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English - Or. English

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Working Party No. 2 on Competition and Regulation

EXCESSIVE PRICES

-- Lithuania --

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1. The Law on Competition of the Republic of Lithuania, hereinafter Law on Competition, as well as European Union law, among other abuses of dominant position, prohibits excessive pricing. Fines and/or behavioural remedies may be imposed for undertakings found guilty of this infringement. Some authors state that regulation of excessive prices might seem contrary to the functioning of integrated common market, because regulation of price levels does not reduce barriers to trade between the Member States. It might slow down the natural self-correcting tendency of market forces, if incentives to enter new markets and gain high profits are weakened[1].

2. On the other hand, excessive prices may cause harm to final consumers as have to pay more to producers who use the monopolist's products or services as input and to society, as it creates a deadweight loss[2].

3. There have not been many investigations concerning excessive pricing in the Republic of Lithuania therefore the Competition Council can only express its general opinion. The Competition Council would consider intervention only if the below mentioned conditions are met. The first condition for intervention is high barriers to entry. Usually in such cases market forces would be unable to challenge the dominant undertaking, thus correcting the abusive practices. Secondly, dominant position must be held due to current/past exclusive/special rights. And the last condition is the absence of a regulator or in exceptional cases the situation when a regulator does not exercise its powers. This last condition requires more attention and is related to the question, whether excessive pricing should be tackled by competition authorities or rather by regulators.

4. There are sectors in the Republic of Lithuania, where the regulatory authorities are given considerable powers, for instance natural gas, telecommunications, transport sectors. Regulator exercises ex-ante control in these sectors, whereas Competition Authority is entrusted with the exercise of ex-post control. For example, new edition of the Natural Gas Law states that the regulator in this sector has an obligation to conduct market researches, which in turn allows it to adopt legal rules in order to prevent an undertaking holding significant market power in the natural gas market from abusing its dominant position. The regulator is also obliged to publish the conclusions on natural gas prices and submit these conclusions to the Competition Council. Furthermore, the regulator has the right to regulate the natural gas prices, if the regulator's market research shows that the undertaking may apply excessive prices due to the absence of effective competition. If the research allows the regulator to establish that an undertaking has significant market power, the regulator can set reasoned and proportionate obligations for such undertaking. The Natural Gas Law defines the Competition Authority's functions quite laconically - according to the Law on Competition, the Competition Council exercises supervision of competition in the energy reservoir market. . It is also stated that regulator can consult with the Competition Council in some cases. So there is no clear distinction between division of powers of the regulator and the Competition Authority in this case. However, it is possible that Competition Council could execute the powers conferred by the Law on Competition in those cases, when the undertakings have sufficient degree of freedom of economic activity and/or the relevant actions of the undertaking are not yet regulated.. However, such assessment would be carried out on an individual basis and would depend on existing circumstances. On the other hand, in terms of remedies, the regulator has a right to introduce a regulation of natural gas prices, while the Competition Authority does not enjoy such a right. The Competition Council can only apply fines and behavioural remedies, for instance, obligation to bring infringement (in this case, excessive pricing) to an end. However, these remedies are difficult to apply and control, as in cases like that the Competition Council is

1 Gal, M.S. (2004) "Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief about Monopoly?", *Antitrust Bulletin*, Vol. 49, Federal Legal Publications. http://ssrn.com/abstract=700863, P. 24.

2 Idem. p. 26.

required to describe the level of a non-excessive price or a method to calculate it, which may be regarded as price regulation.

5. Problems often arise in practice when choosing the most suitable body for assessing excessive pricing and dividing competences in order to avoid situations of punishing an undertaking twice for the same infringement.

6. The Competition Council had one case, when the price regulator (municipality) failed to take appropriate measures seeking to intercept the way for the ongoing infringement of a dominant undertaking in the communication tunnels market. Municipality as the owner of its property (communication tunnels) had a right to settle the conditions of using this infrastructure (methodology and tariffs), change the order of using the infrastructure (to terminate or to amend the agreement with undertaking, which exploits communication tunnels). In this case, the municipality could regulate the prices of a dominant undertaking - to pass a new methodology (together with tariffs) and to control the application of the methodology. Thus, if the municipality had taken active measures (at once after it received complaints on excessive prices), it is likely, that there would have been no competition problems. However, in the absence of any active actions by the municipality, the Competition Council had to intervene.

7. Further attention should be paid to the methodology on establishing unfair prices (including the use of excessive prices). There was a case, where a dominant undertaking had the exclusive right to exploit communications tunnels, which belonged to municipality. Different volume of space of these communication tunnels were leased by the dominant undertaking for different leaseholders. There were no substitutes for these communication tunnels. The prices applied by the dominant undertaking were disproportionate to the factual space occupied by separate cables in the communication tunnels. This led to the conclusion that some leaseholders overpaid for the lease of communication tunnels, while others (including the dominant undertaking itself) did not fully cover the costs of the lease of communication tunnels.

8. The definition of excessive prices for the first time was scrutinized in the *United Brands* case.[3] Few models on assessing whether prices can be regarded as excessive were distinguished in this decision: 1) overpay can be established by making a comparison between the selling price of the product and its cost of production, which would disclose the amount of the profit margin; 2) unfair prices can be established after answering two questions: whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether the price imposed is either unfair in itself (*per se*) or when compared to competing products; 3) other ways for establishing unfair prices[4]. Second model is usually used in the newest jurisprudence of the Court of Justice. Also it is acknowledged that comparison between applied prices and costs is only the first step, seeking to establish whether the prices are excessive. In the *United Brands* judgement the Court of Justice also states that an abuse of dominance is established if the price has no reasonable relation to the economic value of the products or service.

9. According to the second model set out in the *United brands* decision, excessive prices can be established by calculating the difference between the costs incurred and the price charged and by comparing it with competing products or by assessing it as unfair *per se.*

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3 ECJ judgment in case 27/76 United Brands Company and United Brands Continentaal BV v Commission of the European Communities, ECR [1978] 207.

4 Idem. Para. 251-253.

10. The Competition Council had a case, where the alleged undertaking did not administer the separate financial accounting of communication tunnels costs. During the investigation, due to objective reasons, there was no possibility to compare the lease prices of dominant undertaking with the prices of other undertakings providing the analogical services. For this reason the Competition Council could not fully refer to the *United Brands* second model (comparison of the difference of income and costs with competing products).

11. On the other hand, in the exceptional circumstances profit margin of the dominant undertaking was fixed by methodology (legal act). So the profit of the dominant undertaking was fixed (10 percent) and could not be increased unilaterally. Therefore, in this case the Competition Council first of all applied the method assessing fairness of prices by deducting costs incurred in order to set up different leaseholders' communications from income and then assessing, whether the difference (profit) was unfair per se.

12. As mentioned above, according to the methodology, the profit margin of the dominant undertaking from this activity was 10 percent, but it was established that the actual profit received by the dominant undertaking ranged from more than 100 percent to 400 percent of profit from the applied lease fee for certain groups of leaseholders. Since the factual profit margin applied by the dominant undertaking to leaseholders could not be justified by any objective economical criteria, it was concluded that profit gained by the dominant undertaking was unfair per se – the leaseholders were forced to pay unjustifiably high prices for the service provided.

13. However, the Competition Council did not limit itself to the application of the model described above. According to the United brands third model, unfair (excessive) prices can be established in other ways. Because there was no possibility to compare the prices of communication tunnels applied by the dominant undertaking with the prices applied by other undertakings, the Competition Council decided to compare the lease fees applied by the dominant undertaking for the different groups of leaseholders (electric cables, communication cables, radio lines, heat tracks and warm water). During the investigation there was no possibility to compare directly the proportion of lease prices with the economical value of the service (lease prices were paid differently, depending on the space used for lease), so the Competition Council investigated prices paid by various leaseholders by invoking comparative unit - space (cross-section) area. In that way, the prices paid by the leaseholders of communication tunnels for 1 percent of lease of communication tunnel cross-section area were compared, seeking to estimate, whether these groups pay differently for the same space and whether this difference could be justified. Such rule was used by the Court of Justice in the *British Leyland* case[5].

14. Since the established circumstances did not allow to state that the exploitation costs of the communication tunnel differed according to particular space in the tunnel and the dominant undertaking did not provide any proof justifying the differences in costs, it was concluded that 1 percent of communication tunnel bears the same amount of costs, irrespective in what area this 1 percent would be counted.

15. After calculation it was noticed that the lease price for 1 percent of space of communication tunnel significantly differed for the leaseholders of different areas. Thus, if all the buyers leasing 1 percent

[5] ECJ judgment in case 226/84 British Leyland Public Limited Company v Commission of the European Communities, [1986], ECR 3263. In this case ECJ confirmed that European Commission reasonably recognized that undertaking abused its dominant position applying unfair prices. Undertaking collected the fee for the registration of left-hand-drive vehicles that was six times greater than that for right-hand-drive vehicles, though the costs of vehicle registration did not differ. European Commission assessed, whether the price of services which differed 6 times could be justified by costs incurred.

of cross-section receive the same value, the price paid by them to the dominant undertaking for 1 percent of cross-section was apparently disproportionate (price differed up to 28 times).

16. So the Competition Council applied these two different methods for establishing unfair prices. However, it must be mentioned that this case is still pending before the courts (Competition Council's decision was appealed).

17. Talking about appropriate remedies in cases of excessive pricing, first of all it should be noted that the Competition Council cannot apply structural remedies, it can only apply some behavioural remedies (for example to oblige to cease the infringement, etc.). However, the Competition Authorities can choose other appropriate remedies instead of price regulation. For example, if an excessive price is due to a strong past market power and consumer habits, the Competition Authority could employ competition advocacy (for example, to encourage consumers to switch to cheaper offers made by new entrants) in order to improve the situation on the market. In cases where excessive prices are due to entry barriers, the proposed remedy could be to prohibit/remove such barriers. During the investigation Competition Authorities may also submit proposals for amendments of legislation. Considering the before-mentioned case, active actions by the regulator (municipality) might be the most appropriate remedy. It is also important to mention, that tight cooperation between regulators and Competition Authority also plays an important role in finding the best solutions for dealing with excessive pricing practices.