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The Evolving Concept of Market Power in the Digital Economy – Note by Japan

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More documents related to this discussion can be found at

<https://www.oecd.org/daf/competition/market-power-in-the-digital-economy-and-competition-policy.htm>

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1. Introduction

1. As digitization advances and new business models expand, the Japan Fair Trade Commission (Hereinafter referred to as "JFTC".) has taken various measures to promote fair competition in the digital sector.

2. For instance, fact-finding surveys on digital markets conducted by the JFTC¹ point out that digital platform operators are likely to hold dominant or influential positions in the market due to various characteristics of digital platforms (2 below), and in such cases, they tend to hold superior bargaining position over many business partners. In addition, the services provided by digital platform operators have network effects and economies of scale, which closely relates to issues concerning importance of data as inputs and switching costs for users.

3. In the area of law enforcement, the JFTC has been paying close attention to competition in the digital sector. In addition to the above-mentioned fact-finding surveys, the JFTC has conducted investigations based on the Antimonopoly Act (Hereinafter referred to as "AMA".) into the conduct of large digital platform operators and has promptly eliminated alleged violations.

4. In addition, taking characteristics of digital platforms into account, the JFTC has identified new elements to be considered in reviews of business combination regarding the market power of digital platform operators and clarified its view on market definition in multi-sided markets and on assessment of the importance of data, etc. Furthermore, to appropriately handle the cases so-called "killer acquisition", the JFTC has made it clear that, the JFTC reviews business combination plans, even though they do not meet the notification threshold, when the total amount of the acquisition is large and the business combination is expected to affect domestic consumers.

5. This contribution paper first describes the characteristics of digital platforms (2 below), and then explains: how the JFTC evaluates and analyzes market power in the digital sector through the introduction of the fact-finding survey reports on digital markets (3 below); investigation cases where the conduct of digital platform operators may constitute abuse of superior bargaining position, private monopolization, and unfair trade practices (4 below); and the revision of the merger guidelines (5 below).

2. Characteristics of Digital Platforms

6. The JFTC points out the following characteristics of digital markets and digital platforms in its fact-finding survey reports on digital markets and in its AMA guidelines (5 below).

¹ Report regarding trade practices on digital platforms (Business-to-Business transactions on online retail platform and app store)

<https://www.jftc.go.jp/en/pressreleases/yearly-2019/October/191031.html>

Final Report Regarding Digital Advertising

<https://www.jftc.go.jp/en/pressreleases/yearly-2021/February/210217.html>

2.1. Multi-Sided Market and Indirect Network Effects

7. By utilizing information and communication technology and data, digital platform operators provide third parties with the platforms for various services, which, constitutes multi-sided markets with multiple user segments. In the multi-sided markets, network effects work. Network effects consist of a direct network effect and an indirect network effect. A direct network effect is an effect that the more participants belong to the same network, the more the utility for the participants increases. An indirect network effect is an effect in which there are a plurality of participant groups belonging to the same network, and as the number of participants in one group increases, the utility for the participants in the other group increases.

2.2. Low Marginal Costs and Economies of Scale

8. Since a digital platform is a place for transactions using information and communication technology as well as data, marginal costs for providing services can be low and an economies of scale exists.

2.3. Importance of Data as Input Goods

9. The importance of data as input goods is increasing, as digital platform operators can generate significant benefits through expansion and improvement of the quality of their own services by analyzing and utilizing the data collected from their users. For this reason, companies with significant data may have potential competitiveness, even if they are small in size.

2.4. Centralization, Switching Cost and Lock-in

10. Due to low marginal cost and strong economies of scale, concentration would occur on a few particular digital platforms, which may lead to monopolization and oligopolization. In addition, since the accumulation and utilization of data will lead to further expansion of services, the digital platform participants may bear high switching costs and a lock-in effect can work due to the switching costs. While the network effect, economies of scale, etc. work, and the concentration of data on the digital platform increases the utility for the participants, switching costs between digital platforms tend to increase.

3. Activities by Digital Platform Operators that may be problematic under the AMA

11. Due to the characteristics of digital platforms described in 2 above, it is highly likely that a digital platform operator will acquire a monopolistic/oligopolistic position, an influential position in the market, or a superior bargaining position toward business partners. In the 2019 fact-finding survey report, the JFTC states that if a digital platform operator in an influential position² or monopolistic/oligopolistic position engage in "acts which could exclude competitors" or "acts which could restrict transaction partners' business", this may cause AMA problems as an unfair trade practice.

² Article 3 (4) of Section 1 of the "Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act". A general standard of whether one's position is recognized as influential in the market is having shares over 20%.

12. For example, if a digital platform operator provides its own products and services on its own platform, it may compete with businesses that open stores and sell products on the digital platform. Since digital platform operators can basically set the conditions of usage of their platforms, they could exclude competitors by using their position. In the survey report, "acts which could exclude competitors" include (i) restrictions of use of other app stores, (ii) direct sale by operators using competitors' transaction data, (iii) different treatment between competitors and itself or its affiliates, and (iv) reviewing of competing products. The report also mentions that "acts which could restrict sellers' business" include (i) MFN clause³, (ii) restrictions on sales promotion activities, and (iii) setting a commission on an in-app purchase and restrictions on the payment outside of an app⁴.

13. In addition, if a party who has a superior bargaining position against the other transacting party makes use of such position to impose a disadvantage on the transacting party, unjustly in light of normal business practices, such act would impede transactions based on the free and independent choice of the said transacting party, and put the said transacting party in a disadvantageous competitive position against its competitors, while putting the party having superior bargaining position in an advantageous competitive position against its competitors. Since such act poses the risk of impeding fair competition, it is regulated as unfair trade practices, that is, "Abuse of Superior Bargaining Position."⁵

14. There are cases in which digital platform operators hold a superior bargaining position over sellers in digital platforms. This is the case where the seller would be unable to avoid accepting a request from a digital platform operator although the request is substantially disadvantageous for the seller, because the discontinuation of the transaction with the digital platform operator would substantially impede the seller's business. In determining the presence or absence of a superior bargaining position, the degree of dependence of the seller on the transactions with the digital platform operator, the position of the digital platform operator in the market, the possibility of the seller changing its business counterpart, and other concrete facts indicating the need for the seller to carry out transactions with the digital platform operator are comprehensively considered.

15. The survey report identifies acts of the digital platform operators that may be subject to the regulation on the abuse of superior bargaining position as "acts which could do sellers harm", which include (i) change in business terms with contract revision, (ii) calculation methods and grounds for commission fees, (iii) tasks requested towards sellers, (iv) withholding of the payment of sales proceeds, (v) action to damaged/lost products in the warehouse, (vi) handing consumers' request for returns or refund, (vii) requesting to purchase advertisement spots, and (viii) penalty system for violation of contracts.

4. Handling of Suspected AMA Violations in the Digital Sector

16. As mentioned in 3 above, a digital platform that has already obtained a certain number of users is highly likely to further enhance its market position due to network effects and economies of scale. In addition, there is a high probability that a digital platform operator will gain a superior bargaining position over its business partners due to its market position. The JFTC has been dealing promptly with cases where digital platform operators

³ Reference: The Case against Amazon Japan GK (June 1, 2017)
<https://www.jftc.go.jp/en/pressreleases/yearly-2017/June/170601.html>

⁴ See case against Apple in 4 (1) below.

⁵ "Guidelines Concerning Abuse of a Superior Bargaining Position under the Antimonopoly Act" Article 1 of No.1

may violate the AMA by engaging in conduct that may restrict the activities of their business partners or impose disadvantages to their business partners by using market power or bargaining position. The following are a few examples of cases handled by the JFTC in the digital sector.

4.1. Case Against Apple Inc. (Published on 2 September, 2021)⁶

17. Apple Inc. is suspected of violating the provisions of Article 3 (private monopolization) and Article 19 (paragraph 12 [Trading on Restrictive Terms] of the Designation of Unfair Trade Practices, etc.) of the AMA, by restricting business activities, such as selling digital content (e.g. music, e-books, videos, paid additional functions of apps, and subscription services such as unlimited music streaming service), etc., of developers that distribute apps, in accordance with the "App Store Review Guidelines", through App Store operated by Apple Inc., only place where the developers can distribute apps for iPhone.

18. The "App Store Review Guidelines" stipulates that developers are required to use the means of payment which Apple Inc. specifies (IAP: In-App Purchasing) for sales of digital content, etc., and prohibits the developers from including external links or buttons within the apps (in-app link) to induce consumers into purchase using means of payment other than the IAP. In addition, Apple Inc. charges developers with fees which amount to 15 or 30 percent of sales through the IAP.

19. Providing sales channels using means of payment other than the IAP may create price-reduction effect, and consequently benefit consumers. Prohibiting developers from including an in-app link could be a problem under the AMA because it may cause developers' sales channels using means of payment other than the IAP not to function sufficiently or may cause developers to abandon the introduction of such channels.

20. After the JFTC pointed out the concerns in the process of investigation, Apple Inc. reported to the JFTC that it would take measures to allow developers to include an in-app link within reader apps of music streaming service, etc. and to revise the "App Store Review Guidelines".

21. The JFTC recognized that the measure proposed by Apple Inc. would eliminate the suspected violations of the AMA and has decided that it will close the investigation after confirming that the measure is actually implemented.

22. On 30th March, 2022, Apple published the revised "App Store Review Guidelines" and developers become able to place an external link to their websites in their apps.

4.2. Case Against Amazon Japan (Published on 10 September, 2020)⁷

23. Amazon Japan engaged in activities such as price reduction, request for economic benefits, unreasonable return of goods, etc. in transactions with suppliers that were in a weaker position. The JFTC investigated Amazon Japan and suspected that activities of Amazon Japan violated the Article 19 (Unfair Trade Practices stipulated in the Article 2, Paragraph (9), Item (v) [Abuse of Superior Bargaining Position]) of the AMA. The JFTC issued a notice to Amazon Japan in accordance with the Commitment Procedure on 10 July, 2020, and in response to the notice, Amazon Japan made an application to the JFTC for the approval of the commitment plan. The JFTC, after considering the application,

⁶ <https://www.jftc.go.jp/en/pressreleases/yearly-2021/September/210902.html>

⁷ <https://www.jftc.go.jp/en/pressreleases/yearly-2020/September/200910.html>

recognized that the commitment plan from Amazon Japan would conform to the requirements stipulated in the AMA and approved it. The commitment plan includes (a) termination of the suspected actions, (b) recovery of monetary value for the suppliers, and (c) annual reporting to the JFTC for the next three years on the progress of the implementation of the commitment plan. As a result of the implementation of the commitment plan, the total amount of monetary value recovery for the suppliers (about 1400 suppliers) is approximately 2 billion yen (approx.15 million EUR).

5. Clarification of the JFTC's Views on Implementation of the AMA based on the Characteristics of Digital Platforms

24. In addition to dealing with suspected violations by digital platform operators based on the existing AMA framework described in 4 above, the JFTC has clarified its views on the implementation of the AMA taking the characteristics of digital platforms introduced in 2 above into account. For example, the following are brief explanation of "Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination"⁸ (hereinafter referred to as "Merger Guidelines") and "Policies Concerning Procedures of Review of Business Combination"⁹ (hereinafter referred to as "Procedures Policies"), both of which were revised in 2019.¹⁰

5.1. Clarification of the JFTC's Views on Market Definition in Multi-sided Markets

25. The JFTC has announced that a particular field of trade (similar to a relevant market) is defined in principle by the perspective of substitutability for users, using the SSNIP test. However, as described in 2 (1) above, services provided by digital platform operators often supply "places" for online services where multi-sided markets, in which indirect network effects work, are created. In such cases, it is necessary to keep in mind that the competitiveness in one market affects the competitiveness in the other market.

26. In this regard, the JFTC revised the Merger Guidelines in 2019 and clarified that there are some cases where it considers indirect network effects when defining markets ("the particular fields of trade") regarding multi-sided markets.¹¹ Specifically, if there are strong indirect network effects, the JFTC will consider the existence of the effects and

⁸ "Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination"

https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217GL.pdf

⁹ "Policies Concerning Procedures of Review of Business Combination"

https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217policy.pdf

¹⁰ In addition to the Merger Guidelines introduced in this contribution paper, the JFTC published the "Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Operators and Consumers that Provide Personal Information, etc." in December 2019. In the past, the provision of abuse of superior bargaining position was considered to be applied only to business-to-business transactions. However, taking into account a lock-in effect, etc. on users of the digital platforms, the JFTC clarified in these Guidelines the concept of abuse of a superior bargaining position against consumers raised by the acquisition of personal information, etc. on digital platforms or the use of such acquired information by digital platform operators.

https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217DPconsumerGL.pdf

¹¹ The Merger Guidelines state that the existence of indirect network effects should be taken into account not only in the context of market definition but also in the context of competitive analysis.

define the particular field of trade for each user segment and in addition, the particular field of trade comprises each user segment in an overlapping manner.

27. Since digital platform operators set their price in each market in a way that they could maximize the sum of profits from all markets on its platform, they may offer their services for free in some markets. In this regard, the Merger Guidelines clarify how the JFTC defines a particular field of trade in cases where competition occurs, based not principally on the price of the service but on its quality. The JFTC may take into consideration the extent to which users replace the product with another product or purchase the product in another region in cases where in a certain region a product suffers a deteriorating quality, etc. or where users bear increased costs of being offered a product in a certain region.

5.2. Clarification of the JFTC's Standard for Assessment of the Importance of Data for Competition Purposes

28. As described in 2 (3) above, the importance of data as input goods in the digital sector has been increasing. In the Merger Guidelines, the JFTC has clarified how to assess the importance that data has for competition purposes.

29. Specifically, the following points will be taken into consideration:

- a) what kind of data are held or collected by one of the parties (Company A),
- b) how much data are held and how much data are collected by one of the parties (Company A) from how wide an area on a daily basis,
- c) how frequently does one of the parties (Company A) collect data, and
- d) how much are the data held or collected by one of the parties (Company A) relating to the improvement of the product or service, etc. provided by the other party (Company B) in the market.

30. Also, how advantageous are the data held or collected by one of the parties (Company A) as compared with the data that are available to the competitor of the other party (Company B) from the perspectives of a) to d) above, is considered.

5.3. Response to So-called "Killer Acquisition"

31. The JFTC has the authority to review all business combination cases. However, only business combination plans of the parties of a certain size that are considered likely to affect competition are subject to the obligation of prior notification to the JFTC. The AMA sets notification threshold based on the parties' domestic sales, etc.

32. However, as described in 2 (3) above, the potential competitiveness of businesses with high value assets such as data, even if their domestic sales are small, is estimated to be high. In order to prevent potential competition from being nipped and competition restriction effects from rising through the acquisition of such businesses, the JFTC clarified in its Policy Procedures revised in December 2019 that it reviews a notification-free business combination plan when the total value of the acquisition exceeds 40 billion yen, and the plan is expected to affect domestic consumers.¹² Also, the JFTC made it clear that

¹² The JFTC reviewed the proposed acquisition of Fitbit by Google based on this Procedures Policies and published the result in January 2021.

<https://www.jftc.go.jp/en/pressreleases/yearly-2021/January/210114.html>

it is recommended that the parties having such a notification-free business combination plan consult the JFTC.

6. Conclusion

33. Since around 2017, the Government of Japan has been discussing the improvement of regulations in response to the rise of digital platform operators. Based on the successive Cabinet decisions, the relevant agencies including the JFTC have cooperated in various efforts.

34. Based on the basic principles established by the study group set up jointly with the Ministry of Economy, Trade and Industry and the Ministry of Internal Affairs and Communications, the JFTC is actively engaged in advocacy activities in the digital sector, such as conducting fact-finding surveys on the actual status of trade practices of digital platform operators in the online retail platforms and app stores, and the digital advertising, holding study groups comprised of experts in the digital sector and publishing, and releasing discussions and reports on issues and challenges in the digital sector.

35. In addition, as guidelines for the implementation of laws that take into account the characteristics of the digital sector, the JFTC has revised the Merger Guidelines and established "Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Operators and Consumers that Provide Personal Information, etc." in December 2019.

36. Through these activities, the concept of "market power" is steadily evolving based on the characteristics of the digital economy, and JFTC will continue to make efforts to appropriately catch up with changes in the economy and business model accompanying digitalization, while further strengthening cooperation with overseas competition authorities.