mittal litigation. Without underestimating these difficulties, we consider how they may be alleviated in certain cases through reasonable methods for inferring what may constitute an excessive price. Third, while acknowledging the possible validity of concerns about chilling ex ante investment, we outline instances in which these concerns should not serve to support nonintervention. It should be stressed that this article does not advocate across-the-board intervention. It does, however, question the validity of a categorical "hands-off" approach, which deems excessive prices to be outside the realm of competition law. We consider separately the weight that should be assigned to each ground for non-intervention. Subsequently, we argue in favor of a case-by-case approach which explores the factual matrix of each case and considers the benefits, costs, and net effects of intervention.

EXCESSIVE PRICING, ENTRY, ASSESSMENT, AND INVESTMENT: LESSONS FROM THE *MITTAL* LITIGATION

ARIEL EZRACHI
DAVID GILO*

The role of antitrust in curtailing excessive prices has long been a contentious area. Consequently, the charging of excessive prices has been subjected to diverse levels of enforcement across the world.[1] U.S. antitrust law, for example, does not encompass the charging of high prices as such,[2] and was held not to "condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*."[3] By contrast, competition laws in other jurisdictions provide for the condemnation of excessive or unfair pricing. Such is the case under EU

* Ariel Ezrachi is Director, University of Oxford Centre for Competition Law and Policy; Slaughter and May Lecturer in Competition Law, University of Oxford; Fellow, Pembroke College, Oxford. David Gilo is Associate Professor, Buchmann Faculty of Law, Tel Aviv University, Israel. We thank the participants of the Issues at the Forefront of Monopolization and Abuse of Dominance Conference at the University of Haifa (May 2009) for extremely helpful discussions and comments. The authors are responsible for any errors or omissions and for the views advanced in this article.

[1] An excessive price may generally be defined as a price which is excessively above the price that would evolve under viable competition. We deal with the difficulties in assessing such a price in Part III of this article.

[2] *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004); Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1413 (7th Cir. 1995); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 274 n.12 (2d Cir. 1979).

[3] United States v. Aluminum Co. of Am. *(Alcoa)*, 148 F.2d 416, 430 (2d Cir. 1945). Following its statement that the "end crowns the work" (*finis opus coronat*), the Court in *Alcoa* held that "[t]he successful competitor, having been urged to compete, must not be turned upon when he wins." *Id.*; *see also* Chicago Prof'l Sports Ltd. P'ship v. NBA, 95 F.3d 593, 597 (7th Cir. 1996) ("[T]he antitrust laws do not deputize district judges as one-man regulatory agencies."); 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 720b at 4–7 (3d ed. 2008); Michal S. Gal, *Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief About Monopoly?*, 49 ANTITRUST BULL. 343, 346–47, 353, 356 (2004); Eleanor M. Fox, *Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness*, 61 NOTRE DAME L. REV. 981, 985–86 (1986).

competition law,[4] the competition provisions in the European Member States,[5] and in other jurisdictions across the world.[6] But even among those competition regimes which do intervene against the charging of excessive prices as such, one may identify different levels of enthusiasm for doing so. In Europe, for example, recent years have witnessed a restrained approach by the European Commission[7] but a more proactive approach by some of the competition authorities of the Member States.[8]

Varying levels of intervention reflect a controversy as to the merit of prohibiting excessive pricing. Three main grounds are often used to justify non- or limited intervention: (1) intervention is not necessary, as

---

[4] *See, e.g.*, Case 110/88, Lucazeau v. SACEM, 1989 E.C.R. 2811 (Eur. Ct. Justice); Case 30/87, Bodson v. Pompes Funebres des Regions Liberees SA, 1988 E.C.R. 2479 (Eur. Ct. Justice); Case 27/76, United Brands Co. v. Comm'n, 1978 E.C.R. 207 (Eur. Ct. Justice); Case 26/75, Gen. Motors Cont'l NV v. Comm'n, 1975 E.C.R. 1367 (Eur. Ct. Justice); Case 40/70, Sierna S.r.l. v. Eda S.r.l., 1971 E.C.R. 69 (Eur. Ct. Justice); *see also* Case COMP/A.36.568/D3—Scandlines Sverige AB v. Port of Helsingborg, Comm'n Decision (July 23, 2004), *available at* http://ec.europa.eu/competition/antitrust/cases/decisions/36568/reject_en.pdf; Case COMP/C-1/36.915—Deutsche Post AG, Comm'n Decision, 2001 O.J. (L 331) 40. For a detailed discussion of these cases, see ARIEL EZRACHI, EC COMPETITION LAW: AN ANALYTICAL GUIDE TO THE LEADING CASES 158–64 (2008).

[5] *See, e.g.*, Case 2005-0004688, Elsam A/S, Danish Competition Appeal Tribunal Order (Nov. 14, 2006) (alleging excessive pricing in the West Denmark market for electricity); Case Vj-156/2005, E.ON, Hungarian Competition Council Order (Apr. 26, 2007) (concerning termination of proceedings against E.ON, a power supplier, which allegedly charged excessive prices); Case 2006-I/O-12, Banksys S.A., Belgian Competition Council Decision (Aug. 31, 2006) (concerning commitments from Banksys to freeze the prices for electronic payment services); Case NA42129604, Olaines Kudra SA v. Riga Stock Exchange, Latvian Supreme Court (Apr. 25, 2006) (concerning the charge of unfair price by the Riga Stock Exchange and its legality under Article 82); Case 2910, Interpay BeaNet B.V., Netherlands Competition Authority (NMa) (Apr. 28, 2004) (finding excessive pricing by Interpay). For a review of national courts' decisions, see IOANNIS KOKKORIS, COMPETITION CASES FROM THE EUROPEAN UNION (2007). For additional decisions at Member State level see the *e-Competitions* database available online at http://www.concurrences.com.

[6] These include, for example, South Africa, Israel, Russia, and the Bailiwick of Jersey. Like Article 82 EC (now Article 102 TFEU (see *infra* this note)), Article 16(2)(a) of the competition law ruling the island of Jersey provides that abuse of dominant position includes "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions." Competition (Jersey) Law 2005, art. 16(2)(a), L.6/2005, *available at* http://www.jcra.je/pdf/051101%20Competition-Jersey-Law—2005.pdf. As of December 1, 2009, the Treaty of Lisbon became effective and introduced a renumbering of the articles in the Treaty Establishing the European Community. Relevant to the discussion here, Article 82 is now Article 102. However, for ease of reference, we will continue to use the prior numbering in our discussion. *See* Treaty on the Functioning of the European Union, art. 102, May 9, 2008, 2008 O.J. (C 115) 47 (effective Dec. 1, 2009) [hereinafter TFEU].

[7] *See, e.g.*, Massimo Motta & Alexandre de Streel, *Excessive Pricing and Price Squeeze Under EU Law*, *in* EUROPEAN COMPETITION LAW ANNUAL 2003: WHAT IS AN ABUSE OF A DOMINANT POSITION? 91, 104 (Claus-Dieter Ehlermann & Isabela Atanasiu eds., 2006) (emphasizing the small number of cases actually condemning excessive prices in the European Union).

[8] *See* sources cited *supra* note 5.

high prices would be competed away by new entry, attracted by the excessive price; (2) there are practical difficulties in speculating what a price would have been had there been competition and in determining the excessiveness of the prices actually charged; and (3) enforcement which targets excessive prices may chill innovation and investment.[9]

To illustrate the difficulties of assessment and to question some of the justifications that are used to rationalize non-intervention, this article reviews the recent litigation in South Africa related to alleged excessive pricing by Mittal Steel.[10] We use the decisions of the South African Competition Tribunal and the South African Competition Appeal Court as a case study to highlight both the complexity of, and possible merit in, antitrust intervention against excessive pricing.

Our analysis focuses on the three grounds for non-intervention. First, with respect to the self-correcting nature of excessive prices, we illustrate how excessive prices, in and of themselves, do not attract new entry when potential entrants are either informed or uninformed about their post-entry profits. Referring to our previous work on this subject,[11] we question the South African Competition Tribunal's holding in the *Mittal* case with respect to the prerequisite conditions for intervention against excessive pricing. Second, we consider how the difficulties of assessing what is an excessive price affected the outcome in the *Mittal* litigation. Without underestimating these difficulties, we consider how they may be alleviated in certain cases through reasonable methods for inferring what may constitute an excessive price. Third, while acknowledging the possible validity of concerns about chilling ex ante investment, we outline instances in which these concerns should not serve to support non-intervention.

It should be stressed that this article does not advocate across-the-board intervention. It does, however, question the validity of a categorical "hands-off" approach, which deems excessive prices to be outside the realm of competition law. We consider separately the weight that should be assigned to each ground for non-intervention. Subsequently, we ar-

---

[9] *See* ROBERT O'DONOGHUE & A. JORGE PADILLA, THE LAW AND ECONOMICS OF ARTICLE 82 EC at 627–28 (2006).

[10] Case 13/CR/Feb04, Harmony Gold Mining Co. v. Mittal Steel S. Afr. Ltd. (S. Afr. Competition Trib. Mar. 27, 2007) [hereinafter *Tribunal Decision*], *available at* http://www.comptrib.co.za/comptrib/comptribdocs/97/13CRFeb04reasons.pdf, *set aside and remitted by* Case 70/CAC/Apr07, Mittal Steel S. Afr. Ltd. v. Harmony Gold Mining Co. (S. Afr. Competition App. Ct. May 29, 2009) [hereinafter *Appeal Court Decision*], *available at* http://www.comptrib.co.za/comptrib/comptribdocs/1049/70CACApr07.pdf.

[11] Ariel Ezrachi & David Gilo, *Are Excessive Prices Really Self-Correcting?*, 5 J. COMPETITION L. & ECON. 249 (2009).

gue in favor of a case-by-case approach which explores the factual matrix of each case and considers the benefits, costs, and net effects of intervention.

I. THE *MITTAL* LITIGATION

In the *Mittal* case, the South African Competition Tribunal (the Tribunal) found that Mittal Steel South Africa Ltd. and others had infringed Section 8(a) of the South African Competition Act by charging an excessive price for its steel, to the detriment of consumers.[12] The decision is interesting, not least because the Tribunal sought to establish the excessiveness of price without focusing on cost, pricing structure, or comparative price analysis.[13]

The Tribunal first established the existence of "super-dominance," which, according to the Tribunal, was a paramount condition absent which excessive pricing would not have been possible.[14] Accordingly, the Tribunal held that in order to establish the structural basis for charging excessive prices, the undertaking in question must enjoy a market share that "should approximate 100%"[15] and possess extraordinary market power that will allow it to price at a level beyond that available to a merely "dominant" firm. Mittal was indeed found by the Tribunal to hold such market power.[16]

Second, following this determination, the Tribunal assessed whether Mittal abused its super-dominant position in the market by imposing excessive prices on its customers. It noted that "proof of structural super-dominance is necessary, but not sufficient, to find excessive pricing."[17] The Tribunal refrained from considering evidence relating to price levels: it distinguished between the European benchmark of unfairness in Article 82 EC and the benchmark of excessiveness in South Africa.[18] As a result, the Tribunal was of the opinion that the judgment that it is required to make "is not of the price level itself but rather of the market conditions that generated the price level."[19] It concluded

[12] *Tribunal Decision*, *supra* note 10, ¶ 198. Section 8(a) of the Competition Act 89 of 1998, as amended, provides that it is prohibited for a dominant firm to "charge an *excessive price* to the detriment of consumers," and an "excessive price" is defined, in Section 1(1)(ix) of the Competition Act, as "a price . . . which . . . bears no reasonable relation to the economic value of that good or service and is higher than" this value.

[13] *See Tribunal Decision*, *supra* note 10, ¶ 74.

[14] *See id.* ¶¶ 84, 96–100.

[15] *Id.* ¶ 96.

[16] *Id.* ¶¶ 90–121.

[17] *Id.* ¶ 131.

[18] *See id.* ¶¶ 133–138.

[19] *Id.* ¶ 142.

that the price charged by Mittal had no explanation other than the pure exercise of monopoly power and, therefore, was excessive. In particular, Mittal was found to have charged prices that were, according to the Tribunal, determined regardless of competitive constraints. Further, Mittal had forbidden its customers, buying its steel at lower prices, from reselling the steel inside South Africa. Such restraints, enforcing Mittal's price discrimination, supported the Tribunal's conclusion that Mittal had priced excessively.[20]

The Tribunal's decision was appealed to the Competition Appeal Court of South Africa (the Appeal Court). On May 29, 2009, the Appeal Court delivered its judgment setting aside the Tribunal's decision and remitting it to the Tribunal for further assessment.[21] The Appeal Court condemned the Tribunal's reading of Section 8(a) and "the taking of liberties with the language of the Act so as to make s 8(a) serve the Tribunal's preference to deal with market structure rather than price level."[22] It rejected the Tribunal's reliance on the concept of a "super-dominant" firm, as such, had no grounding in the statute.[23] The Appeal Court further held that a finding of excessive pricing necessitates:

> First, the determination of the actual price of the good or service in question and which is alleged to be excessive. Secondly, the determination of the "economic value" of the good or service expressed in monetary terms, as an amount of money. Thirdly . . . is there "no reasonable relation" between the actual price and the economic value of the good or service? Fourthly, is the charging of the excessive price to the detriment of the consumers? The first two enquiries call for factual determinations of the actual price and the economic value and the third for a value judgment. The fourth enquiry also involves, as we will show, a value judgment.[24]

Subsequently, the Appeal Court referred the case back to the Tribunal to determine, according to these guidelines, whether Mittal's pricing was indeed excessive.[25]

In what follows, we consider the commonly used grounds for non-intervention against excessive prices in light of the *Mittal* litigation.

---

[20] *Id.* ¶ 47.
[21] *Appeal Court Decision*, *supra* note 10.
[22] *Id.* ¶ 28.
[23] *Id.* ¶ 32.
[24] *Id.* (footnote omitted).
[25] *Id.* ¶ 75.

II. THE SELF-CORRECTION OF EXCESSIVE PRICES, CONTESTABLE MARKETS, AND ENTRY BARRIERS

One of the main justifications for non-intervention or limited intervention against excessive pricing is the notion that excessive pricing attracts entry and is therefore self-correcting. Moreover, it is often argued that the mere prospect of new entry may suffice to prevent excessive pricing, as it would deter the dominant undertaking from pricing excessively in the first place. Looking at the Tribunal's *Mittal* decision, the notion of "self-correction" implicitly served as a springboard for the finding of abuse. There, the Tribunal focused on the existence of a super-dominant position, which was not susceptible to potential entry. In particular, it noted that there was no prospect of new entry into the domestic market at all.[26] It stressed that in its opinion "Section 8(a) is precisely intended to apply to those rare markets that are *uncontested* (monopolized or 'super-dominated'), *incontestable* (subject to insurmountable entry barriers) and *unregulated* (not subject to price regulation)."[27]

We agree that in a market that is blockaded from entry, excessive pricing is more likely to be long-lived. We disagree, however, that insurmountable entry barriers are a prerequisite for intervention, whereas low entry barriers imply that no intervention is warranted. To show why, it would be helpful to illustrate why excessive prices are not self-correcting.

The perception that excessive pricing is self-correcting dominates the literature,[28] court judgments,[29] and competition agencies' deci-

[26] *Tribunal Decision*, *supra* note 10, ¶ 107.

[27] *Id.* ¶ 106.

[28] *See* 3A AREEDA & HOVENKAMP, *supra* note 3, ¶ 720b, at 6 ("[W]hile permitting the monopolist to charge its profit-maximizing price encourages new competition, forcing the monopolist to price at a judicially administered 'competitive' level would discourage entry and thus prolong the period of such pricing."); RICHARD WHISH, COMPETITION LAW 709 (6th ed. 2008) ("[I]f normal market forces have their way, the fact that a monopolist is able to earn large profits should, in the absence of barriers to . . . entry, attract new entrants to the market. In this case the extraction of monopoly profits will be self-deterring in the long run and can act as an important economic indicator to potential entrants to enter the market. If one accepts this view of the way that markets operate, one should accept with equanimity periods during which a firm earns a monopoly profit: the market will in due course correct itself, and intervention by the competition authorities will have the effect of undesirably distorting this process."); VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE 203 (9th ed. 2007) ("[T]he cost price approach ignores the function of pricing as a signal encouraging new entrants. If prices and profits are high, new firms may be attracted into the market over at least modest entry barriers."); O'DONOGHUE & PADILLA, *supra* note 9, at 635–36; Motta & de Streel, *supra* note 7, at 108; JORDI GUAL ET AL., EUROPEAN ADVISORY GROUP ON COMPETITION POLICY, AN ECONOMIC APPROACH TO ARTICLE 82 at 11 (2005) ("[S]uch a policy intervention [against monopolistic pricing] drastically reduces, and may even forego the chance to protect consumers in the future by competition rather than policy intervention.").

[29] *See, e.g.*, Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 274 n.12 (2d Cir. 1979).

sions[30] in excessive pricing cases. While it is generally accepted that viable new entry into a concentrated market is expected to curtail the dominant undertaking's ability to charge excessive prices, we argue that excessive prices do not attract entry. Therefore, the "self-correcting" reasoning should not serve to justify non-intervention.

A. THE LIMITED SIGNALING VIRTUE OF PRE-ENTRY PRICES

As we explain in detail elsewhere, it is the post-entry price, and not the pre-entry price, that potential entrants consider when deciding whether to enter.[31] Since the dominant firm can usually cut prices immediately upon a rival's entry,[32] its excessive pre-entry prices do not affect the potential entrants' decision of whether to enter. Pre-entry prices are only significant where they signal to potential entrants that the dominant firm is relatively inefficient, making entry profitable.[33] Accordingly, if a potential entrant has sufficient information regarding the incumbent's advantages, and particularly the incumbent's marginal costs, and the entrant perceives the incumbent to be comparatively more efficient than the entrant, it is unlikely to enter, even if the incumbent charges an excessive price. This is because once such an entrant makes its first steps of entry, the incumbent is expected to start a price war with it that could bring prices to levels that render entry unprofitable for such an entrant, given its cost disadvantage. Conversely, if a potential entrant perceives the incumbent to be comparatively less efficient than itself, it is more likely to enter, but not because of the excessive price. Such an entrant would have been more likely to enter regardless of pre-entry price levels. This is because the latter type of entrant would know that regardless of pre-entry prices, and regardless of the incumbent's expected post-entry price cutting, its competitive advantage over the incumbent could allow it to make sufficient post-entry profits.

---

[30] *See, e.g.*, Case CA98/2/2001—Napp Pharm. Holdings Ltd., Decision of the Director General of Fair Trading (UK), ¶ 203 (Mar. 30, 2001) ("The Director considers that a price is excessive and an abuse . . . where it is clear that high profits will not stimulate successful new entry within a reasonable period."), *available at* http://www.oft.gov.uk/shared_oft/ca98_public_register/decisions/napp.pdf; *see also* OFFICE OF FAIR TRADING (UK), OFT LEAFLET NO. 414, ASSESSMENT OF INDIVIDUAL AGREEMENTS AND CONDUCT ¶ 2.13 (1999) ("The Director General will be mindful of the need not to interfere in natural market mechanisms where high prices will encourage new entry . . . ."); Philip Lowe, Dir. Gen., DG Competition, How Different Is EU Anti-trust? A Route Map for Advisors, Speech at the ABA 2003 Fall Meeting (Oct. 16, 2003), *available at* http://ec.europa.eu/competition/speeches/text/sp2003_038_en.pdf.

[31] *See* Ezrachi & Gilo, *supra* note 11, at 255.

[32] One arguably rare exception is where the dominant firm is operating at full capacity, despite its monopoly, associated with curtailed production.

[33] Ezrachi & Gilo, *supra* note 11, at 255.

In our previous work, we also explore the case in which pre-entry prices could serve as a signal to uninformed entrants, and we show that such a signal could be equally clear (or sometimes clearer) in a regime in which excessive prices are prohibited.[34] The reason, in a nutshell, is that even where excessive prices are prohibited, as long as an inefficient incumbent is allowed to charge a higher (non-excessive) price than an efficient incumbent, the pre-entry price continues to signal whether the incumbent is efficient or not. That is, for pre-entry prices to send signals to entrants, prices need not be excessive; it suffices that they are different when the incumbent is efficient than when it is not. For example, assume, for now, that the antitrust agency can determine the incumbent's marginal costs, and can specify that it may charge, without challenge, its marginal cost plus a margin of "k."[35] Under such a regime of prohibition against excessive pricing, inefficient incumbents are expected to charge higher (non-excessive) prices than efficient incumbents, in a way that can signal their efficiency to potential entrants that are unaware of the incumbent's marginal costs as clearly (or at times more clearly) as excessive pricing.[36]

The notion that excessive prices attract entry might be confused with the notion that mergers, or other practices and restraints that soften competition, attract entry. While the former is false, the latter is often true: a horizontal merger among rivals in a concentrated industry, faced by low or intermediate barriers to entry, may well attract entry. The same could be said for any practice or restraint that softens competition in the market. But the reason these practices attract entry is not that they cause pre-entry prices to be high. It is that they cause *post-entry prices* to be higher than before the practice. For example, entry into an industry of four players may not be profitable because the oligopolistic price that would evolve from (imperfect) competition among five players may be too low to justify the costs of entry. After a horizontal merger between two of the four existing players, however, the market would be transformed into an oligopoly of three players. Then, the post-entry price and profits would typically be higher, since they would evolve from imperfect competition among four players rather than five.[37] These increased profits might well attract entry, if entry barriers are not too high.

---

[34] *Id.* at 263–68.

[35] Problems of assessing these figures will be discussed *infra* Part III.

[36] Ezrachi & Gilo, *supra* note 11, at 263–68. We assume here that, just as a potential entrant can at times deduce from a monopoly price what the monopolists' costs are, it can at times deduce from a monopolists' non-excessive price what the monopolists' costs are. For such a deduction, the potential entrant has to have some notion about how "excessiveness" is determined in the industry in question.

[37] *See* JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 220, 283 (1988).

As noted, the same is true for other practices that soften price competition, such as price-matching, or most-favored consumer clauses.[38] These points, of course, do not contradict the fact that *pre-entry* prices, in and of themselves, do not attract entry.

B. CONTESTABLE MARKETS AND ENTRY BARRIERS

One possible objection to our claim is based on the well-known theory of contestable markets. Significantly, the *Mittal* Tribunal decision stressed the incontestability of the market as a prerequisite for intervention.[39] According to the theory of contestable markets:

> [A] market is defined to be perfectly contestable if no price in that market can be in equilibrium when its magnitude is such as to enable an entrant to undercut it and nevertheless earn a profit. Thus, a market that is protected by substantial entry barriers is clearly not contestable, because the barriers permit an equilibrium involving monopoly prices and monopoly profits. In the absence of barriers, those prices and profits would be undermined by entrants seeking to take advantage of the profit opportunity they provide.[40]

First, one should note that in reality no market is perfectly contestable. In any event, the theory of contestable markets cannot realistically mean that excessive prices invite entry. The theory is based on the assumption that incumbents do not react immediately to entry by cutting their prices to protect their market share. But such an assumption is usually not plausible. Since the entrant foresees such behavior by the incumbent, it cannot anticipate making a profit based on pre-entry prices. It needs to anticipate a profitable post-entry price, from its point of view, in order to enter.[41]

This conclusion has direct implications for the Tribunal's holding that the market must be uncontestable for an excessive pricing claim to be valid. Of course, if entry into the market is impossible, then excessive

---

[38] *See, e.g.*, Aaron S. Edlin, *Do Guaranteed-Low-Price Policies Guarantee High Prices, and Can Antitrust Rise to the Challenge?*, 111 HARV. L. REV. 528 (1997); Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses*, 64 ANTITRUST L.J. 517 (1996); Thomas E. Cooper, *Most-Favored-Customer Pricing and Tacit Collusion*, 17 RAND J. ECON. 377 (1986).

[39] *See supra* text accompanying note 27.

[40] Elizabeth E. Bailey & William J. Baumol, *Deregulation and the Theory of Contestable Markets*, 1 YALE J. ON REG. 111, 113 (1984).

[41] *See* TIROLE, *supra* note 37, at 368 (stressing, on a related point, that "[o]ne possibility is that the price of the established firm has commitment value. That is, the entrants expect the pre-entry price to prevail after entry. However, such a theory is not very convincing. Entry into many markets is a decision that covers a period of many months or years, whereas a price can often be changed within a few days or weeks."); Ezrachi & Gilo, *supra* note 11, at 255.

pricing by a dominant firm is likely to be long-lasting because new firms are not expected to enter. Suppose now that entry barriers are not that high, but rather intermediate, in the following sense: a potential entrant that knows it is more efficient than the incumbent is induced to enter, but one that knows it is less efficient than the incumbent is deterred from entry (due to its fear of vigorous post-entry competition). In such a case, based on the reasoning in its *Mittal* decision, the Tribunal would probably hold that there should be no claim against excessive pricing by the dominant firm because entry is not blockaded. But even with such "intermediate" entry barriers, excessive prices are not self-correcting.

One possible (although weak) counter argument is that the latter scenario is precisely the case in which, when the potential entrant does not know what the incumbent's marginal costs are, the incumbent is induced at times to engage in limit pricing: it charges a lower price than its short-run profit-maximizing price, so as to signal that it is efficient, thereby trying to deter entry.[42] Hence, in this case of intermediate entry barriers, at least it could be said that the monopolist may want to restrain itself and charge lower prices than the monopoly price. But, arguably, the hope of such self-restraint does not justify a "hands-off" approach to excessive pricing. First, potential entrants may be sufficiently informed about post-entry prices. In such a case, the monopolist has no reason for restraining its pricing behavior: entrants would base their entry decisions on post-entry prices and not on pre-entry prices. Second, even where entrants are not informed, so that the incumbent is induced to engage in limit pricing, such a limit price may well be "excessive" itself (under the antitrust agency's definition of excessiveness). All we know is that it is lower than the short-run profit-maximizing price.[43]

Other implications of our theory about the relationship between excessive pricing and entry relate to the facts of the *Mittal* case. In particular, as reported in the *Mittal* case, Mittal charged some of its buyers a price equal to what an importer of steel would have charged ("import parity pricing"), with the addition of "a 5% 'hassle factor,' essentially a

[42] *See* Ezrachi & Gilo, *supra* note 11, 257–62 (Part III.B); Paul Milgrom & John Roberts, *Limit Pricing and Entry Under Incomplete Information: An Equilibrium Analysis*, 50 ECONOMETRICA 443 (1982); *see also* David J. Cooper, Susan Garvin & John H. Kagel, *Signalling and Adaptive Learning in an Entry Limit Pricing Game*, 28 RAND J. ECON. 662 (1997).

[43] *See* Ezrachi & Gilo, *supra* note 11, 257–62 (Part III.B). In theory, even when entry barriers are low (e.g., the incumbent is less efficient than most of the potential entrants), the incumbent has no reason not to exploit consumers as much as possible while it can, before entry occurs. In such a case, however, the incumbent's dominance is not expected to persist for long periods. *See id.* at 262–63.

reflection of the additional costs or 'hassle' entailed in importing over the advantage of utilising a domestic supplier."[44]

This sort of pricing could be interpreted in different ways. The Tribunal saw it as arbitrary and detached from the price that would have prevailed under competition. This supported the Tribunal's decision that Mittal's pricing was excessive.[45] Another possibility is that Mittal engaged in a form of limit pricing. That is, rather than charging its short-run profit-maximizing price, it charged a price that, at least on average, would deter a foreign importer of steel from trying to enter the South African market. Perhaps such a price credibly signals to foreign steel producers that Mittal's marginal costs of producing steel are lower than theirs.[46] A third option is that in order to convince large customers to engage in long-term contracts with it, Mittal had to outbid importers. These options are plausible, however, only if Mittal's customers could credibly threaten to buy from foreign firms—a possibility that had been factually overruled by the Tribunal.[47] Be that as it may, Mittal's price may well be excessive. Indeed, a limit price may deter entry (e.g., by signaling that the incumbent is too efficient to make entry profitable) and still be excessively above the price that would have prevailed under viable competition.[48]

III. MEASURING THE COMPETITIVE, OR "NON-EXCESSIVE," PRICE

Our conclusion that excessive prices are not self-correcting shifts our focus to the other two objections to prohibiting excessive pricing, namely, the problems of implementation (what counts as "excessive") and the fear of chilling incentives to invest. The former consideration, namely, that an antitrust prohibition of excessive pricing is too difficult

[44] *Tribunal Decision*, *supra* note 10, ¶ 41.

[45] *Id.* ¶ 47.

[46] Note that this would be a crude form of limit pricing because, at least theoretically, Mittal could have signaled its low marginal costs by charging a price higher than merely the costs of import. *See* Milgrom & Roberts, *supra* note 42. As documented in the *Tribunal Decision*, *supra* note 10, Mittal's marginal costs were indeed lower than foreign producers, although its net profits were low, probably due to large overhead costs. *See* Simon Roberts, *Assessing Excessive Pricing: The Case of Flat Steel in South Africa*, 4 J. COMPETITION L. & ECON. 871, 887–88 (2008).

[47] *See Tribunal Decision*, *supra* note 10, ¶ 59.

[48] *See supra* text accompanying note 43 (explaining why a limit price may still be an excessive price). As noted, according to the Tribunal, significant import barriers deterred imports regardless of this limit price. *See Tribunal Decision*, *supra* note 10, ¶ 59.

to implement,[49] is in our opinion the most challenging obstacle. On a case-by-case basis, it may justify limited- or non-intervention.

The leading European case in which a court tried to define an excessive price is the *United Brands* case, which followed the earlier *GM* case,[50] but *United Brands* put forward a confusing definition which since then has been consistently echoed by regulators, courts, and legislators. *United Brands* defined an excessive price, among other things, as a price that bears no reasonable relation to the economic value of the good or service supplied and is higher than such value.[51] This is the definition adopted by the South African Competition Act as well.[52] But we cannot take this definition literally. A monopolist would never want to charge more than the value of the product to consumers because then they would not buy it. The most the dominant firm can do is exploit its consumers' willingness to pay. Hence, for example, a perfectly discriminating monopolist extracts all consumer surplus.[53] This is the most extreme case of consumer exploitation,[54] even though the monopolist is not charging consumers a price exceeding the product's "economic value" to consumers.[55]

It follows, then, that the definition of an excessive price should hinge on the difference between the price actually charged and the price that would prevail under viable competition. By no means is this an easy benchmark to follow. The price that would have prevailed under viable competition is typically well below the "economic value" of the product to consumers. As is well known, under competition, even imperfect oligopolistic competition, consumers' surplus is typically positive.[56]

Indeed, the *United Brands* decision "corrects" its own phrasing by defining an excessive price along these lines:

---

[49] *See, e.g.*, O'DONOGHUE & PADILLA, *supra* note 9, at 627; WHISH, *supra* note 28, at 709, 710.

[50] Case 27/76, United Brands Co. v. Comm'n, 1978 E.C.R. 207 (Eur. Ct. Justice); Case 26/75, Gen. Motors Cont'l NV v. Comm'n, 1975 E.C.R. 1367, ¶ 12 (Eur. Ct. Justice).

[51] *United Brands*, 1978 E.C.R. 207, ¶ 250.

[52] *See supra* note 12 and accompanying text.

[53] *See* TIROLE, *supra* note 37, at 135–37.

[54] Although exploitative, perfect price discrimination involves no allocative inefficiency because all consumers who should buy the product indeed buy it.

[55] *See* Nils Wahl, *Exploitative High Prices and European Competition Law—A Personal Reflection*, *in* THE PROS AND CONS OF HIGH PRICES 47, 54 (Swedish Competition Auth. ed., 2007) ("[A] statement that it is an abuse to charge prices which are excessive as compared to the economic value is in itself not self-explanatory."), *available at* http://www.konkurrensverket.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_high_prices.pdf.

[56] *See, e.g.*, TIROLE, *supra* note 37, at 67 (showing how consumer surplus is positive in the case of a monopolistic firm that is not engaged in perfect price discrimination).

> [I]t is advisable therefore to ascertain whether the dominant undertaking has 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.[57]

The Tribunal in the *Mittal* case too prefers the latter definition, and elegantly overcomes the problematic phrasing of *GM*'s and *United Brand*'s definition that found its way into the South African statute.[58]

Accordingly, the assessment of excessive pricing requires the competition agency or court to establish what the competitive price might have been had the market been competitive and whether the difference between this price and the price charged by the dominant undertaking is "excessive."[59] This introduces two difficulties: first, different jurisdictions may have different views as to what amounts to an unfair difference between the competitive price and the price actually charged.[60] A related complication is related to the need, in certain cases, to stimulate investment: an investment-intensive industry may justify a larger margin above the competitive price than an industry which is less investment-intensive. Second, the question arises, what is the meaning of "the price that would have prevailed in a competitive market"? It seems clear that this definition does not refer to perfect competition, where price goes all the way down to marginal cost. But how imperfect is the competition envisaged by this standard? For example, imperfect competition between two differentiated or capacity constrained players yields prices different than imperfect competition among more than two players. The degree of product differentiation or capacity constraints affects the "competitive" price that prevails, as does the level of demand, firms' cost structures and cost differences among firms. Hence, even the definition of what an excessive price is supposed to be compared to is ambiguous and changes from case to case.

Courts and agencies use various benchmarks in order to alleviate the problems of implementation.[61] As will be clarified below, a virtue of ap-

---

[57] Case 27/76, United Brands Co. v. Comm'n, 1978 E.C.R. 207, ¶ 249 (Eur. Ct. Justice).

[58] *See Tribunal Decision*, *supra* note 10, ¶ 86.

[59] Indeed, the U.S. Supreme Court stressed these difficulties as part of the rationale for non-intervention as early as 1897. *See* United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).

[60] On the range of approaches to unfairness, see David S. Evans & A. Jorge Padilla, *Excessive Prices: Using Economics to Define Administrable Legal Rules*, 1 J. COMPETITION L. & ECON. 97 (2005); O'DONOGHUE & PADILLA, *supra* note 9, at 621–38.

[61] For example, comparison between prices in different markets or over different times, comparing the price to the firm's own prices in more competitive markets or segments, comparison to competitors' prices, and so forth. For a review of the different methods,

plying several different benchmarks to one particular case is that it helps alleviate distortions caused by using certain kinds of benchmarks.

In *Mittal*, the Tribunal attempted to bypass the difficulties in the assessment of excessiveness. It held that it was not necessary to determine the reasonableness of the relationship between the price charged by Mittal and the "economic value" of flat steel products. The Tribunal chose to disregard comparative pricing analysis provided by the complainants.[62] The Tribunal followed a different path, which enabled it to avoid becoming a price regulator.[63] It stated that "a non-excessive price is one that is determined by competitive conditions in the relevant market."[64] Subsequently it concluded that Mittal's so-called "basket" approach, which relied on an arbitrary array of demand and supply characteristics in other selected national markets to determine prices in the South African domestic market, coupled with limitations that it imposed on the resale of steel by domestic customers who enjoyed lower prices, amounted to excessive pricing. The resale restrictions in question prevented domestic customers of Mittal who enjoyed discounts from reselling the steel inside South Africa. Typically, these were customers who used Mittal's steel to produce products for export.[65] This approach was rejected by the South African Appeal Court. As the Appeal Court put it:

> The words chosen by the legislature when enacting s 8(a) (and the definition of "excessive price") clearly and unambiguously indicate

see *Tribunal Decision*, *supra* note 10, ¶¶ 156–159; *see also* Case 30/87, Bodson v. Pompes Funebres des Regions Liberees SA, 1988 E.C.R. 2479 (Eur. Ct. Justice); *United Brands*, 1978 E.C.R. 207; Case 26/75, Gen. Motors Cont'l NV v. Comm'n, 1975 E.C.R. 1367 (Eur. Ct. Justice); Case COMP/A.36.568/D3—Scandlines Sverige AB v. Port of Helsingborg, Comm'n Decision (July 23, 2004), *available at* http://ec.europa.eu/competition/antitrust/cases/decisions/36568/reject_en.pdf; Case COMP/C-1/36.915—Deutsche Post AG, Comm'n Decision, 2001 O.J. (L 331) 40; Case CA98/2/2001—Napp Pharm. Holdings Ltd., Decision of the Director General of Fair Trading (UK) (Mar. 30, 2001), *available at* http://www.oft.gov.uk/shared_oft/ca98_public_register/decisions/napp.pdf; OFFICE OF FAIR TRADING (UK), OFT LEAFLET NO. 414A, ASSESSMENT OF CONDUCT: DRAFT COMPETITION LAW GUIDELINE FOR CONSULTATION (2004), *available at* http://www.oft.gov.uk/shared_oft/business_leaflets/competition_law/oft414a.pdf; Martin Graham & Anthony Steele, *The Assessment of Profitability by Competition Authorities* (Office of Fair Trading, Research Paper No. 10, 1997); European Comm'n, Commission Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector, 1998 O.J. (C 265) 2.

[62] *See Tribunal Decision*, *supra* note 10, ¶¶ 32–33. The complainants compared the list price for Mittal's flat steel products with prices charged for the same flat steel products to a number of select costumers within the South African market and the price charged across the world. In addition, the price was compared to Mittal's costs of production.

[63] *Id.* ¶ 37.

[64] *Id.* ¶ 47.

[65] *See id.* ¶ 163.

> that what is prohibited is the "charging" of an excessive "price," not so-called "ancillary abusive conduct" designed to take advantage of a particular market structure.[66]

The Appeal Court also questioned the weight given by the Tribunal to the fact that the higher price charged to some consumers by Mittal was based on a calculation of how much it would cost a local customer to import steel, including the additional hassle, from an average foreign firm. As the Appeal Court noted:

> For a domestic producer whose only pricing constraint is the fact that the customer may resort to imports, the [import parity price] is the upper price limit. From this fact, however, it cannot be inferred, without more, that it is a price higher than the economic value of the good or service and hence justify a conclusive finding in terms of s 8(a) of the Act. Nor does it follow that any excess over the economic value is not reasonable.[67]

In other words, a domestic price based on the cost of importing the product may well be a non-excessive price: if the cost of importing the product is not sufficiently above the cost of supplying it domestically, imports, in this case, would pose a sufficient constraint on the market power of the domestic dominant firm. Of course, this begs the question why a dominant firm would constrain itself in this manner before entry into the market of imports. Why not charge the monopoly profit-maximizing price, with the implicit but obvious threat to cut prices once an importer tries to make a competing offer? One reason could be that the domestic dominant firm wishes to signal to potential importers just how efficient it is. That is, the dominant firm could be engaged in "limit pricing."[68] Another reason could be that the dominant firm wishes to abide by the rule prohibiting excessive pricing: in order to avoid legal suits ex post, it restrains itself to the so-called "competitive price" ex ante.

Indeed, in a framework where the dominant incumbent has lower marginal costs than its potential rivals, an (imperfectly) competitive equilibrium, at least in the case of homogeneous products with no capacity constraints, is to charge a price slightly below the marginal costs of its next most efficient potential rival.[69] In this respect, however, the Appeal Court adds that:

---

[66] *Appeal Court Decision*, *supra* note 10, ¶ 28.
[67] *Id.* ¶ 44.
[68] *See supra* note 46 and accompanying text.
[69] This is the so-called Bertrand model with cost asymmetries and homogeneous products. *See, e.g.*, TIROLE, *supra* note 37, ch. 5.

> A dominant supplier which is able, and does, simply set its price at import parity without careful reference to costs would do so at its peril, for . . . the supplier could well have difficulty defending the excess as having any reasonable relation to economic value. However, if in fact the supplier references its price to prices prevailing in other comparable but competitive markets, then its price would be likely to approximate to economic value.[70]

Here we wish to stress that it could be that Mittal's prices could have been excessively above competitive levels even if it were verified that Mittal's calculations about the actual costs of importing steel into South Africa from a foreign competitive market were accurate. This would have occurred if the costs of transporting the steel from the foreign country into South Africa, including all additional costs involved in imports, were sufficiently high and if Mittal's marginal costs were sufficiently low. This is a factual question.

More generally, a dominant firm with lower marginal costs than its potential rivals may be pricing "excessively" even where it charges a price slightly above the marginal costs of its most efficient potential rival. This is the case when the dominant firm's cost advantage is so great that the difference between its own marginal costs and the marginal costs of its potential rivals is excessive. Note that such a large cost advantage need not be the result of ex ante, efficiency-enhancing, investment by the dominant firm (a type of investment we may want to stimulate). It could be the result of high transportation costs, or other barriers to potential competition, or vertical integration between the dominant firm and input suppliers, which are not a result of the dominant firm's welfare-enhancing investments. Indeed, according to conventional market definition principles, imports would be considered "competitors" in Mittal's market only if importing steel into South Africa is profitable at prices 5 to 10 percent above competitive levels.[71] If the costs of import are such that importing at 5 to 10 percent above competitive levels is not profitable, importers should not be considered "competitors" of Mittal. In such a case, if Mittal charges a price equal to the cost of import, it cannot be considered a "competitive" price. A different conclusion

[70] *Appeal Court Decision*, *supra* note 10, ¶ 46.

[71] *See, e.g.*, U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 1.32 (1992, rev. 1997) [hereinafter U.S. Horizontal Merger Guidelines] ("[T]he Agency will identify other firms not currently producing or selling . . . in the relevant area as participating in the relevant market if their inclusion would more accurately reflect probable supply responses. . . . These supply responses must be likely to occur within one year and without the expenditure of significant sunk costs of entry and exit, in response to a 'small but significant and nontransitory' price increase."), *available at* http://www.ftc.gov/bc/docs/horizmer.htm.

could de facto eliminate the prohibition of excessive pricing whenever a dominant firm is insulated from competition through a large cost advantage it has over potential competitors (in the case of Mittal, due to high transportation costs of steel and due to Mittal's low marginal costs).

As to the benchmark to be used in order to see whether the price is excessive, the Appeal Court adopted the EU approach, in favor of using multiple benchmarks, including, if possible, a price-cost comparison, and also a comparison between the allegedly excessive prices charged by the dominant firm and prices charged by it, or by others, that are subject to competitive constraints. For example, it has been shown that the prices Mittal charged when it exported steel were lower than the prices it charged domestically. Since Mittal had invested in increasing its export capacity, the Appeal Court reasoned that it must be that Mittal was making positive profits on its export sales. This implies, in turn, that if the domestic price is excessively higher than the lower export price, the domestic price is excessive.[72]

A. EXCESSIVE PRICING AND LOW NET PROFITS

When assessing, as part of its second appraisal, whether Mittal's prices were excessive, the Tribunal will have to grapple with the extent to which Mittal's supposedly low net profits can serve as a defense to the claim that its prices were not excessive. This claim was part of Mittal's line of defense. However, an excessive price does not necessarily mean that the dominant firm's *net* profits are high. It only means that the dominant firm's *marginal* profits are high. That is, it means that price is excessively above marginal costs. Low net profits, or operating profits, do not necessarily contradict this. For example, a dominant firm may use high marginal profits to finance high fixed costs. A large portion of such profits could be distributed to employees, or to top executives, or even to the community. All of the latter could cause net profits to be low, even though prices were excessive. It appears that the Appeal Court in *Mittal* is aware of this when it says that:

> [A]ccounting costs may reflect an uncompetitive inefficiency. The criterion of economic value, on the other hand, recognises only the costs that would be recovered in long-run competitive equilibrium. Accordingly, it is possible that a dominant firm's price may be substantially and also unreasonably higher than economic value even when the accounting profit of the firm reveals no such picture.[73]

---

[72] *See Appeal Court Decision, supra* note 10, ¶ 52.

[73] *Id.* ¶ 43; *cf. Tribunal Decision, supra* note 10, ¶ 36 ("[A]n inefficient firm may charge excessive prices and still not show exceptional profits . . . ."); Case 110/88, Lucazeau v.

B. USING (INTER-TEMPORAL AND ORDINARY) PRICE DISCRIMINATION AS A BENCHMARK

The *Mittal* case also exhibits an interesting array of benchmarks, in addition to a straightforward comparison between price and marginal cost. As noted, Mittal engaged in price discrimination of various sorts. In particular, it charged different prices to different types of local consumers, based on the consumers' willingness to pay. For example, manufacturers that use steel in their product in competition with manufacturers that use other materials were not willing to pay sums that would put them at a competitive disadvantage in their industries. Other manufacturers used Mittal steel for products which added to the value of the steel and were exported abroad. These too apparently had more bargaining power vis-à-vis Mittal, perhaps because they could have bought their steel abroad.[74]

Mittal also discriminated between the markets into which it exported, which enjoyed competition between Mittal and its foreign rivals, and the prices paid by the South African consumers with the highest willingness to pay (or lowest bargaining power).[75]

The Tribunal in *Mittal* wanted to use Mittal's price discrimination, combined with Mittal's resale restrictions on the low-price consumers, which enforced the discrimination by preventing arbitrage, as evidence of excessive pricing. In its view, this implied excessive pricing without the need to examine whether the difference between the price charged to the low-paying consumers and the price charged to the high-paying consumers was excessive. The concern with this approach, however, is that discrimination could also occur, and also be enforced via resale restrictions, when the *average* price is not excessive. It could be that the dominant firm is restraining the average price but still wants to convince consumers that are more price-sensitive to buy the product by discriminating in their favor. It should be noted that such discrimination, in and of itself, may be welfare-enhancing, as it induces more price-sensitive consumers to buy the product, without losing many of those who are not price-sensitive.[76] Naturally, a discriminating dominant firm wants to prevent arbitrage, so it prevents the low-price consumers from reselling the product to others. Since the welfare effects of discrimination are ambig-

---

SACEM, 1989 E.C.R. 2811, ¶ 29 (Eur. Ct. Justice); Case 395/87, Ministère Public v. Tournier, 1989 E.C.R. 2521, ¶ 42 (Eur. Ct. Justice).

[74] *See* Roberts, *supra* note 46, at 880.

[75] *Id.* at 878.

[76] As is well known, the welfare consequences of price discrimination are generally ambiguous. *See, e.g.*, TIROLE, *supra* note 37, at 137–38.

uous, this in itself should not be a reason for intervention (although some jurisdictions tend to condemn discrimination in and of itself).[77]

Another benchmark based on price discrimination, which we explore elsewhere, concerns inter-temporal price discrimination. That is, a dominant firm's excessive pre-entry price is shown via its lower post-entry price.[78] Both this inter-temporal price discrimination benchmark and the ordinary price discrimination benchmark, which will probably be used on remand in the *Mittal* case, have their virtues and their flaws. The virtue of price discrimination benchmarks is that they allegedly closely resemble the doctrinal definition of what an excessive price is. If an excessive price is a price that is too far above the price that would have prevailed under competition, then a plausible way to examine what price the dominant firm would have charged under competition is to see what price this same firm is charging for the same product in a market (or in a period) in which it is subject to competitive forces or to high demand elasticity.

The downside of using discrimination-based benchmarks in excessive pricing cases relates to the distorted ex ante incentives it creates: a dominant firm that knows its discriminatory pricing could expose it to excessive pricing claims may refrain from, or soften, its discrimination.[79] This benefits consumers who were discriminated against. But at the same time, it harms consumers who enjoyed the discrimination. For example, had Mittal known that its discriminatory tactics would provide proof against it in an excessive pricing litigation, it might not only have lowered the price it charged its high-price consumers, but also raised the price it charged its low-price consumers. The former consumers would have been better off and also would have purchased more steel. This would have been welfare-enhancing. But the latter, low-price consumers, would have become worse off or would have purchased less of Mittal's steel, possibly causing a net welfare loss.

A welfare-enhancing side effect of a dominant firm reducing discrimination is that entry of new firms into the high-price segment could be encouraged. Take the inter-temporal price discrimination example, i.e.,

---

[77] *See, e.g.*, TFEU, *supra* note 6, art. 102 (stipulating that an abuse may consist in "applying dissimilar conditions to equivalent transactions"); Case 27/76, United Brands Co. v. Comm'n, 1978 E.C.R. 207, ¶¶ 204–234 (Eur. Ct. Justice); Case C-18/93, Corsica Ferries Italia Srl v. Corpo dei Piloti del Porto di Genova, 1994 E.C.R. I-1783, ¶¶ 32–35 (Eur. Ct. Justice).

[78] *See* Ariel Ezrachi & David Gilo, *The Darker Side of the Moon: Assessment of Excessive Pricing and Proposal for a Post-entry Price-cut Benchmark*, *in* ARTICLE 82 EC—REFLECTIONS ON ITS RECENT EVOLUTION 169 (Ariel Ezrachi ed., 2009).

[79] *See* Motta & de Streel, *supra* note 7, at 110.

the use of a "post-entry price-cut" benchmark to show that prices were excessive before entry: a dominant firm may hesitate to substantially lower prices upon entry so as not to expose itself to proof against it in an excessive pricing suit. But this behavior in itself may attract entry, where, absent the distorted reluctance to price cut upon entry, such entrants would not have entered.[80]

Of course, when the intrinsic incentive to lower the price to the low-price consumers is very strong, even the fear of producing proof that supports an excessive pricing suit would not deter the dominant firm from charging the low price to these consumers. For example, if Mittal were to raise the price it charges outside South Africa, and world competition in steel were intense enough, Mittal could be forced out of the world market.

The downside of using discrimination-based benchmarks to show that prices were excessive provides us with another justification for using multiple benchmarks in a single case. Basing a case solely on discrimination-based benchmarks might distort the dominant firm's pricing incentives in a welfare-reducing way. But requiring, or at least enabling, the use of alternative benchmarks, and in particular a straightforward comparison between price and marginal costs, would help alleviate this distortion. Since the dominant firm knows ex ante that its excessive pricing could be proved without using its discriminatory practices, the prospects of an excessive pricing claim would not deter the firm from discriminating (in a possibly welfare-enhancing fashion); it would just deter it from raising prices (e.g., the average price between the various segments) too much above marginal costs.

C. Combined Benchmarks

How should competition law cope with cases in which discrimination-based benchmarks are not available, or are liable to cause considerable distortions? An important alternative is a direct price-cost comparison. In this sense, cases that insist on combining a discrimination-based benchmark with a price-cost comparison may actually have it right, but for a reason more subtle than first thought. In the famous *United Brands* case, for example, the European Court of Justice ultimately dismissed the Commission's sole reliance on price discrimination among geographic regions to establish its excessive pricing claim. The court demanded a price-cost comparison. The problem with price-cost comparisons, however, is the difficulty of assessing what the appropriate

---

[80] For a detailed analysis of the pros and cons of the post-entry price-cut benchmark, see Ezrachi & Gilo, *supra* note 78.

measure of cost is and what margin above cost would prevail under competition. Although the difficulties in assessing these factors are shown in the next section not to be all that different from other problems of assessment prevalent with respect to less controversial antitrust doctrines, they do substantially raise the administrative costs of litigating a case. Hence, we can conclude that the cases in which the difficulties of assessment are the least compelling are those in which (1) a reliable discrimination-based benchmark exists, and (2) in the particular case, distorted incentives are unlikely.

The *Mittal* case seems to present such a case. First, Mittal engaged in discrimination, particularly in favor of its export sales. Second, it is unlikely that Mittal would raise the price of its exported steel, thereby considerably jeopardizing its share of the world market, just to cope better with an excessive pricing claim in South Africa. Finally, even if Mittal would raise the price of its exported steel due to its anticipation that its discriminatory pricing would be used against it, foreigners paying more for steel is not a direct concern of South African competition law.

D. Are the Difficulties in Assessment Unique to Price-Cost Comparisons?

In concluding our discussion on the assessment of excessive prices we would like to make a general comparative comment on the difficulty in assessment. While we concede that price-cost comparisons and the assessment of excessiveness can be extremely difficult, it is important to recall that there are a number of other antitrust issues which necessitate highly complex assessments. Predatory pricing claims, for example, are said to be valid claims both in the European Union and in the United States, but they too, although not requiring a value judgment as to excessiveness, require an assessment of an appropriate measure of cost.[81] Price squeeze, or margin squeeze, claims have lost some of their bite in the United States,[82] but are quite common and successful in Europe.[83] Such claims require elaborate and specific cost studies to explore how

---

[81] *See, e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

[82] *See* Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc., 129 S. Ct. 1109 (2009).

[83] *See, e.g.*, Case T-271/03, Deutsche Telekom AG v. Comm'n, 2008 E.C.R. II-477 (Ct. First Instance); Case COMP/38.784—Wanadoo España v. Telefónica, Comm'n Decision (July 4, 2007) (summary at 2008 O.J. (C 83) 2), *available at* http://ec.europa.eu/competition/antitrust/cases/decisions/38784/dec_en.pdf; Case COMP/76/185/ECSC—Nat'l Carbonising Co., Comm'n Decision, 1976 O.J. (L 35) 6; Albion Water Ltd. v. Water Servs. Regulatory Auth., 2008 E.W.C.A. (Civ.) 536; Case No. 1016/1/1/3, Genzyme Ltd. and Office of Fair Trading, [2004] CAT 4 (UK Competition Appeal Tribunal), *available at* http://www.catribunal.org.uk/files/Jdg1016Genzy110304.pdf.

efficient the dominant firm is, and whether its excluded rival is equally efficient. Furthermore, in such cases, as in excessive pricing cases, an error on the part of the antitrust agency or court could chill pro-competitive pricing behavior. Applying a full-blown rule of reason approach to resale price maintenance cases, for example, to verify whether pro-consumer efficiencies outweigh harm to consumers, is also an often formidable task, requiring expert testimony and risking errors that would condemn pro-consumer behavior.[84] Even market definition, according to the U.S. agencies' Guidelines, requires examination of demand elasticities, and consumers' expected reactions to hypothetical price increases from prices at or near marginal costs.[85]

Accordingly, even if in *Mittal* the discrimination-based benchmark, if used exclusively, would considerably distort Mittal's behavior in a welfare-reducing way, a price-cost comparison may be a sensible way to complement a discrimination-based benchmark. As noted, using both benchmarks would discourage the dominant firm from distorting its behavior: to the extent Mittal would expect to be condemned anyway on account of a direct price-cost comparison, there would be no use in it distorting its behavior so as to weaken the discrimination-based benchmark.

IV. CHILLING EFFECT ON INNOVATION AND INVESTMENT

The third justification for non-intervention against excessive pricing is the urge to stimulate the dominant firm to invest in welfare-enhancing investments ex ante. An illustrative explanation of this justification may be found in Justice Scalia's dicta in *Trinko*:

> The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*.[86]

Indeed, in many cases the need to stimulate innovation and investment would serve as a powerful argument against intervention. This argument, however, does not apply with the same magnitude across the

---

[84] *See, e.g.*, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

[85] *See, e.g.*, U.S. Horizontal Merger Guidelines, *supra* note 71, § 1.

[86] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

board. In some instances the enforcement of competition law against excessive prices will have no adverse effect on innovation and investment. In the *Mittal* case, the Tribunal's reasoning implies that the investment justification did not apply to Mittal:

> We agree with Evans and Padilla that excessive pricing allegations should be particularly carefully scrutinised in dynamic industries characterised by investment and innovation. However this dynamism . . . does not characterise the production of flat steel products. . . . [T]here is no claim that Mittal SA's pricing is rooted in the extraction of any innovation rents or patent rights.[87]

In particular cases, the "investment defense" could not protect the defendant in an excessive pricing case, simply because its market is not investment-intensive, or because most of its investment has already been recouped. Another such situation, also related to the *Mittal* case, is where the dominant firm has small net profits, and not because it had invested in improvement of its product. If it has small net profits, it could not make welfare-enhancing investment anyway.[88]

We wish to carefully make a more conceptual point in this respect, however. Antitrust policy is based on the premise that markets will function reasonably well under competition. Hence, a claim that a dominant firm requires supracompetitive prices and profits in order to make socially valuable investment must be seen as an exception. Recall that an excessive price is defined as a price excessively above the price that would evolve under viable competition. Assuming that one overcomes the difficulty in assessing this price, justifying the excessive price by ex ante investment considerations means that the competitive price is not efficient for the industry in question. However, such an assertion contradicts the basic premise behind antitrust doctrine—that the competitive outcome is efficient. For example, antitrust doctrine does not have an "investment defense" when it comes to exclusionary practices by dominant firms. If a dominant firm engages in exclusion of its competitors or potential competitors using methods that are considered an abuse of dominant position or illegal monopolization, it cannot claim in its defense that achieving or entrenching its monopoly position is actually a good thing because then it would be induced to invest more.

---

[87] *Tribunal Decision*, *supra* note 10, ¶ 102 (footnote omitted).

[88] At times, dominance is not due to investment or a superior product, but rather due to historic accident or government-created monopoly. *See* Evans & Padilla, *supra* note 60; Roberts, *supra* note 46, at 872; John Fingleton, *De-Monopolising Ireland*, *in* EUROPEAN COMPETITION LAW ANNUAL 2003, *supra* note 7, at 53, 54.

The question arises then, why should excessive pricing be any different? In other words, if we allow an investment defense when it comes to excessive pricing, why not allow it in cases of exclusionary behavior? This paradox could be extended even further. Why isn't investment a justification for horizontal price-fixing agreements? After all, in the very same industries where it is said that investment could justify excessive pricing by a monopoly, it could be said that several competitors fixing the very same excessive price is socially efficient, because such a price would stimulate all rivals to make welfare-enhancing investments. Here, too, antitrust doctrine overrules this possibility, due to the premise that competition is more efficient than non-competition. In this sense, allowing an investment defense in excessive pricing cases is inconsistent with other antitrust doctrines. Of course, we acknowledge that in some markets, monopoly and monopoly pricing are more efficient than competition. But, at least conceptually, these are markets that are less suited for antitrust, and more suited for regulation limiting entry (and possibly regulating prices and quality).

A different version of the investment justification, also echoed in *Trinko*, is that if excessive pricing is prohibited, firms would not want to compete to become better than their rivals. Under this reasoning, firms invest and compete to become better because they hope to become dominant someday, charge supracompetitive prices, and reap the fruits of their previous efforts. This, however, is not necessarily the case. A firm may invest so as not to be at a competitive disadvantage compared with its rivals, even if it does not hope to gain dominance. After all, if similar firms in a market are similarly inclined to invest in order to gain dominance, none of them will end up gaining dominance. If all such firms know this in advance, it cannot be that they invest due to the hope of reaping supracompetitive prices later on.

Note that Justice Scalia in *Trinko* seems to implicitly support his conclusion with the notion that excessive prices are self-correcting. As he states, "[t]he opportunity to charge monopoly prices—*at least for a short period*—is what attracts 'business acumen' in the first place."[89] But as we have shown, excessive prices are not really self-correcting. Hence, they do potentially pose a substantial societal cost that should be considered. Note also that if one is convinced that the investment justification should receive limited weight, assessing whether a price was excessive also becomes easier. If the price that would have evolved under competition (or at least an upper bound for this price) is plausibly assessed, the decision maker need not consider whether the "excessiveness" of the

[89] *Trinko*, 540 U.S. at 407 (emphasis added).

price charged above the competitive price accounts for investment considerations. Thus, "excessiveness" would be determined generally, according to public policy considerations, without having to adjust it according to the investment intensity of the industry in each particular case.

V. CONCLUSION

Using the interesting *Mittal* litigation, our analysis questions the validity of a categorical non-interventionist approach toward excessive pricing and the weight attributed to each of the three grounds for non-intervention. After showing the "self-correction" ground to be flawed, we argue that the other two grounds, namely, the "difficulty in assessment" and the "stimulation of investment," need to be assessed on a case-by-case basis to determine the merit in intervention.

In cases where investment considerations do not play a significant role, the most serious obstacle to prohibiting excessive pricing is the appraisal of excessiveness. However, the difficulty of determining what an excessive price is, and the error costs such an examination may carry, should be assessed on a case-by-case basis and should not be treated as an overriding argument against intervention.

Prohibition of excessive prices is certainly not costless, but neither are other antitrust prohibitions and rules that are not based on presumptions, per se prohibitions, or per se legality. What antitrust policy makers need to consider is whether they are willing to bear these costs in order to prevent exploitation of consumers when the competitive process fails.