

Two-Sided Markets and Competition Law – nihil novum sub sole, Footnote or Revolution?

Florian Wagner-von Papp
Reader in Law

‘Plan’

- I. How did we treat two-sided markets before the theory of two-sided markets?
- II. What is the ‘added value’ of two-sided markets theory?
 - A. Clarification and refinement through two-sided markets theory
 - B. Limitations of the input by two-sided markets theory

I. How did we treat two-sided markets before two-sided markets theory?

- What are typical examples of two-sided markets?
 - Newspapers (buyers/subscribers - advertisers)
 - Payment cards
 - TV (pay TV – ad-financed TV)
 - Ad-financed ‘free’ services on the WWW
 -

I. How did we treat two-sided markets before two-sided markets theory?

- How were these cases treated before of two-sided markets theory?
 - Two-sided markets theory took off in the early 2000s;
 - this nearly coincided with the arrival of many of the ad-financed free services on the WWW
 - This leaves mainly newspapers and payment cards
- I will focus on **newspapers** for two reasons:
 - (1) there is a fuller body of pre-2000s case law
 - (2) Nicolas Petit will address payment cards much more competently than I could

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers

If there had been no recognition of the issue formalised in two-sided markets theory, we would expect there to have been a prohibition of ‘free’ (i.e., ad-financed) newspapers, based on

1. **abuse of a dominant position** in the form of predatory pricing (but only where the free newspaper has a dominant position)
2. **economic dependency rules** in some national competition laws (‘sales below cost’)
3. **unfair competition laws** (‘sales below cost’)

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers



- There were indeed attempts of subscriber/sale-financed newspapers to suppress competition from free newspapers, for example in Germany.
- How did the courts react?

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers/Journals

Federal Court of Justice, 3 July 1981, I ZR 84/79, GRUR 1982, 53 - *Bäckereifachzeitschrift*

Issue: Is the permanently free distribution of 85-95% of a journal's circulation an infringement of unfair competition law?

Holding: Not as such.

p. 55: **'The economic objective** in the case of permanently free distribution of 85-95% of the circulation **can only be to make the journal attractive to advertisers in order to increase the amount of advertisement and thus revenue**; it is evident that the attractiveness may also be increased by improving the quality of the journal; **the market for readers and the market for advertisements are in this respect in a reciprocal relationship.**'

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers/Journals

Federal Court of Justice, 3 July 1981 – *Bäckereifachzeitschrift* cont'd

- '[T]hus, free distribution is an internally consistent and economically sensible system from the perspective of private incentives to [...] market advertisements [...]. This system centres on the commercial side; **competition for readers by creating content is predominantly influenced by the insight that improved quality of content will increase the market position for advertisements.**'
- 'Therefore one cannot, without more, consider the free distribution of a journal to be unfair competition where ad revenue exceeds the cost of content creation, printing and distribution.'

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers/Journals

Federal Court of Justice, 3 July 1981 – *Bäckereifachzeitschrift* cont'd

- 'The system to finance the journal through free distribution may affect the quality of content; on the other hand, it may also result in an increase of quality through competition on the market for advertisements; content may be influenced negatively by advertisers to suit their purposes; but this is not an inevitable consequence.' (p. 66)
- The Court therefore considered a **comprehensive analysis** necessary that took account, among other things, the **market structure and whether free competition had any exclusionary effects.**

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers/Journals

Federal Court of Justice, 20 November 2003, I ZR 151/01 – 20 *Minuten Köln*

Issue: is the free distribution of newspapers an infringement of unfair competition law? –

Para 16: ‘In this case, an anticompetitive use of free goods as a marketing device is, *a priori*, not an issue where the distribution is intended to be permanently free [...]. **A publisher of a newspaper is active on two different markets, the market for readers and the market for advertisers. If the publisher decides to charge a price only on one of the two markets, then the free provision on the other market does not improperly influence the customers on that market [...]. The reason is that the publisher does receive payment for its services, not from the reader, but from the advertisers.**’

I. How did we treat two-sided markets before two-sided markets theory? – Newspapers/Journals

Federal Court of Justice, 20 November 2003, *20 Minuten Köln* (cont'd)

- Para 16: **‘Such methods of financing are widespread, for example, in internet services or private broadcasting, and this is not considered to be anticompetitive conduct.’**
- The Court considered whether the free newspaper could be an unfair commercial practice because of the ***effects on the market***.
 - The Court emphasized that the **harm to the competitor is not necessarily harm to competition**: ‘nobody in business has a guarantee that its customer base remains unchanged [...] **[N]ovel and particularly effective competitive conduct is not to be considered unfair just because its success has negative effects on competitors**’;
 - To the claimant’s analogy to the constitutional situation in broadcasting, the court responded: ‘[A]fter all, **Pay-TV, which is financed by its subscriber-base and which is the closest parallel, cannot demand either that an ad-financed TV station stops competing.**’

How did we treat two-sided markets before two-sided markets theory? – Newspapers

But ‘predation by free newspapers’ are not the only case scenario in which the ‘two-sided nature’ of newspapers played a role:

Federal Court of Justice, 18 December 1979 KVR 2/79, GRUR 1980, 734 – *Anzeigenmarkt*:

One of the first cases in which the Court recognized the two-sided nature of the market concerned the **issue whether the special merger control rules in the market for newspapers should be applied to competition in the market for advertisements, or whether they were restricted to the competition in the market for readers.**

How did we treat two-sided markets before two-sided markets theory? – Newspapers

Federal Court of Justice, 18 December 1979 – *Anzeigenmarkt* cont'd

The Court held that

- 'For a news publisher, **the markets for advertisements and readers are interrelated in multiple and inextricable ways**. The greater its readership, the stronger it is on the market for advertisements. [...] **Competition for advertisers takes place not only by way of the price for advertisements, but also by way of parameters particular to the market for readers, such as the price of the newspaper and the quality of the content.**'
- 'Furthermore, experience shows that the profitability of a newspaper is to a greater extent determined by the revenue from advertisements, and **revenue from advertisements is used, by way of a mixed calculation, to improve the news content or to stabilise the purchase price of the newspaper.**'
- The Court concluded that the special rules on merger control in the newspaper market applied to the **combined reader/ad market**.

II. What is the ‘added value’ of two-sided markets theory?

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A. Clarifications and refinement

- As shown above, Courts recognized the **intuition** behind two-sided markets theory long before the theory was formalized.
- Formalizing the ‘inextricable interrelationship’ **clarifies the precise relationship**; it is possible to **identify the relationship between membership and transaction prices for buyers and sellers**.
- Formalizing the relationship also **prevents misunderstandings as to the scope**

(For example, a trial court in a more recent case thought that the Federal Court of Justice’s decision on permanently free newspapers could not be extended to a newspaper that was usually sold to readers for a positive price, but which the publisher wanted to make available in a way that would have allowed some customers to get the newspaper for free;

The European Parliament’s googly **idea to separate search engines from other commercial services**).

II. What is the ‘added value’ of two-sided markets theory?

B. Limitations of two-sided markets theory

- Two-sided markets theory can show that there may be a procompetitive explanation for conduct that could otherwise be seen as motivated by intended exclusionary effects. This **should make us more cautious against intervention in two-sided markets.**
- However, **what two-sided markets theory *cannot* do is to demonstrate conclusively that the conduct will not lead to exclusionary effects** (of equally efficient competitors)
 - One can understand various of the Microsoft cases as involving two-sided markets (browser, media player...). This does not, however, determine whether Microsoft’s conduct was exclusionary and anticompetitive.
 - In several of newspaper cases, it was the dominant newspaper that introduced a free (or less costly) alternative in reaction to a new entrant. Is this merely competition on the merits (new entry leads to more competition, and the loss of revenue from sales is made up by increased advertising revenues) or predation?

II. What is the ‘added value’ of two-sided markets theory?

B. Limitations of two-sided markets theory

- The **issue then is what we require for a showing of exclusionary effects; and this is not conclusively answered by two-sided markets theory.**
- Because these markets are by definition characterised by (indirect) network effects, the **costs of a false negative would also be high.**

II. What is the ‘added value’ of two-sided markets theory?

B. Limitations of two-sided markets theory

- What should make us cautious of using the theory uncritically in practice is that it is an equilibrium theory – given particular price elasticities on the buyer/seller market, we would expect to see a pre-determined equilibrium price structure.
- What we see in practice, however, is a much more flexible approach – **different competitors use different distribution methods concurrently; freely distributed content is put behind paywalls** (NewsCorp newspapers); **previously positive prices for content are reduced to zero** (Evening Standard); **positive prices on both sides are modified.**
- In theory, this could reflect differences/changes in residual elasticities, but in many cases, it seems that this is **simply seen as a discretionary choice between competing business models.**

II. What is the ‘added value’ of two-sided markets theory?

B. Limitations of two-sided markets theory

- We should therefore not assume that a given business model is going to stay as it is – which may be particularly important in merger control, where we have to make predictions about the future, but can also be important in dominance cases where exclusionary effects may be irreversible.
- What is more, in many two-sided markets we have to be careful in the application of two-sided markets theory not to lose sight of **non-profit-based motives** (eg, it has been speculated that the decision to make the Evening Standard free was (also) based on the desire to increase readership for political purposes). See generally Gal & Rubinfeld (2014).

III. Conclusions

- The **intuition behind two-sided markets theory predated the theory** by several decades and was applied by the courts. **Two-sided markets theory is therefore hardly a ‘revolution’.**
- The **formalization can be helpful in getting a clearer analytical framework** for the sometimes muddled intuitions, and to determine where we are dealing with two-sided markets. **The theory is therefore not ‘nihil’ sub sole.**
- Where two-sided markets are concerned, we have to be careful not to intervene suspecting exclusionary conduct just based on the price on one side of the markets. However, the *possible* pro-competitive explanation of some conduct **does not relieve us of the much more difficult task of assessing whether the conduct overall is anticompetitive.**

III. Conclusions

- As with all economic theory that is transformed into policy recommendations, we have to be careful not to lose sight of dynamic effects (such as changes in the residual elasticities) and effects that may not have been integrated into the model (such as political motives).
- Overall, then the theory of two-sided markets is neither a revolution nor inconsequential, but **an increasingly important and lengthy footnote.**