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ROUNDTABLE ON "PRICE DISCRIMINATION"

-- Note by Sweden --

29-30 November 2016

This document reproduces a written contribution from Sweden submitted for Item 7 of the 126th OECD Competition Committee on 29-30 November 2016.

*More documents related to this discussion can be found at
www.oecd.org/daf/competition/price-discrimination.htm*

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1. Introduction

1. Price discrimination is a common practice used by firms as a profit-maximising strategy when facing differences in demand in different segments of the market. Price discrimination is often an exploitative practice used by firms to increase profits, at the same time either increasing or decreasing output. But price discrimination can sometimes also have anti-competitive effects by excluding efficient rivals. This submission describes the pro- and anti-competitive aspects of price discrimination, and under what circumstances such discriminatory practices are prioritised for enforcement by the Swedish Competition Authority (SCA).

2. Put simply, price discrimination is when a firm charges different prices to different consumers for the same product or service based on consumers' differing willingness to pay rather than on cost differences for supplying these consumers. In the most general sense, price discrimination can be described as when a firm's ratio of its prices is different from the ratio of its marginal costs for the product or service.

3. In general, three conditions need to be met in order for a firm to successfully price discriminate among its customers. First, the firm needs to have some degree of market power which it can use to charge a price above marginal cost. However, this does not imply that the firm needs to have a dominant market position. Price discrimination is commonly used by both small and large firms. Secondly, the firm needs to be able to segment customers in order to charge them different prices. Finally, arbitrage between different customer groups should not be possible, or at least limited, for a successful price discrimination scheme.

4. Economic theory distinguishes between different types of price discrimination. Under first-degree price discrimination a firm sets individual prices to each customer, and is able to charge each customer the maximum amount that he or she is willing to pay for the product or service. The recent emergence of "big data" collection can possibly facilitate this kind of price discrimination by enabling firms to accumulate large amount of personal customer data, which could allow the applying of personalised pricing. Under second-degree price discrimination a firm offers customers a menu of prices and allows them to self-select among the prices. Different types of discount and rebates schemes belong to this type of price discrimination. Under third-degree price discrimination a firm segments its customers based on some observable characteristic, such as for instance age or geographical location.

2. Price discrimination is often an exploitative practice

5. The welfare effects of exploitative price discrimination are ambiguous. Although price discrimination normally increases a firm's profits, the overall welfare effects could be either positive or negative. On the one hand, the firm is able to extract more customer surplus and increase its profits. On the other hand, customers with lower willingness to pay, who would not be willing to purchase the product or service under uniform pricing, could be able to purchase under discriminatory prices. In general, a necessary, but not sufficient, requirement for price discrimination to be welfare improving is that it increases the quantity supplied in the market.

6. Such price discrimination can, however, also increase the competitive pressure by inducing firms to compete more fiercely in customer segments that are more willing to switch between competitors (so called "customer poaching"). By enabling increased profits it encourages entry, also increasing competition.

3. Price discrimination can have exclusionary motives and effects

7. Price discrimination often has exploitative motives and can also have pro-competitive effects as described above. However, under some circumstances discriminatory pricing by a dominant firm could be motivated fully or in part by the exclusion of competitors or by the creation of barriers for new entrants.

8. When price discrimination is motivated by foreclosure however, it is generally the case that price discrimination is part of an anti-competitive practice with additional elements.

9. This could include predatory pricing in some market segments that are particularly important for existing competitors or new entrants. Under such circumstances, the anti-competitive practice is normally evaluated as predatory pricing rather than as price discrimination. However, price discrimination used with predatory pricing could reduce the costs of a predatory strategy, since it costs less for a firm to charge predatory prices only in some market segments rather than to all customers.

10. Price discrimination could also be part of a tying arrangement by a firm selling two (or more) separate products or services. Under such circumstances, price discrimination is also part of a broader anti-competitive practice which is normally assessed as a tying arrangement rather than as price discrimination. But price discrimination could also lower the cost of anti-competitive tying, for example if the firm can charge a low price of the first product (the “tying” product) and thereafter extract profits by discriminating among its customers in the second product (the “tied” product) based on the customers’ willingness to pay.

11. Price discrimination could also be implemented through volume and fidelity rebates. But, as with the other forms of potentially exclusionary pricing, such pricing is normally evaluated for its loyalty inducing effects and not as price discrimination per se.

12. Finally, price discrimination can take the form of a margin squeeze. A vertically integrated firm could potentially charge downstream rivals a higher wholesale price than it implicitly charges its own downstream subsidiary, e.g. by the subsidiary charging a retail price that is below the wholesale price. This can be evaluated as anti-competitive margin squeeze in some jurisdictions.

4. The legal framework in Sweden

13. Price discrimination can be challenged as an anti-competitive practice in Sweden according to Article 102 of the Treaty on the Functioning of the European Union (TFEU), and Chapter 2 of the Swedish Competition Act which prohibits “*applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.*”

14. When price discrimination is part of a broader anti-competitive behaviour, such as predatory pricing or tying, such conduct can be challenged based on other provisions in Article 102 of the TFEU and Chapter 2 of the Swedish Competition Act.

15. Price discrimination can also amount to a breach of Article 101 of the TFEU if the pricing scheme implies a restraint of cross-border trade between member states within the EU, where the pricing scheme could be considered as an obstacle to market integration in the EU according to the TFEU. Also, a pricing scheme that discriminates between offline (“brick and mortar”) and online retailers could amount to a breach of Article 101 of the TFEU (so called “dual pricing”).

5. The SCA's prioritisation of cases for enforcement

16. The Swedish Competition Authority's Prioritisation Policy for Enforcement describes the factors that are taken into consideration when prioritising competition concerns for enforcement.¹ The most important basis for prioritisation is whether a conduct is able to harm competition and consumers. In such cases, the SCA assesses the benefits of intervention for consumers as well as the importance to the general welfare of eliminating the anti-competitive constraint in question. As regards unilateral conduct, the SCA prioritises the investigation of conduct by dominant firms that is capable of excluding or foreclosing firms which are able to exercise effective competitive pressure on some level of the market.

17. Purely exploitative practices, such as non-exclusionary price discrimination by dominant firms are thus not prioritised.

6. The SCA's approach to analysing price discrimination

18. As follows from the Prioritisation Policy a key concern for the SCA as regards unilateral conduct is whether the conduct is capable of foreclosing firms which are able to exercise effective competitive pressure. A price discrimination scheme suspected of having such exclusionary effects would therefore have a higher likelihood of being prioritised.

19. However, price discrimination is rarely exclusionary in itself. As described earlier, it is generally the case that discriminatory pricing is exclusionary in combination with some other anti-competitive conduct, such as predatory pricing towards key customers or a tying arrangement with anti-competitive effects. The focus of the investigation in such cases would likely not be on the exploitative effect of price discrimination in itself but rather on the exclusionary effects. Also in such cases, possible efficiencies and objective justifications would be evaluated.

20. The SCA can also prioritise the investigation of conduct, such as price discrimination, by an upstream firm that forecloses downstream firms that are capable of exercising effective competitive pressure in the downstream market. A theory of harm showing possible harm to competition and consumers from the conduct is generally an important part of the SCA's prioritisation of cases for enforcement. In cases where a dominant upstream firm is assumed to harm competition in the downstream market through discriminatory prices, a theory of harm needs to explain what incentives a producer has to harm competition between downstream firms. An upstream firm that is not vertically integrated, and thereby is not active in the downstream market, generally has fewer incentives to harm competition among its customers.

21. When assessing the potentially exclusionary effects of discriminatory pricing by a dominant upstream firm in a downstream market, the SCA also considers how large a share of the downstream market is affected by the price discrimination and to what extent the pricing scheme is capable of affecting the competition in the downstream market. For instance, discriminatory prices applied by a manufacturer towards its retailers has limited effects on the competition between the retailers if they sell a large variety of products from other manufacturers, and where the manufacturer at hand only amounts to a small share of the retailers' total sales.

¹ Available in English at http://www.konkurrensverket.se/globalassets/english/about-us/english_prioritisation_policy_for_enforcement.pdf

7. Recent Swedish cases concerning price discrimination

22. In 2012, the petroleum company Preem Aktiebolag (hereafter “Preem”) brought a private enforcement action to the Stockholm District Court claiming that the Swedish port Gävle Hamn AB (hereafter “Gävle Hamn”) abused a dominant position by charging higher prices for identical port services to Preem compared to a competitor, the jet fuel distributor A Flygbränslehantering AB (hereafter “Afab”). The Court found that Gävle Hamn did differentiate prices between Preem and Afab. However, Preem and Afab were not considered active in the same market. Therefore, the price discrimination did not put Preem at a disadvantage compared to the firm’s competitors, and the Court concluded that the conduct did not have any foreclosure effects on the market where Preem was active. Thus, the conduct was not found to amount to abuse of a dominant position.

23. In 2015, the SCA received a complaint against the Swedish postal operator PostNord Sverige AB (hereafter “PostNord”) from a firm, Mailworld Office AB (hereafter “Mailworld”), claiming that PostNord abused a dominant position in the Swedish postal market. Mailworld acts as an intermediary in the Swedish postal market where the firm collects and sorts consignments from many different customers into large volume shipments, in order to reach quantity rebates in postage fees. In 2015 Postnord changed the conditions for its rebates and made them individualised to each end-customer of the postal service. This change in the rebate conditions implied that intermediaries like Mailworld could no longer collect the consignments from many different end-customers in order to reach larger quantity rebates. Mailworld argued that the conduct by Postnord constituted a selective pricing scheme that foreclosed competitors to Postnord.

24. The SCA did not find that the change in Postnord’s rebate conditions was capable of foreclosing competitors to the firm. Moreover, Mailworld's and Postnord’s end customers were not found to be competitors active in the same market. Therefore, the conduct by Postnord did not put Mailworld at a competitive disadvantage to its competitors. Based on these findings the SCA chose not to prioritise further investigation of the conduct.