AUTORITÀ GARANTE DELLA CONCORRENZA E DEL MERCATO
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International Competition Network

ICN UNILATERAL CONDUCT WORKSHOP
Rome 2017

Plenary #4: Assessing price parity agreements

Moderator:
Paolo Palmigiano, General Counsel, Sumitomo Electric Industries

Friday 1 Dec 2017, 9:00-10:30

An Overview of the Economics of Price Parity Agreements

Paolo Ramezzana
U.S. Federal Trade Commission

ICN Unilateral Conduct Workshop
Rome – December 1, 2017

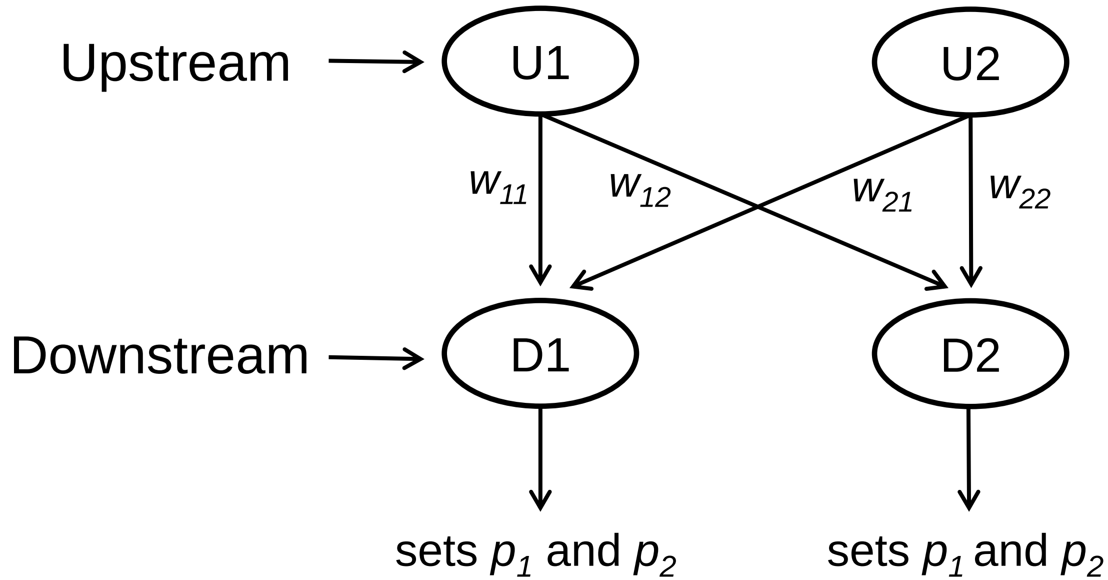
Setting the stage …

- Many transactions require two “inputs”:
  - A product (e.g., e-book, hotel room), supplied by a “producer”
  - Distribution services, supplied by a “retailer”
- Two distribution models:
  - *Wholesale model*:

    Producers set wholesale prices *w,* retailers set consumer prices *p*
  - *Agency model*:

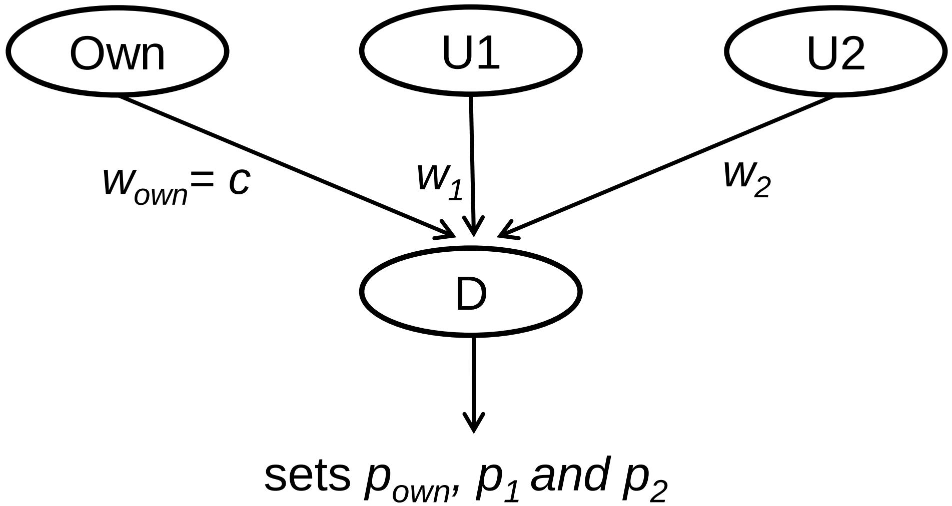
    Retailers set fees *w* (often a % of *p*), producers set consumer prices *p*
- Both models can be analyzed within the same economic framework
  - Hviid (2015), Johnson (2017)
- In both models, concerns about Price Parity Agreements (PPAs)

A general economic framework



- Wholesale model (e.g., U.K. Tobacco and U.S. AmEx cases):
  - Producers are upstream (receive wholesale prices *w*), retailers are downstream (set final consumer prices *p*)
- Agency model (e.g., e-book, hotel booking and Amazon cases):
  - Retailers are upstream (receive distribution fees *w*, often a % of *p*), producers are downstream (set final consumer prices p)

Price Parity Agreements (PPAs) constrain relative prices



- Wide parity (constrains directly *all* consumer prices)
  - U1 requires $p_1 \leq \min\{p_2, p_{own}\}$; U2 requires $p_2 \leq \min\{p_1, p_{own}\} \implies p_1 = p_2$
  - Moreover, if own channel has lowest cost $\implies$ D sets $p_1 = p_2 = p_{own}$
- Narrow parity (constrains directly only prices for *own* channel)
  - U1 requires only $p_1 \leq p_{own}$; U2 requires only $p_2 \leq p_{own}$
  - However, if own channel has lowest cost $\implies$ D sets $p_1 = p_2 = p_{own}$

Competitive implications of Price Parity Agreements (PPAs)

In both the wholesale and agency model, PPAs may

- Foreclose upstream competitors (exclusionary effects)
  - Make it difficult for upstream entrants to expand by pricing low
- Soften upstream competition between existing firms (facilitating effects)
  - Lead to higher wholesale prices / distribution fees w's and thus higher p's
  - Will be discussed further on next slide
- Have efficiency justifications
  - Prevent freeriding on investments
  - Are PPAs necessary to achieve efficiencies? Other business models?

Facilitating effects: (Wide) PPAs may raise *w*'s and *p's*

- One downstream firm D, two independent upstream firms U1 and U2
- If U*i* raises w_i, with PPAs D must raise both p_i and p_j (or none)

  $\Longrightarrow$ U*i* suffers smaller fall in volume than without PPAs

  $\Longrightarrow$ U*i* has stronger incentives to raise w_i than without PPAs

- All upstream firms have incentives to raise *w*'s
- Downstream firms likely to pass through higher *w*'s into higher *p*'s
- Overall analysis must also account for efficiencies, two-sided effects, threat of delisting by D, etc.
- Literature: Hviid (2015), Ramezzana (2016), Johnson (2017), Foros et al. (2017), Carlton and Winter (2017), Johansen and Vergé (2017)

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COMPETITION COMMISSION

Lilla Csorgo

Head of Economics and Policy

Hong Kong Competition Commission

Is Narrow Parity Sufficient for Wide Parity Outcomes?

- Wide pricing parity in an agency model, competition concern, e.g., hotels/OTAs:
  - increases barriers to entry and expansion as hotel cannot favour OTA with better terms with lower room prices; and/or that OTA cannot use its commission earnings to discount the room rate

Narrow Pricing Parity Outcomes

- hotel obliged to price rooms on its website at the same rate as on the incumbent OTA site
- to favour an OTA entrant, the hotel must price relatively higher on its own website
- risk of cannibalizing own, more profitable sales
- 79% of respondents did not differentiate across OTAs based on price (Report on the Monitoring Exercise Carried Out in the Online Hotel Booking Sector by EU Competition Authorities in 2016)

Dissolution of All of Inventory Clauses More Effective?

- greater control
- reduced risk of cannibalization
- 69% of respondents did not differentiate based on room availability (Report on the Monitoring Exercise Carried Out in the Online Hotel Booking Sector by EU Competition Authorities in 2016)

ICN Working Group

Price parity in car insurance

1 December 2017

Chris Prevett
Legal Director and Project Director, CMA

Car Insurance
The market investigation

- 2012-14: CC/CMA conducted a market investigation into private motor insurance (ie ‘car insurance’)
- In part this looked at the use of price parity clauses by Price Comparison Websites (PCWs)
- The investigation concluded that, in car insurance:
  - wide parity clauses soften price competition between PCWs likely leading to less entry, less innovation and higher commission fees, all leading to higher prices
  - that if there were any anticompetitive effects from narrow MFNs they were unlikely to be significant and efficiency justifications are more plausible than for wide parity clauses
- This led to a prohibition on the use of wide parity clauses and equivalent behaviours by PCWs in car insurance

Background
DCTs market study

- In September 2016 the CMA launched a market study looking at Digital Comparison Tools (DCTs) such as PCWs

- The final report was published in September 2017 and among others it looked at whether DCTs competed effectively with each other

- This included looking at agreements between suppliers and DCTs that are likely to or could limit the strength of the competitive constraint on and between DCTs

- It looked in particular at wide and narrow price parity clauses

Wide parity removal - assessment

- We analysed the impact of the prohibition of wide parity clauses in car insurance
- We conducted an econometric analysis looking at the rate of change of commissions pre- and post-removal of the wide parity clauses
- The results indicated that commissions were 3 to 4% higher on average when a wide parity clause was in place than they would have been in the absence of the wide parity clause

Wide parity removal - assessment

- We also received qualitative evidence on retail price discounting in car insurance – mixed but mainly positive:
  - Many suppliers said they were now able to negotiate promotional deals
  - A limited number of suppliers said there had been:
    - No impact on their pricing as narrow parity clauses replicate the effect of wide parity clauses
    - A negative impact as they now had narrow parity clauses where previously they had no parity clauses
  - Views of DCTs were mixed

Wide parity - other findings

- During the market study, we found further evidence of the use of wide parity clauses

- Launched a case under Chapter I of the Competition Act 1998 and Article 101 of the Treaty on the Functioning of the EU into the use of wide parity clauses in home insurance (ongoing)

Narrow parity – assessment

Competition & Markets Authority

- Narrow parity clauses can only replicate wide parity clauses if suppliers are **unwilling to undercut their direct channel**
- That is, the supplier must treat the direct price as a price floor across sales channels
- We found that this was only the case for suppliers accounting for a small proportion of sales (13% to 18%) made through DCTs in car insurance

Narrow parity – assessment

- Stronger concerns about the weakening of the competitive pressure from the direct channel if a DCT is not facing constraints from other DCTs or other channels

- Our evidence suggested that in car insurance DCTs face competitive pressure from other DCTs (eg customer shopping behaviour)

- This may not be the case in every sector

Conclusions

- We still have concerns that wide parity clauses soften competition and this was further supported by our econometrics

- In certain conditions narrow parity clauses may lead to harm, but these conditions do not appear to be present in car insurance

公正取引委員会
Japan Fair Trade Commission

Investigation of Parity Clauses in Japan

Isao KASUBUCHI (Mr.)
Director General for Trade Practices Department
Japan Fair Trade Commission
ICN Unilateral Conduct WS, 1 Dec, 2017 in Rome, Italy

The views expressed in this presentation are solely those of the author and do not necessarily reflect the views of the JFTC.

Contents

1. Competitive effects of parity clauses (in general)

Anti-competitive effect

(1) Reduction of incentive to reduce prices

(2) foreclosure of rivals/ new entrants

(3) Facilitation of concerted practice

Pro-competitive effect

(1) Prevension of "free-riding"

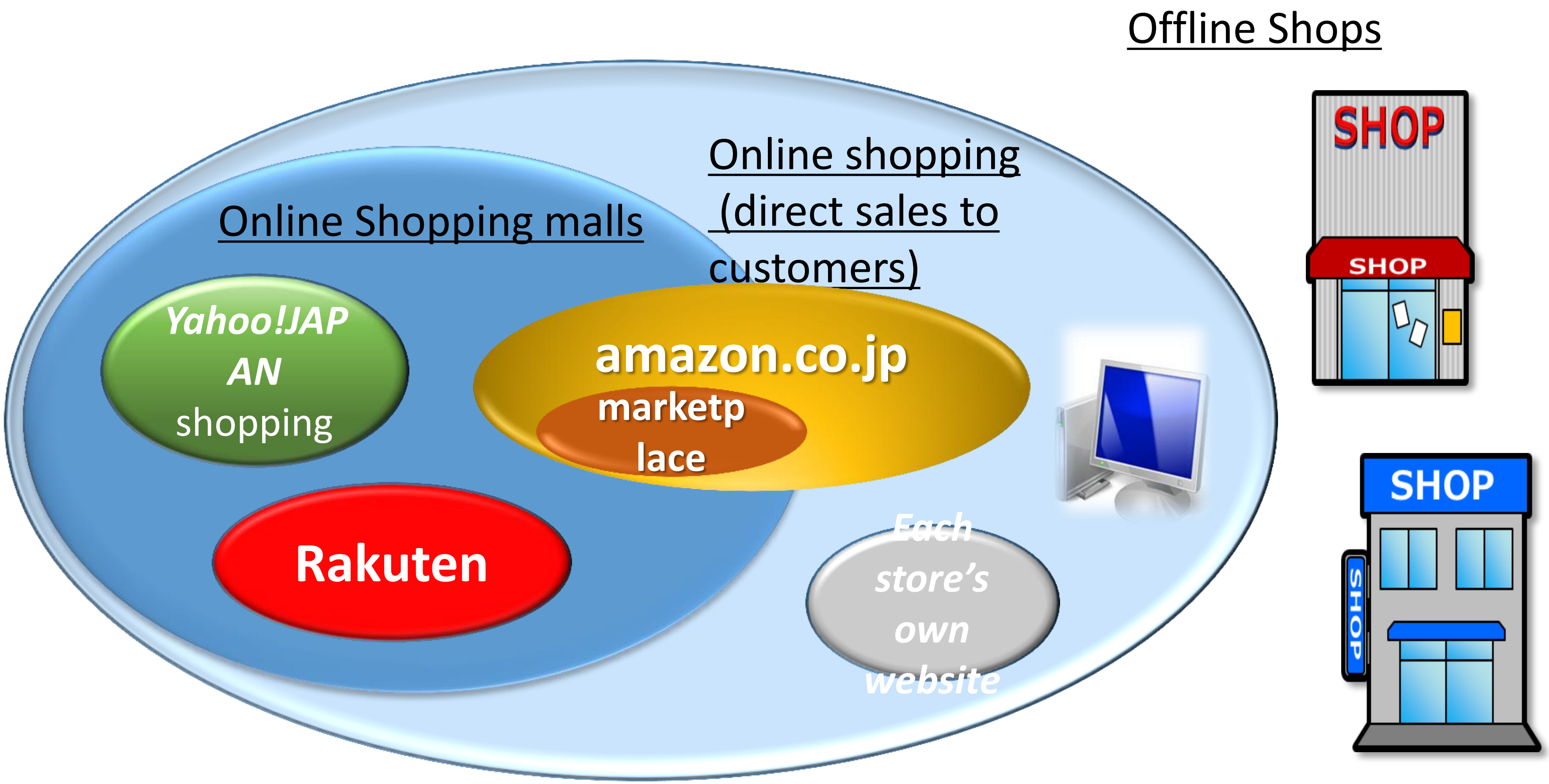
(2) Reduction of transaction cost

2. Investigation against Amazon Japan G.K.
(1)Flow of the investigation

Investigation of parity clauses in Amazon Marketplace

- August 2016: the JFTC conducted a dawn raid on Amazon Japan G.K. (hereinafter called “Amazon JP”) to investigate its price parity clauses and selection parity clauses in the seller contracts on Amazon Marketplace.
  - Relevant article : Article 19 (paragraph 12 [trading on restrictive terms]) of Japanese Anti-monopoly Act.
- April 2017: Amazon JP proposed to take voluntary measures.
- June 2017: The JFTC recognized these measures would eliminate the suspected violation and decided to close the investigation on this case.

2.(2)Online shopping Mall Market in Japan



2.(3) Parity Clauses in the Seller Contracts on Amazon Marketplace

Price Parity Clauses

- → Clauses to require sellers to ensure that prices and sales terms for products they sell in Amazon Marketplace are the most advantageous for purchasers among the ones for the identical products they sell via other sales channels

Wide Parity Clauses

Selection Parity Clauses

- → Clauses to require sellers to offer in Amazon Marketplace all variations in color and size, etc. of all products they sell via other sales channels.

Seller S

Selection parity clauses

Lineup N_A of goods that Seller S offers in Online Shopping Mall A must be equal to or exceed N_B and N_S.
($N_A \geqq N_B$ and $N_A \geqq N_S$)

Price parity clauses

Selection parity clauses

Seller S sells goods on its own website and also sells goods in Online Shopping Malls A and B by concluding seller contracts with these malls. Thus, Seller S sells goods through three sales channels.

Offering N_A types of goods

1 2 … N_A

Online Shopping Mall A

Offering N_B types of goods

1 2 … N_B

Online Shopping Mall B

Offering N_S types of goods

1 2 … N_S

S's Own Website

Price parity clauses

Price P_A for which Seller S sells Product 1 in Online Shopping Mall A must be equal to or lower than P_B and P_S.
($P_A \leqq P_B$ and $P_A \leqq P_S$)

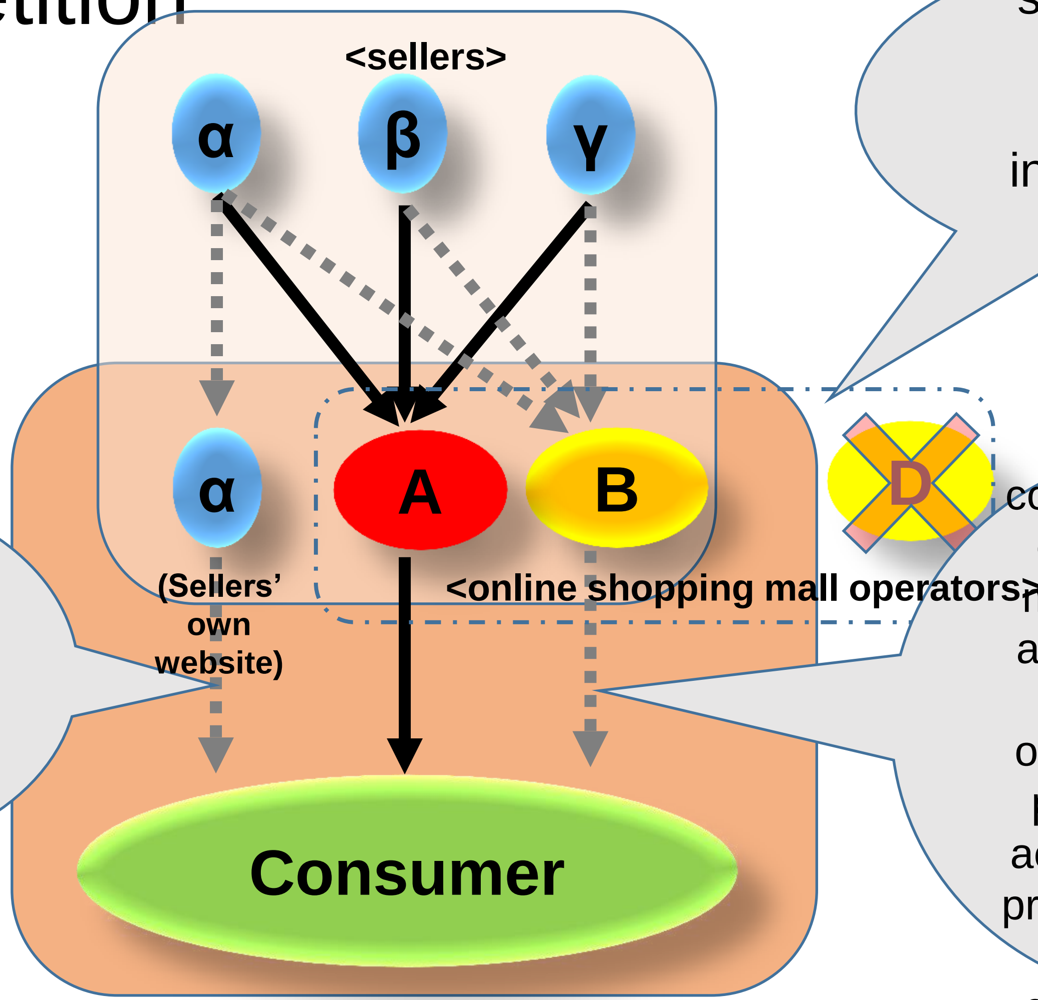
Selling Product 1 for Price P_A

Selling Product 1 for Price P_B

Selling Product 1 for Price P_S

Consumers (Purchasers)

2.(4)The JFTC's concerns over the Influence of the Parity Clauses on Competition



1) limiting reduction of prices and expansions of lineups that the sellers sell via other channels (such asα, B).

2) distort competition among online shopping mall operators by allowing an online shopping mall operator imposing parity clauses to achieve the lowest price/ richest lineup without making competitive effort

3) reduce online shopping mall operators incentive for innovation and hinder new entrants.

2.(5)Measures Proposed by Amazon Japan G.K.

- Measures proposed by Amazon JP (summary)
  - Amazon JP will delete the price parity clauses from concluded seller contracts, or will waive and will not exercise the rights of the price parity and selection parity clauses.
  - It will not provide those parity clauses in seller contracts.
  - Amazon JP will notify all sellers of these measures.
  - Amazon JP will annually report the implementation

The JFTC recognized that these measures would eliminate the suspected violation of the Antimonopoly Act and decided to close the investigation on this case.

3. Subsequent event

<Report on e-Books Agreements from Amazon Services International, Inc.>

- On June 2017, the JFTC received a report from Amazon Services International, Inc. that they would take voluntary measures on the parity clauses contained in the agreements with publishers or distributors regarding the e-books delivered from Amazon.co.jp website.

  <summery of the measures>

  - It will not enforce the contractual obligations of publishers, etc. regarding the parity clauses.
  - It will notify publishers, etc. of the measures it took.
  - It will not provide the parity clauses in e-books agreements.
  - It will have taken those measures for at least five years.

- The JFTC recognized these measures would eliminate the anticompetitive concerns. Additionally, the JFTC requested to have sufficient consultation with publishers and distributors when it intends to alter other clauses as a result of taking the measures.

4. Challenges/ issues

- Factors to be considered to prove the anticompetitive effects of the parity clauses used in online marketplaces

- Effective investigation methods when there are a number of sellers in a transaction with the target company

- Appropriate remedies to address parity clauses

Thank you very much!!!

ICN Unilateral Conduct Workshop
1 December 2017
Rome

ASSESSING PRICE PARITY AGREEMENTS

THE ITALIAN EXPERIENCE IN THE BOOKING/EXPEDIA CASE

Plenary Session #4

Andrea Pezzoli
Director General for Competition
Italian Competition Authority

The views expressed here are personal and do not necessarily reflect those of the Italian Competition Authority

The Booking and Expedia case - timeline

- **May 2014:** investigation opened to ascertain a violation of art. 101 of TFEU against Booking.com and Expedia
  - **Complaints:** Italian Hotels Federation contested the use of price (and others conditions) parity clauses in contracts stipulated between the main online travel agencies (OTAs) and their hotel partners
- **December 2014**: Booking.com submitted a preliminary commitment package
  - **Market testing**
- **April 2015:** closed investigation on Booking.com with a commitment decision
- **March 2016:** closed investigation on Expedia which voluntary had modified its contract clauses in line with Booking.com commitments

Theory of harm

- The **main competition concern** for the Authority was that these parity clauses restricting the vertical relationships between the two OTAs and their hotel partners would have effects on the horizontal dimension, i.e.:
  - competition among OTAs
  - and more generally among all sales channels.

- In particular, these parity clauses could have the potential to substantially **restrict competition**:
  - on the retail price (and other conditions offered to final users) within the OTA channel and across the other sales channels, both online and offline, direct and indirect (e.g., hotels' own websites, traditional travel agencies);
  - on commission fees requested by the OTAs to their hotel partners: in presence of parity clauses, an OTA has no incentives to offer lower fees as these lower costs for the hotels cannot be translated in lower room rates offered on its platform due to the parity obligation.

- In addition, the clauses could **foreclose the market**, preventing entry of new OTAs.

Relevant market

- **Relevant product market.** The ICA considered that the relevant market for the assessment of the parity clauses is the market for online hotel booking services, distinct from the market for offline hotel booking services.

- **Relevant geographic market.** As for the geographic dimension, the market was considered national given that Booking and Expedia operate with country specific websites and differentiate their commission fees based on the national borders.

- In 2013 online hotel booking through OTAs represented nearly 70% of the online channel (in terms of turnover of hotels), and [25-30]% of total hotel reservations. Room booking at the hotels website represents only [5-15]% of total hotel reservations.

Commitments 1 & 2: OTAs

- **Commitment 1)** – No Price Parity / Conditions Parity on OTAS:
- **Commitment 2)** – No Room Availability Parity on OTAs

- Commitments 1) and 2) above are expected to
  - significantly increase competition between Booking and other OTAs in the online segment compared to the ex-ante situation
  - improve competition between OTAs on the level of commission fees they request to hotels
  - to limit foreclosure on new OTAs

Market facts: *in 2013 OTAs represented nearly 70% of the online booking segment. Within this segment, market shares are: Booking [60-65%], Expedia, [5-10]%, HRS [1-5]% and hotels websites [25-30]%.*

Commitment 3: offline sales channels

- **Commitment 3) - offline channels:** allowing accommodations to offer equal or better conditions on offline channels than those offered on Booking.com, provided that these conditions are not published online or marketed online (i.e., they are aimed at the general public)
- This commitment reflects the concern expressed during the market test that the parity clauses had the effect of restricting competition also with regards to offline sales channels.
- This commitment is expected to provide hotels with the ability to use offline distribution channels in such a way to be more competitive against Booking.com and other OTAs.

- ***Market facts***: *the offline channel represents [60-70]% of all hotel reservations*

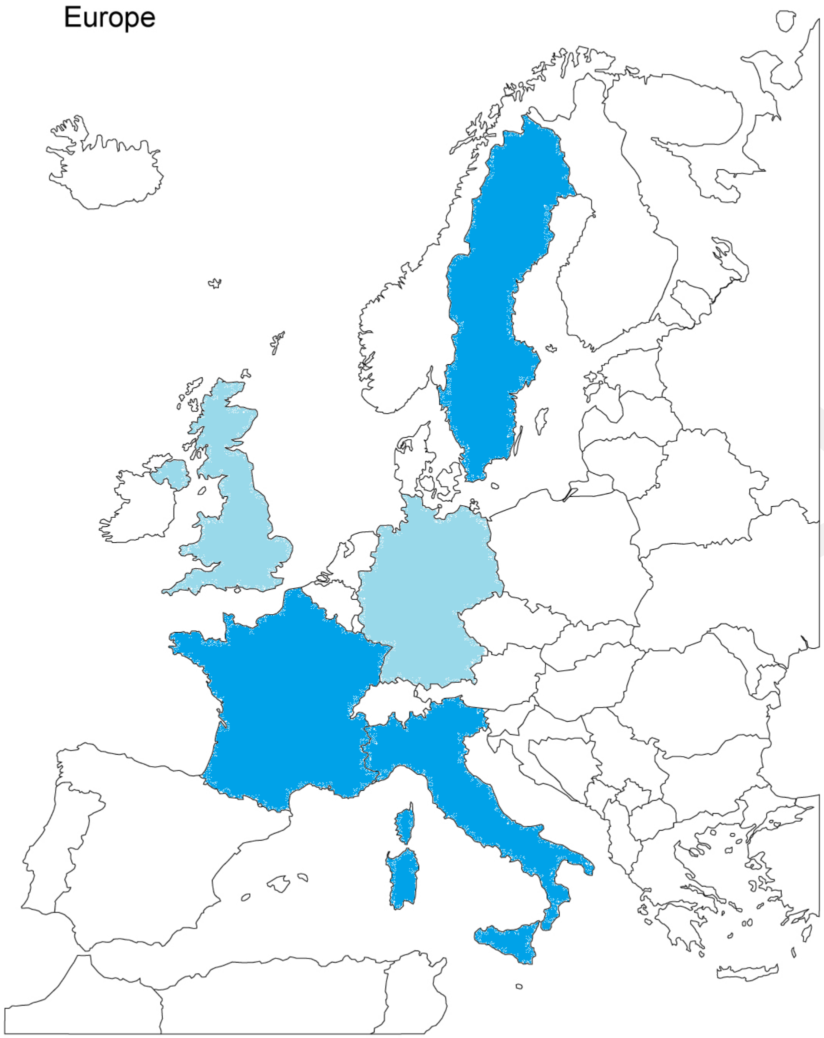
Commitment 4: hotel direct sales

- **Commitment 4) hotel direct sales.** Booking may prevent its hotel partners from offering better conditions provided that they are made available online to the general public (so called **“narrow” MFN clause**).
  - In the preliminary commitment package of Booking.com this clause applied to all hotels offers with the exception of those to prior clients/closed user group
  - In its final version, the parity clause has been amended so that it applies only on deals offered through their own websites to the public at large

- **Striking a balance** between two legitimate interests hinges on the definition of extent of the application of the parity clauses
  - Promotion of direct sales channel
  - Protecting investment of the platforms

***Market facts**: hotel website channel represents only [5-15]% of total (online and offline) hotel reservations and [25-35]% of the sales made via the online channel. Fragmented sector: 85% of hotels are small and independent, large chain hotels only the 6%.*

International cooperation



- Cooperation between Italy, France and Sweden (■)
- Previous cases in Germany and the UK (■)

Conclusions & Challenges

- The Italian Competition Authority considers that the legal, investigative and analytical tools at its disposal allow it to deal effectively with the assessment of clauses such as APPAs.
- The economic framework used to assess the competitive effects of (price and non-price) vertical restraints in offline markets is fully appropriate for assessing vertical restraints in online markets.
- The assessment in individual cases must be carried out by confronting the possible economic justifications and the theories of harm that are applicable and by assessing to what extent the available evidence supports each of them.
- Challenges:
  - Market definition
  - Efficiency justifications
  - Timing and risks of intervention
  - Cross border dimension