



## DYNAMIC PRICING IN AVIATION INDUSTRY AND ROLE OF COMPETITION COMMISSION OF INDIA \*

### INTRODUCTION

Competition law has witnessed its colossal growth in recent years only, especially since the period of liberalisation. The growth has been both in terms of geographical regions as well as in the field of economics activities which are now subject to competition law. As an increasing number of countries have undertaken economic reforms and embraced the market economy, many of them have also introduced competition law to maintain competition in the respective markets. Many economic activities which were earlier either state monopolies or natural monopolies and were shielded from competition are now subject to competition law. Likewise, many other fields such as medicine and law have also come under the ambit of competition law.

Competition has been defined as a situation in a market in which firms and sellers independently strive for buyer's patronage in order to achieve a particular business objective, for example profits, shares or market value.<sup>1</sup> There are certain essential features of pure competition. These characteristics are listed below:

- Large number of sellers acting independently
- A homogenous or perfectly uniform product
- Freedom of entry of new firms

Thus, it can be stated that competition is a market condition in which the seller has no control or influence over the price. If the price is influenced by reason of agreement between enterprises or concerted practice, such agreement is said to be adverse effect of competition in India. In many relevant cases like *Tata Engg.* case<sup>2</sup>, *Mahindra* case<sup>3</sup> it has been stated that competition must be looked at from the view point of commercial interest and agreements must be evaluated from the perspective of the market in order to establish their adverse effect on competition. One of the major functions of competition is to keep the prices down to the lowest possible level. That competition is avoided by competitors cooperating in arresting fall to competition level and thus fixing the prices. The co-operation in that regards is per se anti-competitive, the element of price fixing may occur at any level of production and distribution process. It may be in form of agreement relating to price computations, drawing up of price lists, variations therefore or exchange of information. It may be a part of larger collusive agreement such as collusive

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<sup>1</sup>World bank 1999

<sup>2</sup>*Tata Engg. & Locomotive Company Ltd. v. Registrar of Restrictive Trade Agreement, (1977) 2 SCC 5*

<sup>3</sup>*Mahindra & Mahindra Ltd. v. Union of India, (1979) 2 SCC 529*

tendering, market or customer allocation, sales and production quotas. Price fixing conspiracy may consist of any mutual agreement or arrangement or understanding between two or more competitors or others, knowingly made to sell at a uniform price, or to raise or to stabilize prices or discounts. However, it should be noted that similarity or identical price charged does not always indicate price fixation. It is only established when it is proved that the same is done as a result of some agreement, arrangement or understanding. In the landmark case of *United States v. Socony-Vacuum Oil Co. Inc et al*, it was held that agreements to fix prices are illegal and unlawful. Again in the case of *Arizona v. Maricopa County Medical Society et al* the illegality of price fixation was reiterated.

## PRICE DISCRIMINATION

Price discrimination is merely a price difference; and in order to establish such price discrimination, it is not necessary to show that the lower price is below cost or unreasonably low for the purpose or design to eliminate competition and thereby obtain a monopoly.<sup>6</sup>

It is unlawful when an enterprise uses its dominant position when an enterprise uses its dominant position to discriminate in price between different purchasers of commodities like grade and quality, unless there are good and bonafide reasons because in that case there is no abuse and the prices are not discriminatory or unfair. The law prohibits prices which are unfairly discriminatory. Fair and justified discrimination is not prohibited. Differential prices are legitimate, if they are objectively justified, such as, quantity discounts by cost reductions, cash discounts by prompt payments, functional discounts by service actually rendered by the purchaser, etc. Differentials are not discriminatory or unfair which are based on savings in selling costs from differing methods of distribution or when the transactions are bonafide and not in restraint of trade or where they are made in good faith to meet an equally low price of a competitor.

In *United States v. Borden Co. et al*, the government brought a suit to enjoin appellees from selling fluid milk in Chicago area at prices which discriminate between independently owned grocery stores and grocery store chains. The district court found that pricing plan of each Appellee was prima facie violative of section 2(a) of the Clayton Act, but concluded that these discriminatory prices were justified because the Appelles showed that the average cost of sales and deliveries to all chain stores was lower than the average cost of sales and deliveries to all independent stores. The Supreme Court reversed. It held that class cost justification did not satisfy the burden under section 2(b) of the Clayton Act, due to allowance for differences (in the cost of manufacture sale or delivery), since there was not a sufficient resemblance of the individual members of each class in the cost determination factors on which the classifications were based.

The law, therefore, does not forbid price competition. It however, provides that seller may not sell goods to different purchasers at different prices, if the result may be to injure the competition in either the sellers' or the buyers' market unless such discriminations are justified.<sup>8</sup> The law does not seek to abolish competition or so radically to curtail it that a seller would have no substantial right of self-defence against a price raid by a competitor.<sup>9</sup>

## TEST FOR DETERMINING DISCRIMINATORY PRICING

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<sup>4</sup> 310 US 150

<sup>5</sup> 457 US 332

<sup>6</sup> *FTC v. Anheuser-Busch Inc.*, 363 US 536

<sup>7</sup> 370 US 460

<sup>8</sup> *Utah Pie Co. v. Continental Banking Co et al.*, 386 US 685

<sup>9</sup> *Standard Oil Co. v. FTC*, 340 US 231

The test for determining when a seller has valid meeting competition is whether he can “show the existence of facts which would lead to a reasonable and prudent person to believe that the granting of a lower price would in fact meet the equally lower price of a competitor.”<sup>10</sup>

It is also required to be shown that the seller’s price was actually a good faith response to that competing price. The standard of good faith response is the standard of a prudent businessman responding fairly to what he reasonably believes in a situation of competitive necessity.<sup>11</sup>

The seller’s price discrimination must be defensive response to competition, in the sense that the lower price must be calculated and offered in good faith to “meet not beat” the competitor’s low price, not only to retain old customers but also gain new.<sup>12</sup>

Granting of discounts and rebates is a normal incidence of commercial world and not characteristics of market power. Normal and abusive conduct have to be distinguished. Normal discounts are offered on equal terms to all customers without discrimination. A discount ceases to be normal and becomes abusive when intended to tie its customers to which it is granted and place competitors in an unfavourable competitive position.<sup>13</sup>

Unjustified rebates discounts or sale incentives are discriminatory. It is unlawful to discriminate in regard to granting discount, rebate granted to a purchaser over and above any granted to his competitors, in respect of sale of goods like grade, quality, and quantity. It is also unlawful, if the discrimination is made between different purchasers differently located. However, “delivering pricing”, i.e. selling at uniform price irrespective of location (whatever the transportation cost to the seller), and base-point selling”, where one area has been designated as base point (whereby the seller charges transportation fees from that point irrespective of the actual point of shipment and its costs) are also price-based discrimination.

To establish the existence of a discrimination of price involving injury between seller’s customers, what is to be proved is that the seller has charged one purchaser a higher price for like goods than he has charged one or more of the purchaser’s competitors. The seller could justify the discrimination by cost savings or the necessity of meeting equally low price of the competitor.<sup>14</sup>

### **DISCRIMINATORY CONDITIONS:**

Discrimination involves differentiation in which some enterprises or consumers are given preference over others, not warranted by differences in the circumstances of the transaction or the competitor. The discrimination may relate to prices, terms of sale, or the quality or quantity of what is supplied, and may extend to refusal to sell. The prohibition is not limited to price-based discrimination. Thus discrimination includes terms and conditions in the supply or purchase of goods and services. It also relates to quality and quantity of what is supplied and even refusal to sell. The imposition of discriminatory or unfair conditions by the dominant enterprise is abusive. In *FTC v. Simplicity Pattern Co. Inc.*<sup>15</sup> is one of the largest manufacturers of dress patterns discriminated in favour of its largest customers by furnishing to them services and facilities not accorded to competing smaller customers on proportionally equal terms. The manufacturer was ordered to cease and desist from doing so. It was done despite that the manufacturer’s larger customers sold the patterns for profit while its smaller customers sold them as an accommodation to purchasers of their fabrics and no specific injury to the competition in patterns was shown.

### **VARIETIES OF PRICE DISCRIMINATION:**

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<sup>10</sup> *FTC v. A.E. Staley Mfg. Co.*, 324 US 746

<sup>11</sup> *Falls City Industries Inc. v. Vanco Beverage Inc.*, 460 US 428

<sup>12</sup> See generally *Utah Pie Co. v. Continental Banking Co et al* *supra* note 8, at 14.

<sup>13</sup> *Irish Sugar Plc. v. Commissions*, (1995) 5 CMLR 1300

<sup>14</sup> D.P. MITTAL, *COMPETITION LAW & PRACTICE*, 318-321

<sup>15</sup> 360 US 55

Price Discrimination can be broadly divided into three categories:<sup>16</sup>

### **First-Degree Discrimination**

First-degree price discrimination entails the willingness of the customers regarding the amount they are willing to pay for a particular price and thereby making the sellers to promote such products with respect to that price. This helps the customers and sellers to negotiate the prices of the products. Online traders using a customer's shopping history and data on assessment of purchasing performance to decide prices are especially susceptible to bad exposure and consumer estrangement.<sup>17</sup>

### **Second-Degree Discrimination**

Second-degree price discrimination signifies some kind of exceptional offers being made to the consumers by the sellers, such as discounts, buy two get high rates of discounts on the third ticket, etc. in order to grab the attention of the mass. Thus, by these methods it raises its revenue collection.

### **Third-Degree Discrimination**

Third-degree discrimination are offered to special categories of people such as children, senior citizens, females and teenagers, army personnel and so on by offering them unusual discounts. Third degree discrimination plays a pivotal role in enhancing the business in the market as the consumers get lured by such concessions.<sup>18</sup>

## **DYNAMIC PRICE DISCRIMINATION IN AIRLINES INDUSTRY:**

The concept of dynamic price discrimination has been in practise by the airlines industry for many years. If taken from the viewpoint of the sellers, price discrimination has been used by them as one of the most important tool for obtaining higher revenues from the buyers. Thus, fulfilling its main objective of charging different amount of prices from different consumers for the same good.

There are three kinds of price discrimination prevalent in the said industry which can be described by three parameters:

- *Versioning*
- *.Discounts to large consumers*
- *Frequent flyer program*

**VERSIONING** – The concept versioning sets a uniform price agenda for all the customers interested in buying the tickets. Finally, it rests with the buyers whether they want to buy a ticket of the expensive business class or the economy class which is relatively cheaper. Resultantly, making the consumers pay different prices for different amount of quality of the ticket purchased. The discount given to large consumers exemplifies the third degree price discrimination; *so also, a frequent flyer program* is also an example of second degree price discrimination. Therefore, the consumers are rewarded with a special kind of quantity discount for large purchases.<sup>19</sup>

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<sup>16</sup> Fritz Machlup, *Characteristics And Types Of Price Discrimination*, Princeton University Press, 398-401 (1955)

<sup>17</sup> Alessandro Acquisti, *Identity Management, Privacy and Price Discrimination*, The IEEE Computer Society, 20-21 (2008)

<sup>18</sup> S. Borenstein, & Rose N. L., '*Competition and Price Dispersion in the U.S. Airline Industry*', Journal of Political Economy, 18 (1994)

<sup>19</sup> Joanna Stavins,, *Price Discrimination in the Airline Market: The Effect of Market Concentration*, Report of Federal Bank of Boston, 24 (1996)

These airlines differentiate among themselves by offering different routes and thus, occupy different slots in flight schedules. Moreover, consumers' preferences differ because of their varying price elasticities of demand.<sup>20</sup>

The main objective of consumers is to maximize their expected utility from flying. The consumer's elasticity of demand with respect to his convenience, time, or money plays an essential role in making choices with respect to the good purchased. They mainly make their choices between various price restrictions, such as low price-high inconvenience and high price-no restrictions or any other such lucrative combinations.

The need of the consumers is being exploited by the Airline industry. The policy of the price discrimination is based on the principles demand and supply so also, it depends upon time factor. The price of the air-tickets increases when the supply of the tickets is inversely proportional to the demand of the customers on a particular route networks.

Moreover, these airlines provide sophisticated pricing schemes to reward loyalty and have set up frequent-flyer programs (FFPs) that offer registered traveller's free tickets or free class upgrades after a certain number of miles have been accumulated. These price schemes to reward loyalty play a pivotal role in establishing a firm's market power and thus generating a kind of disparity with respect to the non-frequent flyers. These strategies are being used by the airlines only for raising higher revenues. Considering the oligopolistic market structure of the Indian airlines market, there is high possibility of collusive price fixing arrangements can be suspected which glorifies the likelihood of anti-competitive practices prevalent in the industry. It's necessary for a firm to have some market power in order to charge prices above the marginal cost so as to discriminate price successfully.

Recently, the sale of abnormally low-priced airline tickets has caused much uproar in the Indian airline industry. It has been alleged that airlines which were providing these prices were involved in predatory pricing which consequently aimed at driving competitors out of the market and to restrain the entry of new competitors. In one of such cases, India's Director General of Civil Aviation (DGCA) asked Chennai-based low-cost carrier Spice Jet to stop selling tickets at rock-bottom fares.<sup>21</sup>

Thus, the airlines may possess market power in some market segments which leads to higher price discrimination and more competitiveness.

### **ROLE OF COMPETITION COMMISSION OF INDIA:**

The Competition Commission of India has been acting as a tough regulator by imposing penalties on various leading firms in order to curb various anticompetitive practices taking place in the country, especially in Airlines Industry. Recently, the Air Passengers Authority of India has made a call for CCI scrutiny in airline ticket pricing, which contended that the price hike by domestic airlines depicts signs of complicity. This can be considered as one of the major instance where by CCI has been asked to inquire into costing and other profit-making strategies assessments in the Indian airline industry.<sup>22</sup>

There has always been a kind of conflict of viewpoints between CCI and the Directorate General of Civil Aviation ('DGCA'). The role of CCI mainly focuses on containing the anti-competitive practices in the Indian market for all goods and services and thus, protecting the Indian economy. Whereas, DGCA, being a restrictive, mainly regulates the charge of air transportation

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<sup>20</sup>Paolo Malighetti, Stefano Paleari & Renato Redondi, *Pricing strategies of low-cost airlines: The Ryanair Case Study*, 15Journal of Air Transport Management, 29 (2009)

<sup>21</sup>See generally Paolo Malighetti, Stefano Paleari & Renato Redondi, *Pricing Strategies Of Low-Cost Airlines: The Ryanair Case Study*, 15Journal of Air Transport Management, (2009), *supra* note 21, at

<sup>22</sup>J.Stavins, 'Price Discrimination in the Airline Markets: The Effect of Market Concentration', Review of Economics and Statistics, 24 (2001)

in India. As per Rule 135 of the Aircraft Rules, 1937 empowers DGCA to put a check on airline tariffs and issue guidelines for any malpractices prevailing in the industry.

Considering, the direction of DGCA regarding the revelation of the prices of airline tickets by the airline market players prior to a month would play a pivotal role in scrutinizing whether the prices are 'excessive' or not. Resultantly, this would have killed the objective of promoting the competition law in the Indian market.

The conflict and contradiction between CCI and DGCA must be dealt tactfully otherwise it will lead to discrepancy and uncertainty in policy measures. This will facilitate both CCI and DGCA to take more appropriate decisions. This can be seen from various judgements taken by CCI. Meanwhile in the case of *Mr. Manjit Singh Sachdeva v. DGCA and Ministry of Civil Aviation*<sup>23</sup> - "CCI observed that it cannot decide or fix the price of any product or service so also DGCA must leave the tariff- fixing task to the individual airline operators. CCI also observed that directing DGCA to fix airline tariffs would be contrary to the spirit of the competition law." Further in the case of *Belaire Owner's Association v. DLF Limited*<sup>24</sup>, CCI observed that abuse of dominant position by fixing prices in the basic necessity of housing with a motive of earning profit at the cost of the consumers are contrary to the spirit of the competition law and anticompetitive in nature, imposing heavy penalties upon the DLF Ltd. Moreover, *In Re Domestic Airlines*<sup>25</sup> case, CCI also discussed the principles dynamic pricing and price fixation by the airlines in matters of emergency.

In the case of *Uniglobe Mod Travels Pvt. Ltd v. TFAI, TAAI, IATA and others*<sup>26</sup> - The CCI held that there was cartelization by travel agents and were penalized for breach of section 3 Competition Act, 2002. The CCI found that the acts of the Travel Agents Association were in contravention to the Section 3(1) and 3 (3) (b)<sup>27</sup> of the Act as they were holding substantial market power.

Such anticompetitive practices must be put to an end and CCI must gear up to end this as it is hampering the law of competition in India.

## CONCLUSION

The aviation sector in India has seen an exceptional growth only after the liberalisation and resultantly bringing more and more competition in this sector, infused by the entry of new airline market operators. The entry of these new market players has both advantages and disadvantages. The low air fares and air service levels are some of the benefits arising out of the new entrants.

But the entry of new market players in the airline industry has made the competition very stiff for raising higher revenues. The competitors' have indulged themselves into various anticompetitive practices by entering into anti- competitive agreements by the fixation of ticket prices on the basis of demand and supply. The cost of tickets start accelerating as the date and time of the journey comes nearer. Thus these market players start exploiting the needful persons.

Moreover, these market players get indulged into predatory pricing in order to drive the competitors out of the market or to restrict the new entrants in the airline industry. The Competition Act, 2002 has empowered CCI to prohibit collusive price fixing arrangements. If there has been a case of abuse of dominant position by any dominant firm abuses charging 'discriminatory' or 'unfair' prices, CCI can prohibit such anticompetitive practices by imposing penalties on such dominant firm. Therefore, CCI must put an end to this culture in the interest of welfare of the people.

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<sup>23</sup> <http://cci.gov.in/May2011/OrderOfCommission/682012.pdf> (last visited August 14, 2014)

<sup>24</sup> <http://www.cci.gov.in/May2011/OrderOfCommission/192010S.pdf> (last visited August 14, 2014)

<sup>25</sup> <http://www.cci.gov.in/May2011/OrderOfCommission/Domesticairlinesorderdissenting11jan2012.pdf>

<sup>26</sup> *Uniglobe Mod Travels Pvt. Ltd v. TFAI, TAAI, IATA and others*, Available at:

<http://www.cci.gov.in/index.php>

<sup>27</sup> *Vide* § 3 of the Competition Act, 2002.