

Unclassified

DAF/COMP/WD(2016)75

Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

17-Nov-2016

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**ROUNDTABLE ON "PRICE DISCRIMINATION"**

--Note by BIAC--

**29-30 November 2016**

*This document reproduces a written contribution from BIAC 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](http://www.oecd.org/daf/competition/price-discrimination.htm)*

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**JT03405551**

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## BIAC

### 1. Introduction

1. Price discrimination, i.e. the practice of selling the same product to different customers at different prices even though the cost of sale is the same to each of them, is a widespread phenomenon.<sup>1</sup> In the vast majority of cases, price discrimination increases total welfare and, in addition, most frequently benefits consumer welfare. This also applies in the presence of (significant) market power. Accordingly, in most cases, price discrimination or differentiation does not warrant intervention by competition enforcement agencies.

2. There is consensus among economists that for price discrimination to occur a number of conditions must necessarily be met. In particular, a firm wishing to engage in price discrimination must have (1) some significant degree of market power, have (2) the ability to identify or estimate buyers' individual willingness to pay, and, finally, (3) arbitrage between customers who pay the lower price and those who pay the higher price must be difficult or impossible. These conditions apply to any type of price discrimination. However, even where these conditions are met, price discrimination produces ambiguous effects and should, as a consequence, be subjected to a case-by-case analysis.

3. BIAC takes the view that the application of competition law should first and foremost be targeted at potentially exclusionary price discrimination adopted by dominant companies that may harm competitors, thereby harming competition and resulting in indirect harm to consumers, i.e. primary line price discrimination.<sup>2</sup> Indeed, BIAC believes that there is only limited room, if any, for the application of competition law to secondary line price discrimination, which by its nature does not involve the foreclosure of competitors, but may only affect customers of the dominant firm.<sup>3</sup>

4. The main reason why BIAC believes that secondary price discrimination does generally not merit antitrust intervention is that in these types of cases the dominant company does not have an incentive to exclude rivals (as it is not present itself on downstream markets). This suggests that in cases of secondary line discrimination, the dominant firm has a pro-competitive reason for distinguishing between the various categories of customers.

5. Nonetheless, BIAC notes that some jurisdictions treat secondary price discrimination as a possible violation of competition law. This may either take the shape of sui generis competition law statutes that are based on non-economic considerations, or competition rules that prohibit exploitative price

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<sup>1</sup> See Posner, *Antitrust Law*, Second Edition, University of Chicago Press, Chicago and London, 2001, p. 79-80. Accordingly, charging different prices for the same product does not necessarily amount to price discrimination as such difference may be justified by cost variations.

<sup>2</sup> Primary line price discrimination involves harm to competitors of the price-discriminating firm, which may in turn result in harm to competition and indirect harm to consumers.

<sup>3</sup> Secondary line price discrimination affects buyers of the price-discriminating firm, which may affect competition on the market where those parties compete.

discrimination.<sup>4</sup> While the effects of secondary price discrimination on consumer welfare are at best ambiguous, the application of these statutes raises formidable challenges. Indeed, in addition to delineating the proper relevant market(s), establishing dominance and deciding whether transactions are “equivalent”, whether trading conditions are “dissimilar” and customers are put at a competitive disadvantage, competition enforcement agencies are also called upon to apply often vague and ill-defined standards.<sup>5</sup> BIAC notes that in these cases the risk of over-enforcement and false positive findings of antitrust liability is particularly high and suggests that competition enforcement agencies take a cautious approach.

6. Recently, the debate surrounding price discrimination, including secondary price discrimination, appears to have gained momentum. It seems that two factors are particularly relevant in this respect.

7. First, there is a suggestion that the aggregation of data in the digital economy, often from different sources, may enable firms to model and predict more accurately individual consumers’ willingness to pay. The use of “big data” to potentially personalize pricing has raised concerns about “unfair” value transfers from consumers to firms.<sup>6</sup> A related concern is that personalized pricing will make it harder for consumers to discover a general market price and to assess their outside options. It is suggested that, in turn, this may give rise to “behavioural discrimination” - the ability of sellers to induce consumers to buy things that they otherwise wouldn’t.<sup>7</sup>

8. Second, in particular In Europe, the European Commission’s Digital Single Market (“DSM”) strategy has sparked a discussion around geo-blocking involving online retailers and access to copyright-protected media content in different European member states. Much of this debate centres on different prices offered to customers in different member states, which in turn fuels the discussion on permissible and non-permissible (secondary line) price differentiation (by geographic location). In this environment, the idea that discriminating or differential treatment may in and of itself constitute a prima facie infringement seems to be gaining traction. While BIAC supports efforts to further the DSM, it nonetheless is concerned that those efforts may give rise to irrational and ill-informed policy choices that may not benefit consumers or the economy at large.<sup>8</sup>

9. BIAC appreciates that primary line price discrimination may more readily give rise to anti-competitive conduct and negative effects. This is because primary line price discrimination, by excluding competitors, has the potential to affect inter-brand competition and, as a result, give rise to higher consumer prices. This becomes evident when considering predatory pricing, fidelity and bundled discounts and margin squeeze cases, each of which can be considered as involving the use of price discrimination as a means to exclude rivals.<sup>9</sup> The prosecution of each of these types of exclusionary conduct involves a number of complexities and typically relies on the specific nature of the conduct and the applicable theory

<sup>4</sup> See OECD Background Paper section 4.3. On the notion of “fairness” under EU competition law, see for instance, Akman, *The Concept of Abuse in EU Competition Law* (2012), p. 146 et seq.

<sup>5</sup> For a discussion of the evidentiary standards under EU competition law, and the limited guidance of judicial precedent, see for instance, O’Donoghue and Padilla, *The Law and Economics of Article 102 TFEU* (2013), Chapter 15,

<sup>6</sup> Council of Economic Advisers to the President of the United States, *Big Data and Differential Pricing* (2015).

<sup>7</sup> Ezrachi and Stuecke, *The Rise of Behavioural Discrimination*, ECLR 2016 (forthcoming).

<sup>8</sup> See below, paragraphs 20 - 30.

<sup>9</sup> Another example is “mixed bundling”, where consumers face different prices for a good according to the way they buy it: if the good belongs to a bundle, the resulting price is usually lower. When price discrimination results from quantity discounts, the price paid for a given good or service then differs, according to the intensity of preferences of consumers for the good.

of harm. While BIAC notes that it may be tempting for competition enforcement agencies to investigate these practices under a framework that deals with price discrimination generally, it favours the application of analytical frameworks that are tailored to the specific nature of the abusive conduct at hand and which are less likely to result in incorrect findings of antitrust liability.

10. Below, BIAC will provide a number of economic insights into price discrimination (2), followed by a brief discussion on differentiated pricing in online markets (3) and price discrimination intended to partition national markets (4), objective justifications (5) and policy recommendations and final comments (6).

## **2. Economic insights into price discrimination**

11. As mentioned above, the effects of differential pricing have been well documented in economic literature.

12. Price discrimination may benefit some consumers, i.e. those for whom price discrimination implies lower prices, whereas others (those for whom price discrimination raises the price they pay) may suffer from it. Accordingly, compared to a situation where price discrimination is not permitted, the overall result of price discrimination on consumers' surplus and on the total welfare may either be positive or negative, depending on the dominant effect. In the case where discrimination applies to an intermediate market, for instance where an upstream firm price discriminates between retailers, additional effects may come into play. For instance, in the context of such a vertical relationship, price discrimination between retailers may be used by the upstream firm to give appropriate incentives to provide commercial services and thus to increase sales and consumer surplus.

13. Unfortunately, the abovementioned argument, which considers the market structure as a given, is not sufficient to draw unambiguous conclusions even in specific cases. Indeed, price discrimination (or the prohibition of price discrimination) may also have an impact on entry and exit. For instance, forcing uniform pricing may induce a firm to abandon the market segment of consumers who have a low willingness to pay in order to serve (with higher prices and margins) only those consumers that are willing to pay a higher price. In this case, prohibiting price discrimination may thus induce the exit of firms from some market segments.

14. What may make the analysis of price discrimination complex is that in some cases, price discrimination takes the form of explicit discrimination. This means that the price paid by a buyer depends on some observable characteristics, such as age, or the location of the customer, that have thus to be monitored by the firm. In contrast, in other cases it takes the form of self-selection by buyers: the firm then offers a menu of prices among which consumers choose the most convenient option for them. In the case of non-linear tariffs, according to the knowledge of its own demand, each consumer chooses the unit price that best fits its consumption structure.

15. It is clear however that effective price discrimination is only possible when arbitrage is impossible, or at least limited: would arbitrage be possible, then a buyer facing a high price could profitably buy from another customer facing lower prices. Therefore, price discrimination is often accompanied by measures that restrict the ability to engage in arbitrage. Where competition law seeks to protect arbitrage and/or seeks to prohibit price discrimination, these practices may be viewed as anti-competitive.

16. As mentioned above, price discrimination refers to the ability to charge individualized prices to different buyers. However, charging individualized prices can take several forms. First degree discrimination occurs where the producer takes the whole surplus of the consumer, that is, charges to every

consumer his reservation price. This situation relies on the assumption of perfect observability of consumers' preferences, a condition which is seldom met in practice. Second degree price discrimination applies precisely to these asymmetric information cases: the firm then offers a menu of tariffs to consumers among which, through a self-selection mechanism, the latter pick the most advantageous contract for him. Second degree price discrimination can be found either in the case of a vertical relationship where a producer offers a menu of contracts to its retailers, or in the context of discrimination with regard to final consumers, as in the case of mobile tariffs. A multi-product version of this self-selection mechanism is present in bundling, where according to their preferences for the goods, consumers may choose to buy separate items or a bundle including two goods. Third degree price discrimination, which also appears in asymmetric information contexts, refers to a situation where the price charged to a particular consumer depends on a signal related to the preferences of this consumer. According to their informational and strategic context, these various forms of price discrimination may each have very different impacts on consumers' surplus, as well as on firms' surplus. Price discrimination may intensify or reduce competition when it is used as a strategic tool in an oligopoly, a dimension that appears when participants in an oligopoly market use price discrimination in relation to downstream firms in order to change the competitive outcome upstream.

17. Price discrimination has different implications depending on to whether it applies to final consumers or to downstream firms. The reason why this is so is that while final consumers usually have independent demands, intermediate buyers compete on a final market and thus have interdependent (strategic) behaviors. Therefore, the demand addressed to the upstream firm by any of the downstream firms depends not only on the price this particular firm faces, but also on the prices faced by the others. Accordingly, discrimination has thus different implications, from a competitive point of view, according to the customers to which it applies. If price discrimination is introduced in a vertical relationship where it affects the conditions at which downstream firms compete, then it has an impact (either positive or negative) on quantities bought from the upstream level by the downstream firms and on the intensity of competition between these firms. This effect on competition may be favorable or not to total, as well as consumers surplus, depending on whether the total quantity sold is higher or lower than it would have been absent discrimination.

18. One main lesson that results from microeconomic analysis is that discrimination can be presumed to be bad for consumers if it does not increase the quantities bought, since it then merely transfers their surplus to the firm without increasing consumption.<sup>10</sup> Another lesson is that if a prohibition of price discrimination leads firms to leave the segment of consumers with low valuation in order to serve only high value consumers at a higher price (or to leave the market altogether), then prohibiting price discrimination is a bad thing: in that scenario it leads to a reduction in total quantity which is certainly disadvantageous for consumers. These observations may inform competition law enforcement: in cases where price discrimination can be presumed to increase total output, it should be treated as a priori lawful; in cases where output is decreased, it may -under a consumer welfare standard - exceptionally be objectionable.

19. An approach of price discrimination that relies on sound economic foundations should analyze practices according to their effects on markets, and in particular to their exclusionary effect either on the home market of the firm or on adjacent markets. What matters is not the type of downstream agents to whom discrimination applies (final consumers or firms that compete themselves on a downstream market), but the potentially exclusionary effects it conveys.

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<sup>10</sup> This does not, however, necessarily imply that price discrimination constitutes a competition law infringement. Among other things, this depends on the applicable welfare standard.

### 3. Differentiated pricing in online markets

20. The digital economy has led to significant economic growth by offering firms easier access to new markets, while consumers enjoy more choice and competition. The growth of online markets has also introduced many new services and business formats.

21. Many online markets provide increased scope for competition between suppliers, as consumer search costs are lowered; online markets are often more transparent as product and price information is available via suppliers' own sites, search engines and comparison sites. In many cases, these factors tend to reduce market power.<sup>11</sup>

22. Very generally, online suppliers may be better able to gather and use personal data of consumers, including purchasing and search information and may, as a consequence, be better able to tailor their offerings and prices to potential customers. Thus, the ability and incentive to price - discriminate may be higher online than in the corresponding brick & mortar context.<sup>12</sup> BIAC notes however that in some online scenarios it may also be more complicated to engage in price discrimination. This is because it may be more complex or costly to block arbitrage between different categories of customers.<sup>13</sup>

23. In light of the above, BIAC notes that online markets may increase the scope for the aggregation of personal data, thereby revealing or providing valuable information on individual consumers' willingness to pay.

24. BIAC shares the concern that in some circumstances the aggregation of personal data may be undesirable, and supports adequate privacy protection requirements and the use of ways and means for consumers not to make those data available. From the perspective of competition law enforcement and policy, BIAC is not, however, as a matter of principle, opposed to the aggregation of personal data, or the personalization of offerings to customers' needs or willingness to pay.

25. In this respect BIAC also notes that one main concern in this context relates to potential price increases in relation to customers whose willingness to pay is higher than the price they currently pay. While this phenomenon may perhaps be undesirable, BIAC notes that this would not in and of itself constitute a violation of competition law. Indeed, what matters is whether price discrimination, on balance, results in reduced consumer welfare. As a consequence, BIAC supports the observation in the OECD Background Paper that the impact of price discrimination is dependent on the facts of the case and thus ambiguous. This also applies to price discrimination on online markets.

26. BIAC has taken note of the observation in the OECD Background Paper that "when price discrimination would benefit consumers, it is best for consumers if all competitors have access to information on their willingness to pay, rather than one firm having exclusive access."<sup>14</sup> However, it takes the view that there should be no room for compulsory access in cases where -as the Background Paper notes - price discrimination benefits consumers to start with. In addition, as noted in BIAC's submission

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<sup>11</sup> BIAC notes that online markets may display network effects and other special features which may be conducive to the creation and maintenance of market power in exceptional cases.

<sup>12</sup> BIAC does not suggest that online and offline markets for specific goods or services would necessarily constitute separate relevant markets.

<sup>13</sup> See in this respect also paragraph 142 of the OECD Secretariat Background Paper.

<sup>14</sup> See OECD Background Paper, paragraph 152.

for the OECD Competition Committee's Hearing on Big Data, BIAC refers to the lack of real-world evidence of competitive harm associated with the aggregation of personal data.<sup>15</sup>

27. Finally, BIAC notes that a number of national European competition agencies have taken different approaches regarding contractual obligations imposed on service providers, in particular hotels, not to price discriminate. This has occurred in the hotel booking cases: while some NCAs have found that narrow-scope non-discrimination obligations are welfare enhancing, the Bundeskartellamt has taken the view that those obligations constitute competition law violations. BIAC is in favor of a rational, consistent, economics-driven framework of analysis in the area of price discrimination, including the analysis of price parity clauses.

#### **4. Price discrimination intended to partition national markets**

28. The abovementioned principles also apply when price discrimination is intended or results in differential pricing among customers located in different national (European) markets. As a general matter, BIAC notes that -in line with economic insights - price discrimination along national borders does not ipso facto result in negative effects for consumers. Indeed, there may be many legitimate, welfare-enhancing, reasons why firms would prefer to engage in that type of practice.<sup>16</sup> Excessively strict rules in this respect may also result in inefficient pricing overall, and corresponding welfare losses. Similarly, insisting that prices should be harmonized with a level applicable in a given geographic area could result in higher average prices for all consumers, or markets not being served at all in certain lower-priced geographic regions.<sup>17</sup>

29. BIAC notes that in the EU, the Community Courts have held that Article 102 TFEU does not prevent a dominant firm from setting different prices in different Member States, in particular where the price differences are justified by differences in market conditions and the intensity of competition.<sup>18</sup>

30. BIAC agrees with the notion that in cases where geographic price differentiation is not likely to have exclusionary, exploitative, or distortionary effects, it is best reviewed under a set of policy rules or regulations different from competition law rules.<sup>19</sup>

#### **5. Objective justification**

31. BIAC strongly believes that competition enforcement agencies should engage in an assessment of the economic reasons whether a particular price discrimination arrangement would be pro-or anticompetitive. This principle applies both to settings involving dominant firms and the exceptional cases where legitimate reasons exist to review pricing conduct of and non-dominant firms.<sup>20</sup>

32. A number of factors, such as transport costs, taxation, currency fluctuations, intensity of competition, different categories of customers may provide legitimate reasons for differentiating prices. In

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<sup>15</sup> Summary of Discussion Points, presented by BIAC to the OECD Competition Committee, November 29, 2016, Hearing on Big Data.

<sup>16</sup> See OECD Background Paper, paragraph 127.

<sup>17</sup> Idem, paragraph 128.

<sup>18</sup> Case 27/76 United Brands Company v Commission.

<sup>19</sup> See OECD Background Paper, paragraph 129.

<sup>20</sup> These questions should be distinguished from the question whether the conduct involves, in fact, discrimination between identical customers.

particular, cost differences involved in different transactions should in BIAC's views provide an absolute defense to discrimination claims.

33. Other legitimate justifications for price differences include price reductions for services rendered, price reductions given by a dominant firm when launching a new product or entering a new market or market segment and non-linear pricing in the case of differences in the intensity of use of products, for instance photocopier machines.

34. Moreover, the increase of total quantities may also support one of the efficiency reasons that can justify discrimination: the increase of output that may be associated with discrimination may also allow to recover large fixed costs. Thus, a firm may want to increase output by tailoring prices to consumers, in order to obtain a larger scale of production. This is a favorable case for discrimination since consumers buy more and the firm makes higher profits, which enables it to invest higher fixed investment costs.

## **6. Policy recommendations and final comments**

35. Price discrimination most often increases total welfare and very often increases consumer welfare. Even where the conditions for price discrimination are met, price discrimination produces ambiguous effects and should be subject to a case-by-case analysis. There are no valid grounds for treating price discrimination as a hardcore, per se, or by-object competition law violation.

36. Mandatory rules imposing non-discriminatory pricing may be welfare reducing.

37. The digital economy may in some cases increase the ability and incentive for firms to engage in price discrimination. However, as with price differentiation off-line, such conduct requires a thorough effects-based analysis.

38. Aggregation of personal data may enhance the scope for personalized pricing. However, this phenomenon does not necessarily result in anti-competitive effects. BIAC supports adequate privacy safeguards.

39. Differential prices may be justified by a number of factors. These factors should be carefully considered as part of the inquiry into the legality of price discrimination.