THE DIGITAL ECONOMY AND COMPETITION LAW

By George S. Takach

In the space of several months earlier this year, the following five initiatives were unveiled: the Commission (chief executive body) of the European Union received an important report about the future of competition law enforcement in the digital environment; the Canadian federal government announced that its priority over the next 12 months was to investigate emerging competition issues as they relate to the data driven economy; in the United States, the federal government announced it is investigating a number of the big technology companies for anti-trust violations; the British government received a report about the sufficiency of existing competition law to deal with the challenges presented by the biggest players in the new digital economy; and one of the leading candidates for the Democratic nomination for President unveiled a plan to break apart several of the leading US technology companies using American anti-trust law principles. Whew – that is a lot of IQ points and precious government time and attention trained on the competitive concerns of a single sector. And the degree of competition law scrutiny of the tech sector is actually quite unprecedented - so the question has to be asked, is all this attention on the state of competition in the tech space warranted?

We Have Seen this Movie Before - Microsoft

That's not to say tech companies haven't been the focus of anti-trust scrutiny before. In the 1990's, Microsoft was the big target, and it was sued by the United States government. One of the key concerns was that Microsoft had both "horizontal products", like the Windows operating system, and then vertical products like Word that sat on top of the horizontal product. The concern was that Microsoft could favour its vertical products, like Word, relative to another word processing program made by a third party, because the Microsoft Windows group could feed the Word development group information about new changes coming for Windows before it told any third parties with word processing programs – thereby favouring the Microsoft Word product (ie – it could come out with some new features, that interacted with Windows, well before anyone else came out with their updates, and thereby Microsoft could get a much larger market share of the market for word processing programs than its next place competitor courtesy of its also being the supplier of Windows).

A number of commentators around the US argued that Microsoft should be split up – one company would have the Windows Business (and other "horizontal" software businesses), while one or more new businesses should have divested to them the vertical businesses, such as the Word software (and Excel, etc.). Interestingly, though, such a structural remedy was never pressed into action by the US government of the day.

A couple of decades prior to the Microsoft anti-trust litigation, it was IBM's turn to take the heat of a prolonged anti-trust investigation. But again, as with the Microsoft some 20 years later, the result did not include a break-up of Big Blue. One of their arguments was that the market for technology is so robust, that even if IBM wanted to create a dominant market position for itself, it couldn't, what with how all the dynamic forces in the market place will produce a meaningful competitor eventually (and usually quite soon). And as if on cue, presto, along comes Microsoft, and becomes a great success story, managing to take the anti-trust scrutiny off IBM.

Breaking Up is Hard To Do

The idea of breaking up tech giants is back, courtesy of Elizabeth Warren, the Democratic Senator from Massachusetts, who is running for her party's nomination for President for the 2020 US Presidential election. Ms. Warren has released a plan that proposes that Facebook divest itself of WhatsApp and Instagram, that Amazon divest of Whole Foods, and Google divest of Nest and Waze. Moreover, Ms. Warren would also have Google itself be required to be broken up, with Google Search and Google Ad Exchange being spun out into separate, stand-alone businesses. She says these companies should be designated as "platform utilities", and should be run separately in order to avoid the big problem she sees today, which is that Google (for instance) has a bunch of other companies that are allowed to participate on its own platform business. This is an echo of the concern raised years ago about Microsoft with its horizontal (Windows) and vertical (Word, Excel) products interacting (but which, as noted above, US anti-trust regulators did not require a structural solution for – they didn't order Microsoft to be broken up).

Interestingly, the three academics that recently authored a report for the European Union's Commissioner of Competition on the subject of what to do about "Big Tech" under competition law, did not recommend the kind of structural solution proposed by Ms. Warren; they do, however, conclude that more scrutiny has to be paid to big tech companies when they buy small ones, and perhaps more of those deals should be blocked. Their other preferred solutions veer towards more regulation of certain of the "platform" and "data" practices of the large tech businesses. Like Ms. Warren, they worry about "self preferencing" – that when a company runs an online platform, and also does business on it, it can game the system such that it receives benefits and preferences that are then not available to third parties, who will always be at a disadvantage. Therefore, they suggest that greater competition law oversight could be applied, to ensure that the network effects of big tech platform companies are neutralized.

The Proposed Paradigm Shift in Competition Law Analysis

What's fascinating about the EU report, and several of the other initiatives in tech-competition space, is that there has been a paradigm shift in the underlying rationale for competition law, at least in so far as it relates to the technology industry. For many decades, the touchstone of anti-trust analysis was "consumer welfare". In essence, the key question (sometimes the only question) asked was, is the particular behaviour in the marketplace causing prices to consumers to rise above the usual level for a sustained period of time. If not, there generally was no, or only little, concern with the subject behaviour.

This analytic mode tends to lead to a fairly hands off approach to the tech industry from a competition law perspective because the prices of computer products and services, in general, have been constantly falling, and performance of products was constantly improving (consumers were paying less for a lot more). Broadly speaking, the price-performance ratios of most tech offerings have been impressive, and their improvement over time simply astounding. It's hard to find anti-trust culprits in such an environment.

More recently, the additional dynamic added to this model was the seemingly "free" service – when was the last time you paid for an internet search? Of course sophisticated internet users know that, like everything else in life, there really is no free anything in the marketplace – just because you don't pay an upfront fee, there is certainly a value exchange going on somewhere in the mix. But here's the thing, quantifying that value, and understanding its broader impact on the market, is fiendishly difficult.

Nevertheless, that's what the authors of the EU report, and certain other commentators are suggesting – that instead of focussing on consumer welfare, and concepts such as market definition and market power, the new anti-trust/competition agenda should be animated by the overarching goal of promoting innovation in the digital age.

Reality Check

Whatever shortcomings you may think exist with the legacy approach to competition law analysis, a new proposed principle centred on "promoting innovation" is not without its own challenges. For example, the EU Report authors are in favour of competition authorities blocking the acquisition by the big established tech giants of certain early stage tech companies that could have posed a competitive threat to the acquirer had it been left alone. The challenge with such a model, of course, is that this would capture virtually all M&A activity in the tech space. I do a lot of this type of work. Why does a big tech company buy a small one? Because the buyer wants to enter into a new market, or expand more quickly in an existing market, and the smaller company can help it do that. But here's the thing – every one of these acquisitions is actually a big risk, and the studies are showing us that many (perhaps even a majority) of such deals fail to drive material value creation, because it's actually really hard to make 1+1=3; usually, the most you get is 1+1=2.2; and very often it's 1+1=1.4 (if post closing integration is done very poorly, it's 1+1=.8). Much of the time, the early stage company is very much a "diamond in the rough" – neat idea, but still needs a mature company to help it blossom into a successful business. So, should we really be asking competition regulators – government civil servants, at the end of the day – to decide what the crystal ball looks like for any particular M&A proposal in the tech space? That would be a massive increase in the role of government in the affairs of the tech market.

Moreover, especially in the tech space, there is an entire business model where small companies start up to try out new commercial initiatives, and to bring novel technologies to the market, with a view to getting snapped up by a large "aggregator", who then uses its established global distribution channels to sell the goods or services of the former start up. Do governments really want to interfere with this business model, particularly given that this very approach to innovation is now spreading like wild fire to other sectors of the economy (for example, one of major, leading, global consumer packaged goods company now gets more than 50% of its new product ideas from early stage businesses that began as small start ups, which then sold their embryonic concept to this industry giant). In short, this is becoming an important part of the new product business model – and governments need to realize that they mess with this model at their peril.