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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM**

**Session I: Disruptive innovation in Latin America and the Caribbean:  
Competition enforcement challenges and advocacy opportunities**

-- Contribution from Spain --

12-13 April 2016, Mexico City, Mexico

*The attached document from Spain is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 12-13 April 2016 in Mexico.*

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# LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM



**14th Latin American and Caribbean Competition Forum  
12-13 APRIL 2016, Mexico City, Mexico**

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## **Session I: Disruptive innovation in Latin America and the Caribbean: Competition enforcement challenges and advocacy opportunities**

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### **-- CONTRIBUTION FROM SPAIN --**

#### **1. Introduction**

1. Disruptive innovations are new business models, products or processes that suddenly and drastically alter markets in unforeseen market segments, or segments with lower initial value. The sharing economy represents one of the most significant disruptive innovation phenomena in recent years, and is producing major structural changes in how markets function around the world.

2. The development of this type of platform is the result of a combination of technological, socio-economic and regulatory factors, such as the Internet and the expansion of mobile technology, the financial crisis, a change in consumer culture more focused on accessing services, and regulatory inefficiencies in certain economic sectors such as transport and accommodation.

3. The magnitude of the phenomenon makes it complex to define. However, a number of common features of sharing economy platforms can be identified: (i) the sharing economy typically makes better use of underutilised resources, by making these resources, goods or services available to users of the platforms; (ii) they constitute multi-sided markets, in which each side of the market obtains value from the existence of the other side(s); (iii) the platforms act as catalysts between the different sides of the market, resolving the problem of co-ordinating supply and demand; and (iv) the use of online reputation systems has facilitated access to up-to-date and credible information by users.

4. The emergence of these new Internet-based service delivery models is a source of innovation that has had and continues to have significant effects on competition in markets. These include a number of pro-competitive effects stemming from the increase in the number of operators: quantity and greater variety of supply, more efficient pricing, higher quality and encouraging innovation (new forms of payment, new services, etc.).

5. Other notable effects include reducing transaction costs, principally search costs; access to more information at reduced or virtually zero cost; enhancing economic efficiency and competitiveness through greater use of existing resources; and enhanced traceability and transparency in economic transactions.

## 2. Challenges in enforcing competition law

6. The majority of traditional analytical approaches and theoretical models underpinning competition policy pose problems when applied to the analysis of collaborative platforms. One of the main challenges facing competition authorities is therefore how best to take into consideration the network externalities or effects present in these types of collaborative platform.

7. Collaborative platforms, which are by definition multi-sided, differ from one-sided platforms in collaborative activity among users; a collaboration that takes place between equal participants (*i.e.* peer-to-peer). Indirect network externalities are therefore a key aspect of these platforms, their main challenge being to gain enough users on each of the sides to achieve a sufficient critical mass of consumers to potentiate network effects. Consequently, not only can the existence of network effects heighten barriers to market entry by new operators, it can also encourage the emergence of operators with market power.

8. Despite this initial advantage afforded by network externalities, the platforms set up may not obtain market power. On the one hand, the new platforms may offer differentiated products, distinguishing themselves from their rivals. However, in some cases, in aggregate, consumers can have significant disciplinary power over the platform by possessing information, having nil or insignificant switching costs and having the ability to affiliate with several platforms at once. This phenomenon is called “multi-homing”. Multi-homing has the potential to mitigate the lock-in effects of markets with network effects, helping to make markets more accessible.

9. In some cases, however, the leading platform will obtain significant market power and can thereby influence supply prices through recommendations or guidelines (either through pricing recommendations or clauses referring to rivals). There are multiple examples of clauses referring to rivals, such as exclusivity agreements, which prevent relationships with any rival or competitor, discount clauses referring to sales placed with other operators, and so on. However, despite the potential risk of market lock-in or a reduction in effective competition, these clauses are not always anti-competitive (for example, when they generate efficiencies).

10. In any case, clauses referring to rivals and the effects of differentiation and multi-homing must be both scrutinised and assessed on a case-by-case basis by competition authorities. Similarly, there is also the risk of concerted or consciously parallel practices in the case of collaborative platforms. When two or more traditional operators co-ordinate their strategies in one-sided markets, the result is, generally speaking, an increase in prices and reduced consumer welfare. The economic theory of multi-sided platforms produces much less clear predictions, and this complicates the task of competition authorities. Moreover, due to the existence of interdependent demands, whether collusion is harder or easier for collaborative platforms than for traditional one-sided businesses is subject to debate. It certainly seems that the need to reach agreements on prices on different sides of the demand (or consumer groups) makes collusive conduct more complex.

11. However, it should nonetheless be noted that these types of collaborative platform usually occur in dynamic markets where innovation is generating new, deeper markets. The result of this dynamism can be that network effects initially favouring the growth of the incumbent also facilitate the emergence of a new entrant in the short term. Thus, government authorities should not impede technological development in these markets, but should instead enable and promote disruption by new innovative platforms. In particular, public authorities must ensure that regulations are not restrictive, while competition authorities must guarantee and promote effective competition among market operators.

### 3. Challenges and opportunities for promoting competition

12. The disruptive traits of the sharing economy pose various challenges for government authorities. The main challenge is to respond by adapting existing regulations to these new economic models in which innovation and consumer *empowerment* appear to be a defining feature.

13. The CNMC (Spain's National Authority for Markets and Competition) believes that the competent authorities' regulatory response should be based on the principles of efficient economic regulation. That is, government intervention is justified only if there is proof of market failures and, if such intervention has a causal link with the market failure to be protected (principle of necessity), it is proportionate to the objective pursued, *i.e.* it introduces the minimum possible distortion of competition (principle of proportionality) and is applied in a non-discriminatory manner. From a theoretical perspective, these market failures can be grouped into five categories: (i) the existence of market power; (ii) externalities, whether positive or negative, that are not covered by the market's price mechanism; (iii) the existence of information problems; (iv) public goods; and (v) incomplete markets.

14. Action by the public authorities that is far removed from these principles of efficient economic regulation would constitute a barrier to entry by new market operators and to the development of new business models, preventing new players from developing and drawing on the innovations and productivity gains from these new models. All of this would generate a loss of welfare for consumers and for society. That is why the principal task, for promoting competition, is to ensure that existing (and future) regulations do not impede the correct functioning of these markets by introducing restrictions on effective market competition and to entry by new operators.

15. Accommodation and transport are two sectors in which the sharing economy has aroused most interest, and where most regulatory challenges have arisen in Spain. First, because these are sectors that receive greater investment globally. Second, because in these two sectors, there are platforms in Spain facing court proceedings. In the urban transport sector, in December 2014, a court in Spain, among other protective measures, ordered the cessation and suspension of the Uber service provision and concession, making Spain the first country in which Uber closed its urban transport service. Meanwhile, Blablacar, another platform for intercity passenger transport, and Airbnb, a holiday rentals platform, are now respectively facing legal and administrative proceedings.

16. For this reason, on 6 November 2014, the CNMC launched a public consultation on new forms of procurement and exchange via the Internet, and the phenomenon known as the "sharing economy", with a particular focus on the passenger transport and tourist accommodation sectors. With this consultation, the CNMC sought to obtain the views of all parties interested in giving their point of view, in order to analyse this with a view to the preparation of a study on *New Models of Service Delivery and the Sharing Economy*. The ultimate aim of this study is to produce a series of recommendations to ensure efficient regulations are applied to the sharing economy, to the benefit of consumers and users and, specifically, competition in markets.

17. This study is one of the functions provided for in Law 3/2013 of 4 June 2013 establishing the CNMC, which grants the CNMC the ability to promote and conduct studies and research into competition, as well as producing general reports on specific economic sectors.

18. During preparation of the aforesaid study, the defining features of both markets were analysed in depth, together with existing restrictions on competition. Thus, in the tourist accommodation sector, coinciding with the delegation of authority for tourist rentals to regional level, the emergence of a number of collaborative platforms has been observed. Competing among themselves, these platforms make short-term property rentals of complete homes or rooms available on the market. This new supply of accommodation broadly benefits the level of market competition by introducing new forms of accommodation that complement and/or compete with the traditional supply of tourist hotels and apartments.

19. During preparation of the study, the CNMC detected several regional regulations that impose undue access and operating restrictions on the tourist accommodation market. This has negative effects on competition and welfare, such as the *de facto* establishment of an accreditation scheme at start-up, the limitation on the type of property and its location, the restriction on the number of days the property can be rented, and the imposition of quantitative restrictions that are economically ineffective, such as the establishment of moratoria. Barriers to effective competition caused by the regulations hinder innovation and reduce market dynamism.

20. Given the severity of the restrictions contained in two regulations in particular, the CNMC decided to challenge the regulations on tourist accommodation in the Community of Madrid and in the Canary Islands before the Spanish courts.

21. Both regulations included barriers to effective competition in markets, in that they restricted end consumers' capacity to choose and increased operators' costs, ultimately reflected in higher end prices for consumers. Specifically, in the Community of Madrid, the contested regulation prevented tourist properties from being hired for periods of less than five days. In the case of the Canary Islands, the regulations (i) ruled out properties located in tourist resorts, zones and land; (ii) prohibited rental per room or bedroom; (iii) made starting up subject to an affidavit of liability; and (iv) required the display of a distinctive plaque of the undertaking on the outside of the property and, inside the property, a sign stating telephone helplines in case of emergency, and a list of what is prohibited in the regulations.

22. Pursuant to Article 5.4 of Law 3/2013 of 4 June 2013 establishing the National Authority for Markets and Competition (CNMC), which states that the CNMC is authorised to challenge acts by government authorities subject to administrative law and provisions subordinate to the law that generate barriers to maintaining effective competition in markets, the CNMC decided to file an administrative appeal against both regulations.

23. In the transport sector, in recent years, new models offering new urban and intercity transport solutions have emerged for users. The premise of these new models is using mobile applications to put users in contact with available vehicles in order to request short-distance urban transport within the locality. These new services offer an alternative to the services traditionally offered by the taxi sector and by chauffeur-driven passenger car hire.

24. During preparation of the study, significant undue restrictions on market entry and doing business in the Spanish market were detected in municipal regulations. These restrictions include the maximum quota of licences, the limited geographical scope of the licence and, in the case of taxis, regulated prices in the form of fixed public tariffs. These restrictions hinder or even prevent entry by new operators, generating monopolistic income for incumbents and causing the market to function less efficiently for society.

25. As in the case of tourist accommodation, the CNMC decided to issue the municipalities of Cordoba and Malaga with orders for the annulment of various articles of the municipal ordinances covering the taxi service, on the basis that these articles were especially harmful to free competition. These orders for annulment represent a preliminary step that seeks to avoid filing an administrative appeal if the

two municipalities do not amend or withdraw the restrictions introduced in the taxi sector. Specifically, the CNMC identified five separate categories of impediments included in the aforesaid ordinances: (i) the establishment of a maximum quota of taxi licences; (ii) the undue limitation of operators' right to organise; (iii) the existence of minimum quality and security requirements that were disproportionate or unnecessary, such as that the licensed vehicle should not be more than two years old; and (iv) fares designated as maximum fares in the regulations but outlined as mandatory in other directives, for example, in the minimum fare directive. The regulation was deemed to be preventing market entry and price competition in the provision of taxi services, with resultant harm to consumers.

26. As a disruptive innovation, the sharing economy is capable of generating a number of advantages and benefits to consumers. Lack of response from the public sector or the establishment of unnecessary or disproportionate barriers to doing business diminish dynamism in the market and offer greater leverage to public authorities that are able to review the regulations and remove barriers to entry and doing business.

27. Various government authorities have, at different administrative levels, decided to review the regulations by facilitating the competitive tension that is generated by the presence of new operators, in this instance in the form of Mexico, Amsterdam, Paris, London, Estonia, etc.

28. In this context of innovation and dynamism, the competition authorities have an opportunity, particularly in the promotion of competition and efficient regulation, to foster less restrictive regulations that favour dynamic and competitive markets, much to society's advantage.