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The Economics of Online Platforms : A new approach to vertical restraints?

Speakers: Dr Mike Walker ("MW"), Chief Economist Adviser at the CMA,
Philippe Chappatte ("PC"), Partner, Slaughter and May and
Rick Geerars ("RG"), Counsel, Booking.com

Date: Tuesday 27 September 2016

Venue: Slaughter and May

The purpose of the seminar was to discuss the economics of online platforms in light of recent investigations by national competition authorities (such as online hotel bookings, e-books and the CMA's analysis of price comparison websites in the private motor insurance investigation) and explore whether a new approach was required to analyse vertical restraints in that context.

Dr Mike Walker's presentation

In light of the recent developments in the online platform sector, MW recalled that basic economic principles had to be applied in order to analyse the competitive effects of vertical restraints in an online platform context.

This involves carrying out a "standard" economic analysis, in three stages, i.e.: (i) identifying potential theories of competitive harm; (ii) analysing what (if any) efficiencies are generated by the restraints; and (iii) undertaking a proper analysis of the parties' incentives and how these are affected by the restraints.

1. Potential theories of harm

These are harder to identify in the case of vertical restraints. It is therefore important to act carefully and to formulate potential theories of harm explicitly, rather than assume that particular types of restraint (such as MFNs) are necessarily harmful to competition. Vertical restraints are harmful only when they create a horizontal restriction of competition and involve companies with market power.

2. Efficiencies

It is uncontroversial that online platforms create efficiencies. MW noted that many national competition authorities (NCAs) are not particularly good at undertaking a proper analysis of efficiencies generated by vertical restraints in an online platform context and there was certainly scope for agencies to "do more" in this regard.

3. Incentives

It is important for agencies to consider why manufacturers impose vertical restraints on their suppliers and the reasons why retailers agree to be bound by agreements which appear to be detrimental to them.

MW referred to the eBooks case and the agency model introduced by Apple following the launch of the iBookstore to illustrate the point. He explained that the evidence presented to the US courts indicated that most of the major publishers agreed to sign up to bilateral agency agreements with Apple and accepted a MFN clause (whereby they would ensure that prices made available on the



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iBookstore were no higher than those offered by the publisher on other platforms). One of the key drivers of that decision was that at the time, Amazon (which was the market leader) was pricing aggressively on the basis of a wholesale pricing model. By agreeing to be bound by the MFN clause, each publisher had to increase the prices offered on Amazon. So the incentive to agree the MFN with Apple was that it gave the publishers more bargaining power against Amazon.

4. Conclusion

Economic analysis is key. The basic economic principles must be understood and applied when assessing the impact of vertical restraints. The answer to the question is therefore "no" - vertical restraints by online platforms need not to be approached differently than any other vertical restraints.

MW added that even with object restrictions it should be good practice to ensure that there is an incentive compatible coherent theory of harm.

Philippe Chappatte's presentation

5. PC talked about the Booking.com case and narrow Most Favoured Nation clauses (MFNs) which prevent hotels from offering lower prices through their own websites, but allow hotels to offer lower prices through loyalty schemes and offline sales. Following several investigations by NCAs, Booking.com committed to remove its broad MFNs and only keep narrow MFNs. This was rolled out across Europe and accepted by most NCAs. The German Bundeskartellamt (BKA) however prohibited Booking.com's narrow MFNs, claiming that they are restrictive and do not bring efficiencies. France has also taken legislative action and banned narrow MFNs (loi Macron).
6. PC pointed out that there is no empirical evidence that narrow MFNs in an online hotel booking context restrict competition, i.e. there is no evidence that in the counterfactual world without MFNs there would be greater competition between online travel agencies ("OTAs"). PC highlighted that Booking.com has carried out extensive analysis into the extent of price differentiation and commission levels, comparing accommodations subject to narrow MFNs and those that are not, and find no evidence of greater competition in a world with no MFNs.
7. PC agreed with MW's views that an economic analysis is required to assess the anti-competitive effect of narrow MFNs (theories of harm, efficiencies). He said that narrow MFNs bring very significant efficiencies, which have been accepted by most NCAs.
 - **Consumer benefits:** with narrow MFNs consumers can check prices without having to check each hotel's website. They trust price comparison websites (PCW) to help them do so. PCW allow consumers to save time and give them a lot more choice and flexibility. This has an effect on price because if consumers can easily and quickly compare prices they tend to go down.
 - **Hotels benefits:** It is generally accepted that OTAs increase hotel occupancy. In addition, OTAs allow smaller hotels to acquire online customers, which they would not be able to acquire absent OTAs. A lot of small or medium size hotels don't have a website, or don't have a website which has a real time booking functionality or is available in multiple languages.



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Rick Geerars' presentation

8. RG talked about the ongoing investigations into Booking.com by several NCAs in Europe and said that it has been a learning experience as it shows that more coordination between NCAs in Europe is greatly needed. This lack of coordination has been an issue for Booking.com as they had to deal with different outcomes. He briefly summarised the procedure.

9. Phase 1

In January 2014, several NCA investigations into Booking.com's MFN clauses were pending. RG considers that it was a clear case for the EC to deal with given that (i) there was a real risk of divergent outcomes within Europe (ii) the case raised new issues; and (iii) there is a specific regulation allowing the EC to acquire jurisdiction. However, the EC declined jurisdiction on the basis that investigations were already quite advanced, at least in Germany, and the EC satisfied itself that a uniform outcome could be achieved through coordination of the parallel investigations in Europe through the ECN.

Three NCAs – the French, Italian and Swedish NCAs – became the “lead” NCAs. A working group was established within the ECN for all interested NCAs. The lead NCAs conducted parallel detailed investigations on behalf of the ECN and reported back, with a view to reaching a uniform outcome.

10. Phase 2

RG said that the aim of the European Competition Network working group was to achieve a uniform outcome. Regrettably, this outcome has not been reached. Although the majority of EEA NCAs agreed to follow the position adopted by the lead NCAs, one day before the hearing with the French NCA to finalise the narrow MFN commitments, the BKA sent a Statement of Objections to Booking.com (despite having had the opportunity to participate in the prior investigations by the three lead NCAs).

11. Phase 3

Despite Booking.com having agreed commitments with several EEA NCAs, the matter is far from over.

A working group has been established by Commissioner Vestager, including ten EU NCAs, with a view to analysing the effects on competition and potential efficiencies of narrow MFNs.

The European Competition Network working group is still gathering evidence; their report is expected at the end of this year. RG said that the exact procedure is still unclear and is not sure who will draft the final report.

He also indicated that appeal proceedings are continuing in Germany and the French NCA has a parallel review process of its commitments decision running alongside the ECN process.

12. Conclusion

RG noted that the case illustrates that better coordination between European NCAs is needed. He also said that narrow MFNs are working well.