COMPETITION LAW UNDER FIRE: RESPONDING TO COMPETING DEMANDS FOR CHANGE IN THE CASE OF PRICE PARITY CLAUSES AND LOYALTY REBATES

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I. INTRODUCTION

Competition law is under attack. On the one hand, globalization and the digital revolution have greatly benefited the owners of firms, and particularly the wealthiest 1 percent, while delivering fewer benefits to consumers and workers. This has led to calls for a fundamental rethinking of the principles and purpose of competition law and policy. One area where competition law is particularly under the microscope concerns its ability to ensure that consumers obtain a larger share of the benefits generated by the rise of so-called tech giants and the digital economy. Some commentators have made the case that in order to better protect the interests of consumers and workers a fundamental rethink is not required, but that competition enforcement does need to re-examine the balance of risks that it is prepared to take.[2] Specifically, enforcers should consider accepting a greater risk of inefficiencies and "false positives" (over-enforcement) in order to prioritize the protection of competition and the delivery of fewer "false negatives" (under-enforcement) (**n.1**).

On the other hand, economists have focused on reducing the total number of false results, improving the accuracy of enforcement. In doing so they have criticized the inaccuracy of a *per se* or formalistic approach to practices with ambiguous effects, and have called for the adoption of a more economic effects-based approach, which requires competition authorities to conduct sometimes complex and time-consuming economics analyses in order to reduce the risk of inaccurate enforcement (**n.2**). In practice this approach has no doubt significantly reduced the number of false positives, since the facts of each case are scrutinized and the case-specific inapplicability of certain assumptions is identified. However, in order for this reduction in false positives to translate into fewer false results, it is crucial that the number of false negatives does not significantly increase as well. For example, if the more economic approach creates a deterrence effect that discourages agencies from taking risky cases then the overall accuracy of enforcement may not improve and, more importantly, the nature of enforcement will be skewed towards prioritizing the protection of efficiencies at the expense of competition.

This paper argues that the calls for fewer false negatives and those for the reduction of false positives are less incompatible than they might at first appear. This is because, fortunately, this is not a zero-sum game. The paper uses the lens of recent (mainly EU) decisions and case law related to platform parity clauses and Loyalty Rebates to suggest that they can be reconciled. It argues that call **n.1** can be applied at the level of "legal presumption." In particular, it argues that it is vital, where a more economic approach is adopted, for agencies to actively prioritize the delivery of fewer false negatives and hence take a purposefully brave approach to the mix of battles that they fight. Part of creating such courageous agencies certainly

2 For example, among others, see Herbert Hovenkamp & Carl Shapiro, "Horizontal Mergers, Market Structure, and Burdens of Proof," Faculty Scholarship, (2018); Stigler Center, "Committee for the Study of Digital Platforms," (2019); Tommaso Valletti, "A view from the Chief Economist," CRA Conference (2018); and Andrew Tyrie, "Is competition enough? Competition for consumers, on behalf of consumers," (2019).

requires governments to get the right staff. The way in which governments assess the performance of their agencies is also important, for instance, whether it recognizes that the optimal loss record in court is non-zero. Arguably, however, the only guaranteed way to incentivize agencies to prioritize the delivery of fewer false negatives is either to explicitly provide that objective for the agency, or to establish those presumptions within the legal framework. Meanwhile, we argue that call **n.2** can be simultaneously applied by ensuring there is scope for the rebuttal of those presumptions. Such a rebuttal must be possible, both in the understanding of whether the presumption of an anti-competitive effect is fitting, absent countervailing efficiencies, and if so, in ascertaining whether that effect is in fact outweighed by any such pro-competitive efficiencies.

II. PRICE PARITY CLAUSES

Price parity clauses (also known as Across Platform Parity Agreements and retail Most Favored Nation clauses) prevent producers from setting lower retail prices (or better terms and conditions) on rival platforms that offer more competitive commissions. These have given rise to a range of competitive concerns, generated what some consider to be conflicting decisions among enforcers, been treated as both agreements and unilateral abuses,[3] and have led to government interventions to overrule some agencies' approaches.[4]

The primary competitive concern is that the use of these clauses means that rival platforms cannot turn to price differentiation to increase their volume of sales or bookings. Rival platforms therefore have no incentives to bring down the commission that producers are charged by a platform with a parity clause. Equally, platforms with a parity clause can increase their commission without fear that it will create a price disparity and lead to them losing volume. This means that, in addition to eliminating intra-brand price competition, the parity clause can inflate prices across all producers on the platform even if there exists healthy inter-brand competition.

A second concern is that parity clauses serve to prevent entry by new low-cost platforms, while encouraging entry by high-cost platforms that compete on quality rather than price. The lack of price differentiation prevents consumers from identifying their preferred balance of price and quality. A third worry is that in the presence of parity clauses, platforms are less likely to compete to offer producers a better-quality service because these agreements prevent the producer from steering consumers towards platforms that offer better services (e.g. anti-fraud protection).

There is also a concern that parity clauses might help facilitate collusion: either on retail prices amongst producers by improving their ability to monitor adherence to collusive agreements; or amongst platforms on their commissions by creating an automatic punishment mechanism for platforms that deviate from the collusive commission. Finally, there may also be a concern that parity clauses might incentivize a shift towards an agency relationship which would allow prices to be set by producers who face less competitive pressure. For example, if platforms face less competitive pressure than producers, then platforms would set higher retail prices than those set by the producers (see for example eBooks). Therefore, if the ability to agree on a parity clause makes it profitable for a platform to allow producers to set retail prices, then permitting said parity clause might result in higher prices for consumers.

In addition, where wide parity clauses are removed, but narrow clauses that only impose parity on sellers' own direct sales channel remain, there is a risk that these may have the same effect as wide clauses in eliminating competitive pressure from rival platforms. This is because although sellers are free to differentiate prices across platforms, their incentives to do so might remain limited as this would require them to undercut the price on their own sales channels in order to comply with the narrow best price clause. As the CMA suggested in its motor insurance market study, small producers without strong brands are unlikely to credibly threaten to undercut the price on their own website, particularly since visitors to that website are likely to be more price sensitive. While this was not the case in motor insurance, it might, as the *Bundeskartellamt* argues in *Booking*.com and *HRS*, be a better fit for hotel markets.

Leaving aside the competitive concerns, the question of whether these clauses create efficiency-enhancing effects has been particularly controversial. It has, for instance, been argued that parity clauses protect platforms from free-riding behavior, and hence protect the viability of the platform in addition to facilitating investments to improve its quality. Moreover, it has been argued that no less anticompetitive alternative solutions to the free-riding issue exist.

Some authorities have accepted these arguments and agreed on commitments that allow narrow parity clauses that only impose parity on the sellers' own direct sales channel (and not on other platforms, as is the case for a wide parity clause). These have achieved a quick resolution

3 Pinar Akman, "A Competition Law Assessment of Platform Most-Favoured-Customer Clauses," 2015. Notably the EU Commission opened an 'abuse of dominance' investigation when it probed Amazon's e-books distribution agreements.

4 Among others, "narrow parity clauses" were banned by France in August 2015 and Italy in 2017.

of these cases. However, they arguably embody the concerns expressed in call **n.1** that agencies are not sufficiently prioritizing the delivery of fewer false negatives. In contrast, when the ACCC found parity agreements in airline bookings it fined Flightcentre 12.5million AUD for price fixing. Similarly, the *Bundeskartellamt* concluded in both hotel-booking cases that the claimed efficiency gains were not sufficiently substantiated. In particular, the parties did not sufficiently demonstrate: (i) that there were no less anticompetitive options available for achieving the claimed efficiencies; and (ii) that the risk of free-riding was sufficient to result in platforms exiting the market, thereby denying buyers the efficiency of having access to such a platform.

With the benefit of hindsight, while there may be a degree of free-riding, an *ex post* assessment exercise conducted by the European Commission and a group of ten national agencies in 2016 (the "monitoring report") found no significant difference in conversion ratios in those jurisdictions where narrow parity clauses were removed. Moreover it has demonstrably not resulted in all, or indeed any, platforms exiting markets that have removed narrow parity clauses as a tool for addressing the problem.[5] Indeed, entry has continued with meta-search engines becoming increasingly popular. Consumers in these markets continue to enjoy the benefit of the existence of matching platforms. In addition, the nature of the allegedly forgone investments has not become any clearer. For instance, it is not clear that information on sellers has deteriorated (unsurprisingly, since this content is seller-generated). It is also not clear that potential improvements in the quality of matching by the algorithm have been passed over. The impact on investment in platform advertising has not, to our knowledge, been examined.

The outcome of the Monitoring exercise was ultimately inconclusive, and diplomatically suggests only that both types of enforcement "*which are based on a converging theory of harm (…) go in the right direction.*"[6] However, what can be seen is that the narrow clauses that were removed in 2015 have not led to exit, suggesting that these clauses were not in fact essential to ensuring the viability of the platform business model. This perhaps explains why following the publication of the monitoring report, Italy, Belgium, Australia, Sweden, and New Zealand have all prohibited narrow parity clauses.

The results of empirical studies appear to support a ban on narrow parity clauses.[7] Hunold et al. (2018) report that hotels used the removal of narrow parity clauses to charge the lowest price on their direct sales channel while increasing the use of *Booking.com* (suggesting any reduction in investment did not reduce the choice of hotel on the platform). Meanwhile Mantovani et al. (2018) collected data on listed prices on *Booking.com* for the period 2014-16 with regard to France, Italy, and Spain. In all three countries, the study reports a significant price drop between 2014 and 2015, followed by a price increase between 2015 and 2016. Significantly, countries that intervened (France and Italy) when compared to Spain (which adopted a "wait-and-see" approach) achieved a more marked price decrease in the period 2014-15, and a less powerful price surge in 2015-16. In addition, data shows that among France and Italy, only France – which in 2015 banned narrow parity clauses – managed to keep 2016 prices at a lower level than 2014. While price trends undoubtedly reflect several factors, such as changes in demand, it seems that the ban on narrow parity clauses benefitted consumers without resulting in *Booking.com* exiting the market.

In this light, it is perhaps surprising that in recent months, the *Bundeskartellamt* lost an appeal by *Booking.com* against its infringement finding.[8] While it remains to be seen if it will appeal, the unresolved nature of this case demonstrates the need to be careful in interpreting the implications of a lack of exit in Germany. However, it is notable that the legislation in Italy, France, Austria and other countries is not subject to the same uncertainties.

In the context of concerns that consumers are losing out because agencies are more worried about protecting claimed efficiencies than reducing false negatives, the experience on price parity clause cases is a useful case study. It shows that the existing enforcement framework does not prevent agencies that are willing to do so from taking a strong enforcement stance, and that legislators will not hesitate to take matters into their own hands where agencies appear unable or unwilling to take a strong enforcement stance. However, it also illustrates the risk of court loses that will need to be faced if agencies are to reduce the risk that consumers are left behind in digital markets (call **n.1**) while taking an economic approach to enforcement (call **n.2**). Finally, it demonstrates that in taking a more economic approach it is important to rigorously test the likely effects of claimed efficiencies.

5 Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities, para 39.

6 Notably, many hotels reported that they did not offer cheaper prices on competing platforms because they did not want to undercut their own website.

7 Andrea Mantovani, Claudio Piga & Carlo Reggiani, (2018), "On the economic effects of price parity clauses – what do we know three years later?" note that quality did not fall. Instead, between 2015 and 2016, *Booking.com* enhanced the quality of the services it provides to both hotels and consumers, it enabled users to browse activities in the destination and book tickets in advance, and introduced tools to help hotels to build their websites (Section 3).

8 The Higher Regional Court quashed the *Bundeskartellamt Booking.com* decision. Similarly, the ruling of the Swedish Patent and Market Court requiring *Booking.com* to remove "narrow parity clauses" from its contract terms with hotels was overturned.

III. LOYALTY REBATES

The call for a "more economic effect-based approach" has featured heavily in the practice and recent case law on loyalty rebates. These cases offer a useful lens through which to consider the extent to which this call has been heeded, and whether it has been, or can be, reconciled with the call to "prioritize the delivery of fewer false positives." In particular, we argue that the ECJ judgement in *Intel* seems to set out a framework through which the two calls can be simultaneously answered (false positives can be reduced while a more economic approach is adopted) without the need for trading off or balancing the two concerns.

First, the ECJ approach in *Intel* should be recognized as a substantially new approach. Paragraph 137 recalls paragraph 89 of *Hoff-Mann-La Roche*, and the presumption of the unlawfulness of exclusivity rebates when carried out by a dominant firm without objective justification. In contrast, the ECJ sets out that the Commission is required to conduct an 'effect analysis' every time that "*the undertaking concerned submits, <u>during the administrative procedure</u>, on the basis of <u>supporting evidence</u>, that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects.*" Since dominant undertakings are always expected to argue that their conduct is not capable of producing foreclosure effects, the Commission will in practice be required to address those arguments in almost all cases.

Shifting from allowing "*prima facie* anticompetitive conduct" to continue only where objective justification is demonstrated, to allowing rebuttal on the grounds that the conduct was not capable of restricting competition, delivers on the call for a more effects-based approach. It completes the move away from a formalistic approach that, while not a *per se* prohibition, since it allowed an objective justification defense,[9] was nevertheless a *per se* presumption on the capability of the practice to restrict competition. As such it addresses the problem that there was no opportunity for the defendant to rebut the presumed restrictive effect of a conduct which economic analysis suggests has ambiguous competitive effects. At the same time, placing the burden on a dominant firm to provide evidence to support a rebuttal of the presumed effect allows the Commission, and in turn the ECJ, to simultaneously satisfy the call to "prioritize the delivery of fewer false positives."[10]

The judgement can be seen as requiring the Commission to conduct an "effects analysis" in cases where a dominant firm produces supporting evidence that its conduct was not capable of foreclosing competition. However, it does not suggest that the Commission should in every case (i) conduct an efficient competitor (AEC) test; or (ii) prove that prices were negative, each of which would increase the scope for false positives. This is welcome, as exclusivity rebates do not exclude only through predatory pricing but may also do so through other mechanisms. In this sense, although the AEC test should not be ruled out in principle, as it may still be used in cases where the dominant firm implements the rebates by sacrificing profits, it is only "*one tool amongst others*" for the purposes of assessing whether a rebate scheme amounts to an abuse of dominance (see *Post Danmark*).

The AEC test, indeed, has several limitations, the first being that "*it only makes possible to verify the hypothesis that access to the market has been made impossible and not to rule out the possibility that it has been made more difficult.*"[11] For instance, conduct that raises rivals' costs may reduce the competitive constraint imposed by rivals. This is supported by the ECJ holding in *Tomra* and *Post Danmark II* that "*the invoicing of 'negative prices', that is to say, below cost prices, to customers **<u>is not a prerequisite</u>** of a finding that a retroactive rebate scheme operated by a dominant undertaking is abusive.*" This is consistent with recent court decisions in the US where both *Eisai/Sanofi* and *ZF Meritor/Eaton* rulings set out that price-cost tests need not apply, it therefore appears that where plaintiffs make the case, loyalty rebates in the U.S. need to be analyzed as *de facto* exclusive dealing arrangements rather than predatory pricing practices.

More generally, foreclosure of less efficient competitors can harm consumers if it weakens the competitive constraints upon the dominant firm. For instance, future consumers may benefit if firms with market power are prevented from foreclosing less efficient rivals that - if they had survived - might become equally or more efficient. Moreover, concerns that dominant firms should not be asked to hold a 'price umbrella' over less efficient firms (to keep them viable) do not apply to loyalty rebates as they would in predatory pricing. This is because the option to undercut through a simple unit price reduction, rather than a loyalty rebate, is always available.[12] The pro-competitive effects of less efficient rivals were

9 Richard Whish, "Intel v Commission: Keep Calm and Carry on!," *Journal of European Competition Law & Practice*, January 2015.

10 Wouter Wils, "The judgement of the EU General Court in Intel and the so-called 'more economic approach' to abuse of dominance," *World Competition*, December 2014.

11 See *Intel* paras. 146-153.

12 Steven C. Salop, "Wright is Right and Price-Cost Safe Harbors are Wrong: The Raising Rivals' Cost Paradigm, Loyalty Discounts and Exclusive Dealing," 2013. *Truth on the Market*. http://truthonthemarket.com/2013/06/07/wright-is-right-and-price-cost-safe-harbors-are-wrong-theraising-rivals-cost-paradigm-loyalty-discounts-and-exclusive-dealing/; OECD Executive summary on Fidelity Rebates, 2016.

explicitly recognized by the ECJ when it held that "*(…the presence of a less efficient competitor might contribute to intensifying the competitive pressure on that market and, therefore, to exerting a constraint on the conduct of the dominant undertaking.*"[13] It is also unclear what basis should be used to identify the so-called 'non-contestable share' of the market that is required to run the "discount attribution" variation of the AEC test. This makes it difficult for firms to self-assess the lawfulness of their actions.[14]

In line with the economic analysis, the ECJ recognizes that there is no single test for determining liability in regard to loyalty rebate schemes. Instead, the analysis will depend on "all the circumstances of the case." In particular, the theory of harm and the relevant test for determining the unlawfulness of the rebate schemes will vary according to the kind of asymmetry within the market in question. The presence of some asymmetry is indeed crucial since in its absence, a loyalty rebate that moves the market from competition for units, to competition for customers, will not protect the dominant firm's market power. As such, identifying that a loyalty rebate scheme has "loyalty-inducing" effects is, on its own, not sufficient to show an abuse of dominance. Whenever competition agencies take action against a loyalty rebate scheme, they should therefore be able to demonstrate not only that the scheme has "loyalty-inducing" effects which create exclusive relationships, but also explain, with evidence, why it is more difficult for rivals to effectively compete for that exclusivity.

There are perhaps four different sources of asymmetry. One is that the dominant firm might be able to sacrifice profits, either in the short term, or on "non-contestable" sales, where a rival cannot afford to do so. Second, where there are economies of scale, the asymmetry might come from the dominant firm's ability to prevent rivals from making enough sales to obtain those economies of scale.[15] Alternatively, instead of denying rivals access to consumers, the dominant firm might deny rivals access to key inputs and hence increase their costs. A further possibility is that the dominant firm might be willing and able to coordinate with downstream firms to increase the retail price of its product, while its rivals are not. This coordination would need to split the increase in profits with the downstream firms so that they do not react to the increase in the wholesale price by switching to selling a rival product. It will not always be possible to reach such an agreement; however, in certain circumstances, as in horizontal collusion, a sustainable agreement seems likely to be possible.

One application of this is to consider the argument that ride-sharing services operate driver pay policies that include a low base rate and a bonus for achieving a certain acceptance rate.[16] Such bonus payments may well be loyalty-inducing, and hence incentivize exclusivity. However, where this simply constitutes a move towards competition for drivers, rather than competition for rides, it may not necessarily have an anticompetitive effect.[17] For there to be an adverse effect on competition, there would need to be an asymmetry in the ability to compete for drivers (rather than rides), that non-dominant rivals cannot match. One might, for example, therefore need to consider whether such contracts might limit a rival's ability to expand and obtain economies of scale, thereby raising their costs and reducing competition. Alternatively, and without the need for economies of scale, one might consider whether denying a bonus to drivers that accept rides from rival platforms, in effect places a tax on the price of working for rival platforms, thereby raising rivals' costs when recruiting drivers. In either case, the impact might then be less effective competitive constraints, and hence prices, that are higher than they otherwise would be.

Returning to *Intel* it appears that the ECJ, successfully reconciles the two calls for change. On the one hand it endorses the move towards a "more economic effect-based approach." On the other, it limits the risk of false positives by affirming a presumption that exclusivity rebates will restrict competition absent supporting evidence from the firm that shows the conduct was not capable of restricting competition.

In this context, the EU Guidance on enforcement priorities in applying Article 102 TFEU to exclusionary abusive conduct (Guidance paper), appears somewhat incongruous. In particular, relying exclusively on a price-cost test as a screening device seems likely to misdirect resources towards predatory cases and away from cases in which high prices are set and protected through loyalty rebates. These high price exclusionary strategies are likely to be less risky (since there is no loss-making period), and hence more attractive to dominant firms, as well as more immediately harmful to consumers. A more effective screen would therefore be one that prioritized the investigation of cases in which high prices are insulated.

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13 See *Post Danmark A/S* para. 60.

14 Nicholas Banasevic, King's College London Lecture, March 2017.

15 It might do so by offering individualized rebates, at different times, and without making information available (a "divide and conquer" strategy) to induce buyers fear amongst buyers that a lack of coordination will leave them purchasing from a seller without efficient scale.

16 See Marshall Steinbaum, "Antitrust, the Gig Economy, and Labor Market Power," *Law and Contemporary Problems*, 2019.

17 If it creates an exclusive employment relationship, it may also suggest that drivers are employers of these platforms.

Moreover, if a narrow "prioritization test" gives a safe harbor to cases that may harm competition and consumers, this guarantees false positive results and is therefore difficult to reconcile with call **n.1**.

Finally, while *Intel* has confronted and corrected past mistakes, it did not address the lack of a *de minimis* doctrine under Article 102 TFEU (as established by the ECJ in *HoffMann-La Roche* and later reaffirmed in *Post Danmark II*). In the context of this paper, we would argue that the introduction of a *de minimis* under Article 102 TFEU would be consistent with a more economic approach, since it operates on the scale of the economic effects of the conduct in question (while also introducing helpful uniformity with enforcement of Article 101, Merger control, and State aid).

In summary, the ECJ in *Intel*, and decisions taken by some countries on platform parity agreements have, we argue, shown a way to deliver an approach that is both more economic, and more forceful in ensuring that consumers obtain a share of the benefits of globalization and the digital transformation. In combination with the radical proposals for pro-competitive regulatory action offered by the Furman, Cremer, and Scott-Morton led reviews, they therefore offer the best defense against demands for a more fundamental rethink of the principles and purposes of competition law and policy.