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HEARING ON ACROSS PLATFORM PARITY AGREEMENTS

-- Note by United Kingdom --

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Introduction

1. The growth in e-commerce and online markets in recent years has been striking. In the UK alone, e-commerce sales in 2013 accounted for 20% of business turnover.[1] While the digital world has brought – and promises to continue to bring – benefits to many, it also raises potential risks and novel challenges. The rapid emergence of so-called 'digital giants' has generated a range of new products and services (in particular a multitude of new online platforms and marketplaces). But it has also led to concerns, including some around, among other things, the holding by those players of potential 'gatekeeper' positions.

2. This submission considers those dynamics in the specific context of the use of so-called retail Most Favoured Nation (retail-MFN) clauses in online distribution arrangements. It considers first the nature of those agreements, and the commercial rationale for their use, and then discusses both how – and thereafter when – those clauses are, in the CMA's experience, more likely to raise competition concerns.

1. The growth of the digital economy

3. The growth of online commerce has meant that incumbent businesses now face competitive threats from innovative new entrants[2] or distant competitors not necessarily encountered in the 'pre-digital' era. And they must decide how to respond to those challenges, including, for example, whether and how to adapt the way in which they market or distribute their goods and services or seek to control distribution of such products by third parties. Alongside this, the objective of competition authorities in this online world is – through targeted intervention and education – to foster competitive commercial responses by businesses that can directly or indirectly encourage further dynamic innovation in the market, while seeking to deter and act against commercial practices designed to protect against or inhibit those new market dynamics through means other than competition on the merits.

4. Evidently, those objectives apply equally in 'offline' as well as 'online' markets: however, the rapid growth of e-commerce has required authorities to apply and adapt existing legal rules and economic theory (traditionally founded on the former) to a broader range of practices with the potential to have material (positive or negative) impacts on competition.

5. Reflecting these fundamental changes in the nature of the UK (and global) economy, and in the ways in which consumers engage with goods and services online, the CMA[3] has consistently held as a key strategic priority the goal of ensuring effective competition in online markets and the digital economy.[4] This has manifested itself through both the taking of direct enforcement action, and seeking to contribute to

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1 http://www.ons.gov.uk/ons/rel/rdit2/ict-activity-of-uk-businesses/2013/stb-ecom-2013.html.

2 See further OECD, 'Hearing on Disruptive Innovation – Issues Paper by the Secretariat', DAF/COMP(2015)3, available at http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2015)3&docLanguage=En

3 The CMA (www.gov.uk/cma) took on responsibility for competition law enforcement in the UK on 1 April 2014, replacing its predecessor bodies the Competition Commission (CC) and the Office of Fair Trading (OFT).

4 See further the CMA's Strategic Assessment (November 2014) and its Annual Plan 2015/2016, published in March 2015, both available on www.gov.uk/cma.

the wider policy debate around how existing competition laws should be applied to safeguard competition in online markets.

2. Vertical restraints and 'Retail-MFNs'

6. In the context of that wider policy debate, there has been a particular focus on the use of contractual and other restrictions between businesses at different levels of the online distribution and supply chain. Such 'vertical restraints' are by no means a purely online phenomenon; nor are they necessarily entirely novel.[5] However, it is the competitive impact of those restraints when applied in the context of new online markets which has particularly drawn the attention of competition authorities and commentators in the UK, across Europe and elsewhere.

7. In particular, considerable attention has been directed at the use – especially by providers of online platforms and marketplaces – of so-called Across Platform Parity Agreements (APPAs) – also referred to as 'retail-MFNs'.[6] Such retail-MFN clauses are worded to enable the customer (typically a platform or reseller) to ensure that the retail prices (and/or other non-price retail terms)[7] at which it offers a supplier's goods or services are no worse than those offered by other customers of that supplier.[8] A retail-MFN clause effectively obliges the supplier to ensure that the retail price on its own sales channel and/or on other sales channels is not lower than the retail price offered by the party benefiting from the MFN. Given the way in which they operate, MFNs require the supplier to have some control over retail prices or discounting (or both) of the products it supplies. The supplier may do this through the distribution model it adopts, by agreeing contractual restrictions with a platform or other distributor or by using other *de facto* control mechanisms (such as by exercising market power).[9]

8. At least in part because of increased price transparency and (in principle) reduced switching costs online, the development of online markets appears to have led to a linked increase in the use of MFNs at the retail, rather than wholesale, price level (often manifested as "Best Price Guarantees"). Faced with those changing market dynamics, and the proliferation of the potential new digital channels through which a

5 The European Commission has had specific guidance or regulations governing 'vertical agreements' for over 30 years.

6 The concepts of "retail-MFNs" and "APPAs" are broadly synonymous. However, retail-MFNs can in some circumstances cover aspects which may fall outside a narrow definition of APPAs. A retail-MFN may relate to parity of prices across different competing platforms that offer a supplier's products: in those circumstances, such a 'wide' retail MFN falls within a literal definition of an APPA. Equally, however, where a supplier has its own direct sales channel, such clauses may apply only in relation to the relative prices on the platform benefiting from the MFN and on the supplier's own sales channel. Such 'narrow' retail-MFNs, in contrast with the 'wide' retail-MFNs described above, may not require parity 'across platforms'. Reflecting the UK's experience of such clauses, this paper uses the term 'retail-MFNs', rather than 'APPAs' and considers the potential competitive impacts of both 'wide' and 'narrow' retail-MFNs.

7 In this regard, retail-MFNs can be distinguished from 'wholesale-MFNs'. The latter oblige the supplier to offer a wholesale price to a retailer that is no greater than the wholesale price offered to any other retailer. As such, wholesale-MFNs do not directly limit the retail price at which a particular product is offered: retailers remain free to independently set retail prices (and can 'share' their margin with end-customers). Absent significant market power, such wholesale-MFNs have historically not tended to raise serious competition concerns.

8 Typically, to ensure that it does not breach its contract with the platform/reseller, the supplier will 'police' such parity.

9 The precise legal and economic characterisation of such price control mechanisms will be likely to vary on a case by case basis.

business' products may be distributed to end consumers, businesses may face increased commercial incentives to try to control more tightly how their goods and services reach end consumers. Similarly, the UK competition authorities' experience in relation to such clauses has developed in recent years:

- The Office of Fair Trading (OFT) commissioned a study by Lear to consider the potential competitive impacts of a range of 'price relationship agreements' (*PRAs*) (that is those pricing policies in which the price paid to a seller for a good/service is directly related to the price charged for the same or similar competing products). While certain types of PRA were extensively considered by the existing economic literature at the time of the report, in relation to retail-MFNs (and equivalent 'third party' PRAs) the 2012 study found the economic literature to be limited, and to preclude firm conclusions being drawn as to the likely effects of such clauses on competition.[10]

- The UK contribution to the 2013 OECD Roundtable on Vertical Restraints in Online Sales,[11] included significant discussion of MFNs, reflecting – among other things – the OFT investigations at that time into:

  – the hotel online booking sector (which considered the interrelation of retail-MFNs with provisions that the OFT was concerned involved unlawful Resale Price Maintenance (RPM));[12] and

  – price parity clauses in Amazon's terms for users selling through its 'Amazon Marketplace' platform,[13]

  as well as earlier insights from the OFT's consideration of retail-MFN clauses in the e-books market.[14]

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10 Lear, 'Can 'Fair' Prices Be Unfair? A Review of Price Relationship Agreements' (2012) http://www.learlab.com/pdf/oft1438_1347291420.pdf. The views in that report were those of Lear at that time and do not necessarily reflect the views of the CMA, or the legal position under existing UK or EU competition law.

11 OECD, 'Vertical Restraints for On-line Sales', DAF/COMP(2013)13, pp. 145-150, available at http://www.oecd.org/competition/VerticalRestraintsForOnlineSales2013.pdf.

12 The CMA took over responsibility for the hotel online booking investigation when the matter was remitted to it, following the quashing on appeal of commitments previously accepted by the OFT prior to its abolition. On 16 September 2015, the CMA announced that it had decided to close the case on administrative priority grounds, without making a finding as to whether there had been a competition law infringement. In parallel, the CMA announced that it would continue to monitor the operation of various continuing pricing practices in the market, in particular in light of Europe-wide changes introduced by Booking.com and Expedia to abandon or waive certain retail-MFNs with respect to other online travel agents and certain other sales channels.

13 The OFT and the German Federal Cartel Office (*Bundeskartellamt*), which was investigating equivalent conduct by Amazon on the German market, both closed their respective investigations without reaching a final conclusion as to whether there had been a breach of competition law, after Amazon abandoned its parity provisions across the European Union.

14 The OFT opened an investigation into certain publishers and retailers for the sale of e-books, including carrying out inspections at the premises of several publishers. The investigation was ultimately taken forward by the European Commission. The Commission considered that the MFNs in place between Apple and five major publishers, together with the adoption of an 'agency' distribution model, acted as a "joint commitment device", incentivising each publisher to convert other retailers to that model on the same key terms. In the

- In 2014, following an investigation into the functioning of the private motor insurance (PMI) market in the UK under its market investigation powers,[15] the CMA found that, among other issues, some of the contracts between motor insurers and Price Comparison Websites (PCWs) contained wide retail-MFN clauses (i.e. requiring parity both with other platforms and the insurer's own website) which gave rise to an adverse effect on competition through limiting price competition and innovation, and possibly restricting entry. To remedy its concerns, the CMA prohibited the use of the wide MFNs by PCWs in the PMI market (and – to ensure the effectiveness of that prohibition – also prohibited behaviours by large PCWs intended to have equivalent effect).[16]

- More recently, as an initial stage of a wider economic research project focussing on vertical restraints and the Internet, the CMA held a roundtable with external legal advisors, economic consultants and representatives of business organisations to gather information on their understanding as to why businesses, in particular those active online, adopt the vertical restraints that they do. Although the discussion covered a range of restraints other than retail-MFNs, various points made related directly or indirectly to the use of such clauses. These comments focused in particular on the need businesses felt to protect against potential free-riding[17] and the related, but separate desire to control brand image, particularly in the light of increased online price transparency and the proliferation of possible distribution channels. The insights gained from that meeting will feed into further research seeking views from businesses directly, in particular on how use of such restraints has been affected by the development of the Internet as a marketing and sales channel.[18]

9. In the light of that accumulated and ongoing consideration of retail-MFNs, there are certain broad theories of competitive harm which the economic literature and/or competition authorities' recent enforcement and investigatory experience suggest may principally arise from the use of such clauses. Using those theories of harm and the further practical insights into the competitive effects of retail-MFNs

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Commission's preliminary view, this amounted to a concerted practice between Apple and the publishers. To address its concerns, the Commission accepted binding commitments from the publishers and Apple which included a ban on MFNs being included in the contracts agreed between Apple and each publisher.

15 The CMA's market investigation powers involve an assessment of whether there is a feature or combination of features of a particular market in the UK that gives rise to an adverse effect on competition. Where the CMA finds that there is such an effect, it may put in place legally-binding remedies to remedy, mitigate or prevent the adverse effect or any associated customer detriment. Market investigations are distinct from the CMA's competition law enforcement, and do not involve a finding that competition law had been infringed.

16 The CMA found that "narrow MFNs" (defined as those covering price parity with the insurance provider's website only) adopted by PCWs in relation to private motor insurance did not give rise to an adverse effect on competition (and so were excluded from the scope of the CMA's prohibition).

17 The concerns expressed regarding free-riding had various dimensions. These included in particular the view that contractual protections were necessary to prevent free-riding by other platforms or retailers on specific investments made by a platform into, for example, additional customer functionality and/or enhancements to the (online) environment in which the supplier's products or services are displayed and sold (e.g. the ability to easily research, analyse, compare and combine products).

18 The CMA currently expects to publish the results of the survey in early 2016, together with a review of the relevant economic literature and a summary of the views expressed at the advisers' roundtable.

that the CMA has gained as a basis, certain circumstances can be identified in which we consider that a given use of retail-MFNs is more likely to give rise to significant competition concerns for the CMA.[19]

3. Retail-MFNs: Potential competition concerns

10. From a legal and economic perspective, the principal competition concerns considered potentially to arise from the adoption of MFNs can be grouped into the following broad categories.

- First, such clauses may of themselves soften competition between existing retail-level competitors in a market by disincentivising those businesses (i.e. competing platforms) from competing on the commission or fee rates they charge to suppliers: in the presence of retail-MFNs, those businesses may consider themselves less likely to be able to benefit from offering lower fee rates (i.e. through increased sales)[20] by reducing retail level prices below those of competitors.[21]

- Indeed, retail-MFNs may, in similar ways, also underpin a more formal collusive arrangement between those platforms to set fees charged to suppliers. Where retail-MFNs operate to ensure that any increase in retail sales that can be achieved from a platform deviating from a collusive arrangement on fees – and thus the commercial advantage for that platform from that deviation – will in practice be limited, its incentive to do so will be diminished.[22]

- Similar effects may also serve to make it harder for new platforms to enter a market and attract sales. Such new entrants, including those offering potentially innovative retail offerings better meeting customer needs, will often rely on offering retail prices below prevailing levels to seek to attract customers, overcome any incumbency or scale advantages that existing players may have, and viably establish themselves in the market. Knowing that any such strategy is likely quickly or automatically to be countered may act as a material disincentive to such entry, and to the upfront investment that it might require.

- Finally, such clauses may facilitate collusion between competing suppliers whose products are sold through platforms. As a retail-MFN will limit a given supplier's ability to vary its prices across different platforms, monitoring of each other's prices by competing suppliers is made easier and the costs of enforcing a horizontal agreement are reduced.

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19 Where the CMA considers there to be a reasonable suspicion that competition law has been infringed, it has discretion as to whether it chooses to open a formal investigation in relation to the suspected restriction of competition. In deciding which cases to take forward, the CMA will apply its published Prioritisation Principles, which take into account the nature and extent of the harm to consumer welfare that may arise from the restriction, and which enforcement action would seek to address (see further paragraphs 0-0 below).

20 Where rival outlets know that their attempts to compete vigorously by cutting retail prices are likely quickly – and, in an online world of sophisticated price monitoring tools, perhaps almost instantaneously – to be matched or beaten, their incentive to do so may be reduced. In addition, such competition between competing platforms (or indeed between a platform and the supplier's own direct sales channel) might also be softened to the extent that the MFN may discourage consumers from shopping around and comparing prices (believing, from experience or otherwise, that such shopping around would not uncover lower prices elsewhere).

21 Further (or alternatively), the presence of a retail-MFN may reduce a supplier's negotiating power to resist an increase (or threatened increase) by a platform in the fee it charges.

22 Moreover, the ability for colluding platforms to monitor prices and detect deviation, including from a pre-agreed collusive position, may be enhanced as a result of a retail-MFN being in place.

4. Retail-MFNs: Enforcement priorities

11. Where it has a reasonable suspicion that particular arrangements constitute an unlawful restriction of competition, the CMA decides whether to take formal enforcement action based on a range of factors, which are detailed further in its published *Prioritisation Principles*. These include the impact and strategic significance of such action, and the likely risks and resource costs involved, and will include consideration of the competitive and consumer harm that a particular restriction is capable of having on the market. Such prioritisation decisions do not however involve the application of specific 'filters' to determine whether to take action, but rather an 'in the round' assessment of all the relevant circumstances.

12. Given that assessment of a range of relevant factors, the likelihood of the CMA prioritising a specific restriction arising from the use of a retail-MFN clause or other contractual restraint cannot be precisely determined in the abstract. As noted above, an MFN clause can take various forms and apply in different ways.[23] And similarly both the nature of the parties adopting those clauses, and the extent and nature of pre-existing competition at both the supplier- and the platform-level may vary significantly from case to case. As such, some degree of case by case assessment will always be necessary.

13. The theories of harm set out above do, however, indicate that retail-MFN clauses are more likely to be of competitive concern (and thus more likely to be prioritised) where they are liable to have 'horizontal' effects on competition: that is, where they may impede competition between suppliers of competing products, or between competing platforms (as identified above). This is reflected in the investigations undertaken by the UK authorities in recent years:

- In the CMA's market investigation into the PMI market for example, the CMA prohibited use of 'wide' retail-MFNs (i.e. principally those stipulating that an insurance provider could not offer a product for sale at a lower price than that on the platform with which the retail-MFN was in place, whether through its own direct sales channel or through another platform).That prohibition was based on competition concerns that, in the context of that market, such wide MFN clauses softened competition between competing PCWs on the level of the commission charged and that this was likely to lead to potential barriers to entry of new PCWs (i.e. they had likely horizontal effects on competition between PCWs).

- Similarly, the OFT's concerns regarding Amazon's price-parity policy focused in particular on the impact that the policy would have on the prices offered on other platforms or through the seller's direct sales channel, and on the consequent impediment to the ability of or incentive for new entrant platforms seeking to compete with Amazon to offer prices lower than those on Amazon, and to use this to create a viable market presence.

14. Therefore, by contrast, where a retail-MFN clause has only minimal horizontal effects (for example where it impacts pricing only as between the parties to the agreement (the supplier and the platform)), the CMA is generally less likely – absent market characteristics liable to accentuate the consumer detriment resulting from those effects (see further below) – to consider the case to be an enforcement priority, particularly where there is credible evidence that such 'narrow' restrictions in intra-brand competition are necessary to generate certain pro-competitive efficiencies.[24]

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23 As can the mechanism through which the supplier controls retail prices.

24 Similar matters regarding certain 'horizontal' effects and (inherent) 'vertical' effects of MFN clauses have also been considered by Fletcher and Hviid (A. Fletcher and M. Hviid, 'Retail Price MFNs: Are they RPM 'at its worst'?' ESRC Centre for Competition Policy, University of East Anglia, CCP Working Paper 14-5

- In its PMI investigation, the CMA excluded from the scope of its prohibition 'narrow' retail-MFN clauses which required only that an insurer would not sell products more cheaply through its own sales channel than on the PCW platform benefiting from the retail-MFN (i.e. the insurer remained free to set different prices on different PCW platforms). The CMA considered that, in the context of that market, such 'narrow' MFNs were unlikely to give rise to the same impact on competition as the wide retail-MFNs that were prohibited. Instead, the CMA found that, while narrow MFNs reduced the constraint on PCWs imposed by the insurers' own websites, any such anti-competitive effects were unlikely to be significant in this market. The CMA considered that narrow MFNs might be necessary in the PMI market to ensure the viability of the current PCW business model, the existence of which had in fact served to enhance price competition between insurance providers. The CMA considered that the benefits of such enhanced competition between insurers had the potential to offset the reduction in intra-brand competition between the PCW and the insurance provider.

15. It is not the case, however, that 'narrow' MFNs are incapable of giving rise to competition concerns that may warrant investigation, nor that they will necessarily give rise to pro-competitive effects akin to those that the CMA considered may have resulted from the adoption of such clauses in the PMI market. So, for example, the CMA is keeping under review the effects of remaining narrow and wide retail-MFNs in the hotel online booking sector in the UK, following the recent removal by Booking.com and Expedia of their wide retail-MFNs and certain other MFNs from their contracts with hotels.[25]

16. Aside from the 'scope' of a particular retail-MFN clause, however (i.e. whether it is 'narrow' or 'wide' in its application), certain other characteristics of such a clause, or of the market in which it is adopted, can also affect the likelihood of that clause having greater horizontal effects on competition or can increase the potential consumer detriment resulting from otherwise more limited restrictions on horizontal competition. Those characteristics will also potentially inform the CMA's decision to take enforcement action.[26] They may include, but are not limited to:

- a high proportion of the market being covered by the retail-MFN(s): not only - as noted above – how 'widely' such clauses apply, but also in relation to the number and aggregate market share of the platforms adopting them;

- similarly, whether there are networks of equivalent agreements: in those circumstances, horizontal effects on competition may arise from the parallel operation of restrictions which, on a stand-alone basis, would be expected to have only 'narrow' effects;

- the degree of market power of the platform benefiting from the MFN, and the extent to which a particular platform is therefore a vital channel for sellers (such issues were, for example, a relevant factor in the OFT's investigation into Amazon's price parity policy);

(Draft of 7 April 2014 available at http://competitionpolicy.ac.uk) and forthcoming in the Antitrust Law Journal).

25 After 12 months of monitoring market developments, the CMA will take the views and evidence it receives into account when considering whether or not to take any other steps.

26 Even where the CMA decides not to prioritise a case for a full investigation, if it considers there to be a reasonable suspicion that the law has been infringed, it may send parties to the conduct or agreement in question a warning letter. A warning letter informs the recipient(s) that the CMA has been made aware of a possible breach of competition law by them and that, although currently not minded to pursue an investigation, the CMA may do so in future if it receives further evidence of a suspected infringement or if its prioritisation assessment changes.

- the extent of single-homing or multi-homing by either customers or sellers, which may again impact the proportion of the market affected by a particular MFN;

- the strength of sellers' own websites as an alternative sales route: where such sales represent a significant proportion of the market, even a 'narrow' retail-MFN clause may in practice serve to harmonise prices across a significant part of the market; and/or

- the importance of price (relative to other factors) in the decision of a customer: where other (non-price) factors falling outside the scope of a retail-MFN clause are particularly important in customer purchasing decisions, the impact of an MFN clause relating to retail prices may be lessened.

17. As with all potential restrictions of competition, it may be possible to show that the restriction gives rise to certain pro-competitive efficiencies, which serve to enhance distribution to the benefit of consumers and which could not be achieved through less restrictive means. The likelihood of such pro-competitive effects in a particular case will form part of the CMA's initial 'in-the-round' assessment of whether or not to take enforcement action. Similarly, where it does take such action, demonstrable evidence from the parties of such efficiencies – and the indispensability of the retail-MFN to achieving those – will be taken into account by the CMA in deciding whether ultimately to find that there has been a competition law infringement.

18. While, in the abstract, such countervailing pro-competitive effects would be expected to be more likely where a restraint has only 'vertical' effects on competition (as shown by the CMA's assessment of narrow MFN clauses in the PMI market), specific features of a restraint, the parties adopting it, and/or the market in which it is applied may in certain cases serve either to negate in practice efficiencies expected to arise in theory, or to give rise to significant risks of consumer harm even where the horizontal effects of that restraint are very limited.

5. Conclusion:

19. Online markets continue rapidly to develop and evolve, and aspects of those markets may mean that terms such as 'buyers and sellers', 'suppliers and distributors' and 'upstream and downstream' must be considered in a somewhat different context than was historically. Competition authorities should be sensitive to such evolution in determining when to intervene.

20. That said, however, it is not necessarily the case that the 'rules of the game' (for operators or authorities) are markedly different in those online markets than in the offline markets from which they have emerged. Thus, the effects on competition witnessed, and/or the theories of harm identified by recent economic analysis, can often be the same or similar to those associated with restraints that equally existed in the 'analogue' world. The principal theories of harm associated with retail-MFNs for example – such as facilitating collusion, discouraging entry, or changing incentives so as to soften competition between platforms – are similar to those associated with more 'familiar' vertical practices such as RPM. And evidently, where express collusion between competitors does occur, retail-MFN clauses may represent a mechanism for implementing and enforcing underlying cartel behaviour.

21. To that end, the CMA has been able to use its existing range of legal and economic tools to address potential competition concerns arising from retail-MFNs in various contexts. The CMA will continue – including through our ongoing market monitoring and economic research – to seek to better understand such agreements, their commercial use, and their likely competitive effects; and, more generally, will be mindful to ensure that the laws and theories it applies remain capable of effective application in the digital age.