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Competition law in times of digital transformation

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Digital Transformation

Competition law in times of digital transformation – what does digital transformation mean?

Digital transformation can be described as the changes associated with the application of digital technology in all aspects of human society.

First report of the Strategic Policy Forum: Digital Transformation of European industry and enterprises (2015): - In March 2015, the Forum delivered its first recommendations for political and business leaders to help deal with the need for jobs and growth. The report identifies the **key challenges for Europe** and it provides evidence of the **new business opportunities offered by unprecedented business models that are empowered by advanced digital technologies**. - The work and recommendations of the Strategic Policy Forum had a great impact and helped shape a number of EU policy initiatives and follow-up actions. (see: http://ec.europa.eu/growth/sectors/digital-economy/entrepreneurship/strategic-policy-forum_en)

“Several Commission departments are working on the **Digital Single Market** at the moment.” (Margrethe Vestager, in a speech on 26 March 2015 with the title “Competition policy for the Digital Single Market: Focus on e-commerce”)

Agreements: Background

Margrethe Vestager, Commissioner for Competition, in a speech on 26 March 2015 with the title "Competition policy for the Digital Single Market: Focus on e-commerce" (1):

"Unfortunately, buying goods online is a lot more difficult [than taking back home the goods you have bought during your trip]. It sounds like a paradox, but we still have a number of digital borders. **It is high time we removed these barriers**, which keep Europe's digital markets fragmented."

"[…] it will not come as a surprise to you that the **digital economy is among my priorities**. European consumers should be able to access goods, content, and other services no matter where they live and travel in Europe."

"The bad news is that the reality on the ground is a far cry from really integrated digital markets. There are still many barriers that keep them fragmented. - Some of these barriers are due to public policies. **Others are erected by companies**, either because of the way they run their business or because of the arrangements they have with other companies. - **And this is where competition policy comes into the picture**."

Agreements: Guidelines on Vertical Restraints

Margrethe Vestager, Commissioner for Competition, in a speech on 26 March 2015 with the title "Competition policy for the Digital Single Market: Focus on e-commerce" (2):

"[…] But often it's the companies themselves that **undermine cross-border trade** by erecting technical barriers such as geo-blocking."

"Restrictions like these are **often the result of arrangements** that are included in contracts between manufacturers and content owners on one side and their distributors on the other."

"These arrangements fall under EU competition law. Specifically, they are covered by the Block Exemption Regulation and the **Guidelines on Vertical Restraints** – also called Vertical Guidelines. - The Commission updated these rules in 2010. The review made clear that, in principle, **every distributor must be allowed to use the internet to sell its products**."

"Contractual bans of so-called **passive online sales** are therefore considered hard-core restrictions of competition."

Agreements: Sector Inquiry

Margrethe Vestager, Commissioner for Competition, in a speech on 26 March 2015 with the title "Competition policy for the Digital Single Market: Focus on e-commerce" (3):

"But online business and markets move quickly and the **Vertical Guidelines can only give us a general framework**."

"We need to put more flesh on the bones […]."

"Launching an inquiry into the e-commerce sector"

"We want to **focus on the barriers to the cross-border sale** of goods and digital content erected by private companies, especially in their distribution contracts. We also want to focus on the areas where e-commerce is most used."

→ On 15 September 2016, the **European Commission** publishes a **preliminary report on the e-commerce sector inquiry**: It "confirms the fast growth of e-commerce in the EU and identifies **business practices that might restrict competition and limit consumer choice**."

Agreements: Sector Inquiry Findings

European Commission's preliminary report on e-commerce sector inquiry (1):

The European Commission investigates:

- E-commerce (online sale) of consumer goods
- E-commerce in digital content

In relation to **e-commerce (online sale) of consumer goods**, the European Commission found an increasing use of **contractual sales restrictions in distribution agreements**, i.e.:

- Pricing limitations / recommendations (42% share of retailers with contractual restrictions)
- Limitation to sell on online marketplaces (18%)
- Limitation to sell cross-border (11%)
- Limitation to sell on own website (11%)
- Limitation to use price comparison tools (9%)
- Limitation to advertise online (8%)
- Other limitations (4%)

The term "geo-blocking" is also used in relation with e-commerce of consumer goods.

Agreements: Sector Inquiry Findings

European Commission's preliminary report on e-commerce sector inquiry (2):

In relation to **e-commerce in digital content**, the European Commission identified in its initial results the following main licensing practices:

- **Contractual restrictions** in relation to transmission technologies, timing of releases and territories:
  - Implementation of at least one type of geo-blocking measure (68% of content providers).
  - Agreements with rights holders to restrict access to online digital content services for users from other Member States by means of geo-blocking ("large majority").
  - Exclusive agreements and geo-blocking are widespread.

- **Duration** of licensing agreements and contractual relationships:
  - Right holders tend to have relatively long-term licensing agreements with digital content providers.
  - 4/5 have duration of at least 2 years and almost 1/10 have duration of over 10 years.
  - Competing digital content providers may face difficulties in accessing rights that are under long-term exclusive agreements between their competitors and right holders.
  - This issue may be exacerbated by: right to first renewal, automatic renewal clauses, etc.

Agreements: Case Law

Case law (1):

- **Restriction of online trading** (RPW 2011/3, 372) and Jura (RPW 2014/2, 407):
  - Lawful: Restrictions on online trading **in selective distribution systems**, however:
  - Unlawful: Resale price maintenance (caution re rebates / unilateral influence on prices)
  - Unlawful: Partitioning / foreclosure of markets (including internet sales)
  - Lawful: Exclusion of warranty services re products purchased from not authorized dealers

- **Price recommendations** (Hors-Liste, RPW 2010/4, 660; Dermalogica RPW 2014/1, 191):
  - Lawful: Recommendations are publicly available, marked as non-binding and not supported by pressure or incentives, unless they are observed by significant portion of addressees
  - Unlawful: Recommendations are **observed by significant portion of addressees**, even if there is no pressure or incentive → **Substantial risk / beyond control of undertakings**
  - Grey area: Recommendations are not observed by significant portion of addressees and not supported by pressure or incentive, but are not marked as non-binding and/or not publicly available and/or prices for the products are higher than for similar products abroad
  - Note: legal situation controversial; section 15 para. 2 VertBek of COMCO: pressure and/or incentives necessary for recommendation to be unlawful; COMCO: recommendations are unlawful if they were observed by significant portion of addressees / **EU law is less strict**

Agreements: Case Law

Case law (2):

- **Hotel booking platforms** (RPW 2016/1, 67):
  - Unlawful: Wide parity clauses regarding price, availability and other conditions (prohibiting hotels to offer better conditions on other distribution channels)
  - Lawful / left open: Narrow parity clauses (prohibiting hotels to offer better conditions on their own direct online distribution channels)
  - No sanctions because no hardcore restrictions covered by Art. 5 Para. 4 CartA

- **Restrictions to use online platforms** (German case law, ongoing developments of practice):
  - Lawful: Prohibition of distribution via Amazon
  - Unlawful: Prohibition to use search engines
  - Unlawful: Prohibition to use trademarks on websites of third parties
  - Unlawful: Prohibition to use price comparison engines
  - Note: Pending cases, ongoing developments

Agreements: Case Law

Case law (3):

- **Geo-blocking** (Europe):
  - European Commission's preliminary report on e-commerce sector inquiry (cf. above)
  - ECJ decision of 4 October 2011 re Football Association Premier League Ltd vs. Karen Murphy: Licenses between rights holders and broadcasters under which the broadcaster agrees not to supply its **decoding devices** to people outside the licensed territory amounted to a restriction on competition prohibited by Article 101 of the Treaty on the Functioning of European Union (TFEU) and are therefore unenforceable.
  - What about **digital content transmitted e.g. online or via satellite**? – Paramount:
    - **Film licensing contracts included clauses** that (a) required Sky UK to block access to Paramount's films through its online or satellite pay-TV services (so-called "geo-blocking") to consumers outside its licensed territory (UK and Ireland) and (b) required Paramount to ensure that broadcasters outside the UK and Ireland are prevented from making their pay-TV services available in the UK and Ireland.
    - Found that this **restricts** broadcasters to accept unsolicited requests ("**passive sales**") for their pay-TV services from consumers located outside their licensed territory.
    - On 26 July 2016, European Commission **accepted commitments** by Paramount on cross-border pay-TV services. – **Is this the last word?**

Agreements: Conclusions

The following conclusions may be drawn:

- The European Commission's *preliminary* report on **e-commerce sector inquiry** published on 15 September 2016 **identifies business practices that might restrict competition and limit consumer choice**.

- **Hardcore restrictions** according to Art. 5 Para. 3 and 4 CartA that are subject to direct sanctions **should be avoided**. In vertical relationships particular caution is due in relation to:
  - Any kind or territorial restrictions, including internet sales, geo-blocking
  - Any kind of price fixing; caution is also due in relation to recommended resale prices

- **Monitor developments in e-commerce**. The European Commission appears to be determined to change existing market structures and legal frameworks. This will not only have an impact in the EU, but also in Switzerland.

- We should expect **more to come**.

Market Dominance – Two-sided Markets

Two-sided markets often lead to strong market power and must be assessed differently:

- Two-sided markets (e.g., online portals: Ebay, Amazon; online payment systems: Paypal, Twint; further digital platforms: booking, Uber, Airnbnb): Strong market position due to **indirect network effects**. Indirect network effects mean that the users on the one side (e.g. buyers) have an interest in a high number of users on the other side (e.g., sellers), and vice-versa.

- Market dominance can, due to network effects, be **the economically efficient solution**.

- The price level and the price structure must be differentiated: The **price level** means the total aggregate price paid by both groups of users, and the **price structure** means the amount paid by each group of users. The usual test that a price that is higher than the marginal costs indicates a distortion of competition cannot be applied per se, because the price that both groups of users (market sides) pay regularly differs from the marginal costs generated by them. → **Conclusions:** (i) When assessing the adequacy of a price, the effects (also) on the other market side must be assessed. (ii) The focus should be on the price level rather than on the price structure.

- Both markets should be taken into consideration.

Big Data and Competition Law – some aspects

Possible competition law issues related to Big Data:

- Big Data can often lead to **high market entry barriers**:
  - New market entrants may, unlike established companies, be unable to collect or to buy access to the necessary volume and/or variety of data
  - Competition law: possible obligation for established companies to sell data to new market entrants
  - Take “dataset-volume” of companies into account when assessing a planned merger

- **Market transparency** as a result of Big Data:
  - **Consumers may benefit** from greater market transparency if it allows them to compare more easily prices or characteristics of competing goods or services (e.g., Tripadvisor)
  - The greater information resulting from expanded data collection, especially regarding prices, **may also** be used in ways that could **limit competition** (e.g., facilitate collusion)
  - The **use of algorithms** produced (i) by the same company and even (ii) by different companies could unilaterally be targeted to follow competitors’ price increases, etc.
  - Could **tacit collusion** be the result of sophisticated machine learning and, thus, be unlawful? – Companies have a right to adapt themselves intelligently to the existing or anticipated conduct of their competitors. – Where does collusion start?

Merger Control

Merger control and digital transformation – some aspects:

- Effects of merger on **both market sides should be assessed**; no isolated assessment.
- **Market shares** are only of limited significance.
- Effects on the **price level** (total aggregate price) rather than on the **price structure** (price amount paid by each group of users) should be assessed.
- Besides negative effects on prices, there can be **positive effects** due to network effects. Network effects are maximized in a monopolistic structure.
- **Markets** can be **very dynamic and developing quickly** in case of digital technology and e-commerce: Competition authorities may deem it less necessary to intervene.
- International coordination: **National players** merge in order to be able to compete with **international players** (e.g., this argument was brought forward in the merger Swisscom, SRG, Ringier).

Data Protection – Bonus Material

Not to be forgotten when reviewing digital contents / e-commerce / online transactions: data protection:

Data protection will increasingly become an important topic in the EU and in Switzerland given the threatened high sanctions presumably as from 2018 (at least in the EU; the timetable in Switzerland is yet open):

In the EU sanctions shall amount to up to EUR 20 million or 4% of the worldwide turnover of 1 year in the last business year (whichever is higher) and in Switzerland (as currently proposed) sanctions shall amount to up to 10% of the turnover in Switzerland in the preceding 3 business years – that would be sanctions comparable to the ones under the CartA.

Swiss undertakings that have activities in the EU, as a rule, are subject to the data protection laws in the EU.

Swiss Supreme Court – Bonus Material

The latest decision of the Swiss Federal Supreme Court of 28 June 2016 in the matter Gaba/Gebro is fundamentally changing competition law in Switzerland (decision in writing yet to be published):

The press release reads (extract):

«Preis-, Mengen- und Gebietsabreden im Sinne von Artikel 5 Absätze 3 und 4 KG gelten auch dann, wenn die Vermutung der Wettbewerbsbeseitigung umgestossen wird, aufgrund ihrer Qualität grundsätzlich als erhebliche Beeinträchtigung des Wettbewerbs. Dies gilt unabhängig von quantitativen Kriterien wie der Grösse des Marktanteils der Beteiligten. Entsprechende Abreden sind somit vorbehältlich einer Rechtfertigung durch Gründe der wirtschaftlichen Effizienz unzulässig. Das der Gebro Pharma GmbH auferlegte Exportverbot wurde deshalb zu Recht als unzulässige, den Wettbewerb erheblich beeinträchtigende vertikale Wettbewerbsabrede qualifiziert.»

This decision is surprising given the case law of the Swiss Federal Supreme Court to date, Swiss law, and the rejection of the latest revision of the CartA.

Happy to discuss the consequences of this decision.

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