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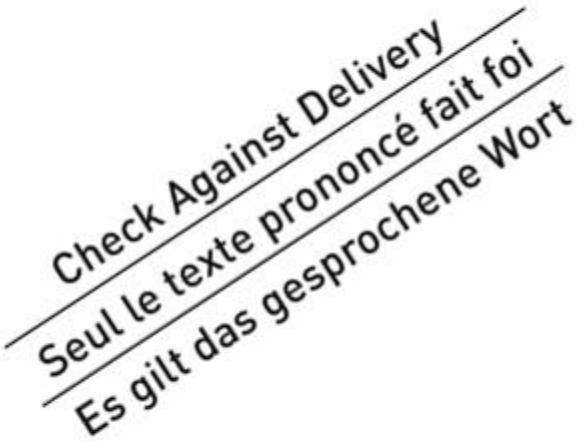
Competition Policy in the Digital Age



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Competition

Competition policy in the Digital Age

Last year, American writer Dave Eggers, who became famous with his book *A heart-breaking-work of staggering genius,* published his latest novel, called *The Circle*.

It is a dystopia: a negative utopia in the tradition of George Orwell's *1984* and Aldous Huxley's *Brave New World*.

In the book, set in the near future, there is a call for American competition authorities to launch investigations into *The Circle*, an all knowing and all seeing social media company that plans to take over the world and destroy all privacy.

This is probably the first time ever that competition law has played a role in a work of science fiction.

I think this perfectly illustrates that the Internet is a new frontier for antitrust enforcement.

Today, I would like to explore just how new the challenges posed by the Internet really are for competition enforcement.

There are two key questions I would like to look at.

First, does the Internet really open up a brave new world for antitrust, or is it in the end just a collection of cables, no different from any other network?

Secondly, either way, what are the consequences for antitrust enforcement, especially within the EU?

Some things, of course, don't change, regardless of the medium we investigate. We fight anti-competitive practices and uphold competition law, also on the Internet. We do so in part because we support innovation, and want the Internet to remain innovative.

When it comes to the internet, some call for greater regulation, and see competition policy as a means to achieve it. Others claim that it is unnecessary to strictly enforce competition law for the online world.

Internet giants are here today, but gone tomorrow, they claim. Developments are so rapid, that competition concerns may simply disappear. After all, everyone knows Facebook. But who still has a Myspace account?

I am sceptical about these claims. First, it's anybody's guess what will happen tomorrow. We enforce competition law in the present, not in the future.

Being featured in a futuristic novel doesn't change this fact.

Secondly, there is nothing new about the process of "creative destruction." In this process described by Joseph Schumpeter – after all we are in Austria today – revolutionary new industries replace the old. Such industries quickly become more mature, their market positions quickly become more stable, and, after a while, innovation takes places incrementally rather than exponentially.

Examples abound: power loom weaving in the 18th century, railroads in the 19th century, the automobile industry between 1910 and 1920, the chemical industry in the 1950s, all these consolidated after a period of rapid growth.

Arguably, this process is already taking place in the computer industry and on the Internet. Extremely innovative companies have appeared over the past decades and continue to do so, on an almost daily basis.

Some of them have quickly matured and established very strong market positions, while others have been absorbed or quickly forgotten. Nobody will know what the situation will be ten, or even five, years from now. This means that any of these companies is until further notice a potential client for us – and some already are.

Plus ça change?

But even so – despite Joseph Schumpeter – the Internet continues to show very rapid expansion, which contributes to the growth of the economy. To paraphrase Dave Eggers: it looks like a breath-taking work of real genius.

In a report published in 2011, McKinsey outlined the importance of the Internet to the economy. Then, the Internet accounted for 3.4 per cent of GDP of the world's large economies.

If it was considered a sector, the Internet would be bigger than the agriculture and energy sectors, and twice as big as mining. Over a fifteen year period, the Internet was responsible for ten per cent of GDP growth in advanced economies. In the same period, Internet accounted for a $500 increase in GDP per capita. It took the Industrial Revolution fifty

years to achieve the same rise in living standards.[1] Even during the crisis, the ICT sector has continued to grow: worldwide by six per cent in 2011. Employment in the sector has increased by the same percentage.[2]

A report by the Rand Corporation predicts that, between 2015 and 2020, the European internet economy will grow by between seven and fifteen per cent.[3] The most rapid growth is taking place in completely new areas. By 2020, revenues from cloud computing are expected to represent between fifteen and twenty percent of the Internet market.[4]

So - changes on the Internet are taking place at a breath-taking speed. Speed is one thing, but how new are these developments really?

I don't know if anyone of you has been to New York recently, but if you are interested in the Internet it is worth walking to 60 Hudson Street in lower Manhattan, where a large building towers over Manhattan's streets and avenues.

It looks a bit like the headquarters of a sinister social media giant bent on controlling the world.

[1] James Manyika, Charles Roxburgh, *The Great Transformer. The impact of the Internet on economic growth and prosperity* (McKinsey Global Institute, 2011).

[2] *OECD Internet Economy Outlook 2012* (OECD Publishing).

[3] Stijn Hoorens, Dieter Elixmann et al. *Towards a competitive European Internet industry: A socio-economic analysis of the European Internet industry and the Future Internet Public-Private Partnership*. Santa Monica, CA: RAND Corporation, 2012.

[4] *Ibid.*

It is, in fact, a data centre, and contains the physical infrastructure of the Internet: cables and servers, and is connected to other data centres worldwide, making the Internet possible.

What is interesting about this building is its previous function: it used to be a telephone and telegraph exchange belonging to Western Union. This is no accident: the floors are strong enough to house the servers and computers that power the Internet. The holes and trays for cables were already present – and there was even a link available to transatlantic cables.

Plus ça change, plus c'est la même chose, as the French say.

Indeed, the Internet is essentially a network. There are many types of networks, and all of them have been subject to competition enforcement: whether electricity and telephone networks, TV cable companies, railways, roads or airline industries.

In the digital age, we've seen mobile telephone companies trying to keep competing services off their networks. Is that really so different from electricity companies keeping competitors off their grid? In German I would say: *Wem der Schuh passt, der zieht ihn sich an.*

To discuss this, I will look at several cases.

Pioneering role by NCAs

One novel aspect of the Internet is its function as a platform for the distribution of goods. Some manufacturers, however, ban online sales. They cite reasons of branding, or "quality control" for restricting online

sales, or claim they are countering "free-riding" by retailers on their public relations and advertising efforts.

Due to such bans, retailers reach fewer consumers. Consumers, in turn, are robbed from having the greater choice and lower prices that competition on the Internet would give them.

An example is the case of perfume manufacturer Pierre Fabre Dermo-Cosmétique, which had demanded that retailers make all sales "in a physical space", in the presence of a "qualified pharmacist".
This wording of the distribution agreement made sales through the Internet impossible.

The French Competition Authority thought there was something "smelly" about Pierre Fabre's distribution agreements, opened an investigation, fined Pierre Fabre €17,000 and demanded deletion of the clause.

Pierre Fabre appealed the decision, but lost. Eventually, the ECJ agreed with the Autorité de la Concurrence that a general prohibition of online sales was a restriction by object.

As far as the Internet and antitrust goes it was a landmark case: it was the first time the ECJ had to consider the Commission's view that "in principle every distributor must be allowed to use the Internet to sell products".

What the Pierre Fabre case especially illustrates is that, also online, there is an effective interplay between European rules, the courts and the enforcement efforts of national competition authorities.

But what is new about this case? After all, the question of free-riding is not really a novelty. Before the rise of Internet, mail order companies were accused of doing the same. The difference is the scale and speed: ease of access makes the Internet a fast and broad means of distribution.

Hotel booking cases

This issue of sheer scale is also a factor in another group of cases pursued by national competition authorities: the hotel booking cases.
In the past, if you needed a hotel in, say, Innsbruck, you first had to find the hotel, and then book it, either through a travel agent or by phoning the hotel directly.

With a simple Internet search consumers now can find dozens of hotels, each with pictures and reviews by other customers. The whole market has become more transparent. Instant worldwide visibility has made it easier for small hotels to compete with large chains.

You can still book directly or through a bricks and mortar travel agency. But being faced with a lot of choice can be bewildering. So on the Internet, a new type of middleman has emerged: the online travel agent, such as Booking.com and Expedia.

Here too, the NCAs have been leading the way. Their investigations into online travel agents feature both old and new elements.

An old element is resale price maintenance.

In classic "offline" RPM, the producer uses his market power to force a reseller to sell his products at a certain price.

The online booking platforms generally describe themselves as agents. But they make significant investments in advertising, software and customer support. This means that, for the purpose of antitrust rules on resale price maintenance, they *may* be considered as resellers. In that case, they will be subject to the antitrust rules on resale price maintenance.

Generally speaking, there is no problem with a hotel setting a particular price for its room, whether the hotel deals directly with the final consumer or through an online travel agent acting on the hotel's behalf. However, two new developments in the online booking sector have attracted antitrust scrutiny.

First, the balance of power has shifted in favour of the reseller. A handful of online travel agents have built up global brands and hotel portfolios and have advertising budgets to match. Increasingly, smaller hotels are finding that they cannot dispense with the online travel agents' services.

The second new development is the combination of resale price maintenance with retail price parity clauses, also known as "most favoured nation" clauses. These oblige the hotel to always provide the online travel agent with the best price for his rooms and the best room availability. The hotel cannot let its rooms more cheaply on its own website or through other agents.

Currently, only around twenty per cent of hotel bookings are made through online travel agencies and ten per cent through hotel websites. But the price parity clause generally extends to the remaining seventy percent of bookings, including customers who walk in off the street or

book by phone. And thanks to the transparency of the Internet, the online travel agent is able to check the hotel's compliance with the clause much more easily.

The British and German competition authorities started investigations in 2010. NCAs in France, Sweden, Hungary, Ireland and Austria are looking at similar cases.

In the UK the case focused on resale price maintenance. Booking.com, Expedia and the InterContinental Group have now given commitments. These enable the online travel agents to offer discounts on final room rates, up to the level of their commission. To ensure that the hotel retains some control over the pricing, these discounts will only be available to a closed group of repeat customers.

The German case focused on price parity. In its recent decision, the Bundeskartellamt banned the use of price parity clauses by HRS.com, a major German online travel agent.

The Commission has been consulted on these cases through the EU competition network and we are ourselves monitoring the sector. And although the OFT and BKA have adopted different remedies, they have identified the same threats to competition. Namely, that the combined use of resale price maintenance and the price parity clause:

- may eliminate intra-brand price competition (for the same room),
- may reduce the incentive for online travel agents to compete on commission
- and may create barriers for new online travel agents to enter.

This therefore is a sector to be closely watched within the ECN.

Net Neutrality

Another issue that competition authorities are looking at is one of the key principles underpinning the Internet: that of net neutrality. This means that anyone can publish and consume any content on the Internet, provided that this content is legal.

The corollary of this individual freedom is that providers of internet access services should not block, slow down, degrade or discriminate against content - except in cases where it is necessary to apply reasonable traffic management measures.

Similar rules govern other networks that enter our homes: water, gas, electricity, telephone, cable. Because of their essential nature, these networks often feature a right to consume. Following liberalisation, qualified suppliers gained rights to offer services on these networks. For instance, large electricity companies are not allowed to block newcomers from providing cheap or green energy over their grids. New airlines must have access to slots at airports so that they can compete.

Still, the Internet differs in two ways. First, the sheer number and diversity of services offered over the Internet are unprecedented by an order of magnitude. Secondly, the level and speed of innovation outpaces that of all preceding network industries.

Think of fibre optic cables and 4G connections, which allow the transmission of vast amounts of data, including video. This makes it possible for new content providers to compete with traditional TV and cable companies by offering Pay TV services over the Internet.

Pay TV

We have now started an investigation into the possible restriction of passive sales in Pay TV services.

At this stage we are focusing on satellite and ancillary online Pay TV services; it is to be seen whether our findings could be relevant for pure Internet players, such as Netflix.

With Pay TV, people can watch as many movies as they like, but not from wherever they like.

They cannot sign up for Pay TV in other countries, or watch the service they paid for in a different Member State.

For licensing reasons, someone who has signed up to Pay TV services in, for instance, Belgium cannot watch movies online when he is, for instance, visiting a conference in Austria.

It is difficult to explain to consumers that national borders still exist on the Internet in this way.

This is a problem for the single market. But there is also a competition concern. That is the restriction of passive sales. This happens when someone residing in Austria who likes movies cannot sign up for Belgian Pay TV because of licensing reasons.

This is why we have started an investigation into licensing agreements between movie companies and Pay TV broadcasters that restrict viewing in this way.

But this scrutiny of passive sales is not new, even as a high tech case. Our starting point is to follow principles established in the Premier League/Murphy case.

Karen Murphy was the landlady of the Red, White, and Blue Pub in Portsmouth in Britain. She used a Greek decoder to show satellite broadcasts of Premier League games. After being fined 8,000 pounds in criminal proceedings, she appealed.

Ultimately, the ECJ found the restrictions placed on satellite broadcasters to be contrary to competition law, because they were tantamount to granting absolute territorial exclusivity. Those restrictions eliminated all competition between broadcasters and partitioned the market along national borders.

What makes the Pay TV case novel is the ease by which the Internet can be used. While it may require some effort to buy a foreign satellite decoder, foreign online Pay TV is only a mouse click away, giving consumers new cross-border choices.

Internet connectivity

Besides TV and cable companies, a second group of incumbents challenged by Internet newcomers are telecom companies. Because the Internet allows two-way communication, newcomers can offer innovative services that rival those of traditional mobile telephone operators, such as voice and video calling and free text messaging.

However, traditional operators often own the network over which such content is transmitted. And the newcomers form a threat to their own paid services.

It is technically possible for incumbents to block or throttle competing services on their networks.

Last summer, the European Commission carried out unannounced inspections at the premises of three telecoms operators: Deutsche Telekom, Telefónica and Orange.

We want to make sure that these companies are not abusing a dominant position when providing internet connectivity services, for example by degrading the quality or limiting the speed of third-party content, in order to favour their own content.

If confirmed, that would make it difficult for medium-sized and small content providers to compete, as they rely on these networks to reach their customers.

Several Member States have also been active, demonstrating that net neutrality is not exclusively an antitrust issue.

In the Netherlands, for instance, mobile telephone operators announced surcharges for the use of free (or cheap) messaging services such as Whatsapp, which competed heavily with their own, paid, texting services.

In response the Dutch parliament adopted a new law in 2012, which banned operators from blocking free services or raising prices for the use of free services.

The effects of the law can already be seen: instead of obstructing innovation, one of the incumbents is now working on its own free messaging service.

Slovenia, too has introduced binding legislation on net neutrality. Operators and access providers must now make every effort to preserve the open and neutral character of Internet.

In France, the national regulator ARCEP has published ten recommendations on net neutrality, which include freedom of Internet access and non-discrimination between Internet traffic streams.

And in the UK, the industry has taken initiatives towards self-regulation.

Connected Continent

Despite all these steps, there are as yet no clear rules on net neutrality at the EU level. To change this, the Commission last year adopted a proposal for a legislative package aimed at building a connected, competitive continent.

One of the key proposed changes in this proposal, in which we were closely involved, is a guarantee of "net neutrality".

For instance, this proposal would end discriminatory blocking and throttling, i.e. intentional slowing of an Internet service by an internet service provider, except for reasonable traffic management measures which should be transparent, proportionate, and non-discriminatory.

To sum up, in the case of net neutrality, a similar observation can be made as in the hotel booking and online distribution cases: the antitrust

concerns or network issues themselves are not new; the novelty lies in the unprecedented scale and rapid pace of developments on Internet.

Google

Which brings me to my last case, but by no means the least.

In our Google investigation, we for the first time examined an issue that was native to the Internet alone: online search.

We were concerned that Google was using the dominance of its general search to promote its specialised search services, in for instance, price comparison, hotels and restaurant reviews.

The results of Google's own specialised search services appeared more prominently on Google's web search results than those offered by competing services.

This matters on the Internet, where users often click first on the most prominent item on screen.

The challenge is to address this issue without limiting Google's ability to innovate.

Google has now proposed commitments which, in our preliminary view, achieve this with the right balance. Google proposes to display three visible links to rival services in its web search results, so that users can make an informed decision.

Another concern regarding specialised search is Google’s use of original content from third party web sites without their permission. For example,

Google’s restaurant search also showed reviews of restaurants posted on other websites. This meant users had no need to visit the original website. Competitors could opt out, but at the cost of not being included in Google's general search.

Google has now offered to address this issue by permitting an opt-out that will not affect the page rank in a general search.

Our other two concerns are, if you want to put it in those terms, an “old fashioned” abuse of a dominant position. Google required publishers to obtain all or most of the search advertisements displayed on their websites from Google.

Google also did not allow software developers to develop tools that made it easy to transfer advertising campaigns from Google Adwords to competing services.

Google has now committed to end both types of behaviour.

Google’s proposed commitments are an important step forward. Google has made significant concessions. No other competition authority has achieved this result. The FTC did not demand such far-reaching steps from Google, though, admittedly, they did face a different market situation.

These commitments can restore competition, are forward looking, and enforceable.

We will not submit the proposals again to a market test. Interested parties already sent feedback on Google’s previous two proposals, which

is valuable input in our assessment of Google's latest proposal.

We will continue to fully engage with the 18 complainants in this case. In the first instance, we will make clear in pre-rejection letters why we believe that Google's commitments now adequately address our concerns.

We will thoroughly analyse feedback from complainants. Only then will the College of Commissioners adopt a final decision on whether to make Google's commitments legally binding. This should take place in the coming months.

Conclusion

Let me return to the questions I asked the in the beginning: is the Internet a new frontier for anti-trust enforcement, and if so, how does it make a difference?

The free riding in the online distribution cases and retail price maintenance in hotel booking cases also happens offline – though the combination with price parity is new.

The speed of developments on Internet demands swift action. This is why the pioneering work of NCAs in these cases is so important.

Both Member States and the Commission have drafted legislation on net neutrality which, as I explained, reflects an established principle of access to incumbents' networks.

What was true for satellite in Premier League/Murphy, is also true for satellite and ancillary internet broadcasts in our Pay TV investigations.

The Internet's ease of use and cross-border nature make this case potentially relevant to very many consumers.

The case of Google demonstrates that, even in an area that is unique to the Internet, the antitrust concerns we investigated can be found in any student handbook on competition law.

To sum it up: characteristics of the Internet such as ease of use, worldwide reach and speed of innovation provide new dimensions to classic competition concerns.

In conclusion, and without betraying the ending of the book, let me say that Mr Eggers got at least one thing wrong in his book *The Circle*.

In the real world, it is a trifle more difficult to get around competition authorities.

I say this only half as a joke. If one thing is clear, it is that despite the speed of developments on the Internet, competition enforcers and policy makers in Europe are dealing actively with anticompetitive behaviour.

The speed of online developments and differing circumstances mean that competition enforcers and legislators in Europe and around the world may adopt slightly different approaches to different cases.

But we are all dedicated to upholding competition – be it online or offline. Our approach is not "one size fits all". Instead I would describe our approach with a quote from an older book: "all for one and one for all".

But before I enter into the E-books case, let me end here.