

## **Approach of the European Commission to Competition in the High Technology Sector**

This note examines the recent approach of the EU's Competition Commission in the enforcement of competition law in the high tech and media sectors. We are concerned that the direction of travel of EU competition enforcement in this sector is progressively more and more anti-competitive and interventionist and will harm innovation in this critical sector on a global basis.

The EU is a major regulatory power, and its actions are copied by other jurisdictions. It is possible that interventionist policies in the EU will lead to a race to the bottom where new and emerging high tech firms will increasingly pull their competitive punches assuming that all jurisdictions will follow the EU's lead. This could have a huge impact on global innovation.

It is therefore useful to look at how these issues have been and are handled by the other major antitrust power, the United States and whether we can learn anything from different approaches to antitrust enforcement in this area.

## **Differences between the EU and US Approaches**

The EC and the US antitrust agencies have diverged considerably in a number of areas of competition law implementation and enforcement. This divergence is particularly great in their approaches to the conduct of high tech firms.

There have been a number of recent cases, where the European Commission has applied its competition law to the very large tech giants from the US. Starting with the Microsoft case in 2007, and moving through Intel, and now Google, and the state aids cases against Apple and Amazon, the Commission has imposed fines or some sort of sanction on the marquee US tech giants. Meanwhile the reaction of the FTC and DOJ in the US has been much more muted. These cases are exposing fault lines between the US and EU approaches, and between an economics based approach and a more legalistic one.

With respect to cartels, US and EU law have become broadly more aligned, and procedures, though by no means the same have been drawn closer. It is in the area of single firm conduct that we see some major differences. The EC has a much lower market share threshold than the US above which a firm could be in dangerous territory. In the US, market share must be quite high (typically seventy per cent or more) before it can possibly have power over price or a dangerous probability of doing so, but even here, the firm must then do something illegal (i.e. abuse that market power). What the firm does must then be judged on the anti-competitive effect, not, crucially on the intent of the firm. In the EU, this threshold is much lower, and is compounded by the use of other doctrines such as the collective dominance doctrine, where a small number of firms (2 or 3) can have collective dominance if their market share is combined and exceeds sixty or so per cent. This approach to competition policy has a chilling effect on innovation particularly in the high tech sector. The EU has typically had a more interventionist approach, finding abuse of dominant position much more readily based on doctrines like the duty to deal.

There are a number of contexts which are important to consider that are unique to high tech firms and that determine the best antitrust approach to them.

First, the marginal cost curve of high tech sectors is decidedly different from that for more basic goods. The U-shaped marginal costs curve of a basic good has been replaced by a marginal cost curve which is

declining to zero. The reduction in the marginal cost means firms in this sector are under considerable pressure to rapidly build as large an installed base as they can.<sup>1</sup>

Second, market power is much less durable than it is for less high tech products. This is a sector where a whole technology can become obsolete more or less overnight. Given this, legalistic and formalistic approaches to market share as a proxy for power over price may not hold good.

Third, and related, it is much easier for potential entrants to break into these markets. The barriers to entry are relatively low – new companies that become global giants start on university students' laptops for example.

Fourth, market definition is changing. Increasingly, across geographies and products, markets are expanding. The traditional approach to market definition is to apply the classic SSNIP test (Small But Significant Non-Transitory Increase in Price) – the test asks if consumer switch if there is a small but significant, not transitory increase in price? If they do, then these products are included within the product market definition. If they do not, you keep expanding what is included in the hypothetical product market definition. In the new media economy where different platforms compete for users, the relevant market can contain a print-based newspaper company, a search engine, or a website. All of these can compete together in the same market place. A principal complaint of the sector is that regulators apply far too strict definitions of product markets (based on historic views of what constituted a relevant product market) that unduly narrow the markets in which firms compete. Clearly, market share declines dramatically as the relevant product market expands.

Fifth, network industries have powerful, positive feedback loops. This is because the development of new products and the development of new consumers who buy that new product are mutually reinforcing.

Sixth, often tech markets are two sided rather than one sided. A two sided market occurs when a particular firm or technology is serving different types of consumers. Credit card markets are an example of two sided markets. The credit card service involves two different types of consumers – the merchants that must accept the credit card, and the end consumer who wishes to use the credit card to buy things from the merchant. In two sided markets, often one offering is free (or heavily subsidized), because the goal of the firm is to increase installed base, and revenue is made in some other way related to the size of the installed base (such as advertising). This makes market shares both harder to calculate but less useful as an indication of power over price.

### **The New Media Economy ("NME")**

As noted in Chapter 14, General Theory of Trade and Competition; Trade Liberalisation and Competitive Markets:<sup>2</sup>

"Downward pressure on the costs of transmitting information are transforming the relative costs of transmitting information and content...consumers now are.. more concerned with the content of the ideas themselves."

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<sup>1</sup> For a general treatment of this subject, see Shanker A. Singham, A General Theory of Trade and Competition: Trade Liberalisation and Competitive Markets (CMP) (2007)

<sup>2</sup> See FN1

We have noted how the new media economy has radically altered the manner in which media and high technology firms compete with each other. Many firms now compete with each other across multiple platforms. Consumers also more pro-actively seek out information rather than being passive receivers of it as they have been in the past. This has also changed the market dynamics. There is a convergence between telecommunications, broadcasting, audio-visual and related services. The EU accepted this reality back in 1997 (EU Green Paper on the Convergence of the Telecommunications, Media and Information Technology Sectors, and the Implications for Regulation (COM (97) 623, 3 Dec. 1997). The EU accepted that the regulatory approach adopted could negatively impact these developments and leave EU citizens “in the slow lane of the information superhighway”. It also noted that a pro-competitive regulatory policy was necessary to ensure that this sector could deliver benefits. An overly intrusive antitrust policy will have the same effect as an anti-competitive regulatory framework.

Convergence and the NME have combined to radically change the way consumers process information. As we noted above, these developments have resulted in a framework where content is far more important to consumers than the manner of transmission. This has fundamentally altered what is local and what is free.

#### Change in Definitions of Local

As content becomes more significant, the definition of locality has changed. Now locality is not bound by transmission. Communities are bound together by interest in content regardless of their locality.

#### Definition of Free

When public service broadcasters had to compete with others for the limited commodity of spectrum, government intervention was needed to preserve spectrum, and regulation was necessary to ensure pluralism, diversity independence and cultural offerings that it was assumed the free market would not provide. Public broadcasting was heavily subsidized in order to enable it to compete with private broadcasters.

As the market has expanded to encompass other platforms for receiving content, and the need to support public broadcasting has diminished, the need for public subsidization and other regulatory barriers are lessened.

#### Ensuring Competition Policy accounts for key concepts

Any antitrust enforcement in the high tech space needs to take full account of the key factors that are set out above.

#### Ensuring Vigorous Inter-Platform Competition

In the NME world of declining marginal cost to zero, ensuring vigorous inter-platform competition will be very important. The industries in this area must seek as wide a market as possible, in order to compete with other platforms. There is an important dimension related to intellectual property protection here. Weakening of intellectual property protection will actually damage inter-platform competition because it will erode the ability of these platforms to actually compete with each other.

#### A Comparative Analysis of US Antitrust and EU Competition Law

While antitrust enforcement is a legal process, as in all economic lawmaking, the law must express real economic forces. Competition law has evolved considerably in both of the major antitrust jurisdictions, the EU and the US in the last century, and it is worth recapping how and why these trends have occurred, in order to understand the present day differences.

In the US, in the early days of competition enforcement, immediately after the passage of the Sherman Act (the US antitrust law), enforcement was focused on breaking up the big trusts, such as Rockefeller's Standard Oil. But, as enforcement evolved, the US adopted a much more legalistic and less economic approach. European competition law arose out of a fear that firms would cartelize European markets, and damage the goal of a market integration in Europe.

In the 1960s and 1970s, US antitrust law was used in profoundly anti-competitive ways to help small businesses, holding that small fragmented markets were a public good in and of themselves. US antitrust enforcement diverged quite considerably from the economic goal of promoting consumer welfare. For example in the *Alcoa* decision,<sup>3</sup> Judge Learned Hand stated that preserving a social landscape of a multitude of smaller players was one of the goals of antitrust at whatever cost. In the *Brown Shoe* case,<sup>4</sup> fragmentation of a market by the courts was seen as an end in itself, favouring the smaller producer against larger rivals. The US supreme court stated that the antitrust laws were designed to "protect small, viable locally-owned businesses" even where this "resulted in higher costs."<sup>5</sup> This was eventually recognized by economists like Harold Demsetz who note in a series of paper in the 1960s and early 1970s that we have no theory that suggests that a fragmented market was an intrinsic good, advocating broad regulatory policies that maximized consumer welfare. Gradually the tide in the US turned towards a much stronger economic underpinning. This economic underpinning has provided the intellectual foundations for the approach of the US antitrust authorities to high tech firms and those operating in the NME.

In the EU, competition law from its inception has been at least as much about promoting EU market integration as it has been about spurring competition. While US antitrust law has been focused on the limited goal of consumer welfare with respect to private behavior, EU law has always had more objectives, tied to the European project itself. These differences have manifested themselves in a number of ways, for example, US law is much more tolerant of vertical restraints on competition, such as exclusive distribution arrangements. EU law is much less tolerant of these arrangements because of concerns that distributors would operate against the wider goals of market integration. The EU competition enforcement system has been more rules-based and legally formalistic than the US one. Since 1995, the EU went through a series of reforms, not unlike the evolution of US antitrust law. In 2001, Mario Monti became the first EU Competition Commissioner to declare that consumer welfare was not only "a" goal of competition policy but "the" goal.<sup>6</sup> So there has been much more convergence between EU and US law between 1995 to 2005.

However recently we have seen some significant differences in particular with respect to cases involving high tech companies and those operating in the NME space.

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<sup>3</sup> See *U.S. v Aluminum Company of America*, 148 F. 2d 416 (2d Cir. 1945)

<sup>4</sup> *Brown Shoe v. U.S.*, 370 U.S. 294 (1962)

<sup>5</sup> *Id.* at 344

<sup>6</sup> Mario Monti, *The Future for Competition Policy in the European Union*, Address at Merchant Taylor's Hall, London (July 9, 2001)

## Recent EU Cases

In its case against Microsoft, the European Commission ordered the firm to make its Windows and Windows Media Player operating systems available to third parties, and to unbundle Windows Media Player from the Windows system. Microsoft objected on the basis that this was a violation of its intellectual property and would chill innovation. In 2007, the approximately half a billion Euro fine was upheld by the European Court of Justice.<sup>7</sup>

In its case against Intel, the Commission found that Intel had infringed Article 102 TFEU—even without providing anticompetitive effects.<sup>8</sup> In the case, there was no requirement to show actual foreclosure, because a violation could be found from “object” practices by a dominant firm. Critically the General Court on appeal found that there was no need to find anti-competitive harm to consumers if an anti-competitive object could be shown for a dominant firm.<sup>9</sup> This approach flies in the face of the Guidance Paper which was released to ensure that Article 102, TFEU was grounded in economic analysis.<sup>10</sup> In that paper, it was expressly stated that the Competition Commission would have regard to the effects tests in ordinary competition enforcement, and move away from intent as evidence of competition harm. In recent cases, the Advocate-General has shown some hostility to economic analysis, noting that cases should be founded on legal principles of EU law and that economic analysis was less valuable.<sup>11</sup>

As Daniel Sokol notes:

“One area of increasing divergence across the Atlantic is in markets characterized by high technology and dynamic innovation. Conduct issues ranging from online search, online resale price maintenance, and online most favored-nation clauses<sup>12</sup>; pharmaceutical reverse payments;<sup>13</sup> and FRAND licensing,<sup>14</sup> among other issues, are hotly contested. Europe seems to be the more aggressive enforcer in areas

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<sup>7</sup> There was a much larger fine subsequently for the firm’s royalty fees for the information which the firm had to make available to third parties, on the basis it was not reasonable and non-discriminatory

<sup>8</sup> Commission Decision Summary No. 2009/C 227/07 (Intel), 2009 O.J. (C 227) 13

<sup>9</sup> Case T-286/09, Intel Corp. v. Comm’n, 2014 E.C.R., ¶¶ 198–206 (delivered June 12, 2014), <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62009TJ0286&from=EN> [<https://perma.cc/6CJK-BHVT>].

<sup>10</sup> Article 82 Guidance, Communication from the Commission—Guidance on the Commission’s Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, 2009 O.J. (C 45) 7, ¶ 19

<sup>11</sup> Case C-23/14, Post Danmark A/S v Konkurrencerådet (Post Danmark II) ¶ 4 (May 21, 2015), <http://curia.europa.eu/juris/document/document.jsf?text=&docid=164331&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=534256> [<https://perma.cc/J29UXMDZ>]

<sup>12</sup> See Pinar Akman & D. Daniel Sokol, Online RPM and MFN Under Antitrust Law and Economics, 50 Rev. Indust. Org. 133 (2017); Ariel Ezrachi, The Competitive Effects of Parity Clauses on Online Commerce, 11 Eur. Competition J. 488 (2015); John B. Kirkwood, Collusion to Control a Powerful Customer: Amazon, E-Books, and Antitrust Policy, 69 U. Miami L. Rev. 1 (2014)

<sup>13</sup> See Michael A. Carrier, Why a “Large and Unjustified” Payment Threshold Is Not Consistent with Actavis, 91 Wash. L. Rev. 109 (2016); Michael Clancy et al., Reverse-Payment Patent Settlements in the Pharmaceutical Industry: An Analysis of U.S. Antitrust Law and EU Competition Law, 59 Antitrust Bull. 153 (2014)

<sup>14</sup> See Damien Geradin, The Meaning of “Fair and Reasonable” in the Context of Third-Party Determination of FRAND Terms, 21 Geo. Mason L. Rev. 919 (2014); Daryl Lim, Standard Essential Patents, Trolls, and the Smartphone Wars: Triangulating the End Game, 119 Pa. St. L. Rev. 1 (2014)

where the stakes are high, the issues complex, the likelihood of mistaken enforcement may be high, and the industrial policy broadly defined may be influencing European competition policy.”<sup>15</sup>

US policymakers have long complained that European approaches to competition are designed specifically to damage US interests. More importantly for European interests they have chilled innovation and the incentive to compete especially in the high tech and NME sectors because it is precisely in these sectors that success is more difficult because of the declining marginal cost curves, the lack of durability of market power, and the ease with which new entrants can enter markets. Structurally, market power in the tech sector is much more transient. Firms now compete for new markets rather than against each other in a conventional product market.

### Refusals to Deal

Another area where there are significant differences between the EU and the UK is the area of refusals to deal, a doctrine at the core of many of the high tech cases. While even the EU economic literature is skeptical of cases where the government should impose some sort of duty to deal, a number of EU cases in the high tech sector have imposed precisely such a duty. [cites].

Again history is instructive here. EU approaches to competition policy in the area of duty to deal are affected by the history of state-owned enterprises where it would be more justified to impose such a duty. The State Owned Enterprise typically has much more government power and privilege than its private sector rivals. Hence it is much more likely to act in ways that damage competition. Hence a more interventionist antitrust policy might be needed to ensure that the SOE was acting on a level playing field for competition. The legacy impact of this is very significant. It increases the cover for antitrust interventionism as we have seen in the EU.

The most recent case against Google has demonstrated that there is limited appetite in DG Competition for an economic effects approach to determine whether a violation has occurred. In these cases, the European Commission found that Google had illegally tied the search app and the google Chrome browser, illegally made it difficult for alternative Android operating systems to be developed, and made payments, conditional on exclusive pre-installation of Google Search. Google’s main concern was to preserve the integrity of the Android operating system itself so it could better compete against other platforms. In making this argument, Google was implicitly realizing that strong interplatform competition was much more important to overall competition than competition by different firms for the same platform. The case thus brought the contexts for the high tech sector and the New Media Economy sharply into focus.

The key problems in the Commission’s overall approach are as follows:

1. Inadequate attempt to define the right product and geographic markets because of the nature of two sided tech markets, and the phenomenon of convergence.
2. Overestimation of durable market power because of assumptions about barriers to entry and potential competition are likely to be false.
3. Overly structural approach to the market including presumptions about intent as opposed to relying on proof of anti-competitive harm.

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<sup>15</sup> D.D. Sokol, *Troubled Waters Between European and US Antitrust*, Michigan Law Review, 115(6) at pp 963-964

4. Treating property that had been developed by private firms at great cost as if it is a form of public goods, or an essential facility where government power can be used to compel the property owner to deal with his property in a way that is not in his interests, but is in the interests of his rivals.

The big problem with this approach is that the Commission is relying on concepts such as refusal to deal which treats these products as if they are public goods or are those provided by a state owned entity. As we note in 4., this approach is also drawn from the essential facilities doctrine which has been used to justify forcing firms to deal with their competitors, simply if an argument can be made that the firm in question has developed a product which other competitors would like to have. US courts have looked this, for example in the *MCI Communications Corp v. American Tel. and Tel. Co.*<sup>16</sup> and found that four key elements must be present in order for the essential facilities doctrine to have any application. First, the essential facility must be controlled by a monopolist. Second, a competitor must be unable to practically or reasonably duplicate the facility. Third, the monopolist must have denied the use of the facility to the competitor. Fourth, it must be feasible to provide use of the facility. In *Intergraph v Intel*,<sup>17</sup> the Federal Circuit court stated that:

“[the] courts have well understood that the essential facility theory is not an invitation to demand access to the property or privileges of another, on pain of antitrust penalties and compulsion; thus the courts have required anti-competitive action by a monopolist that is intended to eliminate competition in the downstream market.”

It is very important that firms that have developed their own products through hard work and the ordinary processes of competition should not be punished as if what they have produced has become a quasi public good. To use government power to compel them to deal with the problem will have a significant chilling effect on innovation because other new and emerging firms will know that one of the penalties of success is that they may be required by the Commission to deal with their competitors. This will cause them to pull their competitive punches as they are closer to having what the Commission might term market power, even if such market power is transient in economic terms.

If threats of antitrust compulsion hang over the heads of innovators they will innovate less, and the world will be poorer for it.

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<sup>16</sup> *MCI Communications v. AT&T.*, 708 F. 2d. 1081 (7<sup>th</sup> Cir. 1983)

<sup>17</sup> 195 F. 3d 1346 (9<sup>th</sup> Cir. 1999) at 1358

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