Dealing with digital dominance: insights from Germany

The German government is looking at how competition law can better address abuse of dominance in digital markets. As part of this, an academic study has recommended giving authorities powers to intervene earlier and in additional settings where large platforms or valuable datasets are involved. How can these proposed reforms improve market outcomes while limiting the scope for unintended consequences?

This article looks at Schweitzer, H., Haucap, J., Kerber, W. and Welker, R. (2018), ‘Modernisierung der Missbrauchsaufsicht für marktmächtige Unternehmen’.

Competition in the digital economy is keeping courts and authorities busy throughout Europe and beyond. Ongoing investigations by competition authorities include the use of marketplace data by Amazon, advertising at Google, and privacy terms at Facebook. In addition, wider debates are looking at the state of competition in online advertising more widely, markets for data, the impact of algorithms, and other issues. Many of the markets under investigation have a small number of players, which raises the question of whether existing competition law adequately captures the concepts of market power and dominance in digital markets.

Of the European member states, Germany is one of the more active when it comes to applying competition law to digital issues. The German government is currently working on an upcoming amendment to the Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen, GWB). This tenth amendment, planned for 2021, aims to modernise the law to ensure that it is fit to protect competition in the digital economy. Similar debates are taking place elsewhere, through expert panels at the European Commission and in individual member states, including the UK. As part of the ninth amendment in 2017, the German government set a precedent for legal change by introducing various reforms relating to digital markets, including a value-based threshold for merger transactions of €400m, above which they become subject to merger control.

To identify the current gaps, the German Federal Ministry of Economic Affairs and Energy (Bundesministerium für Wirtschaft und Energie, BMWI) commissioned a study from a team of academics (Professor Dr Heike Schweitzer, Professor Dr Justus Haucap, Professor Dr Wolfgang Kerber and Robert Welker). The study asked how German competition law could address concerns about market power in the digital economy. While the authors do not recommend a systematically lower threshold for intervention, they do recommend changes in relation to:

- the prevention of market ‘tipping’;
- the assessment of platform dominance;
- potential anticompetitive effects of mergers;
- access to data.

Authorities elsewhere in Europe and beyond are likely to use these insights to inform their own debates on digital competition. This article summarises some of the main recommendations made by Schweitzer et al., and discusses their economic benefits and potential challenges.

Assessing dominance

The study sets out recommendations for how to prevent firms becoming dominant, as well as how authorities can establish dominance when assessing markets.

Behaviour that encourages tipping

Market tipping occurs when one firm emerges as dominant (including where it is the only player in a market), for instance as a result of strong network effects or firm decisions to restrict interoperability. For example, Facebook is often considered to be the ‘winner’ in the market for social networks.

If a market has tipped in this way, and there is no threat of dynamic competition from would-be market ‘disruptors’, this may affect market outcomes when dominant firms act with limited competitive constraints. In these cases,
enforcement could be particularly harmful if additional rules on platforms in markets that are unlikely to tip prevented firms from competing vigorously with each other, or if strategies that primarily enhance consumer welfare were mistaken for anticompetitive behaviour.

In contrast, the proposal may enable more dynamic competition in markets that tip irrespective of firm behaviour. In these cases, additional rules will not stop markets tipping (unless the rules are too restrictive and protect ineffective competitors or promote excessive entry), but could lower the barriers to entry for future competitors (for example, by moderating switching costs).

Such a law would need to take into account the potential benefits of preserving (more) competition on the one hand, and the potential harm from legal uncertainty and over-enforcement on the other. Authorities would therefore need to assess markets and firms’ strategies on a case-by-case basis and provide appropriate ex ante guidance.

Establishing intermediation power

The GWB currently measures market power in terms of buyer and supplier power. In the digital economy, these concepts may not capture the market power of a platform if the platform acts as an intermediary rather than as a seller or buyer.

In order to provide clarity on the concept of dominance, Schweitzer et al. suggest recognising ‘intermediation power’ as a third dimension of dominance. Their recommendation focuses on intermediaries that have a relationship with users on both sides of a transaction. However, the authors reach no firm conclusion regarding information intermediaries (which have a contractual relationship with one side only—such as search engines or news aggregators). In this case, they find that additional considerations come into play, such as potentially ineffective competition if consumers struggle to compare information intermediaries (for example, due to the underlying ranking algorithms of search engines). Schweitzer et al. note that this can mean that consumers need to rely on trust, which may give a platform power even below the conventional thresholds for dominance.

Intermediation power appears to be a reasonable concept in helping authorities and courts to analyse market power. However, it is important to highlight that some platforms also compete with firms that rely on other business models. A high share in intermediation would therefore need to be considered alongside other indicators, including buyer and supplier power. For example, a flight booking platform might have a high share in intermediation, but other booking channels, such as airline websites, might also exert competitive pressure.
Finding dominance without defining a market

Market definition is particularly challenging in investigations in multi-sided markets. This is because it is not easy to apply the standard ‘hypothetical monopoly test’ framework in the presence of multi-sided price setting (with feedback effects between the sides) and zero prices (where users are not charged for services).

One shortcut that Schweitzer et al. propose is to infer dominance from an observed abuse. They suggest giving courts the option to skip the market definition exercise if firm behaviour implies that the competitive constraints are insufficient.

In practice, this would need to balance the potential benefits and harm of such a change. Shorter and more focused proceedings can save legal resources and are more likely to preserve competition, because any anti-competitive behaviour is addressed earlier on. However, as Schweitzer et al. acknowledge, if it becomes easier to make a finding of dominance (and abuse), this is likely to increase the risk of ‘false positives’—i.e. firms being found to be dominant when they are not. This is least likely to happen with strategies that are profitable only for dominant players. In these cases, skipping the market definition stage could allow authorities to analyse the alleged abuse directly.

In many cases, however, strategies can be pro-competitive when implemented by a non-dominant firm, but can harm competition when a dominant firm is involved. In order for the market definition exercise to be skipped, the effects of practices would need to be assessed on a case-by-case basis (which is important anyway for demonstrating an abuse of dominance). For example, increasing the cost of multi-homing can be a suitable strategy for a smaller competitor to build a loyal user base, but may reduce competition if it is the strategy of a large platform.

The box on the right discusses how similar concepts to those of Schweitzer et al. are already applied in the UK.

Strategic purchase of potential competitors

Recently, some large online platforms have acquired small and growing firms, including Facebook/WhatsApp, Google/DoubleClick and Microsoft/GitHub. These transactions have raised concerns about a lack of dynamic competition, as small players have been acquired before they became large enough to pose a competitive constraint on incumbents. Although a new transaction value threshold was introduced in the ninth amendment of the GWB, it is unclear whether authorities have sufficient tools to assess the potential impact of mergers on dynamic competition.

Schweitzer et al. propose to trigger an intervention by the Bundeskartellamt if a dominant firm strategically acquires potential future competitors. This could be done ex post (in the context of abuse-of-dominance proceedings) or at the point of a merger. The study leaves open exactly how such a provision might be implemented; in principle, this would almost certainly result in losses to consumers.

Maintaining dynamic competition is essential in digital platform markets. It would therefore be important to clearly define the types of transaction that would be considered problematic. For example, if the acquirer firm were to ‘shelve’ the innovative service of a newly acquired business, this would almost certainly result in losses to consumers.

However, acquisitions of small start-ups can also have a positive effect on innovation. For example, mergers can promote competition, as some start-ups may see such a deal as a very attractive commercial strategy, and incumbents can also provide the necessary funding to quickly scale up and bring an innovation to market. The potential difference in speed at which innovation reaches the masses means that it is difficult to judge a transaction in hindsight. In the example of Facebook/Instagram, Instagram might have been a credible competing service had it remained independent, but it could also have failed to attract as many users as it did absent the integration with Facebook.

The German proposals and UK competition law

Some of the provisions that Schweitzer et al. propose are already in use in other jurisdictions.

The Bundeskartellamt (the German competition authority) would have more scope to intervene if the GWB explicitly prohibited behaviour that favours tipping, or information asymmetries that prevent users from comparing services effectively. In UK competition law, the competition authority already has the power, in principle, to open market investigations without having to prove dominance if it suspects there is an ‘adverse effect on competition’.\(^1\)

UK courts also have some experience of reaching a judgment in abuse of dominance cases without precisely defining the market. For example, in Arriva/Luton,\(^2\) abuse was found without a specific market definition being provided, as competitive concerns existed irrespective of the specific market definition. In Google/Streetmap,\(^3\) the behaviour was found not to be abusive and there was therefore no need to define a market.

Another challenge concerns how to assess transactions in less closely related markets. As many large platforms turn into ‘ecosystems’ or ‘conglomerate’ structures, it is difficult to anticipate which firms may become competitors (even if just as part of a conglomerate incumbent). While this goes beyond the scope of the Schweitzer et al. study, one way to address this uncertainty at the time of the merger might be to more closely examine the acquiring firm’s plans for its target’s service and introduce more forward-looking remedies in merger proceedings. Other proposals include putting more focus on the shares of multi-homing users between two merging services, as a way to identify those with a potentially high welfare loss through a concentration in advertising markets.\textsuperscript{14}

This raises many open questions, for example about the appropriate scope of data-sharing rules (e.g. how high should the threshold of ‘replicability’ be? How would one ensure that this will not facilitate coordination in the market?) and the appropriate mechanism for compensation (e.g. a FRAND framework\textsuperscript{15} could provide a starting point to balance the incentives for companies that collect data and those that use it).

### Conclusion

Many of the gaps in competition law identified by Schweitzer et al. reflect the concerns of stakeholders across Europe, and highlight how there is an impression of under-enforcement.

At first glance, the recommended changes may appear to be minor; however, their impact on what digital platforms would be allowed to do could be significant. To the extent that imposing additional constraints on large platforms could foster both competition and consumer welfare, they could give enforcers valuable tools to prevent anticompetitive behaviour. Authorities might also be able to act more effectively by intervening earlier and faster, thereby preserving the disruptive potential of promising start-ups and ensuring that data is shared on appropriate terms with those who can use it productively.

In order to achieve these objectives, lawmakers will need to make sure that any unintended side effects do not outweigh the expected benefits. These effects might include imposing additional burdens on players without market power, and increasing legal uncertainty, which could increase the reluctance of both small and large players to engage in some types of innovative and vigorous competitive behaviour. However, if German lawmakers and authorities are able to develop these proposals into well-defined legal provisions, they may also serve as an example to other authorities worldwide.

### Contact:

Aline Blankertz
Manuel Heller

2 European Commission, Google AdSense, Case No. 40411.


10 Using more than one service for the same purpose.

11 A system that is not interoperable with those of other producers.

12 The Bundeskartellamt has launched a sector investigation into comparison platforms that addresses some of these questions—see Bundeskartellamt (2018), ‘Konsultationspapier zur Sektoruntersuchung Vergleichsportale’, 12 December.

13 With most-favoured-nation clauses, a seller guarantees that they will not offer their products on any other platform on better terms (in particular, for lower prices) than on the platform with which it enters the agreement. For further information, see Oxera (2014), ‘Most-favoured-nation clauses: falling out of favour?’, Agenda, November, https://bit.ly/2T5hMSF.


16 FRAND stands for fair, reasonable and non-discriminatory compensation that guides licence negotiations with holders of standard-essential patents as well as with collecting societies.