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THE IMPACT OF DISRUPTIVE INNOVATIONS ON COMPETITION LAW ENFORCEMENT

Contribution from Japan

-- Session III --

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DISRUPTIVE INNOVATION: IMPLICATIONS FOR THE ENFORCEMENT OF COMPETITION LAW

-- Japan --

1. Introduction

1. Recently the issue of disruptive innovation and competition has been lively discussed at the OECD and the ICN (International Competition Network).

2. Because of the ambiguity in the definition of “disruptive innovation” in the first place, it is difficult to assert whether or not there is a case in which the Japan Fair Trade Commission (hereinafter, “JFTC”) applied the Antimonopoly Act (hereinafter, “AMA”) on an enterprise in the industries that are considered to be clearly affected by the disruptive innovation in Japan. However, even if there are industries which are affected by the disruptive innovation, it is quite unlikely that the investigation under the AMA by the JFTC should be conducted in a different way from the normal procedures because of the mere reason of being “disruptive”. There existed more than a few examples in the past that the JFTC investigated technologically innovative industries whether or not the innovation is disruptive.

3. Therefore, this contribution paper provides examples that the JFTC issued cease and desist orders against the enterprises which either brought big changes to the existing industries or created a new market, even though they did not necessarily involve the disruptive innovation, and discuss the study by the Competition Policy Research Center (hereinafter, “CRPC”) of the JFTC that surveyed the trend of the market where the innovative change was being made.

2. Cases

2.1. *Cease and Desist Order against DeNA Co., Ltd¹*

4. The JFTC issued a cease and desist order against DeNA Co., Ltd (hereinafter, “DeNA”) on June 9, 2011, on the ground that DeNA was engaging in conduct which constitutes a violation of Article 19 of the AMA (falling within Paragraph 14 [Interference with a Competitor’s Transactions] of the Designations of Unfair Trade Practices).

¹ For the details of the case, please refer to Japan’s contribution in “Competition in the Digital Economy“ (DAF/COMP/WD(2011)76)

2.1.1. *Background*

5. This is a case that the JFTC issued a cease and desist order against DeNA who runs the Social Networking Service (hereinafter, “SNS”) for mobile phones and operates the businesses to provide by itself or to allow other operators to provide the social games.

6. It was in 2007 that the social game² came out in the market in Japan. In June of the same year, GREE, Inc. (hereinafter, “GREE”) which is another major SNS company launched a social game developed in-house for mobile phones-based platform called “GREE”, and the game became a big hit. After that from May 2009, DeNA also started social game development business by in-house production. Then around January 2010, DeNA decided it necessary to provide a variety of genres of games, and opened³ the “Mobage-Town”, which is its own platform, to start providing the open games. Following the above, around June of the same year, resulting from opening of “GREE” by GREE, many titles of the games were launched on each of these platforms, and then the social game market was on its way to flourish on full scale and has experienced rapid growth after that.

7. The opening of the SNS platform lowered the barrier of entry to the game business and attracted many entries from the neighboring markets. In other words, it is said that the opening changed the way of distribution of the contents in the new channel, that is, SNS.

2.1.2. *Market size*

8. The domestic market size of social gaming is assumed to have been about 800 million yen in 2007 when the social games was first launched in Japan, and about 6,900 million yen in 2008 with increase by 916.5% on a year-to-year basis. Almost all of the sales up to 2008 came from the in-house production games which were provided by “GREE”, and the market size was still very limited. However, the market size significantly grew to about 36.1 billion yen in 2009 resulting from entry of DeNA to the social gaming market.

9. In 2010 because of the platform opening of both “Mobage-Town” in January and “GREE” in June respectively, the domestic social gaming market has entered the period of rapid growth, and its market sales size has become 138.0 billion yen with increase by 382.3% on a year-to-year basis.

2.1.3. *Outline of the case*

10. DeNA internally specified social game developers that were important to them. Some of these developers also provided social games via the mobile SNS “GREE” operated by GREE which was ranked at the second place at the time in terms of revenue of social game in Japan. In these cases, DeNA forced such social game developers not to provide the social games through “GREE” by threatening to disconnect the links to “Mobage-Town” website of these social games. This conduct by DeNA was judged to constitute interference with a competitors’ transaction and was seen as a violation of Article 19 of the AMA.

² “Social game” means the games which are provided to the users through the mobile SNS and which are equipped with the communication function among the users

³ This term indicates that the business operator providing the social networking service for mobile phones discloses the information on the program called “API” to the social gaming developers, and allows the social gaming developers to provide the social games through his own social networking services for mobile phones.

2.2. Warning against NTT East and NTT West⁴

11. The JFTC issued a warning against Nippon Telegraph And Telephone East Corporation (hereinafter, “NTT East”) and Nippon Telegraph And Telephone West Corporation (hereinafter, “NTT West”) on June 9, 2011, on the ground that NTT East and NTT West were engaging in conduct which constitutes a possible violation of Article 19 of the AMA (falling within Paragraph 15 [Interference with a Competitor’s Transactions] of Unfair Trade Practice⁵).

2.2.1. Background

12. In Japan, the penetration of broadband services has been promoted by the Japanese government since the beginning of the 2000s, with the goal of “Creating advanced telecommunications networks at the world’s highest level” under the “e-Japan Strategy” policy. The penetration of ADSL services, which provide services through existing fixed-line telephone networks, has progressed significantly since this period. Telephone networks are essential for providing ADSL services because the services provide broadband internet access through telephone networks to users. Therefore the service providers other than NTT East and NTT West who own telephone networks have to locate their equipment at telephone offices of NTT East and NTT West.

13. The goal of the above strategy was to increase the availability of high speed broadband services including ADSL to cover 30 million households by 2005, but, in fact, it reached 46.3 million out of a total of 51.71 million households in 2005 (the broadband coverage rate : approximately 90%).

14. This rapid expansion was facilitated by a significant decrease of telecommunications fees as well as improvement of service and transmission speeds due to active new entry and vigorous competition resulting from systemic reforms such as the development of rules regarding the unbundling and collocation of the network with the aim of encouraging competition in the telecommunications sector.

2.2.2. Market situations

15. With expansion of the market, the number of businesses providing ADSL has continued to increase up to the middle of 2002.

16. In addition, in 2001 the price competition among businesses was driven by many entries of the new businesses, who provided the services with very cheap price at that time, resulting in significant decrease in price. Furthermore, the price-based competition was actively promoted among businesses, and since each operator actively offered the campaign for free service only during the start-time of usage with limited time, the actual price reflected by that was considered to be much cheaper.

2.2.3. Overview of the case

17. The JFTC found that NTT East and NTT West were suspected of charging the users of other telecommunications carriers fees for the construction works for replacing the protector or switching to metal cable to provide ADSL services, while providing the above replacing or switching works to their own users free of charge, thereby inducing customers by unjust benefits or interfering with competitor’s transactions.

⁴ For the details of the case, please refer to our contribution in “The Financing of the Roll-out of New Generation Access Networks” (DAF/COMP/WP2/WD(2014)11)

⁵ Paragraph 14 of amended Unfair Trade Practice after the date of enforcement of 2009 Notification of the Japan Fair Trade Commission No.19 (1 January, 2010)

18. Therefore, the JFTC issued a warning against NTT East and NTT West on December 25, 2001, on the ground that such conduct could fall under interference with a competitor's transactions or deceptive customer inducement, and therefore constitute a possible violation of Article 19 of the AMA (Prohibition of Unfair Trade Practices)⁶

2.2.4. *Salient features of the incident*

19. NTT East and NTT West were companies born from privatization and split of the old state-owned monopoly in 1985. Since then deregulation has been promoted, and rapid new entries and new services have been carried out as described in 2.2.1. and 2.2.2.. In these disruptive situations, the JFTC warned NTT East and NTT West, who possess telephone line, that the actions taken by them may violate the AMA.

20. According to the report⁷ published by the JFTC in 2004, some telecommunications carriers pointed out that these warnings contributed to the fair competition among NTT and other ADSL telecommunications carriers, promoting the vigorous competition among them.

3. **Trend in the e-book market**

21. The market size of the electronic book (hereinafter, "e-book") was about 62.9 billion yen in FY 2011 in Japan, a dramatic expansion from 1 billion yen in FY 2002. However, the current e-book market still shares only less than 5% of the total publication market, and it is expected to be expanded further (See the Appendix 1). The e-book market has the features of network effect and lock-in effect created by the characteristics of the platform business which cannot be observed in the conventional type book market⁸. The CPRC investigated the actual situations of the e-book market, since it is important to secure fair competition during the early days of the market for sound development of the e-book market and for securing of advantages of the consumers. The results were summarized in the report with the following table of contents and published on June 26, 2013.

Chapter 1 : Summary of the overview of the e-book market in Japan

Chapter 2 : Review of the state of awareness and behaviors of the businesses through a questionnaire survey and interviews with the related parties to the e-book market in Japan

⁶ In another case, the JFTC issued a warning against NTT East on December 9, 2003, on the ground that NTT East undertook sales activities for its FTTH services to users of the other telecommunications carriers through the construction companies it entered into distribution agreements at the time of construction works needed to start ADSL services requested by other telecommunications carriers, thereby unjustly interfering the transaction between other telecommunications carriers and their subscribers. On the same day, the JFTC issued a recommendation against NTT East on the ground that NTT East excluded the business activities of other telecom service providers and it was causing a substantial restraint of competition in the field of the FTTH service for detached houses in eastern Japan. For more details, please refer to our contribution in "Margin Squeeze" (DAF/COMP/WP2/WD(2009)20)

⁷ "Report regarding Competitive Situation in the Broadband Service", February 2004

⁸ It is said that the platform in economics is something which includes the following three elements; (1) multiple different user groups exist in it, (2) the products are traded through the platform among those groups, and (3) the gain obtained by participation to the platform for each economic entity belonging to each group depends on the degree of activity (such as number of participants and trading frequency) of the participants belonging to outside of the concerned groups.

Chapter 3 : Review of the background and the investigation by the authorities on the cartel cases related to the e-book business that occurred in the USA and EU where the e-book market is more developed than that in Japan

Chapter 4 : Analysis of the digital music market, that has similar characteristics as the platform business to the e-book market and that can be analyzed with the use of the available data, from the viewpoint of competition among the platform business operators

Chapter 5 : Summary of the developing process of the market that has the characteristics as the platform business from the theoretical viewpoint of industrial organization, application of the results to the e-book market, and suggestions from the viewpoint of competition policy.

22. Among these, in Chapter 4, the CPRC analyzed the digital music market, that has the similar market structure as that of the e-book market. It was found that the growth rate of the digital music market was increased when the No.2 business operator (Sony) expanded its market share against the No.1 business operator (Apple) in the market of the portable music player which is the main hardware device for downloading digital music. Based on the above summary, it was indicated that the competition among the platform businesses improves the economic welfare while it is necessary to pay attentions to the actions that violate the AMA including trading on restrictive terms and abuse of superior bargaining position.

23. In addition, in Chapter 5, the CPRC theoretically studied the developing processes of the market. It was argued that it becomes important to take a balance of the differences in bargaining power between the platform business by which the e-book business is featured and the contents business operators (mainly publishers) which comes from the feature of the business. Those features of the e-book businesses that affects the differences in bargaining power are; (1) it is necessary to obtain the licensing of the digitization from the author and the publishers have an important role for spreading the e-book and (2) it is normal that the same book using paper media is also published at the same time (or in advance) when any e-book is published and it is very rare that only e-book is published.

APPENDIX 1. TREND AND FORECAST OF THE E-BOOK MARKET SIZE

