Discriminatory Pricing: Comments on a Swedish Case

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Background

The current Swedish Competition Act ("the Act") came into force in July 1993. The rules of the Act are more or less modelled on EC competition law, stipulating prohibitions against anti-competitive co-operation and abuse of a dominant position as well as providing powerful sanctions to deter infringements. It is also explicitly stipulated in the preparatory works of the Act that EC case law should be taken into account when applying domestic Swedish competition law.

Over the years, a significant number of competition law decisions have been handed down by the administrative authorities in Sweden. Moreover, the work of detecting and counteracting anti-competitive behaviour has also received increasing attention both in and outside Sweden and particularly in the European Union. As a result, it may be concluded that the general awareness of the scope of application of the competition rules has increased by a considerable extent during the last few years. In view thereof, it would seem surprising that to date there have been only a limited number of civil cases in Swedish courts dealing with competition law issues, let alone the application of Arts 81 and 82 EC. Consequently, the application of competition rules from a civil law point of view has not, as of yet, been fully elucidated in domestic Swedish case law.

Recently, however, the Swedish Supreme Court, the court of highest instance in Swedish civil law cases, has decided not to grant leave to appeal in a lawsuit regarding alleged abuse of a dominant position under Art.19 of the Act and its equivalent Art.82 EC, brought by Scandinavian Airlines System (SAS) against the Swedish Board of Civil Aviation (*Luftfartsverket*) (BCA).[1] By the decision of the Supreme Court, upholding the ruling of the Court of Appeals, it was confirmed that SAS had been subject to price discrimination due to a special obligation imposed on it by the BCA to bear, in addition to the landing charges generally applied by the BCA, a significant proportion of the construction cost of Terminal 2 at Arlanda Airport outside of Stockholm, Sweden. The case is simply an extension of the jurisprudential sequence initiated by the European Commission with regard to the pricing policies applied at Community airports.[2]

The following is a summary of the *Terminal 2* case and the rulings of the lower courts followed by some brief comments on the case in the light of applicable EC case law.

The *Terminal 2* case

Background

When Terminal 2 was built in the late 1980s, the two domestic carriers SAS and Linjeflyg had a *de facto* monopoly on most domestic routes within Sweden. During that period, the BCA applied a financing system under which the airlines were charged for the cost of capacity expansion at Swedish airports. The financing system was, in part, governed through special capacity agreements between the airlines and the BCA relating to specific terminal facilities, such as Terminal 2, used by the airlines for their air transportation business.

Terminal 2 was built so as to meet the increasing capacity needs at Arlanda Airport. Although given a general design suitable for international use, the terminal would initially be used primarily for domestic traffic and it was therefore designed and built in consultation with SAS, Linjeflyg and the BCA. Shortly after the inauguration of Terminal 2 in 1990, SAS was however

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1 Decision of the Supreme Court of November 12, 2002, Case No.T 2137–01. It should be noted that on May 9, 2003, the BCA lodged a petition for a new trial based on an alleged procedural error by the Supreme Court.

2 See *e.g. Zaventem Airport Landing Fees* (95/364/EC), June 28, 1995 [1995] O.J. L216/8, [1996] 4 C.M.L.R. 232; *Illmailulaitos/Luftfartsverket* (1999/198/EC), February 10, 1999 [1999] O.J. L69/24, [1999] 5 C.M.L.R. 90; *Portuguese Airports* (1999/199/EC), February 10, 1999 [1999] O.J. L 69/31, [1999] 5 C.M.L.R. 103; *Landing Fees at Spanish Airports* (2000/521/EC), July 26, 2000 [2000] O.J. L208/36, [2000] 5 C.M.L.R. 967; Case C–163/99 *Portuguese Republic v Commission* [2001] E.C.R. I–2613, [2002] 4 C.M.L.R. 31; *cf.* Case C–179/90 *Merzi convezionali Porto di Genova v Siderurgica Gabrielli* [1991] E.C.R. I–5889, [1994] 4 C.M.L.R. 422; Case C–18/93 *Corsica Ferries Italia v Corpo dei Piloti de Porto di Genova* [1994] E.C.R. I–1783; *Alpha Flight Services* (98/513/EC), June 11, 1998 [1998] O.J. L 230/10, [1998] 5 C.M.L.R. 611 and Case T–128/98 *Aéroports de Paris v Commission* [2000] E.C.R. II–3929, [2001] 4 C.M.L.R. 38.

forced to move its domestic traffic to another terminal. The reason for this was that Linjeflyg, as a result of a general decline in the market, was in great financial difficulty and had had its operations taken over by SAS. Having virtually doubled its size of domestic traffic overnight, it soon became clear to SAS that it had outgrown Terminal 2 and that a change of terminals was unavoidable in order to consolidate the domestic operations at one terminal.

The Swedish domestic aviation market was deregulated on July 1, 1992. As a result of the deregulation, the BCA changed the manner in which it charged airlines for their use of its services and infrastructure, introducing a new, general landing charge tariff system based on aircraft type, weight, number of passengers, etc. At the same time, all capacity agreements were dissolved and the cost of the terminal facilities governed by those agreements was allocated so as to form part of the general basis of calculation of the general tariff system. As regards Terminal 2, however, the BCA refused to allocate the costs for that terminal to the new general tariff system, and as a result SAS had to enter into a new separate agreement, imposing a special obligation on SAS to bear the bulk of the costs relating to the construction of the terminal. As a result, SAS was liable both for landing charges under the new general tariff system as well as for payments under the special cost liability relating to Terminal 2.

Following years of unsuccessful discussions between the parties in order to solve the dispute, SAS brought action against the BCA before the District Court of Norrköping. SAS argued that due to the special cost liability related to Terminal 2, SAS had to pay more than its competitors for the air traffic services rendered by the BCA at Arlanda Airport, thus constituting an abuse of the BCA's dominant position by way of price discrimination under s.19 of the Act and Art.82 EC. SAS requested that the special cost liability be declared void and that the BCA be liable for restitution of the funds already paid by SAS under that liability. The BCA rejected this, claiming that the terminal had been built on SAS's request and according to SAS's requirements. The BCA further argued that the liability related only to the costs of building the terminal and did not constitute payment for the air traffic services provided by the BCA at Arlanda Airport. Hence, the BCA argued, the special cost liability did not involve any price differentiation with respect to air traffic.

The rulings of the lower courts

It was undisputed in the case that the BCA, on the basis of its statutory monopoly, holds a dominant position in the market for providing access for airlines to Arlanda Airport. The District Court[3] therefore initially focused on whether or not SAS's special cost liability for Terminal 2 constituted price differentiation in the BCA's charging for air traffic services, and argued that unless motivated on the basis that SAS's air traffic at Arlanda Airport, in comparison to other air traffic, involved special costs for the BCA, no distinction was to be made between SAS's special cost liability and the fees charged under the landing charge system. Considering, *inter alia*, that Terminal 2 was built to meet the rapidly increasing general capacity needs of the domestic traffic, the District Court found no evidence that the BCA had incurred such special costs due to SAS's air traffic. The fact that Terminal 2 had been built and its design decided in consultation with SAS must, in the court's view, be seen against the background that the terminal was originally intended to service the traffic existing at that time, *i.e.* the monopoly traffic operated by SAS. Consequently, the court concluded that the special cost liability was commensurate to the landing charge fee structure and that SAS was subject to price differentiation by the BCA.

Next, the District Court considered whether this differential treatment was objectively justified. To this end the BCA argued, *inter alia*, that the construction of Terminal 2 had involved excessive costs due to the requirements put forward by SAS and that the inclusion of these disproportionate costs in the new general tariff system would not only have considerably increased the fee levels but it would also—in view of SAS's involvement in and influence on the Terminal 2 project—have been unfair to burden other operators with these costs. The arguments of the BCA were dismissed by the District Court stressing, with reference to EC case law, that there must be very strong reasons to permit a dominant player to treat trading partners differently from a cost point of view, in particular, as is true for the BCA, where the incumbent holds in principle a monopoly position in the relevant market. In view thereof and considering the arguments put forward by the parties, the District Court held that the BCA had failed to show the existence of any circumstances that would make a price differentiation justified. The BCA was therefore considered to have abused its dominant position by way of price discrimination. As a result, the District Court declared the special cost liability to be null and void and ordered the BCA to refund the amounts already paid by SAS, approximately 400 million Skr (approximately €45 million) plus interest from the respective dates of

3 Judgment of the District Court of Norrköping of December 22, 1999, Case No.T 2746–96.

payments made by SAS. In addition, SAS was released from all of its future payment obligations in respect of the special cost liability declared null and void by the District Court.

The ruling of the District Court was appealed by the BCA to the Göta Court of Appeals. After having elaborated on the case in great detail, the Court of Appeals however rejected the appeal and upheld the ruling of the District Court.

As had the District Court, the Court of Appeals[4] found that Terminal 2 had been built due to a general need for greater capacity at Arlanda Airport and, in light of the monopoly position SAS held at the time, it was natural that SAS had an influence as to the design of the terminal. The construction of the terminal was not a service provided especially for SAS, justifying a special liability to pay the construction costs. The Court of Appeals found that the contractual liability to pay therefore constituted a price differentiation, that there were no objective and acceptable reasons for such a price differentiation and that as a result thereof, the BCA was abusing its dominant position. Consequently, again the payment liability was declared void and the BCA was ordered to reimburse the funds already paid by SAS.

Comment

Applying dissimilar conditions to equivalent transactions

It follows expressly from the wording of Art.82(c) EC, as well as Art.19 of the Act, that a dominant undertaking may not apply *dissimilar conditions to equivalent transactions*. One of the main issues for the courts was therefore to establish whether or not SAS's cost liability for Terminal 2 could be considered equivalent to the payments being made by the airline operators under the new general tariff system. In SAS's opinion, this was clearly the case, as the special cost liability was merely a residue of the former fee system applied prior to the deregulation of the Swedish domestic aviation market, regulating the compensation to the BCA for the services rendered by it to airline operators. This was evident, SAS argued, from the fact that SAS did not receive anything in return for the payments made under the special cost liability other than what the airline operators paid for under the general tariff; the erection of Terminal 2 was a necessary expansion of the capacity at Arlanda and did not constitute a special service for SAS.

The BCA's primary objections were, as has been indicated above, that the special cost liability for Terminal 2 did not constitute compensation for the current air traffic operated by SAS at Arlanda Airport, but was attributable to a historical service—*i.e.* the erection of Terminal 2—the usage and usefulness of which SAS, during the former fee system based on capacity agreements, had agreed to partly bear the financial risk. The special cost liability was to be viewed as a replacement compensation for SAS's obligations under the former fee system on the basis that the terminal could not be utilised to the extent and in the manner intended. In the BCA's opinion, the primary evidence of this was that the compensation under the special cost liability was payable irrespective of whether or not SAS used Terminal 2 for its traffic. Therefore, the BCA argued, the special cost liability should not be evaluated under competition law but on the basis of the invalidity rules of contract law.

As mentioned above, the courts did not accept the arguments of the BCA. Instead, the courts did indeed find the competition law rules applicable and it was explicitly stressed by the Court of Appeals—referring, *inter alia*, to *BPB Industries and British Gypsym*[5]—that the concept of abuse of a dominant position is to be viewed objectively and cannot be derogated from by agreement. That the special cost liability, as claimed by the BCA, was to be viewed as a risk allocation agreed between the parties was therefore considered to be of no consequence in relation to the fact that the compensation payable referred to the same services as those paid for under the general tariff system, *i.e.* the right to use Arlanda Airport.

The courts' rulings emphasised the fact that the assessment of whether or not a transaction is equivalent to other transactions must be made not only on the basis of its contents and design but also, more importantly, on its effects. Clearly, the prohibition against price discrimination would seem to be of little meaning if the result of this "equivalence test" would be negative simply because the dominating actor when concluding, for example, a supply agreement with one of its customers, would force the customer to bear part of its production costs and then claim that this should not be taken into consideration in determining the price to be paid by the customer under the supply agreement. Even though the intention of the customer's liability to bear the production costs may not be to equal price, the effect would be

4 Judgment of the Göta Court of Appeals of April 27, 2001, Case No.T 33–00.

5 Case T–65/89 [1993] E.C.R. II–65.

that that customer would pay more than those customers only paying the price. For the same obvious reasons, it would not be possible to circumvent the prohibition against price discrimination by imposing liability for production costs regardless of whether the customer in question uses a certain good or service.

As regards SAS's special cost liability for Terminal 2, the determining factor in the evaluation of whether or not this liability constituted price differentiation must therefore be whether it resulted in SAS paying more for its use of Arlanda Airport than other airlines. This being held to be the case by the courts, the special cost liability would then in effect be equivalent to fees charged under the general tariff system. However, the same would seem to be true as regards the intention of the cost liability. Since the original capacity agreement regarding Terminal 2 had formed part of the former fee system, arguably any replacement of this agreement must also be deemed as compensation for the air traffic, irrespective of whether the replacement compensation is argued to constitute consideration for relieving SAS of a former obligation.

Objective justification

Having found that the BCA had applied dissimilar conditions to equivalent transactions and also that this differential treatment clearly was to SAS's disadvantage,[6] the courts turned to the issue of objective justification. In support of the special cost liability being objectively justified, the BCA had mainly argued that the price differentiation was motivated because it was intended to cover BCA's cost for an excess investment caused by SAS and that it would not have been fair to other operators if these costs were included in the new general tariff system. In the analysis, the BCA argued, the decision by SAS to leave Terminal 2 and move its business to another terminal should also be taken into account.

As has been indicated above, none of these arguments were accepted by the courts. The Court of Appeals held that the BCA had presented no evidence of having incurred costs for Terminal 2 being of such a nature and scope that SAS should be obliged to bear financial responsibility for them. The fact that the inclusion of the entire cost for the terminal in the calculation basis for the new tariff system would have increased the fee levels did not lead to any other conclusion. Further, the argument that SAS had had the advantage of being able to choose a terminal was equally rejected. In this connection the Court of Appeals noted that the pricing structure under the new general tariff does not take into account the actual costs that a single airline occasions in the use of the services of the BCA. Nor does it reflect from which terminal the airline is operating.

Here, two points should be noted. First, it may be concluded from the judgments that the courts would find a price differentiation justifiable only to the extent that the BCA was able to prove *actual and relevant* cost differences between the air traffic conducted by SAS and that of other operators. This relevance analysis must be made not only on the basis of the airport services in question but also on the pricing structure applied within the general tariff system and the parameters taken into account when calculating the tariff levels. For instance, the rejection by the courts of the BCA's argument with respect to SAS's ability to choose terminals, indicates that any reference to parameters other than those established under the tariff system will clearly face the risk of being considered irrelevant.[7] In *Spanish Airports*,[8] the reference made by the Spanish civil aviation authority to economies of scale was equally dismissed by the Commission on the basis of relevance, as no such economies of scale exist with regard to the airport services in question, *i.e.* landing and take-off services.[9]

Secondly, it may also be concluded from the rulings of the courts that given the very strong position of the BCA as well as many of its counterparts in other countries, the requirements on their application of the tariff systems must be placed at a particularly high level and no differential treatment will be accepted unless made in a truly non-discriminatory manner. This view has been repeatedly confirmed in the above-mentioned EC case

6 With regard to the second criterion for price discrimination, *i.e.* the requirement that the trading partners of the dominant firm be placed at a competitive disadvantage as a result of the discrimination, the BCA argued that the special cost liability for Terminal 2 did not inflict any competitive disadvantage on SAS as it was in fact a significant reduction of SAS's cost liability for the terminal under the old fee system based on capacity agreements. The BCA further argued that a waiver of the right to payment according to an agreement can never constitute an abuse by way of price discrimination as it is favourable—not detrimental—to the trading partner in question. However, again the arguments of the BCA were dismissed by the courts. By contrast, the BCA's reduction argument was found to be of no relevance considering that the duty to pay significant amounts in addition to what other airlines had to pay was nevertheless clearly detrimental to SAS.

7 Similarly, in *Portuguese Airports*, n.2 above, the Commission did not accept the differential pricing based on distance as being objectively justified, as distance was not a parameter when calculating the tariff levels.

8 See n.2 above.

9 On the other hand, in the *Terminal 2* case the courts might have considered SAS's special cost liability for the terminal to be relevant (and thereby objectively justified) had it related to a service not at all available to other operators under the general tariff following the deregulation of the domestic market.

law. In view of this, in the *Terminal 2* case it would seem clear that the only way for the BCA to meet these high standards following the deregulation of the domestic market would have been to include the full costs for Terminal 2 in the new general tariff system.

Civil consequences—invalidity

One final note to be made about the *Terminal 2* case refers to the civil consequences of the abusive behaviour on the part of the BCA. Similarly to Art.82 EC, s.19 of the Act does not expressly provide for any such consequences and no previous precedent exists under Swedish law. Under the EC regime, however, the European Court of Justice has made it clear that agreements constituting an abuse of dominant position are unenforceable.[10] However, it is also clear that the consequences of the nullity of the contract are governed by national law and not Community law.[11] In the *Terminal 2* case the matter was therefore subject to some consideration by—in particular—the Court of Appeals. With reference to Art.10 EC and applicable EC case law, the court noted the requirement under EC law for effective implementation and protection of rights that accrue to individuals by way of the principles of direct effect and direct applicability. On the basis thereof it was confirmed that agreement clauses that comprise abuse of a dominant position under national law and which are also in violation of Community law should be regarded as having no effect. Consequently, the Court of Appeals concluded, in so far as being in violation of competition law, the terms laying down SAS's special cost liability for Terminal 2 were to be deemed invalid.

As regards the civil consequences of agreement terms constituting an abuse of a dominant position under Swedish domestic law, the Court of Appeals observed that, in the absence of any statutory law or precedent, there was no express support for invalidity. With reference to the preparatory works of the Swedish Contracts Act, the court nevertheless concluded that agreements violating the prohibitions of the Act be treated in accordance with the same principles as other agreements that are in violation of mandatory rules. The conclusion drawn by the court was therefore that the special cost liability was also to be considered invalid under Swedish domestic law.

The remaining question for the court was then to consider the legal consequences of the invalidity. Resolutely, the court held that the result thereof was that SAS was undoubtedly to be released from the special cost liability and that all payments previously made by SAS under the cost liability were to be refunded. Only then would the discriminatory treatment of SAS be fully removed as SAS would have paid the same fees as other airlines for the use of Arlanda Airport during the relevant period. Consequently, the alternative solution suggested by the BCA, by which the invalidity of the provision would instead have the consequence that SAS should pay as much as it would have had the costs for Terminal 2 been included in the general tariff, was dismissed by the court. Such a solution would clearly also constitute discrimination, since SAS would still have paid more than other airlines during the relevant period for the same service.

10 See *e.g.* Case 127/73 *BRT v SABAM* [1974] E.C.R. 51, [1974] 2 C.M.L.R. 238; *cf.* Case C–453/99 *Courage Ltd v Crehan* [2001] E.C.R. I–6297, [2001] 5 C.M.L.R. 28, although primarily referring to Art.81 EC.

11 See Case 22/79 *Greenwich Film Productions v SACEM* [1979] E.C.R. 3275; [1980] 1 C.M.L.R. 629.