UNDERSTANDING PRICE DISCRIMINATION WITHIN EUROPEAN COMPETITION LAW FROM AN ECONOMIC AND LEGAL PERSPECTIVE

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Abstract

This article explores price discrimination within European competition law, categorizing it into first, second, and third-degree practices. It introduces the concepts of primary-line injury, which leads to exclusion, and secondary-line injury, which puts downstream firms at a competitive disadvantage, both stemming from price discrimination. It states that European competition law, established since the Treaty of Rome in 1957, aims to safeguard free competition and nowadays, article 102(c) of the Treaty on the Functioning of the European Union (TFEU) addresses price discrimination as potentially abusive when used by dominant firms. The paper explores how the European Commission and the European Court of Justice have interpreted said article and emphasizes that not all forms of price discrimination are prohibited; the focus is on cases where discriminatory pricing harms downstream firms. An example is provided where the Commission found a fidelity rebate to be illegal for limiting purchasers' alternative supply sources.

In conclusion, the article challenges the notion that all price discrimination harms competition and suggests a more nuanced analysis. It argues that the European Competition Authority must meet specific criteria outlined in Article 102(c) to prove abuse of a dominant position, considering the direct link between the conduct and harm to a firm's competitive ability. The paper calls for a more complex assessment of price discrimination strategies and their real or potential effects on the market, competitors, consumers, and upstream/downstream firms to determine whether they violate Article 102 or if it should be analyzed under another provision.

Resumen

Este artículo explora la discriminación de precios dentro del marco de la ley de competencia europea, categorizándola en discriminación de primer, segundo y tercer grado. Introduce dos conceptos derivados de la discriminación de precios: *primary-line injury,* que conduce a la exclusión, y *secondary-line injury,* que coloca a las empresas aguas abajo en desventaja competitiva. En él se afirma que la ley de competencia europea, establecida desde el Tratado de Roma en 1957, tiene como objetivo salvaguardar la libre competencia y en la actualidad, el artículo 102(c) del Tratado de Funcionamiento de la Unión Europea (TFUE) aborda la discriminación de precios como potencialmente abusiva cuando es utilizada por empresas dominantes. El artículo explora cómo la Comisión Europea y el Tribunal de Justicia

de la Unión Europea han interpretado dicho artículo y enfatiza que no todas las formas de discriminación de precios están prohibidas; el enfoque se centra en los casos en los que los precios discriminatorios perjudican a las empresas aguas abajo. Se proporciona un ejemplo en el que la Comisión encontró que un descuento por fidelidad era ilegal por limitar las fuentes de suministro alternativas de los compradores.

En conclusión, el artículo desafía la noción de que toda discriminación de precios perjudica la competencia y sugiere un análisis más matizado. Argumenta que la Autoridad de Competencia Europea debe cumplir con los criterios específicos establecidos en el Artículo 102(c) para demostrar el abuso de una posición dominante, considerando el vínculo directo entre la conducta y el perjuicio a la capacidad competitiva de una empresa. El artículo aboga por una evaluación más compleja de las estrategias de discriminación de precios y sus efectos reales o potenciales en el mercado, competidores, consumidores y empresas aguas arriba/abajo para determinar si violan el Artículo 102 o si deben ser analizadas bajo otra disposición normativa.

Keywords

Price discrimination; European competition law; Fidelity rebates; Article 102(c); Effects-based approach.

Palabras clave

Discriminación de precios; Derecho de Competencia Europeo; Rebates de fidelidad; Articulo 102(c); Análisis basado en efectos..

Index

A. Introduction..4

B. Price Discrimination Overview and The Theories of Harm 4

C. Article 102(c): Economic Effects of Price Discrimination. 6

D. Conclusions..8

A. Introduction

Price discrimination covers a series of strategies that firms can apply to charge consumers differently for the same good, therefore increasing their level of profits or expanding their production. Classically, it has been divided into three categories: first, second and third-degree price discrimination.[1] However, this paper will also discuss primary-line and secondary-line injury caused by price discrimination, in order to understand the application of European Competition law on the matter. It is important to highlight that since the creation of the European Economic Community through the Treaty of Rome in 1957, European law has included the protection of free competition in the market, which was further developed in the Treaty Establishing the European Community[2] and in its current version, the Treaty on the Functioning of the European Union (TFEU), according to which price discrimination can amount to be an abuse of the dominant position[3]. Considering that the Commission, as well as the European Court of Justice have the power to investigate any conducts that might breach European competition law, and can prosecute, impose fines, among other corrective measures to undertakings, it is crucial to analyze the interpretation it has given to article 102(c), referring to price discrimination.

This essay will first provide an overview of the different types of price discrimination. Second, it will conduct an analysis of Article 102(c) to elucidate its significance, through an examination of cases in which price discrimination has been found to be illegal under this provision. Finally, this essay will advocate that not all forms of price discrimination should be prohibited. Instead, it will propose implementing an effects-based approach for evaluating such practices.

B. Price Discrimination Overview and The Theories of Harm

This section will first explain, from an economics standpoint, first, second- and third-degree price discrimination, followed by a classification of the conducts by its impact on the market as: primary or secondary line injury. Prior to that, one must know that there are two main requirements that firms must meet so that their practice of price discrimination is effective and can somehow influence the market: it must have enough market power to set prices and it must be able to restrict consumer's engagement in arbitrage[4].

First-degree price discrimination lets a firm charge each consumer their exact willingness to pay for the good. This strategy extracts all consumer surplus and allows the firm to increase its profits by differentiating the price charged to each consumer.[5] Although this was

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[1] Paul Belleflamme, Martin Peitz. *Industrial Organization: Markets and Strategies.* (Cambridge University Press, 1st edition, 2010) p. 195-197.

[2] Articles 85, 86, Consolidated version of the Treaty on European Union [TEU] OJ C326/13, 1992.

[3] Articles 101, 102, Consolidated version of the Treaty on the functioning of the European Union [TFEU] OJ C326/13, 2012.

[4] Paul Belleflamme, Martin Peitz. *Industrial Organization: Markets and Strategies*, 193-195.

[5] Ibis.

thought to be highly unrealistic, today's technological boom and database availability may help enterprises know their customers better, allowing for a personalized price according to their own valuation of the good[6]. Another example, which will be discussed further in the next section, is when a firm supplies goods to only few customers (as is often the case in national markets such as basic services, imports, etc.) and decides to charge each a different price.

Second degree price discrimination includes a variety of practices with different levels of complexity, which have frequently been found to be a breach of article 102(c) by the European Competition Authority arguably with little economical or legal support. This practice occurs when firms don't know the individual willingness to pay therefore, the best strategy to potentially increase their profit, is to set different pricing options such that it's up to the consumers to select their own price option according to their personal valuation of the good.[7] This often occurs in bundling discounts and loyalty rebates, as explained in the following lines.

On the one hand, a bundling discount gives the firm the opportunity to charge a different price for a group of products, which often have a complementary use and can be more expensive if bought separately. In this case, before deciding to apply said discount, the firm must choose from three options: i) To only offer the products as a bundle at a certain price; ii) To offer both the bundle and the individual items at different prices; iii) To only offer the products separately.[8] The choice of the enterprise depends on factors such as the demand curve, the valuation of the consumers, and the expected profit increase, which in turn varies the effect on the market. What is certainly clear is that, based solely on the nature of bundling discounts, it's impossible to know if the effects on the market would be negative.

Loyalty rebates, on the other hand, enable firms to charge varying prices based on the quantity each customer purchases. This can also appear in different forms[9]: i) A discount is made if the consumer purchases a determined percentage of their needs from the firm (i.e., a constructor buys 85% of the wood needed to build a house from a supplier X); ii) A discount is made if the buyer reaches a given quantity in a period of time (i.e., a market owner reaches the set goal of selling 100 units of ice cream X in 1 month); iii) A discount is made if the customers' purchases are higher in the current period than they were in the last (i.e., the amount of letters sent by a firm through a carrier X grew 20% than last year).

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[6] Gehrig, Thomas, Stenbacka, Rune. "Price Discrimination, competition and antitrust." Essay. *In The Pros and Cons of Price Discrimination,* (2005). Edited by Swedish Competition Authority, Stockholm, Sweden: Konkurrensverket, 131-160.

[7] Paul Belleflamme, Martin Peitz. *Industrial Organisation: Markets and Strategies*, 217-219.

[8] P. Amstrong, Mark. "Price Discrimination." *University College London*, 2006. https://discovery.ucl.ac.uk/id/eprint/14500/1/14500.pdf.

[9] Bishop, Simon. "Delivering benefits to consumers or per se illegal? Assessing the competitive effects of loyalty rebates." Essay. *In The Pros and Cons of Price Discrimination*, (2005). Edited by Swedish Competition Authority, Stockholm, Sweden: Konkurrensverket, 65-100.

Third degree price discrimination happens when a firm can objectively divide its demand into segments based on criteria such as geographical location, age, etc.[10] For example, a firm that sells homogenous products may charge higher prices in different countries. In these cases, the Competition authority seems to focus on analyzing whether the price differences are justified by a variation of costs of production or transportation or not[11].

As described previously, price discrimination can take different shapes when considered from an economic perspective. However, this is not the only classification there is. In fact, it is also possible to differentiate these strategies based on the impacts they have on various market participants: primary and secondary line injury.

Primary-line injury occurs when the result of price discrimination is exclusionary. In other words, the price strategy put into practice by the firm can cause its rivals to be excluded from the market, by taking away all or most of the demand.[12] Primary-line injury can arise, when second degree price discrimination strategies, such as bundling and fidelity rebates, are applied by a firm that holds a dominant position, since it can cut out its competitors from the market. On the other hand, secondary-line injury, is often a result of first- and third-degree price discrimination. This injury takes place when a firm upstream applies "better" prices/terms to one or more downstream firms, which puts the other(s) in a competitive disadvantage. For example, an airport may charge a domestic airline a lower price for using its facilities, when compared to other international airlines, impeding the latter to set competitive prices to stay in the market.

C. Article 102(c): Economic Effects of Price Discrimination.

After explaining the main classifications there are of the price discrimination strategies, it is important to understand how the Competition Authorities of the European Union have applied said concepts under Article 102 of the TFEU. Said article regulates the conducts that are considered an abuse of the dominant position by a firm. As stated before, this paper is concerned with the specific prohibition of price discrimination, however, it is important to reference its complete text:

> **Article 102. Any abuse by one or more undertakings of a dominant position** within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
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> a. directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions,
>
> b. limiting production, markets, or technical development to the prejudice of consumers,

[10] P. Amstrong, Mark. "Price Discrimination."
[11] See Cases: Tetra Pak II, Irish Sugar, British Leyland, United Brands, Michelin II.
[12] Geradin, Damien, Petit, Nicolas. "Price Discrimination under EC Competition Law." Essay. *In The Pros and Cons of Price Discrimination*, (2005). Edited by Swedish Competition Authority, Stockholm, Sweden: Konkurrensverket, 21–64.

c. **applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage**;

d. making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.[13]

According to a less conservative but still very common form of legal interpretation (plain meaning textualism), when looking for the legal effect of a provision, it is enough to consider the meaning of such text, taking into consideration the general context of such law, but there is no need to look for the intent of the policy makers.[14] In this case, the article is sufficiently clear to derive its meaning just by analyzing its content: A conduct is illegal when it's performed by a firm i) with a dominant position, ii) within an identifiable market iii) enforces a price discrimination strategy which puts one of the firms (downstream) in a competitive disadvantage vis a vis the rest. As argued by Bergman, this article doesn't prohibit all types of price discrimination, in fact, its notorious emphasis on the competitive outcome rules out strategies directed at end consumers ("trading parties" refers to firms rather than consumers) and recognizes price discrimination as abusive only when the good is sold on discriminatory terms to a downstream firm which finds it especially valuable for its functioning.[15]

Nevertheless, in the case Hoffmann-La Roche & Co. v. Commission, the Commission found that applying a fidelity rebate to customers depending on how much of their needed products were bought from Hoffmann-La Roche, was a breach of article 102(c)[16]. After defining the relevant market for the case, the Commission agreed that the firm had a dominant position, enjoying enough market power to apply price discrimination. The conduct was found illegal because:

> "[obligations] to obtain supplies exclusively from a particular undertaking, whether or not they are in consideration of […] the granting of fidelity rebates, […] are not based on an economic transaction which justifies this burden or benefit bur are designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market."[17]

Note that the authority argues that fidelity rebates are harmful for competition because they prevent the customers from getting their supplies from other firms, and such discounts can only be justified if they are a consequence of cost reduction associated with higher sales. This is not true. For instance, loyalty rebates reduce the cost of the goods acquired by the customer, which would incentivize it to sell such products at a lower price to the end

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[13] Article 102, TFEU.

[14] Nelson, Caleb. "What Is Textualism?" *Virginia Law Review* 91, no. 2 (2005), 347–418. http://www.jstor.org/stable/3649427.

[15] Bergman, Mats. "Introduction." Essay. *In The Pros and Cons of Price Discrimination*, (2005) edited by Swedish Competition Authority, Stockholm, Sweden: Konkurrensverket, 11–20.

[16] Hoffmann-La Roche & Co. AG v Commission of the European Communities. - Dominant position. - Case 85/76.

[17] Ibis.

consumer, to increase its sales, therefore its profit, and continue enjoying the discount from the supplier. Furthermore, the customer has a high interest to buy the determined amount of goods and sell them, so it is likely to invest in other services, such as demonstration of the good, ads, etc.[18]

The Commission fails to analyze if the fidelity rebate applied by Hoffman-La Roche caused the downstream firm to be in a competitive disadvantage in relation other downstream firms, as is required to prove according to article 102(c). Instead, it focuses on the exclusionary effect that the conduct had with other competitors of the firm. As explained in section I., this refers to primary-line injury, which is not covered by article 102(c), and even then, the Commission would have to compare the benefits for the consumers (price reduction, more complementary services offered), the dominant firm, the downstream firms, total welfare against the possible harm to the competitors.

D. Conclusions

It is oversimplistic to state that price discrimination strategies are *per se* harmful for competition, especially because most of them are a natural and competitive response from firms. It has been shown that fidelity rebates, which are usually found illegal, can also have benefits for the market. The same thing is true with first degree price competition (where the firm can reach the highest efficiency possible by charging its consumers exactly their willingness to pay, meaning that everyone has access to the good and the firm can increase its production); bundling (where offering a ‘package’ price opens up the market to new customers who were before unable to buy the good because of the higher price); objective price discrimination (offers the more sensible consumers an alternative price once the condition is verified, leads the firm to increase their production, so a higher level of profit can be expected), among others.

While acknowledging the potential drawbacks of price differentiation, such as the risk of driving competitors out of the market, it is essential to emphasize that Article 102(c) outlines a specific framework for analyzing potential abuses of a dominant position, primarily focusing on secondary line injury. In other words, the European Competition Authority must demonstrate the direct link between a firm's conduct and the harm inflicted on another company's ability to compete in the market. Demonstrating mere price discrimination's impact on competitors is insufficient, as virtually every business decision can influence rivals to some extent. In fact. the burden of proof set by this article surpasses the Commission's interpretations in its caselaw.

Consequently, the Authority must initiate its analysis by precisely defining the relevant market. It must then assess the potential effects on competitors, consumers, and upstream/downstream firms. Moreover, it is crucial to identify the type of price

[18] Bishop, Simon. “Delivering benefits to consumers or per se illegal? Assessing the competitive effects of loyalty rebates”, 65-100.

discrimination and, more importantly, the Commission must examine the real or potential effects of this conduct on the market. Only when there is a clear understanding of the economic gains and/or competitive harms caused by the price discrimination strategy, the Authority can decide whether it meets the criteria of literal c) or if its better suiter for consideration under another provision of article 102.