

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Quality considerations in the zero-price economy – Note by the United States

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More documentation related to this discussion can be found at:

www.oecd.org/daf/competition/quality-considerations-in-the-zero-price-economy.htm

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1. Zero-Price Products and Services

1. Zero-price products and services—that is, products and services supplied to a consumer or user without a price being charged to that consumer or user for the product or service—are increasingly significant.¹ Zero pricing is particularly common in the context of economic activity on or across multi-sided platforms, where zero (or negative) pricing is often observed on the side or sides exhibiting higher levels of demand elasticity.² But zero pricing also can be observed in other contexts, including, for example: the supply of complementary products and services; the so-called “freemium” model, in which a supplier offers a free version as well as a higher quality paid-for version; short-term strategies (e.g., promotions); or strategies driven by motives other than profit.³

2. Nevertheless, it may be a mistake to think of a separate or distinct “zero price economy” – zero-price products and services may meet similar or identical needs to paid-for products and services, and under appropriate conditions, zero-price products and services may compete to at least some extent against paid-for products and services.

3. As this submission discusses below, U.S. antitrust and consumer protection laws apply in full to zero-price products and services, and to the markets in which such products and services are supplied.⁴ The U.S. Department of Justice and the Federal Trade Commission (the “Agencies”) scrutinize all markets, including those in which zero-price products and services are supplied, for evidence of unlawful anticompetitive activity, including merger control as well as conduct investigations, and also look for evidence of deceptive or unfair acts or practices in consumer protection investigations. U.S. courts also apply the antitrust and consumer protection laws in full to markets in which some or all products or services are supplied at a zero (or even negative) price.

¹ There is a burgeoning literature on free products and services and their implications for antitrust and consumer protection. *See generally, e.g.,* Michal S. Gal & Daniel L. Rubinfeld, *The Hidden Costs of Free Goods: Implications for Antitrust Enforcement*, 80 *Antitrust L.J.* 521 (2016); John M. Newman, *Antitrust in Zero-Price Markets: Applications*, 94 *Wash. U. L. Rev.* 49 (2016); John M. Newman, *Antitrust in Zero-Price Markets: Foundations*, 164 *U. Pa. L. Rev.* 149 (2015); Chris Jay Hoofnagle & Jay Whittington, *Free: Accounting for the Costs of the Internet’s Most Popular Price*, 61 *U.C.L.A. L. Rev.* 606 (2014); David S. Evans, *The Antitrust Economics of Free*, 7 *Competition Pol’y Int’l* 71 (2011).

² *See generally, Jean-Charles Rochet & Jean Tirole, Platform Competition in Two-Sided Markets*, 1 *J. Eur. Econ. Assoc.* 990 (2003); David S. Evans and Richard Schmalensee, *Markets with Two-Sided Platforms*, *Issues in Competition Law and Policy (ABA Section of Antitrust Law)* (2008), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1094820; Lapo Filistrucchi et al., *Market Definition in Two-Sided Markets: Theory and Practice*, 10 *J. Competition Law and Econ.* 293 (2014). *See also* OECD, *Rethinking Antitrust Tools for Multi-Sided Platforms* (OECD 2018).

³ *See* Gal & Rubinfeld, *supra* n.1 at 523.

⁴ For example, consumers do not directly pay for advertising, yet it has long been clear that advertising is subject to consumer protection laws in the U.S. under the FTC Act. *See* <https://www.ftc.gov/news-events/media-resources/truth-advertising>.

2. The Role of Quality

4. In general, quality is an important dimension of output in traditional antitrust analysis.⁵ The Agencies have provided their views on the role and measurement of quality at some length in a previous submission to the OECD.⁶ For example, quality improvements may constitute procompetitive benefits, while quality reductions may constitute anticompetitive effects, of particular forms of conduct or of a particular transaction.⁷ Effects on quality should generally be analyzed along with other effects, including, for example, effects on price and output more generally.⁸

5. The foregoing is at least as true for zero-price products and services as it is for paid-for products and services. Under appropriate circumstances, quality may be particularly significant for competition when products and services are supplied at zero price. This is because when competing products or services in an antitrust market are not differentiated with respect to price (for example, because they are uniformly supplied at a zero price), other forms of differentiation—such as differentiation with respect to quality—may acquire particular significance in decisions made by consumers or intermediate purchasers. Among other things, this means that antitrust doctrine and enforcement should be sensitive to the risk that, in markets in which products and services are sometimes or typically supplied at zero price, competitive effects—whether positive or negative—may manifest, partly or entirely, in the form of effects on quality.

6. “Quality” itself is a complex concept that should be defined broadly and inclusively by antitrust courts and agencies. It is probably neither possible nor desirable to arrive at a detailed taxonomy or closed list of cognizable forms of quality suitable for all products, services, and markets. As the United States has previously indicated, “[a] common economic definition of a quality attribute is one where all consumers would agree that the product or service would be improved with higher levels of the attribute, all else held equal.”⁹

⁵ See, e.g., *Nat’l Soc’y of Prof. Eng’rs v. United States*, 435 U.S. 679, 695 (1978).

⁶ *Roundtable on the Role and Measurement of Quality in Competition Analysis: Note by the United States*, DAF/COMP/WD(2013)31.

⁷ See *id.* at ¶ 3.

⁸ See generally, e.g., *Non-price Effects of Mergers: Note by the United States*, DAF/COMP/WD(2018)45, ¶ 1 (“Many products and services, however, have one or more unique attributes that give rise to competition based on price and non-price factors, such as quality, reliability, durability, and method of distribution. Consumers may thus be willing to pay more for their preferred mix of price and non-price attributes, and competition in these non-price attributes can be a significant aspect of market competition.”), ¶ 8 (“In some markets, the non-price factors of a product or service can help firms distinguish their offerings and better satisfy consumer preferences. For instance, where firms compete to deliver products to customers, travel time or distance to a distribution center may be a key service factor as well as a basis for differences in cost. In addition, the scale of operations and the ability to provide additional services may give a firm an economic or competitive advantage over rivals.”).

⁹ See, e.g., *Roundtable on the Role and Measurement of Quality in Competition Analysis: Note by the United States*, DAF/COMP/WD(2013)31, ¶ 7.

7. Because quality is difficult to define and assess, it may be more feasible to assess competitive effects under zero prices by examining output effects. Output effects do not depend on the existence of positive prices.¹⁰

3. Special Considerations in the Antitrust Analysis of Zero-Price Products and Services

8. In general, the fundamental principles of antitrust doctrine are the same in the context of zero-price and paid-for products and services alike. For example, antitrust or competition law—including prohibitions on anticompetitive agreements, monopolization, and anticompetitive mergers and acquisitions—should be applied in order to protect competition, regardless of whether the specific products or services at issue are partly or entirely sold at a zero price.

9. Thus, for example, anticompetitive agreements, including those among suppliers of zero-price products or services, may constitute an unlawful restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, under either the *per se* prohibition on nakedly anticompetitive agreements or the “rule of reason” analysis that applies to agreements with arguable procompetitive justifications.¹¹ Similarly, anticompetitive conduct likely to create, protect, or maintain monopoly power in a relevant market, including one in which a zero-price product or service is supplied, may constitute monopolization in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.¹² Likewise, an acquisition of stock, share capital, or assets may substantially lessen competition, or tend to create a monopoly, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.¹³

10. Nevertheless, special challenges may arise for antitrust or competition law and policy when products or services are provided at a zero price. For example, it may be hard to measure or estimate market power or competitive effects in such circumstances. One source of complexity in such cases is that the zero-price economic activity is usually closely related to some other activity (or activities) that is (or are) not zero-price, such as the supply of a complementary product or service, or activity on the other side(s) of a multi-sided platform; depending on the circumstances, it may be necessary to analyze the other activity (or activities) as well in order to accurately understand the context and economic effects of the conduct or transaction at issue, as well as the likely consequences of any remedy.

11. For example, when a zero-price product or service is supplied over a multi-sided platform, it may be necessary to consider *all* sides of the platform before reaching any conclusions regarding market definition, anticompetitive effects, or procompetitive efficiencies.¹⁴ Even conduct that involves or results in a price increase on one side of a

¹⁰ See generally The Role and Measurement of Quality in Competition Analysis: Note by the United States, DAF/COMP(2013)17, 119.

¹¹ See, e.g., *Nat’l Soc’y of Prof. Engineers v. United States*, 435 U.S. 679 (1978).

¹² See, e.g., *United States v. Microsoft, Corp.*, 253 F.3d 34, 70-71 (D.C. Cir. 2001).

¹³ See, e.g., *United States v. H & R Block, Inc.*, 833 F. Supp.2d 36 (D.D.C. 2011); *United States v. Bazaarvoice, Inc.*, 2014 WL 203966 (N.D. Cal.).

¹⁴ See generally Evans and Schmalensee, *The Antitrust Analysis of Multi-Sided Platform Businesses*, Coase-Sandor Inst. For Law and Economics Working Paper No. 623, 2012; “*The ‘Sharing’ Economy: Issues Facing Platforms, Participants & Regulators*”, Fed. Tr. Com’n, 2016.

multi-sided platform may nevertheless lead to an overall increase in output and an improvement in consumer welfare. The U.S. Supreme Court recently emphasized this point in the *Ohio v. American Express* decision, in the context of credit card networks:

[T]he fact that two-sided platforms charge one side a price that is below or above cost reflects differences in the two sides' demand elasticity, not market power or anticompetitive pricing. . . . Price increases on one side of the platform likewise do not suggest anticompetitive effects without some evidence that they have increased the overall cost of the platform's services.¹⁵

12. In some circumstances, activities on different sides of a multi-sided platform may fall into separate antitrust markets.¹⁶ For instance, the FTC reached that conclusion in its investigation of a transaction between Zillow and Trulia, two leading consumer-facing web portals for home buying that sell advertising space to real estate agents seeking to attract customers buying and selling homes, while providing potential home buyers with free access to data on homes for sale.¹⁷

4. The Relationship Between Antitrust and Consumer Protection

13. In general, antitrust law, on the one hand, and consumer protection law, on the other, serve goals that are distinct but complementary. Antitrust law promotes consumer welfare through the specific enterprise of protecting competition and the competitive process.¹⁸ Consumer protection law also promotes the interests of consumers, but it typically does so by responding to other forms of conduct (such as fraud and deception) that can injure consumers independently of the effect of that conduct on competition. Sometimes conduct by a company may give rise both to competition and consumer protection concerns, and if it does, the FTC's tools allow it to challenge such conduct under both its competition and consumer protection authority.¹⁹

¹⁵ *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2285–86 (2018) (citations omitted).

¹⁶ See *Roundtable on Two-Sided Markets: Note by the United States*, DAF/COMP(2009)20, 149.

¹⁷ Statement of Commissioner Ohlhausen, Commissioner Wright, and Commissioner McSweeney Concerning Zillow, Inc./Trulia, Inc., FTC File No. 141-0214 (Feb. 19, 2015), https://www.ftc.gov/system/files/documents/public_statements/625671/150219zillowmko-jdw-tmstmt.pdf.

¹⁸ See *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977); *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958); see also *Reiter v. Sonotone Corp.*, 422 U.S. 330 (1979); *City of Lafayette v. La. Power & Light Co.*, 435 U.S. 389 (1978); see also generally, e.g., OECD, Contribution from the United States, *Does Competition Create or Kill Jobs*, https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/1510jobscompetition.pdf_5 (explaining that “non-competition factors do not play a role in the analysis conducted by U.S. antitrust agencies”).

¹⁹ See e.g., *In re Intel Corp.*, Dkt. No. 9341 at 5 (FTC Complaint alleging that “Intel’s failure to fully disclose the changes it made to its compilers and libraries. . . violated both competition and consumer protection provisions of Section 5 of the FTC Act.”) (analysis to aid public comment), available at https://www.ftc.gov/sites/default/files/documents/cases/2010/08/100804intelanal_0.pdf; *Rambus Inc. v. Fed. Trade Comm’n*, 522 F.3d 456, 464 (D.C. Cir. 2008); see also *Microsoft*, *supra* n.13 at 76-77 (Microsoft’s deception with respect to java applications found exclusionary).

14. The Agencies believe that the interests of consumers are best served, and that a vigorous, innovative, and competitive economy is best maintained, when the distinction between antitrust law and consumer protection law is maintained. U.S. antitrust law respects this distinction by prohibiting only conduct that has, or is likely to have, significant anticompetitive effects, either in a particular case or in the aggregate. Even the categorical *per se* rule under Section 1 of the Sherman Act against certain kinds of conduct (*e.g.*, price-fixing) is grounded in the proposition that such conduct is virtually always likely to have anticompetitive consequences, making a case-by-case evaluation of competitive effects unnecessary.

15. This approach to antitrust enforcement does not reflect or imply the view that economic competition is the only social goal worth protecting. Rather, it reflects an appreciation that antitrust enforcement (including, in the United States, the threat of private treble-damages litigation that may be brought on a class-wide basis) represents an extraordinarily powerful tool that must be applied with great care, and with as much transparency and predictability as possible, lest its social costs exceed its social benefits. In particular, vague, ambiguous, or politically pliable standards of antitrust legality would deter, and perhaps punish, a great deal of activity that benefits consumers, including by promoting lower prices and higher quality for everyday goods and services throughout the economy.

16. This distinction is as important in the context of zero-price products and services as it is in the context of paid-for products and services. As noted above, conduct may have, or be likely to have, anticompetitive effects in such markets; under such circumstances, antitrust enforcement action may be appropriate. Conversely, conduct relating to zero-price products and services may raise consumer protection concerns – for example, fraudulent or deceptive conduct in the provision of zero-price products and services may significantly injure consumers without significantly restricting competition, and under such circumstances, the consumer protection laws may be implicated.²⁰

17. Similarly, certain forms of conduct regarding the maintenance of consumers' personal or other data may also implicate consumer protection law or a specialized data privacy and security law. Data concerns may be particularly acute in markets characterized by zero pricing, including because access to consumer data may form part of a business model that partly or completely subsidizes the provision of some zero-price products or services to consumers (*e.g.*, through the sale of individually targeted advertising). However, in the absence of actual or likely harm to competition, the misuse or abuse of consumer data does not present a mandate for intervention under the U.S. antitrust laws, and the Agencies believe that this ultimately serves the interests of consumers. On the other hand, to the extent that firms compete with one another to offer effective protection of consumer data—a non-price dimension of competition—conduct that restrains competition on that basis (*e.g.*, an agreement not to offer certain kinds of data protection)

²⁰ For example, the FTC recently challenged an online business using “negative option” schemes, luring customers with the promise of a free trial product while deceptively enrolling them in an expensive membership program. *See* <https://www.ftc.gov/news-events/blogs/business-blog/2018/07/time-rosca-recap-ftc-says-risk-free-trial-was-risky-not-free>.

could give rise to an antitrust violation. That analysis would be separate from the evaluation of privacy violations, as such, as a consumer protection concern.²¹

18. Nevertheless, in some areas the concerns of consumer protection and competition law may overlap. For instance, the free flow of truthful advertising regarding products and services is essential to a well-functioning market for goods and services,²² and private restrictions between competitors to limit the sharing of truthful information can harm competition and violate the antitrust laws even without directly affecting prices.²³ Consumer protection law responds directly to advertising claims that are unfair or deceptive, while antitrust law generally prevents competitors from agreeing not to engage in truthful advertising that would otherwise permit consumers to accurately evaluate different product or service offerings.

²¹ OECD, Note by the United States, Implications of E-commerce for Competition Policy, DAF/COMP/WD (2018) 48 at 7-8, https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/e-commerce_united_states.pdf.

²² *Bates v. State Bar of Arizona*, 433 U.S. 350, 364 (1977) (advertising “serves to inform the public of the availability, nature, and prices of products and services.”)

²³ *FTC v. Indiana Fed’n of Dentists*, 476 U.S. 447, 461-62 (1986) (“A concerted and effective effort to withhold (or make more costly) information desired by consumers for the purpose of determining whether a particular purchase is cost justified is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned even absent proof that it resulted in higher prices or, as here, the purchase of higher priced service, than would occur in its absence.”)