



International
Competition
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The Unilateral Conduct Working Group Webinar on Price Discrimination

March 1, 2011

Introductory Remarks

- This Teleseminar will be recorded and posted on the ICN website
- Audience will be muted during the presentation portions of the teleseminar
- Audience lines will be unmuted during Q&A sessions following the opening presentation and each of the case studies

Program

- Introduction to the law and economics of price discrimination by **Damien Geradin**, Covington & Burling
- Nationwide Poles and Sasol Limited – Price Discrimination Case Study presented by **Trudi Makhaya**, Senior Analyst, South African Competition Commission
- Price Discrimination Affecting the Russian Fertilizer Market, presentation by **Vladimir Kachalin**, Advisor to Chairman, FAS Russia
- Panelists
 - **Radoslav Depolo**, Ministro, Tribunal de Defensa de la Libre Competencia, Chile
 - **Felix Engelsing**, Head of the 10th Decision Division, Bundeskartellamt

Post-Program Presentation

- Presentation by **Ekaterina Rousseva**, Policy Analyst , European Commission on the ECJ's recent decision in TeliaSonera, which concluded that margin squeeze is an independent form of abuse of dominance.



Introduction to the law & economics of price discrimination

Damien Geradin, Covington & Burling

Price discrimination is a complex issue

- Price discrimination covers many different practices (discounts and rebates, bundling, selective price cuts, discriminatory input prices set by vertically-integrated operators, etc.) whose objectives and effects on competition may significantly differ.
- There is a consensus among economists that the welfare effects of (the various categories of) price discrimination are ambiguous. It is hard to say *a priori* whether a given form of price discrimination increases or decreases welfare. The response to this question may depend on which type of welfare standard (total or consumer) is actually pursued.

Definition of price discrimination

- There is no clear legal definition of price discrimination.
- Economists have provided economic tests helping to identify price discrimination. For instance, in his famed antitrust book, Richard Posner explains that:

“Price discrimination is a term that economists use to describe 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. More precisely, it is selling at a price or prices such that the ratio of price to marginal costs is different in different sales [...]”.
- This definition is helpful in that it provides an objective criterion, i.e. the presence of different ratios of price to marginal costs (i.e. rates of return), to identify the occurrence of price discrimination.

Conditions for price discrimination to occur

- It is generally admitted that several conditions must be present for price discrimination to occur:
 - A firm must have some market power (i.e., the ability to set supra-competitive prices) to be able to price discriminate. Otherwise, it cannot succeed in charging any consumer above the competitive price.
 - The firm must have the ability to sort consumers depending on their willingness to pay for each unit. The level of information enjoyed by a firm over its customers may in turn determine the forms of price discrimination it decides to put in place.
 - The firm must be able to prevent or limit the resale of the goods or services in question by consumers paying the lower price to those who pay the higher price.
- Absent one or several of these conditions, price discrimination is impossible or at least unlikely to succeed.

Different forms of price discrimination

- The objective of all methods of price discrimination is to “capture as much consumer surplus as possible” (Carlton and Perloff). But this can be achieved through different forms of price discrimination:
 - **First degree price discrimination** occurs when a firm is able to perfectly discriminate between consumers, i.e. when it enjoys the ability to charge the maximum each consumer is willing to pay for each unit of a given product.
 - **Second degree price discrimination** occurs when a firm sets a price per unit which varies with the number of units the customer buys. This can, for instance, be achieved through volume discounts whereby the price of a unit varies depending on the quantity purchased by the buyer.
 - **Third degree price discrimination** takes place when a firm charges different prices to different groups of customers depending on their elasticity of demand (Ramsey pricing).
- The distinction between first, second and third degree discrimination is only of limited relevance in the competition law analysis context as it tells little about the effects on competition generated by the different forms of price discrimination it distinguishes.

More relevant distinction for competition law

- Discussions competition lawyers and economists over price discrimination often draw a distinction between:
 - **“Primary line” injury**, which is occasioned by the dominant firm to its competitors by applying different prices to its own customers (discounts and rebates, selective price cuts, tying and bundling, etc.)
 - **“Secondary line” injury**, which is imposed on one of several customers of the dominant firm as against one or several other customers.
- In most competition law regimes, “price discrimination” in the strict sense of the term refers to secondary line injury. That is, for instance, the case in EU competition law.

Secondary-line injury

- Second-line injury may occur in two different types of scenarios:
 - Discriminatory pricing **by vertically-integrated operators** (classic form of vertical foreclosure designed to exclude downstream competitors)
 - Discriminatory pricing by **non-vertically-integrated operators**. This scenario is rather rare as non vertically-integrated operators typically have no incentive to price discriminate so as to place one of their customers at a competitive disadvantage:
 - Upstream firms benefit from a competitive downstream market for distributing their goods;
 - An upstream firm discriminating between distributors may discourage them from distributing its products; and
 - Discrimination among buyers may lead to the exclusion of the discriminated purchasers and increase concentration on the purchasing market, hence creating countervailing buying power.

Q&A

Question & Answer Period

Nationwide Poles and Sasol Limited - Price Discrimination Case Study

Trudi Makhaya
Competition Commission South Africa

Outline

- Overview of the complaint
- Sequence of events
- Price list
- Price discrimination in the South African Act
- The relevant market
- A substantial lessening or prevention of competition
- An alternative view
- Conclusion

The complaint

- Nationwide Poles was a pole manufacturing and treatment company in the Eastern Cape
- Bought creosote from Sasol
- Creosote a key input for treating poles
 - A by-product produced by Sasol and Suprachem
- Another chemical, CCA, also used for treating poles – not suitable for poles to be used in vineyards (Nationwide's customers)
- Nationwide realised that Sasol charging it higher price than its competitors, including its most important competitor in the Eastern/Western Cape, Woodline
- Discovered that sales made on the basis of price bands based on historical sales volumes (previous three months)

Sequence of events

The three competition bodies reach different conclusions

•Investigation & Non-referral by Competition Commission

- Nationwide submits complaint to Competition Commission
- South African Competition Commission investigates the case and decides not refer it to the Competition Tribunal (adjudicating body; November 2003)

•Competition Tribunal finds in favour of Nationwide

- Nationwide Poles then approached the Competition Tribunal directly without the benefit of Commission's investigative powers (December 2003)
- Tribunal finds prohibited price discrimination

•**Competition Appeal Court finds in favour of Sasol** – substantial lessening or prevention of competition not demonstrated

•**Exit** – in 2005, Nationwide Poles exits the market

Price list based on historical sales

Customer's historical volume in tonnes p.a.	SAK K current price per tonne (excl. VAT)	Additional amount per tonne relative to lowest price	Additional % relative to lowest price	% Discount relative to highest price
2002-2003				
> 5 500	R1 600			16.32%
3 601 – 5 500	R1 638	R38	2.38%	14.33%
2 501 – 3 600	R1 660	R60	3.75%	13.18%
1 001 – 2 500	R1 700	R100	6.25%	11.09%
451 – 1 000	R1 780	R180	11.25%	6.9%
0 – 450	R1 912	R312	19.5%	
2003 - 2004				
> 5 500	R1 928			15.29%
3 601 – 5 500	R1 974	R46	2.39%	13.27%
2 501 – 3 600	R2 000	R72	3.73%	12.13%
1 001 – 2 500	R2 049	R121	6.28%	9.97%
451 – 1 000	R2 127	R199	10.32%	6.55%
0 – 450	R2 276	R348	18.05%	

- Lowest volume band paying between 18 – 19% more than highest volume band
- Sales on the same method of delivery – full tanker loads
- No clear economies from higher volume sales
- Pricing bands not transparent – Nationwide Poles sought them out from Sasol

Price Discrimination in the SA Act

- **Dominant firm** – prohibition restricted to dominant firms
 - Market share over 45% presumed dominant
- Likely to have the effect of **substantially preventing or lessening competition**
- **Equivalent transactions** of goods or services of like grade and quality
- Discrimination in terms of price, **discounts** etc, provision of services, payment for services provided
- **Defenses**
 - Reasonable allowances for differences in cost or likely cost of supply
 - Meeting price or benefit offered by competitor
 - Changing conditions (deterioration, obsolescence, liquidation, discontinuation)
- **No penalty** for first offense

The relevant market & dominance

- Tribunal and CAC found a market for creosote, excluding CCA
- Sasol found to be dominant
 - Market share greater than 45%
 - Behaviour independent of customers and competitors
 - Price increase due to plant switch/recognition of opportunity costs (move towards fuel equivalent price) – 300% increase in price
- Role of Suprachim in the market (Tribunal)
 - Follower
 - Relatively fixed production capacity
 - Sasol set prices independent of Suprachim
 - Any competition likely to have been at supra-competitive prices
- Role of Suprachim (CAC)
 - Felt more evidence required to assess its ability to constrain Sasol

Substantial lessening & prevention of competition - Tribunal

- Held that Nationwide had to show ‘competition relevance’, not generalised harm to the market
 - Small business intrinsically unable to show generalised harm given limited role in any market
 - “Substantial” meant to distinguish the trivial effect from the weightier
 - Public interest argument: the Act had the development of small business in mind (Preamble talks to equitable participation by SMEs, Explanatory Memorandum of the Act)
 - Note: SLPC interpreted differently in other sections of the Act (e.g. merger provision sec 12A – SLPC means more than competitive relevance, small business development mentioned alongside it)
- Incentives for Sasol to discriminate unclear
 - Creosote a by-product – Sasol claimed preference for larger suppliers who could be reliable off-takers
 - Yet, price bands were not made transparent to the buyers
 - Evidence of previous lobbying from larger pole manufacturers – as can be seen from their previous influence on Sasol to discriminate against micro-producers

Tribunal finds on behalf of Nationwide Poles

- Material differentiation between most and least favoured
- Likely that complainant, similarly situated firms, new entrants are less effective competitors due to conduct
- Absent discrimination, a market where small firms could be effective competitors
- Sasol did not make a case for any of the defences
 - Record suggested that Sasol had not undertaken any cost studies; no suggestion of differential costs of supply for differing volumes
- Finds that conduct substantially lessened or prevented competition in respondent's market

Substantial lessening & prevention of competition - Appeals Court

- Found that the burden of proof had not been discharged
 - Provided effects of practice on respondent's own cost structure (3.5 – 4% higher than competitors)
- Insufficient evidence that Sasol's pricing structure impedes the ability of small pole producers to compete
 - No evidence on exits
 - Nationwide Poles able to compete and continue to operate in the relevant market
 - No evidence on the cost structures of other small firms in the market
- Insufficient evidence on Suprachim's role
- Argued that this was attempt to protect competitors instead of competition

An alternative view: prevention versus lessening (Petersen)

- Prevention = impediments to expansion
- Can be established by impediments placed in the way of a single competitor
 - Lessening – full market analysis
 - Prevention – hinder/impede
 - What stands in the way of a firm expanding competitively within a market is likely to hinder or impede, and thus prevent, competition in the market
 - EU test provided by Article 82(2)(c) whether the application of dissimilar conditions to equivalent transactions places those discriminated against at a ‘competitive disadvantage’
 - Morton Salt – no need to show actual harm, stop discrimination in its incipiency
 - Competition means more than survival

Conclusion

- SA law has limited restriction on price discrimination (dominance, likelihood of lessening or prevention of competition, defences)
- Case turned on demonstration of likelihood of substantial lessening or prevention of competition
- Tribunal and Appeals Court espousing different standards
- It could be argued that further identification of downstream markets, likely local, could have demonstrated harm to downstream consumers
 - Concentration of pole makers higher at local level
 - Inhibiting Nationwide Poles as effective competitor – increased market power for small number of local rivals
- Direct approach by Nationwide limited evidence that could be brought on other small buyers (non-referral by Commission)
 - Petersen third way?
 - A question of evidence with Appeals Court standard?

Q&A

Question & Answer Period

PRICE DISCRIMINATION AFFECTING THE RUSSIAN FERTILIZER MARKET

Vladimir Kachalin
Assistant to the President
FAS Russia

LEGAL FOUNDATIONS FOR CONSIDERING PRICE DISCRIMINATION CASES IN RUSSIA

- “Actions (inaction) of an economic entity occupying a dominant position, which result or can result in prevention, restriction or elimination of competition and (or) infringement of the interests of other persons are prohibited, including the following actions (inaction):
...
economically, technologically or in any other way unjustified establishment of different prices (tariffs) for one and the same commodity if another is not established by the law...” (FL 135, Article 10)
- Efficiency based defenses do not apply to price discrimination.

MARKET DEFINITION AND DOMINANCE ASSESSMENT

- **Product market:** Phosphate based fertilizers cannot be cost effectively substituted with other types of chemical fertilizers in Russia.
- **Geographic market:** Only one developed natural deposit of apatite in the European part of Russia used for apatite extraction and selling the concentrate in the market. Use of apatite concentrate from Eastern parts of the country or abroad is not efficient due to prohibitively high transportation costs.
- Apatite Co. controls the only natural deposit of apatite used for commercial distribution, i.e. 90% of production of apatite concentrate (the remaining 10% is used by a company that extract apatite for own use).

PRACTICE IN QUESTION AND ITS INFLUENCE ON THE MARKET

- 20-30% difference in prices established by Apatite Co. for its daughter companies and independent producers of fertilizers
- Price discrimination combined with “constructive” refusal to deal
- “Margin squeeze” often go in parallel to price discrimination
- Through these practices Apatite sought to monopolize the downstream fertilizer market. The number of independent producers reduced from 6 to 4 (out of the total number of 8) in about 3 years
- These “constructive refusals to deal” ended when the independents agree to be acquired by Apatite Co. Reduction of price and adequate terms of shipment followed after the former independent producers agree to join Apatite holding.
- Price increase for apatite concentrate is not passed over to fertilizer consumers due to competition in the fertilizer market and threat of FAS involvement in case of collusive or unilateral price raise in fertilizer market

FAS ENFORCEMENT ACTION AND REMEDIES

- Uniform agreed-on price established for all sales of apatite concentrate regardless of the customer (independent or daughter company)
- Price = last year (base) price x inflation x depletion ratio
Base price = total costs of inputs + overheads + cost of capital (actually was taken close to pre violation price)
Price for daughter companies is 5% less due to absence of transaction costs
- Attempt to oblige Apatite to sell all its outputs through commodity exchange proved to be not as efficient as establishment of agreed on price due to output reduction, “constructive” refusal to deal and intra-company subsidies within Apatite Co.

More on Price Calculations: Stakeholders' Involvement

- Cost data were provided by defendant, which bore legal responsibility for data accuracy.
- Apatite customers were relied upon to spot and report on price differences/increases.
- Ultimate fertilizer consumers did not participate in price determinations because:
 - Apatite price increases were not passed on to ultimate customers, due to competition in the downstream fertilizer market and the threat of FAS intervention.
 - Ultimate customers, the farmers, were (1) numerous, (2) dispersed, and (3) not very knowledgeable regarding fertilizer production technology, apatite extraction, and apatite purification.

Consumer Welfare Effects

- Apatite Co.'s price discrimination imposed no short term harm on apatite purchasers before the ban on price discrimination:
 - The favored subsidiaries' discounts put competitive pressure on market price level.
 - Also, some of the independents bought by Apatite Co. maintained pre-merger price levels, due to FAS merger approval conditions.
 - Also, the FAS warned independents and Apatite Co. subsidiaries to avoid major large fertilizer price increases or face sanctions.
- FAS did not apply downstream effects-based considerations in this case.
- Nonetheless, after the FAS ban on price discrimination, average apatite prices fell.
- But apatite prices have tended to rise over time due to rising input costs and a depletion of apatite deposits.

Why no Appeal of FAS Ruling to the Court by the Defendant?

- Defendant preferred to settle with FAS and agree on the price because its violation of law was obvious: the evidence was sufficient to prove price discrimination and efficiency defenses did not apply as well Article 10 defenses (inability to supply).
- Also, settling the case at an early stage reduced defendant's exposure to fines.
- Defendant also benefited from playing a major role in developing the pricing mechanism and in convincing FAS to support a 5% discount for Apatite Co. subsidiaries, due to reduced transactions costs.

Broader Implications of this Case: “Precedent” / message to industry

- Case clearly signaled FAS’s intention to combat price discrimination affecting fertilizers as well as other industries
- Sanctions will be higher if the anticompetitive intent is obvious
- But sanctions will be minimized in cases the defendant is cooperative and undertakes to cease the violation
- Case also highlighted the issue of constructive refusals to deal and implicit “margin squeezes” that have exclusionary effects on downstream markets.
- Compliance can be enforced not only by market monitoring by the agency but by informed consumers knowledgeable in production technology throughout the value chain and the market (they will file a new complaint if the violation repeats).

Q&A

Question & Answer Period

Conclusion

- Concluding Remarks by **Markus Lange**, Head of Unit, International Competition Matters, Bundeskartellamt