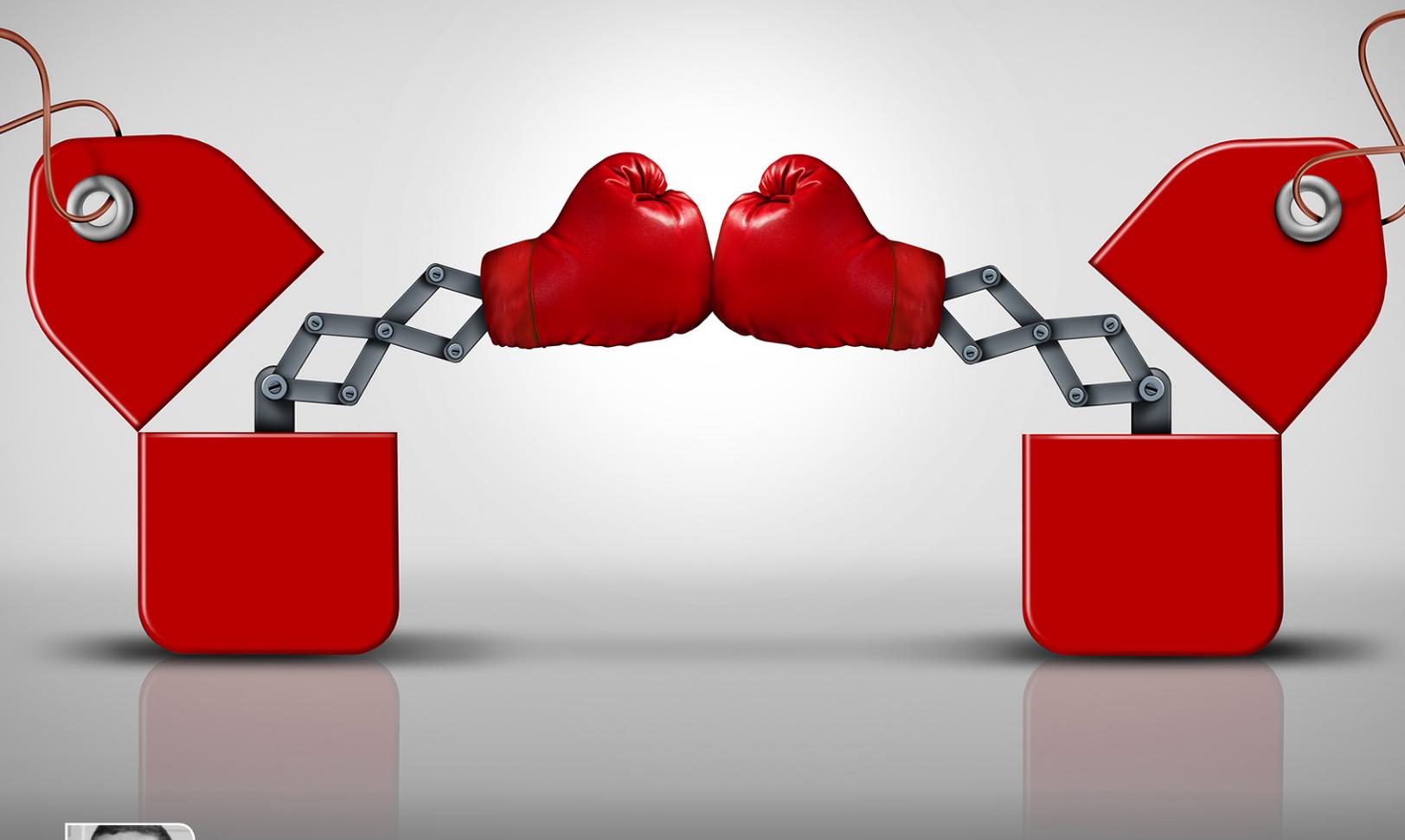


# ARE PRICE PARITY CLAUSES NECESSARILY ANTICOMPETITIVE?



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## I. INTRODUCTION

Price parity clauses, also referred to as retail most-favored nation clauses, have recently triggered several antitrust investigations, almost all of them in markets involving intermediation platforms and agency business models (i.e. where suppliers keep control of final prices). Such clauses are frequently imposed to suppliers by intermediation platforms, each platform attempting to guarantee the best available price for a given product to its final consumers.

Price parity clauses were considered about five years ago during the investigations against Apple and leading publishers in Europe and in the U.S., but the main focus was on explicit anticompetitive agreements between Apple and six large publishers.<sup>2</sup> In May 2017, the European Commission accepted commitments from Amazon to abandon price parity clauses.<sup>3</sup> During this investigation, started in 2015, “the Commission considered that such clauses could make it more difficult for other e-book platforms to compete with Amazon by reducing publishers’ and competitors’ ability and incentives to develop new and innovative e-books and alternative distribution services” (*European Commission Press Release, May 4, 2017*)

A few years before, Amazon had already been the subject of antitrust investigations by the UK Office of Fair Trading (“OFT”) and the German Bundeskartellamt (“BKartA”), but the cases were dropped in 2013 after Amazon announced its plan to abandon the price restrictions on Amazon Marketplace across the EU. In September 2014, the UK Competition and Markets Authority (“CMA”) ended its investigation of private motor insurance concluding that wide price parity clauses imposed by price comparison websites (“PCWs”) were likely to harm consumers (although the CMA did not identify any antitrust violation) and ordering a ban on such clauses that apply across the board, though allowing narrow price parity, a practice that guarantees a PCW not be undercut by a supplier’s direct distribution channel.<sup>4</sup>

Similar issues have been debated in cases against payment card systems in the U.S., Europe and many other jurisdictions, regarding the no surcharge rule that prevents merchants from charging a higher price for card payments than for cash payments.<sup>5</sup>

Although price parity clauses have been the subject of investigation in relation to various markets, the online booking market is probably the sector that has concentrated most of the cases with possibly conflicting outcomes in different jurisdictions.<sup>6</sup> Investigations started a few years ago in the UK and Germany.

In December 2013, the BKartA reached a decision against HRS, a leading online travel agency (“OTA”) on the German market, and prohibited its price parity clauses.<sup>7</sup> In December 2015, it reached a similar decision against Booking.com and an investigation of Expedia is ongoing.<sup>8</sup>

<sup>2</sup> See the European Commission’s decisions in Case COMP/39847/*E-Books* (2012, 2013) and *United States v. Apple Inc.*, 952 F. Supp. 2d 638, 15 647 (S.D.N.Y. 2013).

<sup>3</sup> See the European Commission’s decision in Case COMP/40153/*E-Books MFNs and related matters* (May 4, 2017).

<sup>4</sup> See the CMA’s final report and notice of order on the Private motor insurance market investigation respectively published on September 24, 2014 and March 18, 2015, both available at: <https://www.gov.uk/cma-cases/private-motor-insurance-market-investigation>.

<sup>5</sup> As part of settlements with the US Department of Justice, Visa, Mastercard and American Express have all accepted to stop imposing any no-surcharge rule.

<sup>6</sup> For a detailed description of the cases, see Hviid (2015), “Vertical Agreements Between Suppliers and Retailers That Specify a Relative Price Relationship Between Competing Products or Competing Retailers,” paper prepared for the OECD Competition Committee Hearing on Across Platform Price Parity Agreements; and, González-Díaz & Bennett (2015), “The law and economics of most-favoured nation clauses,” *Competition Law & Policy Debate*, 1(3), pp. 26-42.

<sup>7</sup> Bundeskartellamt, *Hotel Reservation Service (HRS)*, Case B 9-66/10. This decision was later confirmed by the Düsseldorf Higher Regional Court [Düsseldorf Higher Regional Court (OLG), VI - Kart. 1/14 (V)].

<sup>8</sup> Bundeskartellamt, *Booking*, Case B 9-121/13.

In a parallel investigation, the OFT accepted, in January 2014, commitments offered by Booking.com, Expedia and Intercontinental Hotels Group. The OFT's focus was not directly on the price parity clauses but rather on the platforms' ability to offer discounts to final consumers (by giving back part of their commission). The accepted commitments thus concentrated on the platforms' ability to offer rebates to "closed consumer groups" rather than on banning best price clauses. This later led the UK Competition Appeals Tribunal to overturn the decision, but, in September 2015, the CMA (in charge of launching a new investigation) dropped the case although it "committed to 12 months of on-going monitoring of market developments."<sup>9</sup>

Several EU countries later started investigations and, in April 2015, the French, Italian and Swedish competition agencies simultaneously accepted commitments offered by Booking.com that included a switch from wide to narrow price parity clauses.<sup>10</sup> Booking.com unilaterally extended those commitments to the other European Economic Area Member States, and Expedia soon followed suit. The Swiss Competition Commission (October 2015) and the Australian Competition and Consumer Commission (September 2016) also "banned" (through formal prohibition or commitments) wide price parity clauses but allowed narrow clauses.<sup>11</sup>

Yet, it did not all end there. During the summer 2015, the French parliament voted to prohibit any form of price parity (or control by the platforms) for hotel room bookings. They were soon followed by their Austrian (January 2016) and Italian (August 2017) colleagues.

In the U.S., antitrust agencies did not intervene, and, in February 2014, the District Court of the Northern District of Texas decided against plaintiffs in a class action against hotel chains and OTAs.<sup>12</sup>

What is striking from these various cases, is that despite reaching different conclusions – some agencies or governments choosing to ban all kinds of price parity clauses (Germany, France, Austria, Italy), while others only required a switch from wide to narrow price parity only (other EU countries, Switzerland, Australia) – they all relied on a relatively similar theory of harm. The common view is that price parity clauses limit competition between platforms on commission rates, ultimately leading to higher prices being charged to consumers. When wide price parity clauses are used by platforms, a supplier has to set the same price on all of them as well as on its direct distribution channel. In this case, each platform has an incentive to increase its commission above the "competitive" level since it does not risk losing market share to its rivals. This ultimately leads to supra-competitive commissions being charged by platforms and thus to higher prices being charged by suppliers to final consumers. As we will see in what follows, the validity of such a theory of harm relies on the implicit assumption that suppliers cannot avoid being listed on all platforms.

The differences in approaches – regarding the final outcome – may be explained by variations in market structure in different geographic markets, but they may also reflect the fact that economists have not yet reached a consensus on the competitive effects of such price parity clauses.

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<sup>9</sup> OFT 1514dec; [2014] CAT 16; CMA decision (September 16, 2015) to close the case CE/9320-10.

<sup>10</sup> Autorité de la concurrence, Case 15-D-06; Konkurrensvetket, Case 596/2013 ; Autorità Garante della Concorrenza e del Mercato, Case I779 B.

<sup>11</sup> Competition Commission (COMCO/WEKO), *Online-Booking Platforms for Hotels*, Decision of October 19, 2015; ACCC media release MR 158/16 (September 2, 2016), available at: <https://www.accc.gov.au/media-release/expedia-and-bookingcom-agree-to-reinvigorate-price-competition-by-amending-contracts-with-australian-hotels>.

<sup>12</sup> *In re Online Travel Company (OTC) Hotel Booking Antitrust Litigation*, Case No. 3:12-cv-3515-B (N.D. Tex., Feb. 18, 2014).

## II. ACADEMIC RESEARCH: NO CONSENSUS YET

### A. Theoretical Analysis

Although there exists a large body of literature on the effects of wholesale MFN clauses, the academic research on the competitive effects of platform price parity clauses is still relatively scarce. The earlier papers, inspired by the *EBooks* cases, have focused on the impact of a switch from the traditional retailer model (where platforms such as Amazon acquired e-books from the publishers at a negotiated wholesale price and were then setting prices charged to final consumers on their platforms) to the agency model (where publishers keep control of the final prices and pay commissions to platforms for all sales). In a setting where consumers first acquire a device such as a reading tablet or mobile phone before prices for books or mobile applications are set, Gans (2012) showed that a price parity clause could help solve a hold-up problem and thus be welfare-enhancing.<sup>13</sup> Focusing on the choice of business format (retail or agency model) by platforms, Foros, Kind and Shaffer (2016) show that even if commission rates do not change (for exogenous reasons) when price parity clauses are introduced, such clauses may facilitate the adoption of the agency model which, in turn, may lead to higher consumer prices.<sup>14</sup>

The literature focusing on the effects of price parity clauses in the agency model has approached the issue of price parity clauses from two different angles.

A first strand of papers focuses on more traditional vertical relationships models, with suppliers competing on the downstream market and buying intermediation services from the platforms (platforms thus compete on the upstream market to provide services to the downstream firms). Platforms are usually assumed to have all the bargaining power *vis-à-vis* suppliers and thus setting commissions (or commission rates) through take-it-or-leave-it offers. Suppliers then decide which distribution channels to use and set prices charged to final consumers. Boik and Corts (2016) consider a simple framework in which two (differentiated) platforms compete to offer intermediation services to a monopolist supplier. Assuming that the supplier is constrained to sell through both platforms if it decides to be active on the final market, they show that price parity clauses soften competition between intermediaries and thus increase the prices charged to final consumers.<sup>15</sup> In addition, such clauses also reduce the incentives for low-cost platforms to enter the market. In an earlier version of his paper, Johnson (2017) extended this result to multiple suppliers and any number of platforms.<sup>16</sup> In both papers, the intuition for this anticompetitive effect of price parity clauses is identical to the theory of harm put forward by competition agencies in the European cases on hotels booking platforms.

Johansen and Vergé (2017) extend the earlier models allowing suppliers to compete with the platforms to attract final consumers (i.e. direct sales) and to select whether to be active on platforms or not.<sup>17</sup> Once these two important features are added to the model, they show that price parity clauses are not always harmful to suppliers and consumers. When suppliers are sufficiently close substitutes, price parity clauses may indeed lower commissions as suppliers would otherwise be tempted to delist from an expensive platform to become more competitive (and thus substantially increase their market share) in the remaining channels. However this result only holds when direct distribution is a sufficiently good substitute for intermediation platforms otherwise the threat of delisting would not be effective.<sup>18</sup>

Pure vertical relationship models do not account for some important features of online intermediation platforms: for instance, these platforms help consumers to find the best product and offer additional services or benefits on which suppliers could attempt to free-ride by letting consumers search on the platforms and then attempting to divert them to their direct distribution channels.

<sup>13</sup> Gans (2012), "Mobile Application Pricing," *Information Economics and Policy*, 24, pp. 52-59.

<sup>14</sup> Foros, Jarle Kind & Shaffer (2016), "Apple's Agency Model and the Role of Most-Favored Nation Clauses," *Rand Journal of Economics*, 48(3), pp. 673-703.

<sup>15</sup> Boik & Corts (2016), "The Effects of Platform Most Favored-Nation Clauses on Competition and Entry," *Journal of Law and Economics*, 59, pp. 105-134.

<sup>16</sup> Johnson (2017), "The Agency Model and MFN Clauses," *Review of Economic Studies*, 84(3), pp. 1151-1185.

<sup>17</sup> Johansen & Vergé (2017), "Platform Price Parity Clauses with Direct Sales," *University of Bergen Working Paper 01/17*.

<sup>18</sup> See also Rey & Vergé (2016) who show that price parity clauses have no impact on marginal commission rates when commissions can be non-linear (for instance including a fixed component and a constant price per sale). In this case, the only impact of price parity clauses is to lead to uniform prices [Rey & Vergé (2016), "Secret Contracting in Multilateral Relations," *TSE Working Paper n°16-695*].

A second strand of literature tries to incorporate such features in the models. Wismer (2013) – in a model inspired by the no-discrimination rule sometimes imposed for credit cards – introduces a simple model in which consumers start searching for the best supplier on one distribution channel (the “monopolist” platform or the sellers’ direct distribution channels) and then observe all available prices for their selected product.<sup>19</sup> In this setting, he shows that price parity clauses do not necessarily lead to an inefficient allocation of sales across channels and their impact will actually depend on different parameters including the magnitude of the cost faced by consumers to switch channels.

Introducing a risk of showrooming (i.e. the possibility to attract consumers who search on the platform by offering lower prices in the direct distribution channels), Wang and Wright (2017) consider how price parity clauses may help prevent showrooming, thus guaranteeing the platforms’ economic viability.<sup>20</sup> However, consumers do not necessarily benefit from the reduced search cost on the intermediation platforms since this surplus can be fully extracted by the platform through higher commissions.<sup>21</sup> With competing platforms, wide price parity clauses remains harmful for consumers but they may benefit from narrow price parity clauses. Wang and Wright (2016) extend the previous model to allow for platform investment and show that all the benefits generated by increased investment can again be extracted through commissions and thus do not necessarily benefit to final consumers. Investment may also be excessive (leading to too high prices on the final market) when price parity is in place, a point also made by Edelman and Wright (2015).<sup>22</sup>

## B. Empirical Evaluations

Since the theoretical models are not conclusive and suggest that the effects of price parity clauses on consumer surplus or suppliers’ profits may be ambiguous, economists have tried to empirically evaluate their effects. Some of them have tried to take advantage of the recent investigations in the hotel cases to collect data before the decisions where effective to propose before-and-after analysis or even difference-in-differences approaches.

Two recent academic papers use price data scrapped from metasearch sites such as Kayak or Trivago. Hunold et al. (2017) evaluate the effect of price parity clauses on price dispersion and on the frequency with which one platform (namely Booking.com) exhibits the lowest price.<sup>23</sup> However, their empirical evaluations have so far focused more on price dispersion than on price levels or on commission levels, thus the common theory of harm has not yet been directly tested. According to Mantovani, Piga and Reggiani (2017), the evidence suggests that hotel prices decreased in 2015 (the year Booking.com’s commitments were accepted) but bounced back in 2016.<sup>24</sup> But the analysis is focused on one-night bookings in the touristic islands of Sardinia, Sicily, Corsica and the Balearic Islands where one can presume that consumers stay for more than one night. Moreover, the commitments only entered into force in July 2015, thus 2015 prices combined before and after prices. It is thus quite difficult to draw any conclusion on the effects of price parity clauses from their analysis.

European competition agencies have also tried to carry out empirical evaluations of the effects of price parity clauses. But once again, the focus has been on price dispersion rather than on price levels when it may have been easier for them to collect the relevant data (on commissions) to directly evaluate the validity of their common theory of harm. If anything the results of their evaluation suggest that the ban of wide price parity clauses in most EU countries (and of all price parity clauses in Germany and France) has not been very effective. In a press release that followed the publication of its interim assessment of the commitments offered by Booking.com, the French *Autorité de la concurrence* concluded that:

19 Wismer (2013), “Intermediated vs. Direct Sales and a No-Discrimination Rule,” *Working Papers 131, Bavarian Graduate Program in Economics*.

20 Wang & Wright (2017), “Search platforms: showrooming and price parity clauses,” mimeo.

21 Ronayne (2015) makes a similar point showing that price comparison websites may not necessarily increase consumer surplus as they can extract the surplus they generate through the commissions charged to participating sellers [Ronayne (2015), “Price Comparison Websites,” mimeo].

22 Wang, Chengsi & Wright (2016), “Platform investment and price parity clauses,” mimeo; Edelman & Wright (2015), “Price Coherence and Excessive Intermediation,” *Quarterly Journal of Economics*, 130, pp. 1283-1328.

23 Hunold, Kessler, Laitenberger & Schlütter (2017), “Evaluation of best price clauses in hotel booking,” mimeo (earlier version published as *ZEW Discussion Paper n°16-066*).

24 Mantovani, Piga & Reggiani (2017), “The Dynamics of Online Hotel Prices and the EU Booking.com Case,” *NET Institute Working Paper #17-04*.

The assessment results held by the Autorité may suggest that more hoteliers are now varying their prices according to the online hotel booking platforms. This price difference is evidence of an initial change in the sector, though without any visible sign of increased competition among OTAs, based on other more qualitative or quantitative criteria (market share, quality of the offering, change in commission rates).<sup>25</sup>

The European Competition Network (“ECN”) working group similarly concluded that:

Very few hotels said that they engaged in trade-offs whereby they grant OTAs more favourable room prices or room availability in return for a lower commission rate. (...) According to evidence obtained from certain OTAs, the average effective rates of commission paid by hotels (basic commission plus optional additional commission) remained relatively stable or slightly decreased in almost all participating Member States in the period from January 2014 to June 2016. This was also true for France and Germany.<sup>26</sup>

Only one attempt has been made to look directly at the effect of price parity clauses on commissions. In March 2015, after a two-year market investigation, the CMA decided to prevent price comparison websites from using wide price parity clauses in their relationships with private motor insurance providers.<sup>27</sup> In September 2017, the CMA ended its market study on Digital comparison tools during which it carried out an econometric analysis of the commissions charged by price comparison websites to private motor insurance providers between 2010 and 2016.<sup>28</sup> In this report, the CMA concludes that the removal of wide price parity clauses by the leading price comparison websites led to a decrease of about three percent of the commissions charged to insurance providers. One may nevertheless worry about the source of variation in the commissions over time since the ban on wide parity only came into force after March 2015 and the post-order data covers a very short period.

### III. WHAT CAN WE CONCLUDE AT THIS STAGE?

Despite the number of cases over recent years, no consensus has been reached by competition agencies on the competitive effects of price parity clauses: there seems to be a consensus among European agencies (and maybe some others) that wide price parity clauses restrict competition between platforms on commissions’ rates and may also prevent entry by innovative low-cost platforms. However, even within the ECN, agencies seem to disagree on the effect of narrow price parity clauses.

In a similar way, no consensus has been reached among economists who proposed potentially conflicting theoretical results. Moreover, there is still a lack of satisfactory empirical evidence on the effects of price parity clauses (and possibly on the differences between wide and narrow price parity).

Although more work needs to be done by academics and competition agencies to better understand the role of different factors (competition between platforms and/or suppliers, importance of direct sales, etc.) that may affect the commissions negotiated between platforms and suppliers with and without price parity, we can still draw some insights from the existing body of theoretical literature.

One important factor that affects the theoretical effects of price parity clauses on commission rates seems to be the ability of suppliers to threaten platforms to delist in case the commissions are considered to be too high. The credibility of such a threat will indeed affect the platforms’ ability to raise commission rates (especially when price parity clauses are imposed by several large platforms) above the competitive level. Therefore, price parity clauses are unlikely (or much less likely) to have adverse effects on commission rates – and thus on prices paid by final consumers – when suppliers can reasonably be expected to delist from a platform which would try to charge “excessive” commissions. Whether suppliers can credibly threaten to delist from a platform depends on their ability to divert the lost sales towards more profitable distribution channels and especially towards direct sales.

<sup>25</sup> *Autorité de la concurrence*, Press release dated February 9, 2017, *Hotel booking platforms*. Available at: [http://www.autoritedelaconcurrence.fr/user/standard.php?id\\_rub=663&id\\_article=2945&lang=en](http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=663&id_article=2945&lang=en).

<sup>26</sup> ECN working group (2017), *Report on the Monitoring Exercise Carried Out in the Online Booking Sector by EU Competition Authorities in 2016*, September 2017.

<sup>27</sup> See the CMA’s final report and notice of order on the *Private motor insurance market investigation* respectively published on September 24, 2014 and March 18, 2015, both available at: <https://www.gov.uk/cma-cases/private-motor-insurance-market-investigation>.

<sup>28</sup> See Appendix 2: DCT Commissions and wide MFNs (Econometric Analysis) of Part E of the CMA’s final report on the *Digital comparison tool market study* published on September 26, 2017, available at: <https://www.gov.uk/cma-cases/digital-comparison-tools-market-study>.

For instance, one may well believe that it would be difficult for small suppliers that cannot rely on a well-known brand to threaten to leave a large marketplace such as Amazon. This thus suggests that a price parity clause imposed by Amazon to small suppliers may indeed have the potential to harm suppliers and final consumers. On the contrary, large insurance companies may find it much less costly not to be active on a price comparison website that would charge commissions that are too high. Therefore, one should expect price parity clauses to be less likely to lead to higher commissions and higher prices in this market.

Similarly, on the hotel booking platforms market, the effects of price parity clauses may well depend on the structure of the hotel market and on the role played by metasearch platforms such as Trivago, Tripadvisor or Kayak. Small independent hotels that rely on large platforms such as Booking or Expedia to attract consumers are less likely to delist from one of the platforms than large hotel chains that can use their well-known brand names (and own websites/booking platforms) to generate room bookings.

In 2012, several major hotels chains in Norway (First, Nordic Choice, Rica, Scandic and Thon) decided to leave Expedia's program and to instead promote their own websites.<sup>29</sup> After a rather lengthy "boycott," some of the chains restarted listing on Expedia in 2014, having renegotiated the commission rates charged by Expedia as well as price parity clauses imposed by the platform.<sup>30</sup> More recently, the U.S. hotel chain Hyatt considered ending its agreement with Expedia if they could not obtain "more reasonable and competitive commissions as well as improved flexibility on the OTA portals."<sup>31</sup> A few weeks later, in August 2017, Hyatt confirmed that it signed a new contract with Expedia. Hyatt's spokesperson was quoted saying that "[t]hese recent agreements with both Booking.com and Expedia allow us to achieve our goal of making Hyatt hotels available where many guests are booking while also reducing costs and improving flexibility," suggesting that they had managed to negotiate better terms with the two leading platforms.<sup>32</sup>

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29 <http://www.newsinenglish.no/2012/12/06/hotels-check-out-of-internet-giant/>.

30 <http://www.newsinenglish.no/2013/10/07/hotel-chains-cut-new-deals-with-online-giant/>.

31 <https://www.tourism-review.com/large-hotel-chain-to-leave-expedia-news5440>.

32 <https://skift.com/2017/08/18/hyatt-and-expedia-formally-sign-new-deal/>.

