SOME THOUGHTS ON “THE PROS AND CONS OF ANTITRUST IN TWO-SIDED MARKETS”, SWEDISH COMPETITION AUTHORITY, 28 NOVEMBER 2014, STOCKHOLM

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In November 2014, the Konkurrensverket - the Swedish Competition Authority - hosted in Stockholm a seminar of the series “Pros and Cons”, this year focused on two-sided markets, an area of great interest, especially after the award of the 2014 Nobel Prize in Economics to Professor Jean Tirole, who has much contributed to the development of the theory.

A discussion on both general – from an economic and legal perspective – and specific aspects – in relation to media and card payment markets – developed around papers presented by the panelists and comments by their discussants.

From the debate it generally emerged that the two-sided markets theory has greatly enriched, at least potentially, the instruments of competition authorities, providing insights into the analysis of market definition and market power, especially in relation to digital markets. It has contributed, for example, to understanding the functioning of markets where a service may be offered for free to one side, the relation between prices on the two sides of a platform or the efficiencies deriving from the networks effects benefiting users on the other side of the market. The theory, however, leaves open to competition policy a number of delicate issues, above all in terms of the welfare standard to be adopted. More specifically, some practices may generate cross-market efficiencies, with one side of the market suffering negative effects while the other enjoys positive effects, involving difficult subjective evaluations in solving trade-offs across different user categories. In this context, focusing only on one side of the market increases the probability of finding an infringement as the scope for possible efficiency gains is reduced. Much of the debate has consequently focused on the caution that should guide antitrust enforcement in two-sided markets, especially in innovative sectors, discerning practices that may be efficiency enhancing from those which are not.

First of all, the debate focused on the need to continue empirical work in economic literature in order to reduce conceptual uncertainty. Nicolas Petit (Professor at the Law School of the University of Liege) recalled that definitions of two-sided markets in literature range from the narrowest one of Rochet and Tirole,2 which

1 Italian Competition Authority.

2 A “market is two-sided if the platform can affect the volume of transactions by charging more to one side of the market and reducing the price paid by the other in an equal amount; in other words, the price structure matters, and platforms must design it so as to bring both sides on board” (Jean-Charles Rochet, Jean Tirole, Two-sided markets: a progress report, RAND Journal
focuses on the price structure between the two sides for a given price level, to the loosest one of Rysman, centred on the existence of indirect network effects between the two sides. While in the opinion of Lapo Filistrucchi (Researcher at the University of Florence and Associate Professor at Tilburg Universite) “two-sidedness” is a matter of degree and a two-sided platform is different from a firm selling complement products, also in terms of implications for competition policy. Divergences in definitions involve uncertainty about which industries can be defined correctly as two-sided.

Indeed, Salvatore Rebecchini (Commissioner at Italian Competition Authority) suggested that another difficulty in the implementation of the theory relies with the existence of so-called no-transaction markets, where one side of the platform offers a service for free. In these markets there is no direct commercial relationship between the two sides as, for example, between broadcasters and viewers in the free-to-air television. On the contrary, in so-called transaction two-sided markets, there is a direct commercial relation between the two sides, as, for example, between merchants and cardholders in card payments. No-transaction market are becoming a great area of challenge for antitrust authorities, as they are increasingly common in the online world.

Panelists also agreed on the need to better frame the legal implications of the theory, as two-sided markets have been so far mainly a topic for discussion among economists.

More specifically, many comments concerned the recent judgments of the Court of Justice in the field of card payments. In the Groupement des Cartes Bancaries (GCB) decision, which concerned restrictions by object, the Court of Justice held that the General Court could not properly conclude that the pricing measures adopted by GCB had the restriction of competition as object, and, consequently, annulled the judgement. In order to assess the harmfulness of the coordination carried out by GCB, the rules of competition law, as well as the case law, must be interpreted in the light of the economic principles that underlie the theory of two-sided markets.

Moreover, it is important to note that two-sided markets have become increasingly common in the online world, and their particular characteristics require a careful assessment of their impact on competition. The Court of Justice has acknowledged the difficulty in the assessment of the harmfulness of the coordination carried out by GCB, and it is likely that future cases will need to take into account the economic principles that underlie the theory of two-sided markets.

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GCB, the General Court had to consider all the relevant aspects of the “economic or legal context in which that coordination takes place”, also when this relates to “interactions between the relevant market and a different related market”; furthermore when “there are interactions between two facets of a two-sided system”. A restriction of competition in one side of a two-sided market (in the case at hand, the issuing market) cannot be considered as “by object”, if there is a justification for the restriction in the other side of the market (the acquiring market). The judgment, however, leaves open the possibility to prohibit such coordination for its possible anti-competitive effects.

On the same day, the Court of Justice confirmed the judgement of the General Court, thus validating the Commission’s decision, prohibiting the multilateral interchange fees (MIF) applied by MasterCard. Such decision concerns restrictions “by effect” and their assessment under article 101.3 of the Treaty. Here, “the Court of Justice notes that the General Court took into account the two-sided nature of the system, since it analysed the role of the MIF in balancing the issuing and acquiring sides of the MasterCard system, while recognizing that there was interaction between those two sides”. However, when consumers on the two sides are not “substantially the same”, “appreciable objective advantages” deriving from the restrictive measure must be assessed in the same relevant market (in the present case, the acquiring market), before taking into account - in the context of article 101.3 of the Treaty - efficiencies on the other side of the market (the issuing market). Only then, benefits for other users (cardholders), who are substantially different from merchants, on a separate but connected market, can be considered.

In this regard, Alfonso Lamadrid (Senior Associate at Garrigues) noted that the application of the law in relation to network effects, which are typical of two-sided markets, tended to focus on their anticompetitive potential, which is paradoxical for a positive externality. In his opinion, network effects are a most effective basis for legal arguments challenging allegedly anticompetitive conduct, both, when prices are considered too high (for example, in relation to MIFs in card payment), or too low (for example, in relation to Google Maps). Furthermore, Lamadrid suggested that multi-sided considerations should not be left at the tail-end of the analysis and that the specific acknowledgement of the two-sided nature as part of the economic and legal context should take place before the finding of the prima facie restriction, prior to the shift in the burden of proof typical of article 101.3, as it seems confirmed by the recent approach of the Court of Justice.

Katarzyna Czapracka (Associate at White & Case), in analysing the impact of the

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7 Note 5 above, par. 74, 76, 77 and 78.
8 Judgement of the Court of Justice, 11th September 2014, C-382/12 P, MasterCard Inc. and Others v. European Commission.
9 Court of Justice, Press Release n. 122/14.
10 Note 7 above, par. 179, 181, 182 and 242.
MasterCard judgement beyond the card payments industry, argued that, in future cases, it will be difficult to state that there is one relevant market if different services are delivered to distinct groups of users and that a narrower market definition leaves little scope for considering the effects of a practice on other users.

More generally, Cristina Cafarra (Vice President, Head of European Competition Practice at Charles River and Associates) highlighted that it is a field where approaches seem to diverge across the Atlantic. Indeed, differently from Europe, in the United States restrictions of competition on one side may be compensated by efficiencies on the other side.

The seminar also focused on two specific sectors, the media and card payment ones.

Markus Reising (Professor and Chairholder, WHU – Otto Beisheim School of Management) considered Internet media as it offers several interesting features, in terms, for example, of consumers often receiving content for free and focused its intervention on the implications of consumers multi-homing in the Internet, instead of single-homing in the traditional media, and on search biases that can occur when using search engines.

He pointed out, firstly, that in traditional audiovisual media, consumers often stick to one media platform (single-home) while advertisers are active on many platforms (multi-home). Platforms become a competitive bottleneck, as they are an exclusive provider of that user to advertisers. On the contrary, in the Internet, not only advertisers, but also consumers, multi-home, as users spread their attention across various platforms, advertisers can reach a user on multiple platforms. Consequently, platforms no longer dispose of a monopoly power over their users and advertisers are willing to pay less for a shared user than for an exclusive one, giving rise to new competitive effects, contradicting the standard theory models. Indeed, when consumers multi-home, fiercer competition can lead to increased advertising and lower advertising prices, while on the traditional competitive bottleneck model, when consumers single-home and advertising is a nuisance for users, competition leads to reduced advertising. In this context, Birgit Schwabl-Drobir (Senior Economist/Austrian Federal Competition Authority) highlighted the potential trade-off for competition authorities between, on one side, lower advertising levels – since advertising is annoying for consumers – but higher advertising prices or, on the other side, lower advertising prices but higher advertising levels. Markus Reising, also, affirmed that users often access the web through search engines and that these activities could be biased in a detrimental way towards consumers as, for example, results may favour the search engine’s vertically integrated contents. There could be, first of all, a bias coming from the tension between organic and sponsored links, as high quality organic results could cannibalize sponsored links on which the search engine earns revenue. Higher quality, indeed, attracts more users, but may prevent them from clicking on the advertised link, consequently providing an incentive to search-quality degradation. Secondly, if advertisers are fierce competitors, they will have an incentive to pay a lower per-click-price on the advertised
link, as they will be listed anyway along with their closer competitors, providing another incentive to search engines towards search-quality degradation. Lastly, if advertising on a platform is a particularly close substitute to advertising on the search engine, the search engine prefers to bias results against the platform. Furthermore, if the search engine is integrated with the platform, it benefits from the revenues on that platform and may bias results in favour of it.

The debate then focused on card payments, highlighting the anti-competitive effects of MIFs and the reasons to move towards regulation of its levels in Europe. Some panelists, indeed, pointed out that MIFs cannot be neutralized as long as surcharging is costly for merchants. In relation to regulation, it has been, however, observed that it may imply a number of unintended consequences and that introducing a common level of MIFs in Europe may be inappropriate.

In this context, Ozlem Befre-Defoile (Assistant Professor at the European School of Management and Technology) pointed out that usage externalities in payment markets could be internalized perfectly, neutralizing MIFs, if merchants could price discriminate based on payment method at no cost. However, in practice, externalities are not perfectly internalized, since surcharging is costly for merchants, for example, in terms of transaction costs or missed sales. Hence the volume of transactions depends on the allocation of transaction fees, both to cardholders and merchants, and, consequently, on MIFs. In this context, potential reasons for market failures derive from platform’s pricing, which might distort the price structure by inducing too high MIFs and merchant fees. Furthermore, the no surcharge rule can be considered as a price restriction imposed by payment networks on their merchants, acting as a vertical restraint in a two-sided market. In a vertical relationship, the practice of the supplier restricting pricing of its services by the retailer, a practice known as resale price maintenance, would normally raise anti-competitive concerns.12

Alexis Walckiers (Chief Economist at Belgian Competition Authority) recalled that the tourist test defines the optimal MIF as such that card payments do not harm merchants and that “banning surcharging increases welfare if the merchant fee is sufficiently high (above the tourist test level) and decreases welfare otherwise.”13 He also pointed out that in order to know if a common level of MIFs across Europe - as proposed in the new legislation - is an appropriate solution to the market failure, more information should be

11 Besides the merchant (M) and the card (F) membership fees, the presentation considered also per transaction fees both on the merchant and cardholder sides (respectively, “m” and “f”).

12 In the United States, Visa and MasterCard, differently from American Express, reached a settlement with the Department of Justice in order to eliminate the no surcharge rules from their network rules. No surcharge rules have also been banned in Australia and United Kingdom, but merchant surcharges are subject to cap regulations based on merchants costs of card acceptance.

13 Bourguignon, Gomes, Tirole, Shrouded Transaction Costs, September 2014.
provided on costs and benefits for merchants of cards and cash payments, and their degree of differentiation among countries. Furthermore, he recalled that regulation may imply a number of potential unintended consequences, as also Tirole seems to suggest.\textsuperscript{14}

Rita Wezenbeek (Head of Unit Antitrust\&Payment Systems, DG Competition, European Commission) and Andrea Amelio (Chief Economist Team, DG Competition, European Commission) described the state of the debate in terms of passing-on to consumers of savings related to MIFs by merchants, the effect of decreased MIFs on the usage and acceptance of cards, as well as on the possible incentives for banks to find other sources of revenues. In relation to the latter, the impact is likely to be mixed as banks will also benefit from increased card usage and cost savings, for example, in cash handling.

Finally, Nicolas Petit concluded that two-sided markets theory could be very useful in competition policy as it helps moving beyond the boundaries of narrow relevant market definition, framing correctly current competitive dynamics, especially in digital markets.

In conclusion, the debate has highlighted different perspectives in the application of two-sided markets theory in antitrust enforcement. Economic and legal boundaries of the theory still do not seem to be univocally shaped, explaining the relatively low number of cases involving explicitly two-sided markets arguments.

However, some steps forward seem to have been taken by the Court of Justice in its judgements related to card payments. The GCB judgement stated that in order to define a restriction as by object in the context of article 101.1 of the Treaty, all relevant aspects of the economic and legal context should be considered, including the two-sidedness of the market.

This approach may prove useful to overcome, as noted by Salvatore Rebecchini, the formalistic tendency of competition authorities to find restrictions by object, as often effects are difficult to be ascertained.

Furthermore, it was highlighted by many participants that the MasterCard judgement seems to go in the same direction allowing, at some conditions, to broader the range of efficiencies to be claimed also in a connected but different relevant market.\textsuperscript{15} Indeed, the Court of Justice clarified that the absence of consumer commonality is not in itself an obstacle to cross-market efficiencies; when appreciable objective advantages are found on the same market of the restriction of competition, benefits in a related, but different, market can be accounted for.

\textsuperscript{14} Jean Tirole, \textit{Payment card regulation and the use of economic analysis in antitrust}, Toulouse School of Economics, n. 4, 03/2011.

\textsuperscript{15} See also Andreas Scordamaglia-Tousis and Claire-Marie Carrega, \textit{The application of article 101(3) in the context of multi-sided markets following MasterCard}, Competition Policy International, December 2014.
This more holistic approach to article 101 may prove useful in taking into account - in antitrust enforcement - the two-sided nature of a market, especially in relation to the widespread and growing digital sector.