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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

HEARING ON ACROSS PLATFORM PARITY AGREEMENTS

-- Note by BIAC --

27-28 October 2015

This document reproduces a written contribution from BIAC submitted for Item 7 of the 124th OECD Competition Committee on 27-28 October 2015.

More documents related to this discussion can be found at www.oecd.org/daf/competition/competition-crossplatform-parity.htm

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-- **Business and Industry Advisory Committee (BIAC)** --

1. Introduction

1. BIAC welcomes the opportunity to provide its views to the OECD Competition Committee on across platform parity agreements ("APPAs"). The treatment of these arrangements is a concern for business and the challenge in assessing them is reflected by the fact that, although multiple investigations into these arrangements have been opened across the world in recent years, a number of different approaches are taken, with differing outcomes:

(i) The European Commission has invested time and effort to coordinate in this area but the agencies of EU member states appear to have differing views on the competitive impact of APPAs on inter- and intra-brand competition, the circumstances in which they may be efficiency-enhancing and the appropriate standard of analysis.¹

(ii) Recent legislation in France takes a strict approach to APPAs by banning all rate parity clauses in contracts between price comparison websites and hotels, which is at odds with the approach taken by the French competition authority in its Booking.com investigation which viewed narrow online MFNs as permissible.² Israel also prohibits APPAs under its restrictive practices law without an analysis of the actual effects of such provisions.³

(iii) BIAC understands that the Australian competition authority has used its "facilitating practices" provisions to challenge APPAs. While the agency enforcement decision was overturned on appeal, that outcome is now being appealed by the authority.

(iv) Press reports suggest that China may regulate e-commerce platforms in the automotive sector.⁴ BIAC understands that APPAs could potentially be pursued in China either as a monopoly agreement (i.e. a vertical anticompetitive agreement) or as an abuse of dominance.

(v) In contrast, in the USA, enforcement has been limited to parity clauses which were allegedly part of a wider collusive strategy.⁵

2. BIAC considers that it is important and timely for WP3 to consider APPAs. Comprehensible and coherent guidance on this topic would be welcomed by business, particularly since these models are often operated internationally and can be undermined even where decisions of competition agencies are limited to national markets.

¹ In particular, the agencies of each of the UK, Italy, France, Sweden (and presumably the European Commission itself, given its coordinating role) seem more sympathetic to 'free rider' arguments than Germany. While the Swedish, French and Italian competition agencies took the view that in the Booking.com case narrow MFNs provided a satisfactory alternative to wide MFNs, the Bundeskartellamt took a harsher line and held that a complete ban on MFNs was justified. The Bundeskartellamt noted that the divergent approach was possible as its decision concerned the national German market.

² <http://www.mlex.com/EU/Content.aspx?ID=691162>

³ <http://www.icn2015.com.au/download/ICN2015-special-project-online-vertical-restraints.pdf> (page 72)

⁴ <http://www.mlex.com/China/Content.aspx?ID=708526>

⁵ United States v. Apple Inc., No. 13-3741-cv(2d Cir 2015) at page 58 confirming that parity clauses were condemned not because of their independent effect but because of the alleged conspiracy orchestrated among publishers. See also Prof Ariel Ezrachi for this Hearing at page 17.

3. Against this backdrop, BIAC makes three specific points in connection with APPAs which are developed further in the following sections of this submission.

4. First, BIAC is conscious that APPAs can take on a variety of forms and may have different effects (including in different markets simultaneously). As such, BIAC believes that APPAs should be assessed in their proper legal and economic context and under a rule of reason or “by effect” standard. BIAC is concerned that, if APPAs are presumed to have an anticompetitive effect, business will face very significant challenges in jurisdictions which have a strong (if rebuttable) market share based dominance presumption and uncertain procedural rules.

5. Second, BIAC submits that, to avoid over-enforcement, inconsistent outcomes and the risk of over-simplifying issues for less experienced agencies, any enforcement should be based on a robust theory of harm, supported by empirical evidence.

6. Third, as a corollary, BIAC considers that the antitrust assessment should include full consideration of the likely benefits and efficiencies. There is a risk in that resolving cases without conducting, in advance, a genuine assessment of the likely effects will result in enforcement outcomes which are not in the consumer interest. There is a particular risk of divergent and unintended outcomes when an agency is able to offer an alternative to a fully reasoned decision, in particular in the form of settlements or commitments without a full consideration of the economic arguments by that agency or indeed by other agencies.

2. Background and economic rationale

7. Before discussing APPA’s, it is helpful to note that APPAs in the online environment tend to be agreed between suppliers of goods or services and an intermediary - the platform – that is active in the downstream market. Such platforms may operate in different roles, including as wholesalers buying goods for resale, on an agency basis or as price comparison websites. They provide a range of benefits to consumers.

8. Specifically, platforms may improve information flows by bringing together information from different suppliers and product offerings. As potential customers are able to more quickly and more efficiently access and process information, platforms contribute to lowering information and search costs, which may in turn lead to allocation efficiencies,⁶ price transparency and support a reduction of market power of sellers and a lowering of switching costs.⁷

⁶ J. Yannis Bakos, ‘Reducing Buyer Search Costs: Implications for Electronic Market Places’, [1997] 43 (12) *Management Science* 1, 5.

⁷ J. Yannis Bakos, ‘Reducing Buyer Search Costs: Implications for Electronic Market Places’, [1997] 43 (12) *Management Science* 1, 13; Joseph E Stiglitz, ‘Imperfect information in the product market’ in *Handbook of Industrial Organisation* (Volume 1), edited by R. Schmalensee and R. D Willig (Elsevier Science Publishers, 1989) 769; J. Yannis Bakos, ‘A Strategic Analysis of Economic marketplaces’, [1991] *MIS Quarterly* 295..

9. Platforms may also offer significant benefits for suppliers. They provide a valuable channel for entry and expansion, in particular for smaller and less sophisticated sellers.⁸ They mitigate cost and risk associated with advertising and can provide a safe online environment where consumers may be willing to enter into transactions with suppliers that they may otherwise not select.

10. APPAs, which are a type of “most-favoured-nation clause” (“MFN”) play an increasingly important role in the relationship between platforms and their suppliers. These provisions seek to provide assurance to the downstream platform that it and its customers receive goods or services from the supplier, at terms that are at least as favourable as those offered to other buyers.

11. APPAs differ considerably in their scope and operation but competition authorities have divided them into two broad categories: narrow and wide, differentiated by their scope and effects. Typically, a narrow APPA ensures that the prices and terms quoted on the online platform will not be less attractive than those that are available directly from the upstream supplier (either on its website or, in some cases, also offline). A wide APPA clause provides for similar protection, but in addition ensures that the price and terms offered on the platform will not be higher than on any other platform.⁹

12. The supplier may use an online platform as its sole platform, or in addition to selling goods through other means, either online or offline. The platform, on its part, offers demand-enhancing features (marketing, advertising, guarantees, information, reviews) that benefit the supplier’s products. These features generally require continuing investments. APPAs often play a critical role in facilitating those investments.

13. One of the main and most frequent phenomena in vertical relationships that may hamper a company operating in a downstream market is the risk of free-riding. This vertical externality may undermine the retailer’s incentive to invest. One example is the situation where the supplier is able to undercut the price offered on the platform, thereby incentivising buyers to use the platform for search, information and other services, while subsequently concluding the transaction direct with the upstream provider. In addition to such a vertical externality, platforms may also be disincentivised from investing in demand-enhancing features where other platforms are permitted to free-ride on the platform’s investments. In such a setting, the externality is of a horizontal nature.

14. APPAs are often included in vertical agreements in order to minimise these externalities and facilitate investments. For instance, a narrow APPA which prevents the supplier from offering products or services on its own website at better terms, encourages platforms to invest in the quality of their offering, as customers may not see a benefit in completing the transaction on the supplier’s website or through other channels.

⁸ Consumer Futures, ‘Price comparison websites: consumer perceptions and experiences’, July 2013, available online: <http://www.consumerfutures.org.uk/files/2013/07/Price-Comparison-Websites-Consumer-perceptions-and-experiences.pdf>, page 35.

⁹ MFNs may also be categorised by distribution model that they support. In a wholesale model, MFN clauses governs the price at which the upstream buyer will sell on the online platform. In contrast, under an agency model, the upstream supplier sets the price on the platform. In those cases the MFN ensures that products and services sold through the platform will be priced competitively. Other distribution models may include a combination of both wholesale and agency agreements.

15. Other potential benefits of APPAs include their role in supporting risk-sharing between the upstream and downstream operators and preventing delays in transacting (by removing uncertainty of better alternative offers) and reducing transaction costs (by avoiding the need for negotiation of terms between the contracting parties).¹⁰

3. APPAs are agreed in a vertical context

16. It is important to emphasise that APPAs are agreed between firms operating for the purposes of the agreement at different levels of the supply chain.

17. As an essentially vertical restraint, APPAs will generally be less harmful (absent market power and collusion) than horizontal restraints and may, in contrast, provide substantial scope for efficiencies. After all, absent market power, a supplier can generally be assumed, in the absence of special circumstances, to be choosing the way to distribute its products which is best for consumers.

18. BIAC therefore notes that competition concerns will only arise if there is insufficient competition at one or more levels of trade, i.e. some significant degree of market power at the level of the supplier or buyer or both levels, or collusion either between suppliers or between buyers. This is reflected by the fact that restrictions included in vertical agreements are block-exempted under EU competition law, provided certain criteria are met.

19. BIAC would therefore be concerned about intervention without evidence of actual competitive harm and emphasises that competition authorities should not intervene in the absence of market power or other exceptional circumstances. In BIAC's view, it would also be constructive to specifically acknowledge that APPAs can be positive or at least neutral in competitive effect.

4. The need for evidence-based enforcement

20. In BIAC's view, any enforcement action in this area must be based on a robust theory of harm, supported by empirical evidence. Care should also be taken not to conflate distinct antitrust categories such that particular conduct qualifies (unduly) for per se treatment.

21. BIAC is also conscious that, in common with many areas of antitrust, there is often no shortage of (theoretical) theories of harm that can be put forward. Consequently, BIAC believes that agencies must ensure that only theories which are supported by evidence are taken forward. This is where commitments, particularly attractive to defendants using international business models, may give rise to problems for development of the law.

22. In BIAC's view, enforcement which is unsupported by sound evidence may give rise to a number of risks for business. For example, there may be a risk of over-enforcement - especially in new markets which are in the course of being 'disrupted' by innovators.

23. BIAC is also concerned that inconsistency could give rise to undue uncertainty for business, which may increase as e-commerce becomes even more prevalent. BIAC would be concerned about any chilling effect on legitimate and commonly used business arrangements. There is also a risk, it seems, of a loss of agency credibility (especially in regions which apply the same substantive law).

¹⁰ Martha Samuelson, Nikita Piankov, Brian Ellman, 'Assessing the effects of most-favored nation clauses', ABA Section of Antitrust Law Spring Meeting, 2012; Jonathan B. Baker and Judith A. Chevalier, 'The Competitive Consequences of Most-Favored-Nation Provisions', (April 15, 2013), Antitrust Magazine, Vol. 27, No. 2, 2013, available on SSRN: <http://ssrn.com/abstract=2251165>.

24. Finally, BIAC is concerned that less experienced agencies may 'follow' (whether by enforcement or regulation) without having properly assessed the facts and specific economic impact of the clauses in question.

5. The need to assess APPAs in their proper legal and economic context

25. Given that many vertical restraints are benign in effect or generate benefits for consumers, BIAC submits that it is necessary to examine their effects in their actual legal and economic context. BIAC suggests that following issues may require careful consideration by agencies:

(i) What is nature of the clause at hand and how does it operate? This is especially important given the variety of clauses in this area. As will be discussed in some additional detail below, narrow APPAs may have a different effect compared to wide APPAs. Relatively subtle variations may alter the competitive impact to a material degree. For example, an apparent reduction in inter-platform price competition as a result of an APPA may be mitigated where platforms are able to pass on their commissions direct to end-customers (and therefore enhance price competition).

(ii) Who is benefitting versus who is at risk of being harmed. BIAC notes that this presupposes rigour around the definition of the relevant market. If the theory is one of foreclosure then BIAC points out that actual evidence of hindered market entry or of constrained growth is needed.

(iii) Two-sided markets: because APPAs are often used in the context of two-sided markets, it is necessary to examine how the clauses operate and affect incentives at both sides of the market. In BIAC's view, this feature in itself precludes a *per se* or "by object"¹¹ approach. On the one hand, BIAC notes that the need for platform operators to be able to attract both merchants and consumers (e.g. hotels and travellers) may give rise to specific concerns of foreclosure/barriers to entry. For example, an APPA may preclude price competition from a new entrant (since lower commissions would not encourage suppliers to offer lower prices on the new entrant platform). However, the impact would need to be addressed by reference to the nature and degree of actual competition in the market. BIAC is keen that enforcement does not simply protect individual competitors. Indeed, in certain situations, APPAs could facilitate new entry by enabling smaller firms to make price promises to consumers or, where commissions may be shared with the end customer, by being more competitive on price than might otherwise be the case.

(iv) Market characteristics will be key: e.g. power/concentration; heterogeneity of buyers/sellers; entry barriers; market coverage.

26. BIAC notes that the literature on MFNs contains some useful factors/indicia which agencies (and business/advisors) can consider when assessing the likely impact of MFNs.¹² At the same time, BIAC believes that it is important that "rules of thumb" do not become enforcement short-cuts and, as a consequence, a substitute for a proper and balanced assessment of the economic impact of the clauses in question.

¹¹ See for example *Cartes Bancaires* which counsels against use of *per se* approach in, for example, two sided markets - judgment of 11 September 2014, *CB / Commission* (C-67/13 P) ECLI:EU:C:2014:2204

¹² See for example Salop S.C. and F. Scott Morton (2012), *Developing an Administrable MFN Enforcement Policy*, 27 *Antitrust* 15.

6. Potentially negative effects of APPAs

27. Platforms may bring about significant consumer benefits and, as set out above, APPAs may be instrumental to their operation. However, APPAs may in exceptional circumstances also produce negative effects and therefore require careful review and balancing.¹³ BIAC stresses again that the precise welfare effects of APPAs depend on their scope, application, the level and nature of competition at different levels of the supply chain and other relevant factors.¹⁴ BIAC believes that the following three observations are particularly relevant for the proper assessment of APPAs.

28. First, as narrow and wide APPAs produce different results, it is critically important to understand the precise scope of the parity clause under consideration.

29. Second, while negative effects on interbrand competition are perhaps more likely to occur in the context of wide APPAs, negative effects are never a given. As a result, a per se treatment of wide APPAs is not warranted.

30. Third, it is important to distinguish between the various theories of harm that may potentially apply to a given case and to ensure that a finding of an antitrust violation is supported by a credible and specific theory of harm that is properly substantiated by evidence. In this context, it is relevant to distinguish between theories of harm that are based on exclusionary and collusive effects.

31. Below, BIAC summarises briefly three theories of harm that are most commonly associated with (agency-model) wide APPAs, followed by a brief discussion of potential competitive effects of narrow APPAs.

6.1 *Wide APPAs*

32. First, wide APPAs may soften competition between platforms with respect to the fees they charge to their suppliers. This may lead to higher commissions.¹⁵ However, in many cases this effect is not likely to occur, in particular where suppliers have buyer power, or can credibly threaten to terminate their agreements with the platform.

33. Second, while wide APPAs may sometimes increase market-wide price uniformity, and result in less interbrand competition upstream, those effects are critically dependent on a multitude of factors, in particular the nature and intensity of interbrand competition.

34. Third, in some cases wide APPAs may hinder entry by competing, lower-cost, platforms. However, this theory of harm is also dependent on a number of necessary conditions, while in some cases wide APPAs may actually encourage entry of platforms (in particular because they may prevent free-riding by other platforms).¹⁶

¹³ On the necessity of case-by-case assessment, see for instance the UK Office of Fair Trading Report (Lear) (2012), “Can ‘Fair Prices’ Be Unfair? A Review of Price Relationship Agreements”, point 6.75.

¹⁴ For a review of the range of factors which play a role in the assessment, see Steven C. Salop and Fiona Scott Morton, ‘Developing an Administrable MFN Enforcement Policy’, (2013) *Antitrust*, Vol. 27, No. 2, Page 15.

¹⁵ See Boik and Corts, ‘The Effects of Platform MFNs on Competition and Entry.’” http://economics.yale.edu/sites/default/files/corts_17-oct-2013.pdf

¹⁶ Idem and see paragraph 25(iii) above.

6.2 *Narrow APPAs*

35. In contrast, narrow APPAs do not give rise to many of the theoretical concerns associated with wide APPAs.

36. First, narrow APPAs do not prevent suppliers undercutting their prices on a particular platform elsewhere and may, as a consequence, allow interbrand competition between different platforms. In addition, narrow APPAs allow intrabrand competition as suppliers are able to offer different prices on different platforms.

37. Nonetheless, narrow APPAs may reduce competition between the supplier and the platform but this reduction of intrabrand competition may result in higher prices only where interbrand competition is weak.

38. In addition, it has been suggested that the combined effect of a number of narrow APPAs may limit price competition between platforms.¹⁷

7. **Benefits and efficiencies**

39. BIAC would stress that vertical restraints such as APPAs have a number of positive effects. It is important for agencies to assess these and base their conclusions on empirical evidence.

40. Just like other vertical restraints, APPAs may be justified to solve a free-rider problem. For example, an APPA may help a high cost/high quality (or high reputation) platform to defend its quality (and reputational) investments, by preventing other platforms from free-riding on them.¹⁸

41. The UK competition authority reached a similar conclusion on the free-rider problem in PMI.¹⁹ The distinction between narrow and wide APPAs underlies commitments accepted in recent investigations by the Italian, French and Swedish competition authorities.²⁰ Other agencies (such as the German agency) have been more sceptical of free riding arguments.²¹ It may be useful to examine the impact of any free-riding²² and look for evidence of the effect of removal of the alleged foreclosure in Germany, given recent enforcement in the hotel sector there.

42. More generally BIAC is conscious that a platform may have every incentive to attempt to ensure it offers lower retail prices because that has an impact on the number of customers it attracts.

¹⁷ See CMA Report on the Private Motor Insurance Market, points 8.46- 8.54.

¹⁸ Lear (2012), Can Fair Prices be Unfair? A Review of Price Relationship Agreements, OFT1438. paras 6.71 -6.75. http://www.learlab.com/pdf/oft1438_1347291420.pdf

¹⁹ Private Motor Insurance, https://assets.digital.cabinet-office.gov.uk/media/5421c2ade5274a1314000001/Final_report.pdf

²⁰ <http://www.mlex.com/EU/Content.aspx?ID=622587>

²¹ http://www.bundeskartellamt.de/SharedDocs/Entscheidungen/EN/Entscheidungen/Kartellverbot/B9-66-10.pdf;jsessionid=59344D3A02EE4549A8C20E488ED3634D.1_cid371?_blob=publicationFile&v=3

²² Although noting that platforms operating internationally may still have sufficient incentives to invest despite the weakening of these incentives in a single free-riding jurisdiction.

8. Conclusion

43. In summary, APPAs may produce a number of complex and inter-related effects that require a careful and fact-specific analysis. On the one hand, they produce unambiguous positive effects that benefit suppliers, online intermediaries and customers. On the other hand, they may sometimes produce negative effects on interbrand competition.

44. In light of the ambiguous effects that APPAs may produce, there is no basis for subjecting them to a per-se analysis. Instead, these provisions require a fact and market-specific analysis.

45. Recently, many European competition enforcement agencies have found that narrow APPAs provide an adequate balance by providing platforms a limited degree of protection against free-riding, while at the same time safeguarding sufficient intra-and interbrand competition.

46. BIAC is concerned that at least one European competition agency has taken a radically different approach vis a vis narrow APPAs and believes that there is a need for reinforced cooperation mechanisms between European competition agencies to minimise the risk of such diverging outcomes.

47. BIAC is equally concerned that the legislator in at least one European jurisdiction has put forward an absolute ban on APPAs, deviating from the findings of that country's own competition agency.

48. Faced with the fundamentally different approaches currently taken by various competition authorities with respect to the proper analysis of APPAs, BIAC respectfully submits two suggestions. First, that competition authorities should confirm that all APPAs ought invariably to be subjected to an effect-based analysis and that a per-se standard is inappropriate. Second, BIAC suggests that authorities should seek to align their approach to each aspect of the analysis, in particular when APPAs restrict competition between the platform and suppliers, how the effects of narrow and wide APPAs differ, which efficiency benefits may be created and how to evaluate the risk that free-riding or other factors may undermine these benefits. Convergence on these essential aspects of the analysis of these important contractual arrangements would bring significant benefits to international online platforms and their users, both upstream suppliers and downstream customers.