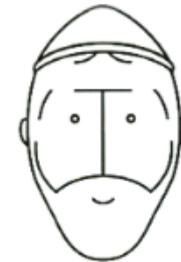

MFN clauses

Competition enforcement in the face of regulatory intervention

EU Competition Law Summit

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I T H A < A

NB: The slides reflect my personal views only, not necessarily Oxera's views in general. Oxera has assisted companies involved in the cases discussed, including a party currently under investigation.

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Introduction

- A **most-favoured nation (MFN) clause** (or ‘parity clause’) is part of an agreement between **two parties** where one party commits itself not to offer any **better terms** than those available to the counterparty to the contract...
 - used quite extensively by online travel agents, price comparison websites and online marketplaces (‘digital comparison platforms’)
- Such clauses, like most **vertical restraints**, can be pro-competitive but also potentially lead to anti-competitive effects
- They have been under ‘heavy fire’ in Europe, mainly in the last five years
- The investigations have often led to **commitments**, **bans** and even **fines** for those platforms that use certain MFN clauses
- Is the treatment of those clauses justified by the theory and their effects?

Overview

- Basic concepts
- The theory of MFNs
- Anti-trust enforcement
 - MFNs in the hotel booking sector
 - PCWs and insurance
- Conclusions

Basic concepts

Digital comparison platforms

- They are essentially websites (and/or applications) which allow consumers to **find, compare** and **purchase** products and services online which are provided by different *suppliers*
 - their services offered vary from simple directory listings to full integration with the booking/IT system of the various suppliers
 - prices are set by suppliers and not by the platforms (i.e. an agency model)
- for example, these are online-travel agents (OTAs) that provide hotel, flights, car rental, etc.; and price comparison websites (PCWs) where consumers compare insurance, utility providers, credit cards, etc.
- these are essentially **two-sided platforms** that exhibit strong **network effects**, enhance **inter-brand competition** and help **market expansion** through:
 - ...lowering search and transaction costs; increasing consumer engagement; and facilitating entry for suppliers

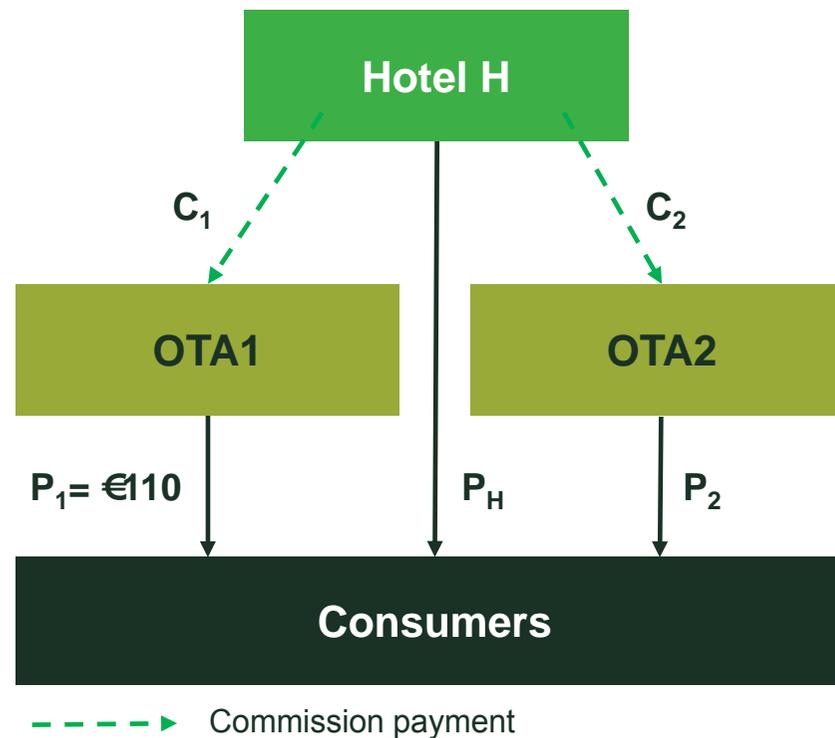
Basic concepts

Wide v narrow MFNs

- The restrictions that MFNs impose on suppliers can vary a lot; from very **narrow** clauses to very **wide** ones
 - widest possible MFNs specify that better terms cannot be offered to *any* party, or via *any* channel, than that available to the contracting party
 - for example, a hotel owner might be required by Expedia (an OTA) to always advertise on www.expedia.fr the best available prices
 - narrower MFNs state that better terms cannot be offered via some channels or parties where pricing is controlled by the supplier
 - for example, a hotel owner would be able to offer lower prices on other OTAs (e.g. Booking.com) as long as the price at www.expedia.fr is not higher than that available on the hotel's own website

Basic concepts

MFNs and the agency model



A 'narrow' MFN with
OTA1 implies:

$$P_H \geq P_1$$

A 'wide' MFN implies:

$$P_2 \geq P_1 \text{ and } P_H \geq P_1$$

The theory of MFNs

Main pro-competitive effects

- + **Effect 1:** limit 'free-riding' by hotels which could undermine platforms
 - platforms may spend a lot of money marketing, hosting customer reviews, providing advice, etc. to help consumers find a product
- + **Effect 2:** build trust and enhance the credibility of the platforms
 - more consumers can be motivated to try the platform and compare suppliers
 - for example, > 70% of consumers in the UK trust that PCWs offer the best price (CMA (2017), DCT Market study, Final report)
- + **Effect 3:** reduce search costs for consumers
 - consumers can infer that they are getting a good deal on a platform which reduces search time, effort and can enhance switching
 - The size of the benefits depends on the market characteristics (e.g. whether consumers have low trust and how costly is to search) and the type of MFNs...

The theory of MFNs

Main anti-competitive effects

- **Effect 1:** softening of competition on commissions
 - platforms have incentives to increase commissions by more than they would absent the clause (and reduced incentives to decrease them)
 - **Effect 2:** restriction on entry from other platforms
 - new entrants, even if they charge lower commissions, can't compete on price and gain market share from the incumbents
 - **Effect 3:** excessive advertising by platforms
 - by removing competition on commissions, MFNs can lead platforms to engage in excessive levels of advertising; that can also be barriers of entry
- Anti-competitive effects depend on the market characteristics and the type of MFNs, but in some cases can lead to important benefits (see next slide)

Some thoughts on the theory



🔑 Two key points worth mentioning

▶ **Point 1:** Anti-competitive effects arise through potentially **higher commissions**, while the positive effects arise through potentially **stronger competition** between suppliers

- means that the overall net effect of MFNs depend on the distribution of welfare along the value chain

▶ **Point 2:** Many of the anti-competitive effects can also have a **positive impact**

- MFNs may **increase entry and expansion** as they increase expected returns for platforms (for example: CMA (2017), DCT Market study, Final report)
- advertising from platforms can help **small suppliers grow**, creating a competitive constraint on established brands; and **motivate consumers to become engaged**

Anti-trust enforcement

The tale of two...cases

- **Case 1 – Hotel bookings:** Many national competition authorities in Europe (e.g. France, Germany, Italy, etc.) have been looking since 2010 at different MFN clauses used by large OTAs (e.g. Booking.com) when dealing with hotels
- **Case 2 – Insurance:** In the United Kingdom, the CMA has scrutinised since 2012 the MFN clauses used by price comparison websites in selling private motor (i.e. car) and, more recently, in home insurance

🔑 Three key questions:

1. Were the enforcement actions taken justified by the facts of the case?
2. Were the ex-post assessments in line with NCAs' expectations?
3. Are the more recent developments reasonable from a policy perspective?

MFNs in the hotel booking sector

Background

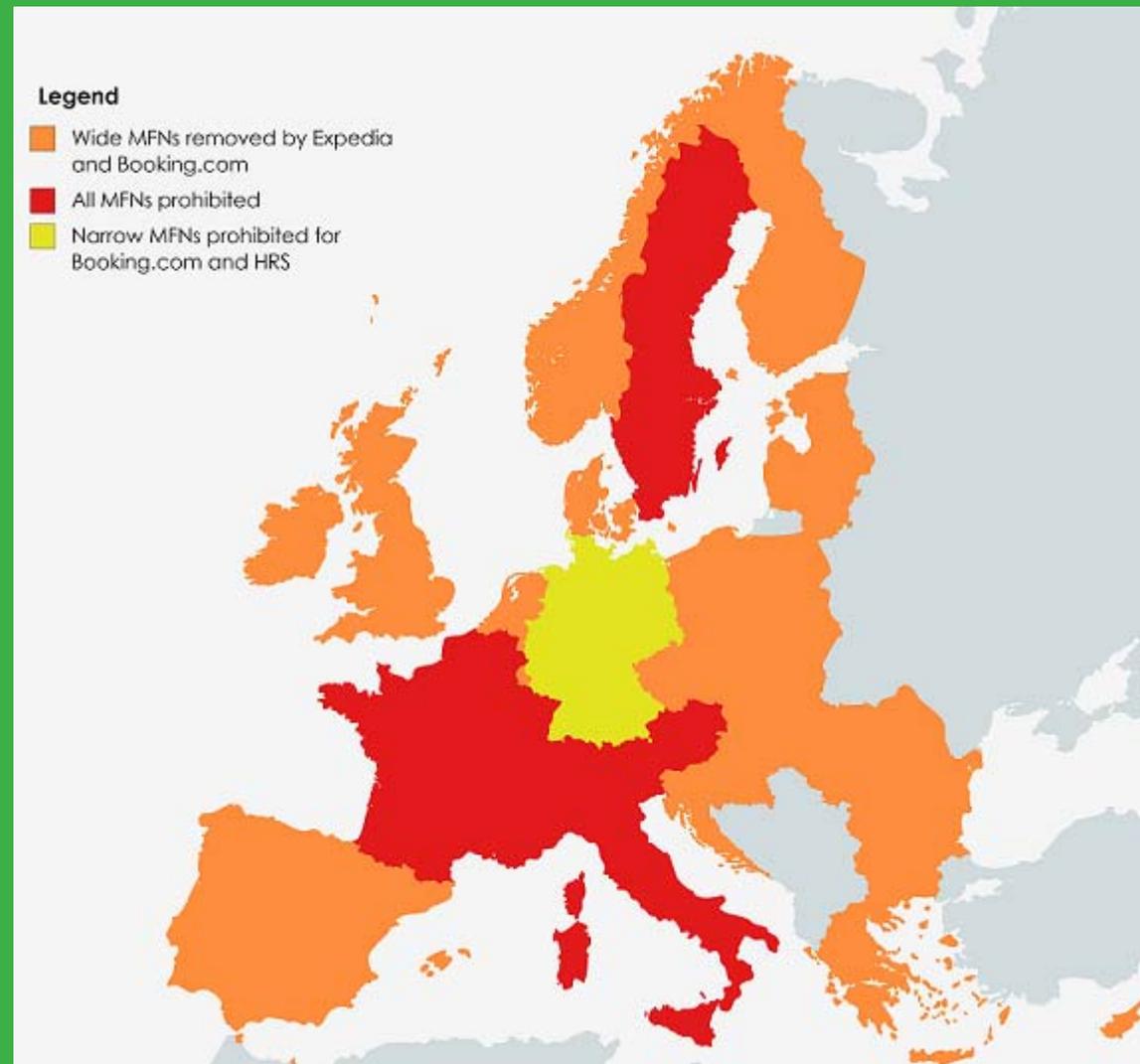
- Authorities have been looking at MFN clauses that guarantee to OTAs that they will be getting from hotels the best deal (typically on price and availability)
 - Booking.com, Expedia and HRS (and their large number of affiliated sites) have had their clauses scrutinised in different European countries
- At first NCAs were concerned about wide MFN clauses that prohibit hotels offering better deals on any other website
- Lately the 'narrow' MFN clauses, that restrict a hotel from publishing lower prices on their *own* website have come under fire as well
- Things got complicated...
 - some NCAs decided to coordinate their work and others acted independently
 - legislators and courts had their own say
 - different approaches and remedies have been adopted as a result

MFNs in the hotel booking sector

NCAAs v courts and legislators

- First, the German NCA decided to prohibit both **wide** and **narrow** MFNs used by HRS and Booking.com in 2013 and 2015 as they violated Article 101 TFEU
 - however, the Cologne Regional Court in 2017 ruled that Expedia can use narrow MFN clauses as they have a market share of less than 30% for online bookings
- French, Italian and Swedish NCAs agreed commitments with Booking.com in 2015 to remove only **wide** MFN clauses
 - this leads to both Booking.com and Expedia to remove those MFNs across Europe in the same year
- However, a number of courts and parliaments disagreed with their own NCAs, and prohibited the use of **narrow** clauses
 - for example, this July, a Swedish court ruled that Booking.com's narrow clauses are a by-effect infringement of EU competition law; while in France *Loi Macron* in 2015 banned all MFN clauses

Different approach across Europe



MFNs in the hotel booking sector

Key questions (I)

1 Were the enforcement actions taken justified by the facts of the case?

- Most of the NCAs have focused on **wide** MFNs, which were eventually prohibited, or removed as part of commitments
 - ▶ The hotel booking sector is dominated by small and medium-sized hotels, that might not have sophisticated IT booking systems, ability to advertise, etc. and therefore rely more on OTAs for their sales
 - ▶ It is possible that entry of platforms has been restricted, as market concentration for online bookings is quite high across Europe
 - Expedia and Booking.com account for vast majority of online bookings
 - ▶ Search costs are low and ‘trust’ threshold isn’t high (e.g. little personal information is provided, compared to insurance products)
- Overall, it appears that wide MFNs may not bring substantial benefits above narrow MFNs, and smaller hotels likely to benefit more from their removal

MFNs in the hotel booking sector

Key questions (II)

2 Were the ex-post assessments in line with NCAs' expectations?

- On 6 April 2017, the European Commission and 10 NCAs published a joint report focusing on the impact on prices and commission rates from the removal of wide MFNs across Europe
 - survey of over 16,000 hotels was a key information source
- ▶ It showed no clear evidence that commission rates had actually changed
 - around 90% of hotels saw no difference in the commissions charged
- ▶ There was limited evidence on price differentiation by hotels
 - nearly 80% of hotels had not knowingly price-differentiated between OTAs
- The analysis undertaken did not provide conclusive evidence that MFN clauses caused harm in the hotel booking sector. Many possible explanations...

MFNs in the hotel booking sector

Key questions (III)

3 Are the more recent developments reasonable from a policy perspective?

- A number of courts and parliaments decided to prohibit **narrow** MFNs
 - **mostly, following complaints from hotel associations across Europe**
- ▶ These prohibitions do not appear to be proportionate, and are not in line with the analysis carried out by a number of NCAs
- ▶ Smaller hotels are unlikely to benefit as many do not have established websites and offline bookings (e.g. through phone) were not covered by MFNs
- ▶ Free-riding of platforms can increase as search costs are low, leading to lower investment in quality, booking experience, after-sales service, etc.
- ▶ Little evidence that OTAs were charging higher commissions than the 'traditional' travel agents which were a key source of booking a hotel

PCWs and insurance

Background

- Back in 2012 the Competition and Markets Authority started looking into **wide** and **narrow** MFNs as part of the private motor insurance (PMI) investigation
- MFN clauses were used at the time by a large number of price comparison websites, where consumers can search and compare different products, such as car and home insurance (e.g. GoCompare)
- CMA was particularly concerned about **wide** MFNs and concluded that they restrict entry, lead to less innovation, increase commissions and ultimately prices that consumers pay
- In 2014 the CMA banned only **wide** MFNs in the sector
 - CMA expected that if commissions were to fall by 20% as a result of the ban, consumers would benefit by around £60m per year
- In 2017, an investigation against a PCW was launched for suspected breaches of Article 101 TFEU due to the use of wide MFNs for home insurance products

PCWs and insurance

Key questions (I)

1 Were the enforcement actions taken justified by the facts of the case?

- The decision to prohibit wide MFN clauses in the PMI sector followed a long market investigation, which looked at the specific characteristics of the sector
 - ▶ In this case, consumers appear to be engaged, with high switching rates, and visiting multiple sources to compare products
 - for example, FCA has observed switching rates close to 50%
 - ▶ Many consumers in the UK use PCWs to buy PMI (almost one in two)
 - ▶ There might be a smaller chance of ‘free-riding’, as consumers are asked to provide much more information, compared to the hotel bookings
 - then again, after the ban, over 40% of consumers use a PCW, but then buy PMI elsewhere, without the platform receiving a commission
- Based on the levels of consumer engagement and trust, it is possible that wide MFNs may not be needed anymore in this market, and narrow clauses suffice

PCWs and insurance

Key questions (II)

2 Were the ex-post assessments in line with NCAs' expectations?

- In 2017 the CMA decided to undertake an ex-post assessment of the effect that the wide MFN ban had on commissions charged by PCWs
 - ▶ The results indicated that commissions were 3 to 4% higher on average when wide MFN clauses were in place
 - it is possible that the effect is inflated (e.g. due to a 'regulatory chilling effect')
 - ▶ This translates to up to £2 per policy...
 - tiny compared to the benefits that consumers get from switching (over £100 on average according to the CMA)
 - in the same sector, the CMA had considered that remedies that would lead to a reduction of £3 *per year* were not warranted (in post-accident services)
- The ex-post assessment has indicated that commissions have dropped only slightly and the ban's effect was below expectations. Regardless...

PCWs and insurance

Key questions (III)

3 Are the more recent developments reasonable from a policy perspective?

- ...in 2017 an investigation against a PCW was launched, for its use of wide MFNs for home insurance products
 - CMA expects to reach a decision on whether to issue an SO in September
- ▶ This enforcement action was justified by the CMA, based on the previous PMI and hotel booking investigations
 - however, as shown, in those cases the effects found were underwhelming
- ▶ This is a market with low levels of switching and PCWs are not prominent
 - only 25% customers are using PCWs and switching rates <30%
 - of all policies in force around 10% sold through PCWs
 - only 2% of customers think they will save over £50 by switching
- Overall, there are a number of questions in relation to the theoretical and empirical basis for CMA's decision to launch an investigation in this sector

Conclusions

- MFN clauses have come 'under fire' by competition authorities in Europe
 - the 'wide' MFNs that restrict pricing across platforms particularly affected
- Their anti-competitive effects appear, in theory, to be accepted, but the evidence so far has been underwhelming and not clear-cut
 - the facts of each case and the importance of efficiencies matter a lot
- Anti-competitive effects arise through potentially higher commissions, while the positive effects arise through potentially stronger competition between suppliers
 - a total welfare assessment has not been undertaken
- European regulators and governments have mainly focused the impact to suppliers, and have to some extent side-lined the benefits to consumers
 - this is in contrast to the recent *Ohio v American Express* ruling in the US where the effect on both sides was a key consideration

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