

11th EU-China Competition Week

20 October 2015

Shanghai

ONLINE RESTRAINTS

EFFECTS, ANALYSIS AND ENFORCEMENT

Remarks from the Italian experience in the Booking/Expedia investigation

Antonio Buttà

Italian Competition Authority

The views expressed here are personal and do not necessarily reflect those of the Italian Competition Authority

Online platforms

- **Standard retail model**

- Suppliers do not set final retail prices
- Suppliers sell their products or services at wholesale prices to a downstream retailer and then leave it up to the retailer to set final retail prices
- The retailer is remunerated for its own services through the difference between retail and wholesale prices

- **Online platform model**

- Suppliers themselves set final retail prices
- Suppliers pay the retailer directly for its services
- The retailer is remunerated for its own services through the fee paid by the supplier

Across platform parity clauses

- A price parity clause is an agreement between a seller and an electronic platform - often referred to as Across Platform Parity Agreement (APPA) or Retail Price Most Favoured Nation (MFN) clause – that requires the seller to price on the platform its goods/services no higher than they are priced
 - on other online platforms
 - on offline retailing channels
 - on suppliers' direct sales channels
- From a consumer perspective the price parity clause looks like a “best price promise”

Potential anticompetitive impact of MFN clauses

- **Soften competition between retailers**

- A platform with a Retail Price MFN will have an enhanced incentive to raise its fees to the sellers, because it knows that it won't thereby be disadvantaged, in terms of retail prices, relative to other platforms. In equilibrium, these higher fees will lead to higher retail prices.

- **Restrict entry at the retail level**

- The Retail Price MFN clause can disadvantage potential retail competitors with low-end business models by eliminating an entrant's ability to win customers away from the incumbent through cutting its own margin, i.e. fee, and offering products/services at lower prices to final consumers.

Potential efficiencies of MFN clauses

- **Specific investments.** Specific investments by OTAs have created innovative portals that have radically changed the industry offering new methods to book hotels that benefit consumers
 - reduction of search costs
 - innovation
 - increase transparency fostering inter-brand competition
- **Free riding.** The incentives to invest would be substantially reduced if hotels and other OTAs could freeride on OTAs' specific investments

The Booking and Expedia case

- In May 2015 the ICA, following complaints by the Italian Hotels Association (Federalberghi) opened a **proceeding against Booking.com – the market leader in Italy - and Expedia** in order to investigate possible restrictions of competition related to the use of price (and others conditions) parity clauses in contracts stipulated between the main online travel agencies (OTAs) and their hotel partners.
- In particular the ICA was concerned by the **MFN clauses** applied by the two OTAs to their hotel partners, whereby the latter would not be able to offer equal or better room rates on any other sales channels, offline and online, including other OTA platforms and hotel's own websites. These parity clauses applied not only to prices but also to other terms and conditions, including room availability.

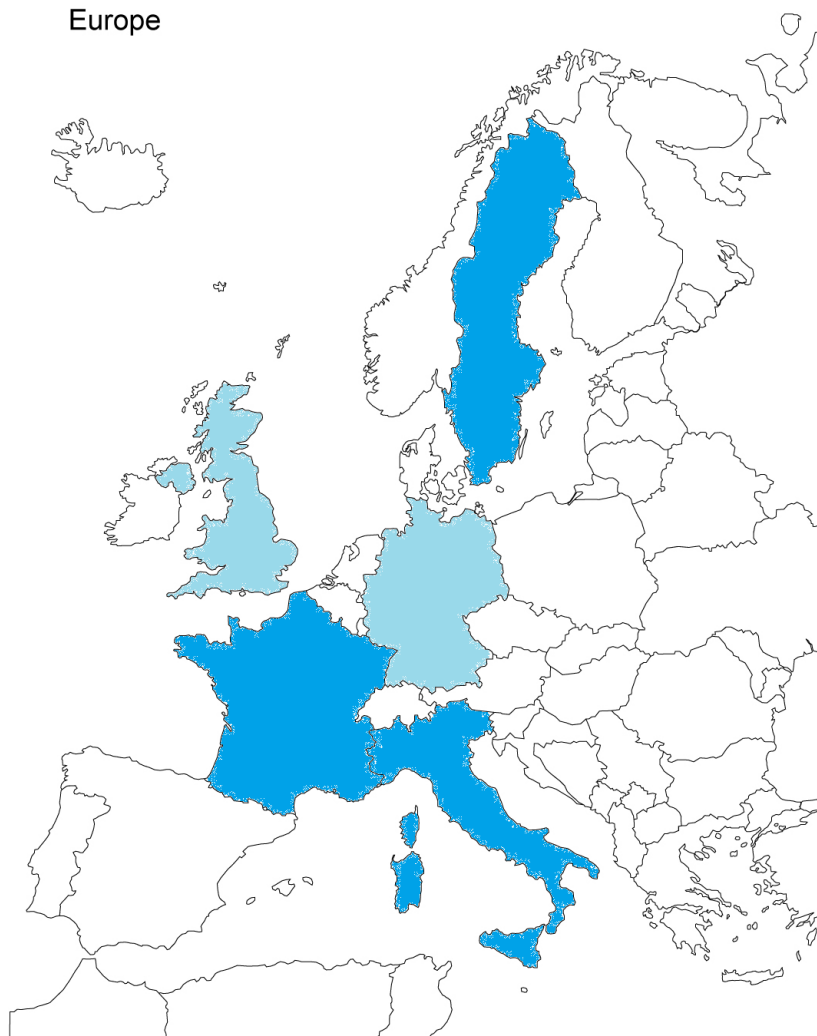
Theory of harm

- The **main competition concern** for the Authority was that these MFN clauses restricting the vertical relationships between the two OTAs and their hotel partners would have effects on the horizontal dimension, i.e.:
 - competition among OTAs
 - and more generally among all sales channels.
- In particular, these parity clauses could have the potential to substantially **restrict competition**:
 - on commission fees requested by the OTAs to their hotel partners: in presence of parity clauses, an OTA has no incentives to offer lower fees as these lower costs for the hotels cannot be translated in lower room rates offered on its platform due to the parity obligation.
 - on the retail price (and other conditions offered to final users) within the OTA channel and across the other sales channels, both online and offline, direct and indirect (e.g., hotels' own websites, traditional travel agencies);
- In addition, the clauses could **foreclose the market**, preventing entry of new OTAs.

Relevant market

- **Relevant product market.** The ICA considered that the relevant market for the assessment of the parity clauses is the market for online hotel booking services, distinct from the market for offline hotel booking services.
- **Relevant geographic market.** As for the geographic dimension, the market was considered national given that Booking and Expedia operate with country specific websites and differentiate their commission fees based on the national borders.
- In 2013 online hotel booking through OTAs represented nearly 70% of the online channel (in terms of turnover of hotels), and [25-30]% of total hotel reservations. Room booking at the hotels website represents only [5-15]% of total hotel reservations.

International cooperation



- Cooperation between Italy, France and Sweden (■)
- Previous cases in Germany and the UK (■)

Commitments

- During the investigation, Booking.com submitted commitments consisting in a **significant reduction of the scope of the MFN clauses**
- The revised MFN clauses will only apply to prices and other conditions publicly offered by the hotels through their own direct online sales channels, leaving them free to set prices and conditions on other OTAs and on their direct offline channels, as well as in the context of their loyalty programs
- Commitments affect
 - Competition between OTAs
 - Competition between OTAs and direct sales
 - Competition between OTAs and offline channels

Commitments: OTAs

- **Commitment 1) - Price Parity / Conditions Parity:** refraining from requiring accommodations to enforce parity clauses on price and other conditions offered on any other OTA.
- **Commitment 2) - Availability Parity:** refraining from requiring accommodations to offer on Booking.com the same or a greater number of rooms, of any type, as those offered on any other OTA, or as is reserved for the accommodation itself.
- Commitments 1) and 2) above are expected to significantly increase competition between Booking and other OTAs in the online segment compared to the ex-ante situation.
 - hotels have more flexibility in allocating rooms across different OTA's platforms and may use this competitive variable when negotiating their commission fees with the OTAs
 - increase incentives for OTAs to reduce fees

Commitments: offline sales channels

- **Commitment 3) - offline channels:** allowing accommodations to offer equal or better conditions on offline channels than those offered on Booking.com, provided that these conditions are not published online or marketed online (i.e., they are aimed at the general public)
- This commitment reflects the concern expressed during the market test that the parity clauses had the effect of restricting competition also with regards to offline sales channels.
- This commitment is expected to provide hotels with the ability to use offline distribution channels in such a way to be more competitive against Booking.com and other OTAs.

Commitments: direct sales

- **Commitment 4) hotel direct sales.** Refraining from restricting unpublished conditions that accommodations are able to offer, provided that these are not marketed online at the general public
 - Booking may prevent its hotel partners from offering better conditions if they are made available online to the general public (so called “narrow” MFN clause).
- The preliminary commitment package of Booking.com envisaged the elimination of the parity clauses only with respect to other OTAs, i.e., excluding hotels’ websites.
 - During the market test it was argued that this commitment (called narrow MFN clause) would have no pro-competitive effects as it would ultimately replicate the status quo (i.e., parity clauses applying to all channels)
 - On the other hand, the promotion of direct channels by hotels partly conflicts with the aim of limiting the free-riding problem and protecting OTAs investments in the online platforms (which benefit consumers).
- **Striking a balance** between these two legitimate interests hinges on the definition of extent of the application of the parity clauses.
 - In its final version, the parity clause has been amended so that it applies only on deals offered through their own websites to the public at large: Booking’s hotel partners are still able to offer promotions through their own online channel provided that these promotions are targeted/selective and not marketed online to the general public. In the preliminary version of the commitments this possibility was limited to hotels prior customers and other “closed user groups”.

Conclusions (1/3)

- The Italian Competition Authority considers that the legal, investigative and analytical tools at its disposal allow it to deal effectively with the assessment of clauses such as APPAs.
- The use of Internet is significantly changing the way in which goods and services are distributed, particularly with respect to some sectors such as touristic services.
- However, the economic framework and the traditional antitrust tools are, in general, still valid and the ICA considers that there is no need, at the moment, for different or special rules or approaches for online vertical conducts since the possible anti- and pro-competitive effects are roughly the same and the existing rules are flexible enough.
- Intervention on vertical restraints generally raises the need to assess and balance potential anticompetitive effects and efficiencies, preserving the operators' ability to offer and develop innovative services that are valuable to consumers. **This holds true for both price and non-price restraints.**

Conclusions (2/3)

- The economic framework used to assess the competitive effects of (price and non-price) vertical restraints in offline markets is fully appropriate for assessing vertical restraints in online markets.
- The “story” is the same: the traditional economic framework for (price and non-price) vertical restraints fits also vertical restraints in online markets.
- The difference, if any, lies in how the peculiarities of different online retail activities, in specific circumstances, fit within the general framework:
 1. benefits for consumers
 2. the nature and of the real size of externalities and free riding
 3. the increasing role of Price Parity Clauses (PPC, APPA, MFN...)
 4. the role of buyer power
- A greater understanding of the likelihood of the nature and of the real size of efficiency motivations for vertical restraints in online markets (e.g. externalities, specific investments) might be helpful for a better understanding of the implications of vertical restraints. But the nature and type of the good/service will always play a key role in the assessment.
- Particular attention to agreements that
 - shape the distribution of digital content
 - shape the nature of competition between online platforms

Conclusions (3/3)

- Confront the **possible economic justifications and the theories of harm** that are applicable and assess to what extent the available evidence supports each of them.
- Formulate a group of competing “stories” which describe the channels through which the vertical restraint would produce its pro-competitive or anti-competitive effects. These narratives would highlight some important elements that make each of them more or less plausible and that will have to be checked against the **actual facts of the case**. Some elements that are likely to play an important role are:
 - the market position of the parties and their competitors
 - the nature of the products and the relevance of the complementary services
 - the existence of factors naturally leading to concentration (economies of scale, network externalities)
 - the presence of entry barriers
- Investigate “**the reason why**” the parties decided to ask for or to accept the specific restraints imposed by the agreement.
 - Answering this question does not solve the legal problem because an anti-competitive intent is not required to find a violation of competition law. Yet an understanding of why the parties made recourse to a specific arrangement may shed some lights also on its likely effects.

THANK YOU!
