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# Admissibility of the most favoured clauses (MFNs) on booking platforms in competition law

## Abstract

MFN clauses are often applied on platform markets, through which the seller is obliged to offer its products on a platform under the best conditions. From the competition law perspective these clauses are controversial. In the past, courts have classified such clauses as restrictive vertical agreements which abused dominant position on the relevant market. Based on such decisions, the following article highlights the competitive economic impact as well as the competitive admissibility of these clauses.

**Keywords:** MFN, Personal data, Online Platforms, Search engines

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# Dopuszczalność klauzul największego uprzywilejowania (KNU) na platformach bookingowych w prawie konkurencji

## Streszczenie

Klauzule KNU często są stosowane na rynkach zależnych od platform internetowych, gdzie sprzedawca jest obowiązany oferować swój towar na najlepszych warunkach. Z perspektywy prawa konkurencji klauzule te rodzą kontrowersje. W przeszłości sądy uznawały takie klauzule za restrykcyjne porozumienia wertykalne skutkujące nadużyciem pozycji dominującej na rynku właściwym. Na podstawie takich wyroków niniejszy artykuł bada wpływ ekonomiczny tych klauzul na konkurencję oraz ich dopuszczalność.

**Słowa kluczowe:** KNU, dane osobowe, platformy internetowe, wyszukiwarki

## Introduction

Through MFN clauses<sup>2</sup> the supplier agrees not to grant more favourable terms to other buyers. By contrast, it is quite possible, in case of false MFN, to grant other market participants more favourable conditions even if, the supplier was expected to provide these favourable terms to the original contract partner. So far, this business model has been used (due to the absence of control mechanism) very little in the over-the-counter retail trade. Fortunately, the Internet provides sufficient transparency and allows monitoring and effective implementation. False MFN are used by platforms that are active on the so-called two-sided market, such as the online marketplace (eBay, Amazon) and hotel booking platforms (Booking.com, Expedia). In the literature this business practice is known as the Across Platform Parity Agreements (APPA). This business strategy has drawn attention of competition authorities<sup>3</sup>. In this model the manufacturer reaches the end users via intermediary (the platform), but the transaction takes place directly between the manufacturer and the end user. The platform receives a commission for its service.

## Circumstances of the case

A German company X committed hoteliers at the end of 2010, by implementing APPA, not to offer their services on other platforms at lower prices. The clauses grew more stringent in the following years. In 2012, the commissions have increased from 12% to 15%. In the same year the company X acquired a new booking platform in Germany. Other booking portals like Booking.com and Expedia also introduced APPA, so ultimately the retail price on the platforms should be the same.

The analysis of the intended or effected restriction of competition is relevant here, since proving the intended restriction of competition eliminates the need to check the concrete effects, and according to Art. 101 (1) TFEU<sup>4</sup> this is in any event unlawful.

<sup>2</sup> P. Akman, M. Hviid, *A Most-Favoured-Customer Clause with a Twist*, "European Competition Journal" 2006, 2(1).

<sup>3</sup> In US see the case *United States of America v. Apple Inc. et al.*, 12 Civ. 2862 (DLC); in the EU see the case COMP/39.847/E-Books.

<sup>4</sup> P. Svoboda, *Úvod do evropského práva*, Praha 2010.

The effect of restricting competition is however affirmed when actual or likely negative impacts are applicable on at least one competition parameter of the market.

The restriction of competition may be allowed, provided the vertical block exemption is applicable. According to the Block Exemption Regulation (VBRE) the vertical restraints are not exempted if they are either hardcore or if their market share exceeds 30%. It means that by contractual constellations, subject to exemption, it will be assumed that the pro-competitive effects outweigh the contra-competitive ones. It is true that certain types of vertical agreements<sup>5</sup> can improve economic efficiency and can lead to a reduction in the transaction and distribution costs of the parties (incl. optimisation<sup>6</sup> of their sales). If the market share threshold is set above 30%, we cannot presume that vertical agreements falling within the scope of Art. 101 (1) TFEU will usually give rise to objective advantages. We also cannot presume that such vertical agreements are either caught by Art. 101 (1) TFEU or that they fail to satisfy the conditions of Art. 101 (3) TFEU<sup>7</sup>. The VBRE should not exempt vertical agreements<sup>8</sup> which contain restrictions that are likely to severely restrict competition and harm consumers.

Overall, the agreement could be allowed, provided the pro-competitive effects on consumers outweigh the limitations of competition. The possibility of an individual exemption according to Art. 101 (3) TFEU appear very unlikely. The burden of proof bears the defendant who has to prove the indispensability of such clauses for the generation of these efficiencies. Particularly problematic is the question of how the market would have developed, if the clause had not been implemented? Regardless the positive effects (e.g. enable welfare-enhancing investment and innovation downstream)<sup>9</sup> exceptions are rarely granted.

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<sup>5</sup> Art. 1.1. (a) of the Block Exemption Regulation describes 'vertical agreement' as "an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or service".

<sup>6</sup> R. Funta, *Business strategy and competitive advantage*, [in:] *Human Resource Management as a Basis for the Development of Innovative Economics*, Krasnoyarsk 2014.

<sup>7</sup> Para. 5 of the preamble of the Block Exemption Regulation states, that "the benefit of the block exemption established by this Regulation should be limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Art. 101(3) of the Treaty".

<sup>8</sup> There are examples of severe restrictions of competition like minimum and fixed resale-prices, or certain types of territorial protection (they are excluded from the block exemption Regulation regardless of the market share of the undertakings under examination).

<sup>9</sup> A. Ezrachi, *The competitive effects of parity clauses on online commerce*, "European Competition Journal" 2015, 11(2–3).

## Economic analysis

Below I will evaluate the market definition and the impact assessment in more detail. Firstly, the product and geographic market have to be determined, which includes all competitive constraints faced by the parties. The focus is on the relevant product market. Under a relevant product market we understand a market that comprises all “products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products’ characteristics, their prices and their intended use”<sup>10</sup>. The easiest available way to define the relevant product and geographic market is to rely on their qualitative nature. To this end, there are several quantitative economic tools used in the market definition analysis, such as the price correlation analysis<sup>11</sup>, critical loss analysis<sup>12</sup> or the demand estimation<sup>13</sup>.

In order to evaluate the substitution possibilities from a hotel perspective, one has to verify whether it is a two-sided market, so that the decisions on accession between hotel operators and their customers are interdependent. The so-called matchmaking is an example of the concept of two-sided market, which must be used by at least two different groups of customers to generate benefits for the individual customer.

In the present case the company X needed hoteliers for the distribution of its service in order to serve the end consumer and vice versa. Thus, the hoteliers and consumers are linked by indirect network effects, as there are externalities on both sides. The hotel owner benefits from the resulting consumers increase due to a wider customer base and more bookings. This effect leads to competition between inter-

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<sup>10</sup> Commission Notice on the definition of relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997. The relevant geographic market is defined as “the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas”.

<sup>11</sup> This analysis examines whether the relative price of 2 products does not change significantly if the price of one product increases. In case of a high degree of price correlation we presume the existence of a single market. An increase in the price of one product would trigger demand substitution (this will lead to an increase of price of the substitute while the relative price of the 2 products will remain unchanged). A criticism to the application of the price correlation analysis is provided by J.B. Baker, *Why Price Correlations Do Not Define Antitrust Markets: On Econometric Algorithms for Market Definition*, Washington D.C. 1987.

<sup>12</sup> The key question to be answered is what amount of sales would must be lost in order to make a hypothetical price increase unprofitable?; See also M.L. Katz, C. Shapiro, *Critical Loss: Let’s Tell the Whole Story*, Palo Alto 2003.

<sup>13</sup> It is used to estimate elasticities and cross-elasticities of demand. It provides information on how would the consumers react if there is a 5–10% price increase and/or quality decrease in their product. In case of a merger it will give an answer to the questions of what would be the effects of a concentration on prices and/or quality in a market?

mediaries, so their price and investment strategies are determined by interdependent demands. The presence of positive network externalities on two-sided markets directly affects the price structure. First, the market side (hotel customers) is subsidized by the demand side (hotel operator). This is exactly the case by hotel portals. Second, network externalities lead to certain price-setting power towards hotel operators. It is characteristic for two-sided markets that – as long as customers remain on the portal – a price increase through the portal towards the hotel operators is relatively unrealistic, since customers create added value. In order to determine the proximity of a potential substitute for mediation services of the company X, the demand behaviour of hoteliers and consumers needs to be analysed. Overall, the consumer willingness to change and the platforms competitive pressure is high when both demand groups operate multi-homing<sup>14</sup>.

APPA can evoke higher equilibrium prices only under specific circumstances. For example, the APPA provision must have direct impact on the final price of the customer – including possible rebates – in order to facilitate collusion. Conversely, the so called hassle costs undermine this effect. Other relevant aspects are the level of the transaction costs and the price dispersion. It is relevant to consider whether the provision refers to an indirect or a retail price. The differentiation between APPA and MFN<sup>15</sup> can be decisive in the process of evaluation. In literature, there are theoretical models showing that APPA promotes market entry, provided the market participants choose similar business model. New market entrants can provide equal price conditions to consumers and be attractive for them due to slight commission reductions, discounts, additional services and differentiated search capabilities. Due to low switching costs and often selective presence of the hotels on the platforms, such entry into the market can be realized for intermediation services. Each market structure must be taken into account, in particular the nature of the product concerned. In our case the company X provides the intermediation services free of charge. If a consumer is directed via the search function to the preferred hotel, but the booking is made through another distribution channel, higher costs can not be translated into gains. The reason for this is that portals with lower quality (and thus lower cost) can profitably undercut the high quality portal (as the hotels are also allowed to deliver their service through the cheaper portals). This price-cutting competition is based on the free-rider profit. Accordingly, the absence of APPA can accelerate the competition between portals based on quality deterioration. In order to apply control mechanisms as efficiently as possible, it is

<sup>14</sup> It gives the computing device or network presence on more than one network.

<sup>15</sup> J.B. Baker, J.A. Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, "Antitrust" 2013, 27(2).

useful to observe affected markets in the long term and to evaluate the ex post corrective measures. Despite the merger of the company X and the presence of another German online platform, and the intensification of the contractual terms of the company X, the market share decrease and therefore the alleged market power – the increase in the total turnover of the company – is irrelevant. It is also clear that the market is constantly changing and market relations shift quickly. In this context it should be noted that both current and potential competitors<sup>16</sup> may affect the possibility of action by the company X. In particular, global actors which are already active on the neighbouring markets such as Google, Amazon and eBay represent, due to their large customer databases, potential competitors and are able to control the scope of conduct of the company X.

## Concluding remarks

The existence of a two-sided market has to be answered in the affirmative, since the bundled product with the booking function enables a direct transaction between the consumer and hoteliers. Through hotel nonspecific promotions (e.g. through discounts on initial registration or repeated posting), the retail price under different service providers may vary heavily, so the price competition is further intensified. While the number of bookings increases, hoteliers continue to receive their base price and benefit from the increase in bookings. If the commission is raised on individual platforms, hoteliers can react due to multihoming and selectively use the booking platforms. In this context, the causes responsible for the “Best Price” commitment, despite the ban of APPA, will be identified. A reason behind it is an intense price competition between platforms, so that the promise plays an essential role. It seems unlikely that the discrepancy of market power between platforms and hoteliers is so significant that hoteliers continue to offer their lowest price due to possible sanctions. Thus, the ban on APPA seems not justified. If a market intervention is necessary, less restrictive means such as the introduction of maximum limit on commissions should be considered. This will restrict price increases, but efficiency gains will be generated. In several European countries agreements were concluded, based on which only the scope of application was limited but APPA as such were not prohibited. This approach has been chosen by the French, Swedish and Italian antitrust authorities in the Booking.com case.

From the foregoing analysis it transpires clearly that a regulatory intervention in a dynamic two-sided market has effects that are not always obvious and pre-

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<sup>16</sup> V. Karas, A. Králik, *Právo európskej únie*, Bratislava 2012.

dictable. Because of this complexity, it is essential *a fortiori* to break down the individual substitution relationships. Only in this way it is possible to provide adequate market definition as well as an effective efficiency analysis. The intent and purpose of the market definition is to capture the competitive relationship between the market players whose relations are examined primarily in a specific case. This is similar to our MFN clause between the company X and the hotel operators. For hotel operators is crucial who and under what contractual conditions provides the switching service.

Up to now, the literature on this issue remains not well developed and the legal practice has not provided uniform guidelines. Furthermore, there is a need for development of an effective tool, such as an alteration to the SSNIP test, which is used as an indicator of the existence of a potential market power. Overall, an intervention due to the market dynamics does not appear necessary. Instead the focus should be placed on other big market players such as Google, Amazon and eBay. Due to their large customer databases, they represent important potential competitors which could in short-term move market power relations.

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