Washington Center *for* Equitable Growth

A Consistent if not Unified Vision:
A Summary of the Stigler, UK Competition and EC Competition Reports[1]

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Without resolving whether the questions of whether there are competitive problems in high-tech industries and particularly those involving platforms, it is worth considering what tools could address such problems, should they exist. In some ways, this puts the cart before the horse because the solution depends on the scope and substance of the problem. At the same time, three recent reports, one by the Stigler Center, one by an expert panel for the United Kingdom, and one commissioned by the European Union all attempt to synthesize current literature, identify challenges in technology markets, and propose solutions.[2] Each report is unique, and easy summary is impossible. But there are broad areas of agreement, which this summary explores as it relates to two issues: acquisitions of nascent competitors and platforms discriminating against competitors.

Acquisitions of nascent competitors occurs when a dominant technology company buys a company that, although currently small, could develop a technology or business model that will dethrone the acquirer's position. For example, some argue that, absent Facebook's acquisition of Instagram,[3] Instagram could have developed as an alternative social network and challenged Facebook's position. Similarly, others argue that Waze presented a unique and potentially successful challenger to Google Maps, which Google's acquisition of Waze eliminated.[4] Platform discrimination concerns two related issues. An intermediary like Amazon's Market Place and Apple's App store arguably provides an important outlet to competition, but merchants using that outlet (sellers on the Marketplace or App Developers) may find themselves in competition with Amazon products or Apple's apps. The outlet or platform may discriminate against its competitors.[5] Alternatively, the outlet or platform may impose conditions and restrictions that limit the ability of businesses to use alternative outlets, such as most favored

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[1] An early version of this paper was submitted as part of the American Bar Association Antitrust Fall Forum Tech Summitt

[2] Stigler Center for the study of the Economy and the State, Committee for the Study of Digital Platforms, "Market Structure and Antitrust Subcommittee," (Stigler Center July 2019), https://research.chicagobooth.edu/-/media/research/stigler/pdfs/market-structure-report.pdf?la=en&hash=E08C7C9AA7367F2D612DE24F814074BA43CAED8C (hereinafter *Stigler Report*); Report of the Digital Competition Expert Panel, "Unlocking digital Competition," (2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf (hereinafter *U.K. Competition Report*)
Jacques Cremer, Yves-Alexandre de Montjoye, and Heike Schweitzer, "Competition Policy for the digital era," (European Union 2019), https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf (hereinafter *EC Competition Report*)

[3] *See Stigler Report,* at 50 n. 100; *U.K. Competition Report,* at 11; and *EC Competition Report* at 114-115.

[4] *See Stigler Report,* at 53 n. 110; *U.K. Competition Report,* at 11-12 and 48-50;

[5] *See Stigler Report* at 52-53, *U.K. Competition Report*, at 45-47; and *EC Competition Report* at 5-7.

nation clauses.[6] None of the reports reach conclusions about any specific company or its conduct, nor does this summary.[7] The examples provided here merely provide an illustration of the concerns.

All three reports identify similar market characteristics that make these types of competitive harms more likely: as a result of networks effects, the markets have dramatic economies of scope and scale, marginal costs and distributional costs are low, and the markets have a global reach.[8] After explaining these factors, this summary will address the two competitive concerns raised about acquisitions of nascent competitors and discrimination, considering whether current antitrust doctrine can address those issues should they exist, how antitrust law might develop or change, and the role of regulations. Although the reports cover a broad range of topics, they come to broadly similar conclusions. Current antitrust doctrine may not be flexible enough to deal with these challenges. A combination of stricter and more modern antitrust enforcement combined with regulation is likely the best approach.

A. Key Market Conditions

A key question is whether certain conditions make some hi-tech markets unique. As described above, the three reports focus on similar criteria. Network effects can create barriers to entry and lead to tipping, or a winner-take all dynamic. As the *U.K. Competition Report* explains, network effects can be direct or indirect. Direct network effects "occur when the benefits to a user increase as the number of users increases."[9] For example, having a telephone becomes more valuable as more people have them.[10] Indirect network effects "occur when the benefits to users on one side of a platform market increase with the number of users on the other side of the market." The higher a newspaper's circulation, the more valuable it is to advertisers.

Second, as the *EC Competition Report* explains, "new technologies of information are incompatible with traditional modes of competition" because "they show very strong returns to scale": the cost of producing or providing the service to many customers is little more expensive than to a few..[11] Although returns to scale are common in many markets, the scale of the scale makes information technologies unique. For example, the fixed cost to Google of updating calendars for 100 million users is not much more than if it serves a fraction of that number.[12] Further, digital markets have distribution costs close zero.

Similarly, digital markets have dramatic economies of scope based on data driven products. For example, "Combining mapping software in a platform that already offers email, for example,

[6] *See Stigler Report*, at 50-51; *U.K. Competition Report*, at 48, and *EC Competition Report* at 6-7
[7] Both as to the examples specifically and the issues generally, one would need to consider procompetitive aspects of the transactions or the conduct. The goal of these piece is simply to summarize the concerns being raised, not to render a judgment on any particular transaction or type of conduct.
[8] *See Stigler Report,* at 11-16: *U.K. Competition Report*, at 32-40, *EC Competition Report* at 2-3.
[9] *U.K. Competition Report* at 35 ¶1.80.
[10] *Id.*
[11] *EC Competition Report* at 20.
[12] *Stigler Report* at 13; *see also EC Competition Report* at 4.

allows that platform to offer a higher quality restaurant recommendation product."[13] Similarly, on the revenue side, more customers and more products can lead to higher revenue per customer and machine learning, once developed, can provide benefits across many products.[14]

Third, because of extremely low distribution costs, networks effects, and economies of scale, monetary zero pricing is common to one set of users.[15] Internet search is free, consumers pay no fee to use eBay or Amazon, and Facebook users do not pay directly for the social network. This is not to say that there is no price. If the product is advertising funded like Google search, the price is paid by advertising and eventually by those who purchase the product. Users are giving up their data and attention (as more advertisements populate search results, for instance, users in some sense are paying a higher price). And, a zero monetary price is not an absolute floor; the price could be less than zero (a network could pay its customers to use its services).[16]

Finally, unlike other industries, at minimal costs, information technologies and platforms have global reach in the sense that it is much easier for digital platforms to reach a worldwide market than traditional brick-and-mortar business.[17] The *Stigler Report* also discusses how insights from behavioral economics explain how consumer behavior can be and is exploited to maintain a dominant position.[18]

What does all this mean for competition policy? None of the reports suggests that we have created the bleak technological dystopia pictured in *Blade Runner*. To the contrary, they all recognize that these features have and will likely create dramatic benefits:

> We find it natural to communicate seamlessly with virtually anyone around the world mostly for free. The accessibility of information has greatly increased—not least thanks to the emergence of new information intermediaries. Transacting across national borders has been facilitated, both for individuals and firms. Consumer choice has increased. Navigation apps give us directions to avoid traffic jams using real-time information from hundreds of thousands of commuters and allow us to make better use of our time. The distribution of cultural goods and news has become much easier. The data revolution promises to bring about a revolution in healthcare, finance, mobility, and education. Digitization is impacting essentially every industry, from manufacturing to services to agriculture. [19]

Many of the products of digitization (search, email, navigations) are high-quality with low monetary prices.[20] Digital innovation can lower the price of starting a business, scaling up (cloud

[13] *Stigler Report* at 14: *see also U.K. Competition Report* at 33 (explaining implications of Financial Stability Board).
[14] *Stigler Report* at 14.
[15] *EC Competition Report* at 20.
[16] *Stigler Report* at 6; *U.K. Competition Report at* 22-23, ¶¶ 1.32-1.36.
[17] *Stigler Report* at 17.
[18] *Stigler Report* at 35.
[19] *EC Competition Report* at 12.
[20] *U.K. Competition Report* at 3.

computing), and competing (internet comparison sites).[21] As the *Stigler Report* concludes: "The speed, scale, and scope of the internet, and of the ever-more powerful technologies it has spawned, have been of unprecedented value to human society."

Without sufficient competition, however, innovation may slow, meaning we fail to achieve the true benefits of these advances, and only a few may benefit from them. The three reports largely agree that the very same dynamics such as network effects, economies of scale and scope, near-zero distribution costs that have driven innovation in digital markets also create an opportunity to stifle competition.

The combination of these features means that digital markets are subject to tipping, or a winner-take-all scenario.[22] In a market with high fixed or development costs and low variable costs, substantial economies of scope and scale, and large network effects, companies will want to invest heavily in their product or service, offer a least some customer segments a low or zero price and grow quickly. Often, once one or two companies reach a certain size, they have won the market. Existing competitors likely wither away, and new entrants face a significant disadvantage because they must build scale and invest heavily.[23] So it may be not be all that surprising that, at any given time, there is a dominant search engine or a single social network.

This dynamic, however, does not mean that a winner of today's market is unassailable or that competition is irrelevant. Rather, competition in these markets is different. Instead of the day-to-day competition in a market (such as Ford, General Motors, Honda, Volkswagen, and Toyota all competitor to win each customer) the meaningful competition is for the market (such as Google dethroning Alta Vista or Facebook replacing Myspace). In these types of markets, we are likely to see periods of fierce competition in which a new entrant, either by offering a new or dramatically different product, seeks to dethrone the incumbent.[24] Those competitive wars yield tremendous benefits to users of the product, although at the end of each war, there will likely be only one or two companies standing.

As a result, in comparison to traditional markets, the incentive and pay-off from eliminating these periods of competition is larger than in traditional markets.[25] "Competition for the market cannot be count on, by itself to solve the problems associated with market tipping and winner-takes-most."[26]And, "large incumbent digital players are very difficult to dislodge."[27] This is a problem all three reports emphasize: "In the view of this committee, protecting entry for existing and potential competitors is the most important way to protect or improve consumer welfare in digital platforms."[28]

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[21] *Id.*
[22] *U.K. Competition Report* at 4, *EC Competition Report* at 12-13.
[23] *Stigler Report* at 6; *U.K. Competition Report* at 4; *EC Competition Report* at 2.
[24] *Stigler Report* at 12.
[25] *U.K Competition Report* at 2.
[26] *U.K. Competition Report at* 4.
[27] *EC Competition Report* at 3.
[28] *Stigler Report* at 12.

B. Nascent Competition Acquisitions

Major digital platforms and ecommerce sites have acquired a substantial number of companies and assets over the past decade.[29] Google, Facebook, Apple, Amazon, and Microsoft have "made over 400 acquisitions globally."[30] In most markets, acquisitions of small start-ups are unlikely to raise issues.[31] Generally, if a small company is an important competitive constraint, its size and youth would suggest that another company can easily replace it. In contrast, the combination of factors that create winner-take-all markets makes it difficult to confidently conclude either that a particular nascent competitor will become a threat or that it is easily replaced.[32] But, these nascent threats "may be the most important source of competition faced by the incumbent firm."[33] If so, the cost of underenforcement, failing to prevent the acquisition of a potential competitor that would have disrupted the dominant incumbent is high.

The three reports offer related solutions. The *U.K. Competition Report* suggests what it calls a cost-benefit analysis, that focuses less on the likelihood that the merger will have an effect and more on a cost-benefit approach.[34] In other words, the law should be concerned about a merger where the likelihood of the effect is less than 50 percent but the size of the harm is large. The *EC Competition Report* argues antitrust law should be more skeptical when a market exhibits the characteristics of tipping or winner-take-all dynamics, although it explicitly disavows the creation of a new presumption.[35] In contrast, the *Stigler Report* offers the possibility of creating a presumption of illegality for mergers between dominant firms and "uniquely likely future competitors."[36]

One question is whether current antitrust law provides the flexibility to deal with these concerns. In the case of a nascent competitor, a court may be faced with the following: the acquired firm has a relatively small chance of usurping the dominant incumbent. If it did, however, the benefits would be substantial. In other words, there is a small chance that the acquisition would cause tremendous harm. Arguably, Section 7 of the Clayton Act provides sufficient breadth.[37] It prohibits acquisitions for which the effect "may be substantially to lessen competition or to tend to create a monopoly." Courts regularly explain that Section 7 deals with probabilities not certainties.[38] A court could interpret the "may be" and "substantially reduce" as related, the greater the harm that would occur, the lower the probability required to block the transaction.

[29] *EC Competition Report* at 110.
[30] *U.K. Competition Report* at 11. *Stigler Report* at 50 (describing evidence on degree of platforms' acquisitions of potential competitors to be "anecdotal but fairly robust."
[31] A recent working paper, however, suggests that, in the pharmaceutical industry acquisitions of development products by buyers with an existing competing product may stifle innovation. Collen Cunningham, Florian Ederer, and Song May, "Killer Acquisitions," https://equitablegrowth.org/working-papers/killer-acquisitions/
[32] *Stigler Report* at 67.
[33] *Stigler Report* at 67.
[34] U.K. Competition Report at 12.
[35] EC Competition Report at 124.
[36] Stigler Report at 77.
[37] 15 U.S.C. §18.
[38] *United States v. General Dynamics Corp*, 415 U.S. 486, 505 (1974) *quoting Brown Shoe v. United States*, 370 US 294, 323 (1962).

Although such an interpretation is possible, the doctrine of potential competition in merger cases has developed in a different direction, requiring far more certainty about the likelihood of competition, requiring proof that the acquired firm had "available feasible means' for entering and "that those means offered a substantial likelihood of ultimately producing deconcentration of the market or other significant procompetitive effects."[39] The question is whether legal doctrine addresses the harm that the three reports identify from a dominant platform's acquisition of a nascent competitor.

A second alternative would be to use Section 2 of the Sherman Act to address a dominant platform's acquisition of nascent competitors. In *United States v. Microsoft Corp.*, the DC Circuit held that "[I]t would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will." Applying Section 2 also would allow courts to focus on a series or pattern of acquisitions. At the same time, Section 2 has traditionally been backward looking. Despite the government's victory in *Microsoft*, consumers were stilled harmed, and *Netscape's* potential was stifled. It is unlcear whether the theory could apply proactively.

The three reports identify similar concerns with dominant firm acquisitions of nascent competitors in data-intensive markets.[40] And, the three reports offer a broad consensus on the tools needed to address those risk.

C. Platform Discrimination

In theory, digital platforms and e-commerce sites, once they obtain a dominant position, can take actions that further limit competition without offsetting benefits. For example, Spotify has complained that Apple, by requiring a 30 percent commission on Spotify subscriptions purchased through the Apple App store, is harming Spotify to the benefit of Apple's streaming services.[41] Others worry that a platform's use of most-favored nation or price parity clauses limits the development of alternative ecommerce sites.[42] Policies that make it difficult for customers to take their data from one service to another or that prevent interoperability also increase entry barriers and can limit competition.[43]

All three reports to varying degrees acknowledge that competition law alone is unlikely to resolve these problems and recognize the role of regulation (although the *EC Competition Report*

[39] *Yamaha Moto Co. v. Federal Trade Commission*, 657 F.2d 971, 977-78, quoting *United States v Marin-Bancorporation*, 418 U.S. 502, 633 (1973). More recently, the Federal Trade Commission suggested a four-part test "(1) the relevant market is highly concentrated, (2) the competitor "probably" would have entered the market, (3) its entry would have had pro-competitive effects, and (4) there are few other firms that can enter effectively." *See Federal Trade Commission v. Steris Corp.*, 133 F. Supp. 3d 962, 967 (2015)

[40] This is not to suggest that there is consensus generally on whether technology markets are unique or that these concerns are prevalent.

[41] James Vincent "Spotify files antitrust complaint over 'Apple tax", The Verge, May 13, 2019, https://www.theverge.com/2019/3/13/18263453/spotify-apple-app-store-antitrust-complaint-ec-30-percent-cut-unfair#targetText=Spotify%20announced%20this%20morning%20that,enforces%20on%20the%20App%20Store.

[42] *EC Competition Report*, at 5; *U.K. Competition Report*, at 36, ¶1.87

[43] *Stigler Report* at 18; *U.K. Competition Report* at 36, *EC Competition Report* at 6.

is most explicit about the dangers of regulation).[44] There is variation in what regulatory reforms are proposed. The *Stigler Report* proposes a new agency; the *U.K. Competition Report* proposes a digital markets unit that could be a separate agency or part of an existing regulatory agency, as well as the development of an industry code of conduct; the *EC Competition Report* analyzes how specific types of regulations can enhance competition. Notably, all three reports reject traditional utility-style regulations as a solution.[45] And, they see regulation as a complement to competition law. The *U.K. Competition Report* describes this project as developing a "pro-competition" regulatory framework.[46] Although a slight oversimplification, the reports suggest that antitrust law is best addressed at stopping or preventing harm while regulatory policy can promote competition.

In practice, this approach suggests that regulations can lower the barriers that limit competition and solve general problems. Regulations can promote interoperability, allowing companies' products or systems to work with existing, dominant platforms. Those rules allow companies to offer complementary services to the platform and can lead to greater competition. Regulations on data portability makes it easier for consumers to move from one platform to another and can promote multihoming, where consumers or businesses use multiple platforms simultaneously. Other regulations may apply only to dominant and would set rules to prevent harmful self-dealing, discrimination against actual or potential competitors, and foreclosure.[47]

Conclusion

The discussion about competition in digital platform and ecommerce will continue. Three recent reports discussed here, however, reach broadly similarly conclusions. First, digital platforms and ecommerce sites present unique and common economic dynamics based on their large economies of scale and scope, network effects, low distributional and marginal costs, global reach, driven by their heavily reliance on data. These conditions have both positive and negative implications. Further, all three reports suggest that a combination of antitrust enforcement and competition-enhancing regulations provides the best path forward to exploiting the benefits of these markets while limiting the dangers they pose for competition.

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[44] *Stigler Report* at 78-79, *U.K. Competition Report* at 55-56., *EC Competition Report* at 4, 9, 58-59, 73-73

[45] *U.K. Competition* Report at 56 ¶2.15; EC Competition *Report* at 15, 126; *Stigler Report* at 82-83 (discussing lessons from failed regulatory approaches).

[46] *U.K. Competition Report* at 54-55, ¶¶2.4-2.6.

[47] *Stigler Report* at 85-95; *UK Competition Report* 54-84,