

# **Regulating digital platforms in Europe – a white paper**

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## EXECUTIVE SUMMARY

The idea of regulating digital platforms has gained popularity in France, and in Europe. The French National Digital Council (CNN) issued a report recommending legislation targeting digital platforms. The report cites the need for measures to regulate market power held by platforms vis-à-vis content and service providers, and to guarantee transparency towards end-users. In its annual report, the French Council of State recommended imposing a general duty of fairness on digital platforms. As part of its Digital Single Market strategy, the European Commission announced that it will investigate potential harms to consumer welfare caused by platforms. Some of the recommendations in the French debate show an acute distrust of platforms<sup>1</sup>, with a focus on what platforms are able potentially to do, as opposed to what they actually do.

In the context of the upcoming debates on these measures, the present paper is intended to address the economic and legal challenges of regulating digital "platforms." What exactly is the "thing" to be regulated? Digital platforms have many forms: They may be marketplaces, application or content stores, or simply a multi-sided business model. The infrastructure of telecommunications networks can even be considered "platforms." The economic literature characterizes platforms by the services they offer, the effects they cause, the business model they represent, or the ecosystem they are a part of.

The concept of "platform" does not currently exist in legal texts. Laws generally regulate a particular activity, such as the activity of hosting content on behalf of users, or acting as a broker. Most laws are technology neutral, in that they do not regulate an activity differently depending on the technology used to deliver the service. From an EU-law standpoint, most services commonly referred to as "digital platforms" are considered "Information Society Services."

Our paper also focuses on the economic characteristics of platforms and explains why the assessment of market failures and consumer harm in the context of platforms is particularly challenging. Platforms are complex and fast-changing collections of services in a multi-sided market. Studied by Nobel prize winner Jean Tirole, the competitive effects of platforms, positive and negative, are not yet fully understood. For some economists, data collected by platforms could be an entry barrier or a source of lock-in (Newmann, 2014). But others (Lerner, 2014) argue that user data cannot be "privatized" and does not constitute a significant entry barrier.

Evans and Schmalensee (2014) or Peitz and Valetti (2014) show that market shares or price-cost margins are not reliable indicia of market power. A platform serves multiple groups of customers with interdependent demands and uses complex price strategies. For instance, the market share of an advertising-based platform on the end-user side is not very informative about its actual market power. The strategic side is the advertiser

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<sup>1</sup> A proposal from several French senators shows that the effort to regulate platforms is also intended to address a perceived dependency of European companies and consumers on large US Internet services: *"Fears regarding the monopoly power of the large US Internet sites are increasing in France and in Europe.... Europe cannot remain a 'digital colony', and the moment has come to fight against the increased dependency of our companies on the Internet as it exists today, and which has become for them a factor of vulnerability."*

side where they compete not only with platforms that provide substitutable services on the user side, but with any platform that gets its revenues from audience. This explains why regardless of market shares, competition for eyeballs leads to zero price for consumers.

These conclusions are confirmed by the Autorité de la Concurrence and UK Competition & Markets Authority (2014), who point out that *“focusing too narrowly on only one part of the system and disregarding its other sides can lead to finding to competition problems where they do not exist (‘false positives’) or, on the contrary, to observe fierce competition, while at the same time monopoly rents are extracted through a lock-in of consumers on another market (‘false negatives’)”*. Ignoring both the multi-sided feature and the digital nature of a platform market can lead to biased views of market power (i.e. fallacies) and inefficient remedies. Before any intervention, it is important to assess the net effect of the platform (negative or positive) on all groups served by this platform.

Economic literature shows the complexity of regulating platform activity because of the interdependencies and feedback loop (indirect network effect). The multi-sided dimension of platforms implies that a regulatory intervention focused on one side can be inefficient, with counterproductive or uncontrolled effects on the other sides. New business models and use patterns can quickly be misinterpreted as market failures, leading to "Type I" errors and needless (and sometimes harmful) regulation (Shelanski 2013).

Moreover, current law applied to platforms. Platforms are already highly regulated under existing law. Data protection law has been applied in numerous cases to Internet-based services and platforms, prohibiting, among other things, various forms of "unfair" processing. The CJEU "Costeja" decision has led to a major change in how search engines deal with individual delisting requests. The Conseil d'Etat's "Pages Jaunes" decision has affected how certain Internet-based information aggregators create profiles based on publicly available information.

French consumer protection and commercial codes prohibit various forms of unfair terms and conditions, or unfair business practices, and these provisions have been applied to online platforms, including Kelkoo and Expedia. Detailed guidelines have been issued regarding abusive clauses contained in the terms of use of social media, and the French consumer protection authority (DGCCRF), as well as French consumer groups, regularly enforce these measures.

Competition law addresses a wide range of anticompetitive practices, including those committed by so-called platforms. Booking.com recently reached a settlement agreement with several competition authorities based on accusations that it imposed anticompetitive clauses on hotel operators. In an emergency proceeding lasting only four months, Google was ordered by the French competition authority to make its procedures for Adwords more transparent and non-discriminatory. In another case, Google was fined 500,000 euros because of alleged predatory pricing for access to its API for Google maps.

In addition to these general legal rules, specific regulations apply to certain activities: advertising intermediaries must comply with transparency obligations under the French "Sapin" law, payment intermediaries must comply with legislation on payment services,

insurance intermediaries must comply with specific rules on insurance brokers, travel agents are subject to special regulation, etc. In most cases, services provided via digital platforms are regulated just as they are in the offline "physical" world.

The principles of evidence-based regulation should apply when considering any platform-related initiative. OECD principles on Internet regulation (2011) recommend caution before adopting new measures that target Internet intermediaries. Given the fast-moving and poorly understood aspects of the Internet ecosystem, the risk of regulatory error is high, as are the costs of poorly designed regulatory measures (Shelanski, 2013). OECD and European Commission (2015) principles of good regulation require a full analysis of the market failure that is the object of regulation, and whether existing law can be used to address the problem. Multi-stakeholder, self, and co-regulatory initiatives should also be considered, as well as international standards and benchmarks, where available. Technologically-neutral and adaptive forms of regulation should be preferred. Any new regulatory proposal must include a cost-benefit analysis, including an evaluation of potential harms caused by the proposed regulation on innovation, competition, and fundamental rights.

Our report leads to the following conclusions:

The concept of platform covers broad range of services and business models that have very little in common. Before considering regulatory measures targeting platforms, further work is required to define exactly what services or activities should be covered by regulation, and why. If a new regulatory category is created, it should be done at a European level in order to avoid fragmentation within Europe.

Economic literature shows that classic indicia of market power do not necessarily apply to multi-sided business models. There is no consensus as to whether open or closed ecosystems maximize social welfare. Economists disagree as to whether the accumulation of user data creates barriers to entry that require regulatory intervention. Caution is therefore required before concluding that platforms create a market failure requiring special regulation.

We have seen no evidence of harmful conduct by platforms that is not already covered by existing law. Obligations of fairness already exist in data protection, consumer protection and commercial law, and those principles have been applied by courts to online platforms. Competition law has been used successfully to address abuses of dominant position or anticompetitive agreements imposed by platforms. Emergency procedures exist, and have been used, to address immediate competitive harms.

Further work on platform regulation should include evidence-based analysis of the harms actually created by platforms and what legal tools already exist to deal with them. Analysis should also include consideration of self- or co-regulatory solutions, and an evaluation of the potential harms created by new regulatory measures, including the risk of error, and adverse effects on the Internet ecosystem.

## 1. INTRODUCTION

The idea of regulating digital platforms has gained popularity in France, and in Europe. The French National Digital Council (CNN) issued a report recommending legislation targeting digital platforms. The report cites the need for measures to regulate market power held by platforms vis-à-vis content and service providers, and to guarantee transparency towards end-users. In its annual report, the French Council of State recommended imposing a general duty of fairness on digital platforms. As part of its Digital Single Market strategy, the European Commission announced that it will investigate potential harms to consumer welfare caused by platforms. Some of the recommendations in the French debate show an acute distrust of platforms<sup>2</sup>, with a focus on what platforms are able potentially to do, as opposed to what they actually do.

The debate surrounding platform regulation in France has brought to light two main categories of potential harms that allegedly require regulation. The first category of harm relates to anticompetitive conduct towards **third party content and service providers**. These forms of anticompetitive conduct generally involve unfair contractual terms, exclusivity, discrimination, or lack of transparency. The other category of potential harm relates to individual **Internet users**, and including unfair contract terms, lock-in effects, and lack of transparency. Some proposals also cite broader harms to society, such as the use of platforms to circulate illegal content, or a reduction in plurality of information. The existence and severity of these harms have not, to our knowledge, been studied in detail. Most proposals cite anecdotal evidence, and highlight **potential** improper behavior by platforms, as opposed to actual improper behavior. Some proposals assert that competition law is too slow to deal with anticompetitive conduct.<sup>3</sup>

In its May 6, 2015 communication on the digital single market, the European Commission identified the benefits, and potential harms, associated with digital platforms.

The benefits of platforms are linked to increased efficiency and innovation, leading to growth, jobs and increased consumer choice. According to the European Commission, platforms are "enablers" for the digital economy:

*"Online platforms (e.g. search engines, social media, e-commerce platforms, app stores, price comparison websites) are playing an ever more central role in social and economic life: they enable consumers to find online information and businesses to exploit the advantages of e-commerce. Europe has a strong potential in this area but is held back by fragmented markets which make it hard for businesses to scale-up.*

*Platforms generate, accumulate and control an enormous amount of data about their customers and use algorithms to turn this into usable information. The growth of such data is exponential – 90% of all data circulating on the Internet were*

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<sup>2</sup> A proposal from several French senators shows that the effort to regulate platforms is also intended to address a perceived dependency of European companies and consumers on large US Internet services: *"Fears regarding the monopoly power of the large US Internet sites are increasing in France and in Europe.... Europe cannot remain a 'digital colony', and the moment has come to fight against the increased dependency of our companies on the Internet as it exists today, and which has become for them a factor of vulnerability."*

<sup>3</sup> A more detailed examination of current regulatory proposals appears in **Annex 1**.

*created less than 2 years ago. Moreover, platforms have proven to be innovators in the digital economy, helping smaller businesses to move online and reach new markets. New platforms in mobility services, tourism, music, audiovisual, education, finance, accommodation and recruitment have rapidly and profoundly challenged traditional business models and have grown exponentially. The rise of the sharing economy also offers opportunities for increased efficiency, growth and jobs, through improved consumer choice, but also potentially raises new regulatory questions.”<sup>4</sup>*

The potential harms cited by the Commission are linked essentially to market power and information asymmetries.

*Although their impact depends on the types of platform concerned and their market power, some platforms can control access to online markets and can exercise significant influence over how various players in the market are remunerated. This has led to a number of concerns over the growing market power of some platforms. These include a lack of transparency as to how they use the information they acquire, their strong bargaining power compared to that of their clients, which may be reflected in their terms and conditions (particularly for SMEs), promotion of their own services to the disadvantage of competitors, and non-transparent pricing policies, or restrictions on pricing and sale conditions.*

*Some online platforms have evolved to become players competing in many sectors of the economy and the way they use their market power raises a number of issues that warrant further analysis beyond the application of competition law in specific cases.”<sup>5</sup>*

The Commission also referred to the need to improve mechanisms for the removal of illegal content on the Internet, including the idea of imposing some form of duty of care on Internet intermediaries with regard to illegal content.

The Commission concluded by announcing the launch of a comprehensive assessment on the role of platforms, focusing on transparency, use of information, contractual relations with suppliers, barriers to switching, and the fight against illegal content.

In the context of the upcoming debates on these measures, the present paper is intended to address:

- the economic and legal definitions of "platform." What exactly is the "thing" to be regulated?
- the economic characteristics of platforms, and why the assessment of market failures and consumer harm in the context of platforms is particularly challenging;
- how existing legal measures apply to platforms;
- the principles of evidence-based regulation that should apply when considering any platform-related initiative.

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<sup>4</sup> COMMUNICATION FROM THE COMMISSION « A Digital Single Market Strategy for Europe » COM/2015/0192.

<sup>5</sup> *Id.*

## 2. THE DIFFICULTIES ASSOCIATED WITH DEFINING A "PLATFORM"

This section will address the definitional problems of regulating platforms, pointing out that what policymakers call "platforms" represents a collection of heterogeneous infrastructures, services and markets that are often subject to their own sets of legal obligations. As we will see, there are several ways to define a platform which creates some ambiguity about the sectors of activity and the companies that are in the perimeter of "platform-based markets". The lack of clear rules to identify and delimit a "platform" makes creation of a specific regulatory framework targeting platforms difficult. The regulation potentially could apply to a broad range of online and offline services.

### 2.1 Economic approach

Economists have proposed different approaches to defining a platform.

#### (a) Platform as infrastructure

A first approach is to define **a platform as an infrastructure** that supports economic activities and facilitates exchanges and interactions. From this perspective, any telecommunication operator or Internet service provider is a platform that is composed of a set of interconnected networks, equipment, and databases (i.e. network infrastructure) that support communication services (calls, SMS, email, instant messaging,...) and many other applications. This approach has been used in the field of communications; for example, where Benkler (2000) and Cooper (2003) argue that the physical infrastructure layer for communications platforms must remain open.

#### (b) Platform as service

A second approach is to define the **platform by the service it provides**. Platforms play a major role as intermediary between economic agents (traders, content and services providers, advertisers, end-users...). They deliver different types of offline and online services: communication, entertainment, information/news, social networking, dating, gaming, search, electronic commerce... Typically, the economic literature distinguishes four types of platform: matchmaking or exchange platforms (e.g. AirBnB, AmazonMarketplace, Match.com...), cost sharing platforms (e.g. App Store, Google Play Store, Windows, iOS...), audience or advertiser-supported platforms (e.g. Bing, YouTube, Spotify,...) and knowledge management platform (e.g. Wikipedia, Tripadvisor...) (Brousseau and Pénard, 2007).

Matchmaking platforms connect two groups that are willing to interact or trade (sellers and buyers on AmazonMarketPlaces, hosts and guests on AirBnB, men and women on Match.com), and provide them with services of search, recommendation, reservation, and payment. In other words, the service of a matchmaking platform is to help economic agents on each side to interact in a valuable way and in a secured/trusted environment.

Cost-sharing platforms provide hardware and software systems and a set of standards and interfaces that allow third party developers to design applications and services and allow end-users to run these applications and services on their devices (e.g. computers, tablet, smartphone, video game console...). These platforms reduce the cost of developing and using many digital applications, and facilitate their implementation.

Advertiser-supported platforms provide two types of services: they deliver information (news), content (video, music) or other services (search, recommendation) to end-users and they offer advertising solutions (banners, sponsored links,...) to companies that want to promote their products and attract these users in their stores. A newspaper or a commercial TV channel is also an advertiser-supported platform.

Finally, knowledge management platforms provide services of data collection and aggregation or crowdsourcing and then process data to build value-added services and knowledge-based services. Wikipedia is a good example, but the concept of knowledge management platform also encompasses any platform that relies heavily on algorithms, like search and recommendation platforms (Google, Amazon).

Note that some platforms like Google or Facebook are hybrid and are positioned on the four categories of platforms. For instance, Facebook is a social network site that facilitates social interactions between its users, offers advertising, and third party applications or content (social games) and provides recommendations services.

(c) Platform based on "effects"

The third approach is to define a platform **by its effects**. The main effects of a platform are to reduce search, transaction and implementation costs that are incurred by economic agents in markets. Another effect is to reduce information and coordination problems (externality, information asymmetry, uncertainty) in markets. Platforms perform a regulatory role and use different instruments and incentives to stimulate positive externalities (i.e. network effects), reduce negative externalities (i.e. congestion) or inefficient behavior (Boudreau and Hagiu, 2010). Another effect of platforms is to facilitate innovation. Platforms create new opportunities to innovate: new production and distribution process, new services, new organizations. For instance, C2C marketplaces allow consumers to create markets for second-hand goods that could not exist in physical markets, or only on a limited scale (i.e. collectible goods).

(d) Platform as a business model

The fourth approach is to define **a platform as a business model**. The theory of two-sided markets (or multi-sided platform), popularized by the Nobel Prize winner Jean Tirole (Rochet and and Tirole, 2003, 2006), characterizes a platform by the three following conditions: i) the platform faces at least two groups of users, ii) the

platform faces cross-group externalities (i.e. the platform faces interdependent demands) and iii) the pricing structure or scheme matters (i.e. it determines the volume of interaction or transaction through the platform and the value created). Evans and Schmalensee (2007, 2014) propose another definition that captures the key features of platform businesses. A multi-sided platform “has (a) two or more groups of customers; (b) who need each other in some way; (c) but who cannot capture the value from their mutual attraction on their own; and (d) rely on the catalyst to facilitate value creating interactions between them.” With such a definition, a platform is always perceived as efficiency enhancing (i.e. saving cost and creating value that would not exist in its absence). Rochet and Tirole (2006) focus on the price structure in defining two-sided platforms: “the platform can affect the volume of transactions by charging more to one side of the market and reducing the price paid by the other side by an equal amount; in other words, the price structure matters and platforms must design it so as to bring both sides on board”.

Platform-based business models rely on price and non-price instruments that serve to reach critical mass (i.e. to attract enough users on either side, and in the right proportions). Some platforms’ strategies are also used by traditional firms, like discrimination, subsidization, exclusive dealing. But platforms also use specific strategies like “divide and conquer” strategies (Caillaud and Jullien, 2003) or piggybacking and zigzag strategies (Parker and Van Alstyne, 2014) to get both sides on board and eliminate rival platforms. A common platform strategy is also to charge one side with price below marginal costs (or even free access or negative price) whereas the other side has to pay high prices (membership fees, usage fees...). From this point of view, AmazonMarketplace is a business platform (i.e. the seller side contributes more than the buyer side) whereas Amazon.com is not. The latter is an online retailer that buys products to resell them.

(e) Platform as an ecosystem

Finally, a platform is also compared to an **ecosystem**. For the French and UK Competition Authorities, an ecosystem is “a number of firms – competitors and complementors – that work together to create a new market and produce goods and services of value to customers” and the core of the ecosystem is composed of one or several interconnected platforms that link the multiple sides of the ecosystem (such as consumers, component producers, developers, etc) (Autorité de la Concurrence/Competition & Markets Authority 2014). The role of the platform is to manage and regulate the ecosystem (Boudreau and Hagiu, 2010). Platforms develop governance rules to regulate the access and the interactions between the different parties involved in the ecosystem, using monetary and non monetary instruments (standards, quality norms, technical requirements). Similarly, Gawer and Cusumano (2014) define a platform as an innovation purpose ecosystem. For these authors, a platform is “a set of assets, products, services or technologies that provide the foundations upon which outside firms can develop their own complementary products, technologies or services.”

(f) Conclusion

For economists, a digital platform will be regarded either as an infrastructure, as a group of services, as a form of business models, as a private market regulator, or as an ecosystem. Depending on the definition, platform regulation could be focused on the infrastructure layer (networks, hardware or operating systems) or the service/application layer. A business model approach would imply regulation of only the platforms that rely on a two-sided business model whereas an ecosystem approach leads to regulate the platform and the different parties linked to the platform (providers of complementary products and services...). These multiple economic approaches would make it difficult to create a regulation targeting a legal category called "platform" or "digital platform". The range of services and business models is potentially vast.

## 2.2 Definition of a platform from a legal perspective

(a) Platform under the E-Commerce Directive

Currently European law includes most online services in the category "information society services." The E-Commerce Directive 2001/31/EC provides that information society services may not be subject to prior authorization regimes, and that Member States may not interfere with the provision of information society services supplied by entities established in other Member States. The E-Commerce Directive imposes minimum information requirements on providers of information society services.

In addition, the E-Commerce Directive recognizes that certain categories of information society service providers may benefit from a liability safe harbor for content supplied by their users. These actors are ones that provide "mere conduit", "caching" or "hosting" services.

In addition, European law imposes special rules on providers of "electronic communications services" and on providers of "on-demand audiovisual media services," not to mention rules applicable to payment services, insurance and financial services.

The closest European law comes to the definition of a "platform" is the definition of a hosting provider under the E-Commerce Directive, ie, an information society service that "consists of the storage of information provided by a recipient of the service."

(b) Other forms of intermediaries

The law also recognizes other forms of intermediaries, including agent, distributor, commissionaire, broker, "régie publicitaire", payment service provider. These intermediaries are often subject to specific regulations, eg. insurance brokers, travel agents, advertising agents, distributors that resell goods without transformation, and payment providers. These legal definitions refer to the

economic role of the service provider, not to the existence of any technological platform. For example, an entity that purchases and resells goods under its own name will be considered a distributor. An entity that facilitates a transaction between a buyer and seller will be considered an agent or broker, regardless of the technologies used.

When addressing complex online markets, courts are accustomed to separating the different activities of service providers into different legal categories, recognizing that a same service provider may be a hosting provider for some kind of activities, a broker for other activities, and a distributor for other activities.

Under this "unpacking" approach, courts will avoid any general definition of platform, and instead look at digital platforms as a collection of different services, each of which may fall under distinct legal regimes (hosting, brokerage, payment, etc.). Courts will impose legal obligations based on the nature of the underlying service provided, regardless of whether the relevant services are facilitated by a digital platform.

(c) Conclusion

Digital platforms are often considered as "information society services" under EU law, and therefore benefit from the freedom to provide cross-border services under the E-Commerce Directive. When examining legal questions such as liability, courts and competition authorities will treat platforms as bundles of different services, and will look at each service separately to determine the legal rules that apply.

**3. EX ANTE REGULATION OF DIGITAL PLATFORMS IS RISKY, AND SHOULD BE CONSIDERED ONLY AS A LAST RESORT**

**3.1 Network effects can create temporary "winner takes all" situations**

Digital platform-based markets are characterized by economic features that can both constrain and stimulate competition.

- a specific cost structure (high fixed cost and relatively low marginal costs of production) which creates economies of scale and induces a market structure dominated by few firms;
- large direct and indirect network effects: a user's gain or benefits to consume a service is directly and/or indirectly enhanced by the (actual and expected) number of users that are consuming the same service. These network effects are higher for platforms that are providing communication services like social network sites (Facebook, Twitter, Snapchat ...) than search engine or media platforms.
- positive feedback: economies of scale and network effects play together to create positive feedback or self-reinforcing diffusion process (Shapiro and Varian, 1998). It means that strong platforms become stronger and weak platforms weaker. The

success and dominance of a platform depends on its capacity to reach a critical mass of users (i.e. tipping point). This property makes platform businesses highly risky, but very attractive (winner-takes all effects).

- dynamic markets: digital markets are characterized by a fast pace of innovation, that can rebalance market power and facilitate entry. A dominant firm can never feel protected and has to move permanently to preserve its position and prevent other firms from innovating faster.

### 3.2 Lock-in effects

Large digital platforms such as Google or Facebook organize the exchanges or interactions between different groups. They can also provide access to essential services and content. Typically they play a structuring and regulating role of economic activities. This raises some competition concerns if consumers are locked in and the dominant platform can deter entry from competing platforms or providers of complementary services. Through their activity, platforms can collect a lot of user data. This also raises some privacy and competition issues. For some economists, data collected by platforms could be an entry barrier or a source of lock-in (Newmann, 2014). They argue that a platform can gain competitive advantage from data by improving the quality of its algorithms or customizing its services. But this advantage is relative because user data are not exclusive. A platform cannot prevent users from disclosing the same information on other platforms (it is not possible to “privatize” user data). In other words, data are non-rival and non-excludable “goods”, and a platform cannot control or capture all user data. Moreover, the benefits of user data are subject to diminishing returns to scale (Lerner, 2014). Consequently, no consensus has emerged as to the potential anti-competitive effects of large amounts of user data.

### 3.3 Multi-homing diminishes market power

Digital markets are characterized by multi-homing from end-users and low switching cost. The success of platforms can be tremendous, but their decline can also be fast. Most of the time, the domination of a platform is explained by other factors than “network and lock-in effects”: innovative capacities, design and quality of service... There is no reason to presume that the accumulation of user data is detrimental to innovation and consumer welfare. According to Lerner (2014), platforms like Google or Facebook *“leads to valuable services being offered to users at subsidized prices, often for free”*. *“Claims that collection of user data creates significant economies of scale, and thereby leads to the entrenchment of dominant online platforms, are unsupported by real-world evidence.”*

Another counterargument is that the dominance of major platforms tends to be temporary and constrained by the heterogeneous tastes of end-users in digital markets. The positive feedback mechanisms that are at the core of digital markets facilitate the emergence of winner-take-all platforms and accelerate their success. But these mechanisms also cause their decline and replacement by new platforms.

The European Commission was worried that Microsoft’s bundling strategy regarding Windows, Internet Explorer and Windows Media Player was a way to leverage monopoly

on the browser and player markets. The recent announcement of Microsoft to release Windows 10 without Internet Explorer and the presence of two alternative browsers (Chrome and Firefox) suggest that the threat was overstated.<sup>6</sup> A platform's dominance is also constrained by the fact that end-users prefer to multi-home and customize their offer because no single platform can fit all their needs. Many economists argue that the fast pace of innovation and the possibility of customization of digital services promote quality-based and innovation-driven competition. The fact that many platforms are free of charge for end-users and that digital services are modular, encourages end-users to switch from a platform to another, or to combine the services of several platforms.<sup>7</sup>

### 3.4 Market share does not necessarily correspond to market power

Another issue is to assess market power of platforms in order to establish the list of the platforms to regulate and to design "ex ante" remedies for the so-called "dominant" platforms. As shown by Evans and Schmalensee (2014) or Peitz and Valetti (2014), methods used in traditional markets are not adapted or reliable for "platform-based" industries. Reliance on market share or price-cost margins in assessing market power is questionable. A platform serves multiple groups of customers with interdependent demands and uses complex price strategies. Market shares are not the best instrument or index to measure market power. For instance, the market share of an advertising-based platform on the end-user side is not very informative about its actual market power. The strategic side is the advertiser side where they compete not only with platforms that provide substitutable services on the user side, but with any platform that gets its revenues from audience. This explains why regardless of market shares, competition for eyeballs leads to zero price for consumers.

### 3.5 Open versus closed ecosystems

The report on the Economics of Open and Closed Ecosystems (Autorité de la Concurrence / Competition & Markets Authority 2014) also points out that "*focusing too narrowly on only one part of the system and disregarding its other sides can lead to finding competition problems where they do not exist ('false positives') or, on the contrary, to observe fierce competition, while at the same time monopoly rents are extracted through a lock-in of consumers on another market ('false negatives')*". Ignoring both the multi-sided feature and the digital nature of a platform market can lead to biased views of market power (i.e. fallacies) and inefficient remedies. Before any intervention, it is important to assess the net effect of the platform (negative or positive) on all groups served by this platform. Similarly, for Evans and Schmalensee (2014), "*as a general matter, a platform could increase consumer welfare overall if it increased the value it*

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<sup>6</sup> The browser market share of Internet Explorer hit a peak in 2004 and then declined steadily, well before the European Commission ruled in 2009 that Microsoft had to offer users of Windows choice among different browsers and to allow computer manufacturers and users to turn Internet Explorer off.

<sup>7</sup> The lock-in concerns raised by platforms are also very different depending on their type (in terms of services and business models). For instance, a search engine or an advertiser-supported platform doesn't provide "two-way indirect network externality" and consequently users of a search engine have lower switching costs (and lower risk of lock-in) compared to a marketplace like AirBnB or Blablacar, or to a social network site like Facebook. This implies that the same regulatory approach cannot apply to marketplaces and to audience platforms like Google or Facebook. A case-by-case approach is needed. This kind of case-by-case analysis is very complex and costly to conduct and better adapted to courts or competition authorities when they apply general legal principles in ex post disputes.

*delivered by more than it increased the prices it charged. It is possible, however, that change in platform prices and products benefit customers on some sides while making customers on other sides worse off. In evaluating such changes, there is no economic reason why one would focus on losses to one group of consumers and ignore gains by another group.”<sup>8</sup>*

One argument to support platform regulation is that the market, if left alone, creates closed ecosystems that are detrimental to innovation, because they develop their own services and content and prevent competing services to access the platform (or reduce the quality or compatibility of the competing services). A first counterargument is that there is no clear benchmark in terms of efficient market structure in digital platform markets. Open platform-based ecosystems and closed platform-based ecosystems have their own advantages. According to the report on Open and Closed Ecosystems (Autorité de la Concurrence / Competition & Markets Authority 2014), an open platform “*achieves full benefits of network effects and economies of scale for component makers*”, increases intra-ecosystem competition and stimulates market entry through component innovation. However, closed platforms can be good for competition: “*closed systems increase inter-system competition (which can lead to fierce competition ‘for the market’) and they can lead to an increased incentive to innovate and to entry due to future profit expectations.*” “*Open systems generate efficiencies in four ways: they maximise network effects, they maximise scale economies, they enable the system owner to commit not to renegotiate ex post the access fees with the component developers, once the specific investments in the system have been incurred and they enable the system owner to commit not to exploit the users who have joined the system, which increases incentives to join the system. However, there are also four ways in which closed systems generate efficiencies: they ensure compatibility between components, they avoid free-riding, they allow user coordination, and avoid the drawbacks of standardisation.*”

It is therefore incorrect to claim that closed platforms necessarily harm competition and innovation.

### 3.6 Innovation by users

It is also important to point out that innovation in digital markets may come from end-users or communities of users (see Von Hippel, 2005). They can also combine or assemble the services of several platforms to have a customized service. Regulating platforms might reduce user innovation on these platforms if it bans some valuable services or activities. Obviously some measures like data interoperability or services compatibility between platforms could promote user innovation. But the cost and benefits of enforcing new rules have to be carefully assessed, in terms of incentives and capacity to innovate for the platform, the third parties and the end-users.

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<sup>8</sup> Evans and Schmalensee (2014) also underline that “the fact that platform-based industries deviate from perfect competition should not raise competition policy concerns any more than the fact that almost all real-world single-sided markets also deviate from perfect competition.”

### 3.7 What is the optimal number of platforms?

Another open question remains the optimal number of platform: 1, 2, 3, more? In the case of wireless communication, European regulatory agencies have evolved in their analysis. Some years ago, "4 or 5 mobile operators" was considered necessary for effective competition. Now, some regulators are favorable to mergers that would consolidate the industry and lead to 3 competitors. For platforms, a case by case approach would be needed given the diversity of markets covered. In some markets characterized by strong network effects, the optimal structure may be one or two leading platforms. In other markets, the heterogeneity of customers' tastes can lead to a larger number of specialized platforms. Sometimes, the optimal configuration is a large platform that serves the mass audience and several niche platforms. There is no single scenario that maximizes social welfare. Consequently, there is no target scenario for regulation to seek to emulate.

### 3.8 Competition for the market as a whole.

As any student of competition law knows, a dominant position is not illegal; only its abuse is illegal. Indeed, the possibility of one day becoming the next Facebook or Google is what fuels innovation and competition, particularly in the Internet field.

Shelanski (2013, p. 1669) summarizes this Schumpeterian phenomenon as follows:

*"...competition on the Internet is very often competition for the whole market through innovation, rather than competition for a share of the market through pricing. Pressure on a dominant incumbent comes from rivals innovating to supplant the incumbent over time rather than from current competitors trying to chip away at the incumbent's market share at a given point in time; competition is thus more sequential than simultaneous. Antitrust enforcement based on a static view of market dominance runs the risk of missing the real source of competitive pressure on apparent monopolists and reducing the rewards for innovation by potential rivals. Proponents of this view conclude that the costs of overenforcement errors are sufficiently high that society should prefer errors of antitrust underenforcement in digital platform markets." (footnotes omitted)*

Daigle (2015) refers to examples of Alta Vista and MySpace to illustrate the principle that there are "no permanent favorites" on the Internet: "Systemically, the Internet supports and fosters approaches that are useful; old outdated or otherwise outmoded technologies die away." (Daigle, 2015, p. 9)

If a regulatory agency wants to regulate dominant platforms, the result might be to accelerate the replacement of the "winner-take-all" platform, by a new dominant platform facilitated by regulation. The effects on the incentives to innovate are unclear. On the one hand, it could create more incentives for potential competitors to develop new platforms since they could count on regulation to help give them an advantage. But the entrepreneurs or investors could anticipate that the benefits of winning the market will be shorter, since dominance will be accompanied by new regulatory obligations in favor of

competitors. Platform regulation could create more uncertainty and instability and reduce the incentives to innovate, which would be counterproductive.

Shelansky (2013) and Manne and Wright (2011) have shown that in antitrust remedies, the risk of regulatory error is high when dealing with new Internet-based business models. Regulators have a systematic bias toward seeing anticompetitive conduct in new business models. More important, the cost of error is much higher in the case of a so-called "Type I" error -- i.e. when a regulator mistakenly imposes a remedy -- than for a "Type II" error -- i.e. when a regulator mistakenly fails to impose a remedy. This leads to the conclusion that where there is a significant uncertainty due to rapid technological and market changes, regulators should have a bias in favor of doing nothing rather than imposing a remedy.

This is illustrated by the concern focused on iTunes' market power in the early years of the 21<sup>st</sup> century. In 2004, competition complaints were filed, arguing that Apple's DRM system was an essential facility. The French competition authority found that the DRM was not an essential facility, and that there was insufficient proof of an abuse of dominant position. The competition authority cited the intense competition at the time among different music listening systems. In 2006, France created a specific regulation, and a regulatory authority (the "ARMT"), to organize access to DRMs, but by the time the regulatory framework was put in place, the market had evolved. Today, iTunes' market power has been contested by streaming services like Spotify or Deezer, and DRMs are no longer a key competitive issue. Market evolution addressed the competitive concern, making regulatory remedies unnecessary.

For all these reasons, one can share the view of Shelanski (2013) that *"the error costs of overenforcement of antitrust laws in digital markets would be much higher than the error costs of underenforcement"*. It can be very costly to regulate digital platform markets given the rapid pace of change in these markets. The guidelines in digital markets should be "first do no harm" to avoid counterproductive effects.

### 3.9 Conclusion

Economic literature shows the complexity of regulating platform activity because of the interdependencies and feedback loop (indirect network effect). The multi-sided dimension of platforms implies that a regulatory intervention focused on one side can be inefficient, with counterproductive or uncontrolled effects on the other sides. The risk of error, i.e. doing more harm than good, is high in any form of regulatory proposal that attempts to treat platforms as a homogeneous service or infrastructure that can be regulated. Regulation should focus instead on certain anticompetitive or harmful conduct of service providers, without tying regulation to the concept of platform. Moreover, regulation should remain technologically neutral. The kinds of harmful conduct targeted by regulation should not depend on the technology used. An anticompetitive or unfair commercial practice should be treated the same regardless of the technology used: digital, analog, postal service, telephone...

Finally, when targeting so-called dominant platforms, proponents of regulation should be careful not to affect motivations for innovation. For Internet services, competition often

expresses itself as sequential innovations and competition for the market as a whole, as opposed to classic price-based competition.

#### 4. APPLICATION OF EXISTING LAW TO DIGITAL PLATFORMS

##### 4.1 Many services offered by platforms are already subject to specific regulations

The services provided on each side of the platform may in some cases involve regulated activities. For example, a platform that provides medical information such as doctissimo.fr will have to deal with a host of regulatory constraints applicable to the provision of medical advice and advertising. A platform that provides users with access to ride sharing and transportation services such as blablacar.fr or uber will have to take into account passenger transport regulations.

An online newspaper such gala.fr, which consists of providing information services to readers on the one hand, and advertising services to merchants on the other, must deal with defamation laws and other rules applicable to media.

A platform that helps put sellers of advertising space in touch with buyers will have to be concerned with advertising regulations such as the Loi Sapin in France. Platforms such as meilleurtaux.com that offer services in the financial or insurance sector will need to be concerned with regulation of insurance or financial intermediaries. A payment platform such as paypal.fr will be subject to rules on payment service providers.

Thus for any platform, whether in the digital or physical world, the services offered by the platform will often be subject to **specific laws applicable to the relevant services**. In most cases, those laws are technologically neutral, and seek to address market failures linked to the nature of the relevant service.

##### 4.2 Contract, competition, commercial and data protection law already apply to services offered by platforms

In addition, all platforms will be subject to laws of general application, including contract law, consumer protection, competition law, and data protection law. When it provides a service, whether to an end-user, to a merchant or to a third party content provider, a platform enters into a contract. In the online context, the contract will generally consist of acceptance of the service provider's terms of use. Terms of use attract considerable attention from courts, consumer protection agencies, competition authorities, and data protection authorities. These authorities rely on existing law to sanction unfair or anticompetitive clauses contained in terms of use, as well as commercial practices that may not be reflected in the contract.

For instance; France's consumer protection laws prohibit unfair clauses in consumer contracts (the French term is "*clauses abusives*"). What constitutes an "unfair" clause is in some cases fixed by regulation. But in many cases, the term is left to the interpretation of the courts and France's consumer protection agency, the DGCCRF. France created an advisory panel to issue guidance on what constitutes an unfair clause in various circumstances. On December 3, 2014, the panel published a lengthy opinion identifying

46 clauses in **social media terms of use** and privacy policies that the panel considers unfair. Although focusing on social media services, the panel's conclusions can be extended to many online services.

Existing laws are for the most part **technologically neutral**. They do not distinguish between digital, analog or physical activities. For example, a contractual clause may be deemed "abusive" regardless of whether the service provider offers services via an online platform or through the post-office or telephone calls.

The box below provide examples of how existing law has been applied to harmful conduct on digital platforms. Existing law has been applied against a broad range of digital platforms to sanction unfair contracts with merchants (expedia.fr; booking.com), unfair business practices (kelkoo.fr), protection of users against excessive use of personal data (pagesjaunes.fr; google), anticompetitive practices (booking.com; google), unfair terms of use (French Commission on Abusive Clauses).

#### **Examples of recent decisions relating to digital platforms in France**

On July 24, 2014, the site Kelkoo.fr was found to have violated French law by committing unfair and misleading commercial practices. The case was brought by a merchant who claimed that Kelkoo's comparison site was unfair.

On May 7, 2015, Expedia was found to have violated commercial law, because its contracts with hotels created a "significant imbalance" in the rights and obligations of the parties.

On April 21, 2015, Booking.com entered into a settlement with several competition authorities, agreeing to end certain anticompetitive practices in contracts with hotels.

On January 31, 2012, Google was fined 500,000 euros for abuse of dominant position in connection with Google Maps. The case was brought by the French company Bottin Cartographes, which argued that Google applied predatory prices for access to its Google Maps API. Google appealed the decision to the Paris Court of Appeals, and the Paris Court of Appeals suspended the case in order to seek the advice of the Competition Authority.

On June 20, 2010 decision, Google was sanctioned for abusing its dominant position on the market for AdWords. The competition authority ordered Google to ensure that its conduct with advertisers using the AdWords service complied with principles of objectivity, non-discrimination, and transparency. Google was required to give reasonable and advance notice to advertisers of any change in Google's policies. This decision by the French Competition authority was issued under emergency proceedings, after a complaint by NavX. The decision was issued in four months, and not appealed.

On September 21, 2011, the French directory platform "PagesJaunes.fr" was sanctioned for unfair processing of personal data collected from social media sites. The sanction was confirmed by the Council of State on March 12, 2014.

On January 3, 2014, Google was sanctioned for improper use of cookies and for changes to its privacy policy.

5. **"BETTER INTERNET REGULATION" METHODOLOGY REQUIRES A PRUDENT APPROACH TO REGULATING DIGITAL MARKETS**

In the EU better regulation methodology, the proponent of a new proposal must compare different regulatory options with a baseline model (European Commission, 2015b). The baseline model is not static, but should take into account likely evolution of the market and the regulatory environment over the next several years (Renda et al., 2013). In the case of a proposal to regulate platforms, the baseline scenario should include a simulation of how existing laws will be enforced against online service providers over the coming years. This would include taking into account increased sanctions available under the future European General Data Protection Regulation and the increasing availability of class actions in many Member States. The baseline scenario should also take into account the fact that competition law concepts applicable to online services are becoming easier to apply, as competition authorities and courts gain experience with these new markets and services.

Once a baseline scenario is prepared, the baseline scenario must be compared with various regulatory options. The option providing the least cost, and risk of error, should be chosen.

As noted above, Internet regulation is particularly prone to error because of fast-moving market structures. Shelanski (2013) posits that the costs associated with a regulation that misses its mark will be much higher than the costs associated with doing nothing. This is because in fast-moving Internet markets, the market will often address the issue.

The Internet also presents other special characteristics that require regulatory caution. The 2011 OECD recommendations on Internet policy making state that rules should wherever possible respect the multi-stakeholder approach that has heretofore been successful for Internet regulation (OECD, 2011). National policy makers should wherever possible seek to make their rules compatible with the global norms established for the Internet. The recommendations emphasize the need to make rules technologically neutral. Any national measures should respect the fundamental principle of allowing cross-border provision of services, which is central to the success of the Internet. The recommendations state that barriers to the location, access and use of cross-border data facilities and functions should be minimized. National policy makers should consider in priority self-regulatory measures such as codes of conduct that are backed-up by appropriate accountability measures. The codes of conduct should encourage and facilitate voluntary cooperative efforts by the private sector to respect the freedoms of expression, association and assembly online and to address illegal activity. Where self-regulation does not reach the desired result, other regulatory measures can be envisaged, but as a second-best option.

The OECD recommendations call for data-driven policies, including using empirical evidence to evaluate the proportionality and effectiveness of regulatory measures. The

recommendations note that the protection of Internet intermediaries against liability for content provided by third parties is a key factor to promoting innovation and creativity, the free flow of information and in providing the incentives for cooperation between stakeholders. The recommendation calls for an assessment of the social and economic costs and benefits of any regulatory measure, including impacts on Internet access, use and security. The evaluation of various policy options should be considered including their compatibility with the protection of all relevant fundamental rights and freedoms, and their proportionality in view of the seriousness of the concerns at stake. Any proposed legislative or regulatory measure should be assessed in light of its effective enforceability and its compatibility with fundamental rights.

In sum, under the European Commission and OECD "better regulation" methodology, a regulation of digital platforms may be envisaged only after showing that:

- the relevant harms cannot be addressed by existing law, including improvements to enforcement (eg class actions, increased sanctions);
- the "baseline scenario", including a simulation of future evolution of the market and of enforcement of existing laws, will not address the problem;
- self-regulatory (or co-regulatory) initiatives cannot address the issues;
- the regulatory measure is narrowly targeted to address the untreated harm, and is likely to do so, but will not have spillover effects that may distort the market, discourage innovation or affect fundamental rights;
- the regulatory measure is to the full extent possible technologically neutral.

## **6. TELECOMMUNICATIONS REGULATION IS NOT A GOOD ANALOGY FOR PLATFORM REGULATION.**

Some observers draw an analogy between the regulation of telecommunications and the regulation of platforms. The reasoning is that some form of telecom-like regulation could be extended to digital platforms in order to address some of the potential harms that platforms can cause. The comparison with telecommunication regulation is used to justify a form of asymmetric regulation of so-called "dominant" platforms. Under European telecommunication law, network operators holding "significant market power" are subject to enhanced regulatory burdens. Proponents of platform regulation argue that a similar form of asymmetric regulation could be applied to so-called dominant digital platforms.

However, the comparison with telecommunication regulation is flawed. Digital platform services do not fit this model. Digital platform services are more akin to software, and should be governed by competition law and consumer protection law only.

### **6.1 The de-regulatory philosophy of the EU framework for electronic communications**

#### **(a) Sector-specific regulation to disappear**

The whole premise of the European directives on the regulation of electronic communications is that sector-specific regulation should disappear and leave way

for the application of competition law only. Sector-specific regulation for telecoms is a necessary (and temporary) evil to address the situation of a state-controlled monopoly transitioning to a system of open competition. Because of the existing infrastructure owned by the former monopoly, the emergence of competition would be impossible without a regulatory framework that tips the playing field in favor of new entrants by obligating the former monopoly operator to grant access to essential elements of its network at cost-oriented rates. Experience in telecom liberalization around the world (and particularly in New Zealand) showed that the reliance on competition law alone was insufficient in a situation where competitors need access to the incumbent's network in order to enter the former monopoly's market. However, this form of sector-specific access regulation only exists in industries where there is a transition from a state-controlled monopoly over network infrastructure toward a regime of open competition. The sector-specific regulation of electronic communications networks in Europe is supposed to be transitory in nature. Once competition has achieved a foothold, sector-specific regulation should decrease and finally disappear, to leave way for reliance on competition law only.

(b) Three-criteria test

This de-regulatory philosophy is evident in the European Framework Directive governing the regulation of electronic communications in Europe. The European Commission allows asymmetric regulation to exist only in precisely defined markets satisfy the so-called three-criteria test: (i) there are durable barriers to entry, (ii) technological and market innovations are unlikely to change the competitive situation, and (iii) competition law is insufficient by itself to address the problems. For markets that satisfy these three criteria, it is possible to impose asymmetric obligations on certain operators that hold a dominant position on the relevant markets. The dominant position must be proven through classic competition law analysis. It must be shown that the relevant operator is immune from competitor pressure, and can behave independently from its competitors and ultimately of consumers.

(c) Remedies narrowly-tailored

The final set of safeguards put in place by the Framework Directive is to ensure that any remedies that are imposed are narrowly tailored to the competitive problem that is identified in the market analysis, and that those remedies are removed as soon as they are no longer absolutely necessary to address the problem. Remedies, like sector-specific regulation itself, must be narrowly-tailored, and are supposed to be transitory in nature.

## 6.2 Telecom regulations target a narrowly-defined service

The European regulatory framework for electronic communications only applies to a narrowly defined set of services ("electronic communications services") and networks that are used principally for those services. The regulations do not extend to "information

society services." Within the class of electronic communications services covered by the directives, regulations must be "technologically neutral."

"Platforms" are not a single service, but a group of heterogeneous services often falling under separate regulatory regimes. A regulation of digital platforms would therefore apply to all forms of services, provided they are supplied under a "two-sided market" business model. Regulating digital (as opposed to non-digital) platforms would also mean that similar services and/or business models would be regulated differently depending on whether the services make use of digital communications technology. An online yellow pages service would be regulated differently than the print version. This violates the principle of technology neutrality, which is one of the core principles of telecommunications regulation.

### 6.3 **The Commission has reduced the number of markets that can be regulated**

Under the European framework for electronic communications, the number of markets that are deemed to satisfy the three criteria test ((i) durable barriers to entry, (ii) market or technological evolution unlikely to change the competitive situation, (iii) competition law insufficient) has been reduced from 18 to 5. Regulatory remedies on incumbent operators have progressively been lifted as competition has developed and the basic building blocks necessary for competitive entry, such as access to the local loop, have been made available. *Ex ante* regulation of telecom operators in Europe is on the path to extinction. This extinction is part of the original design of the European regulatory framework. The Framework Directive seeks to achieve a situation where telecommunications services will be regulated solely by competition law, consumer protection law and data protection law, just like other kinds of services in the economy. The first step was to regulate the access to the essential infrastructures owned by the incumbent (i.e. unbundling) to allow the entry of new operators and the development of services competition. Then the second step was to encourage the entrants to invest in their own network to foster infrastructure competition and make asymmetric regulation no more necessary.

### 6.4 **Digital platforms do not share the characteristics of telecom networks**

The reasons that justify temporary *ex ante* asymmetric regulation of dominant telecommunications providers are not present for digital platforms. First, no digital platform results from a former government monopoly. Consequently, whatever market position a platform possesses results from competition on the merits and not from special or exclusive rights granted by the government. Second, digital platforms do not possess an infrastructure that is difficult or impossible for competitors to replicate and that is necessary for competitive entry. The notion of "essential facilities" is limited to physical infrastructure such as telephone lines, gas, water distribution pipes and train tracks.

Third, technological market evolutions are likely to change the competitive situation quickly in the markets for digital platforms. Internet-based businesses are contestable through technological innovation. The open character of the Internet permits "innovation without permission." (Benkler, 2006). As pointed out by the French competition authority's study on open and closed digital ecosystems, even closed ecosystems provide incentives to innovation. Closed systems are constantly under threat from open systems.

Finally, where there exist dominant positions, competition law is sufficient to address the problem. As the French Navx and Booking.com cases show, competition law is able to recognize and sanction anti-competitive practices that occur in the context of digital platforms. Competition law is technologically neutral, and has no difficulty addressing issues that emerge in the context of new technologies or business models.

Under the regulatory philosophy underpinning the regulation of electronic communication services in Europe, digital platforms would under no circumstances qualify for *ex ante* regulatory provisions. On the contrary, digital platforms occupy a situation similar to that of software. The market for software shows strong competitive dynamics driven by technological innovation. Market failures, including anti-competitive conduct, can exist but are addressed through competition law and consumer protection law.

The 2002 Framework Directive and the 2009 Better Regulation Directive stress this deregulatory philosophy.

*"The aim is progressively to reduce ex ante sector-specific rules as competition in the markets develops and, ultimately, for electronic communications to be governed by competition law only. Considering that the markets for electronic communications have shown strong competitive dynamics in recent years, it is essential that ex ante regulatory obligations only be imposed where there is no effective and sustainable competition." (Preamble 5, Directive 2009/140/EC of 25 November 2009 ("The Better Regulation Directive").*

#### 6.5 **"Emerging markets" should not be subject to ex ante economic regulation**

In connection with the definition of relevant markets and the finding of significant market power on electronic communications markets, the European Commission has said that regulators should refrain from imposing *ex ante* regulation on emerging markets. In emerging markets, the market leader is likely to have a substantial market share. *Ex ante* regulation can be harmful in emerging markets because the regulation may unduly influence the competitive conditions taking place within the new market. (Commission guidelines on market analysis and the assessment of significant market power (2002/C 165/03).

Paragraph 7 of the Commission's recommendation on relevant markets states that:

*"Newly emerging markets should not be subject to inappropriate obligations, even if there is a first mover advantage, in accordance with Directive 2002/21/EC. Newly emerging markets are considered to comprise projects or services, where, due to their novelty, it is very difficult to predict demand conditions or market entry and supply conditions, and consequently difficult to apply the three criteria. The purpose of not subjecting newly emerging markets to inappropriate obligations is to promote innovation as required by Article 8 of the Directive 2002/21/EC; at the same time, foreclosure of such markets by the leading undertaking should be prevented, as also indicated in the Commission's guidelines on market analysis and the assessment of significant market power under the community regulatory framework for electronic communications and services". Commission*

*recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector (2007/879/EC) §7.*

The Commission explanatory note accompanying the Commission recommendation on relevant products and service markets explains further the concept of emerging market as follows:

*"In general, new and emerging markets are unstable, exhibiting uncertainty of supply and demand and fluctuations in market shares. They are characterized by a significant degree of innovation which can lead to abrupt and unexpected changes (as opposed to a natural evolution over time)."*

The Commission considers that "emerging markets" are markets which are so new that it is not possible to establish whether or not the "three criteria" test is met. Only markets which satisfy the three criteria warrant consideration for *ex ante* economic regulation, although consumer protection rules may nonetheless apply.

## 6.6 Telecom operators as platforms?

As we saw above, the concept of platform is so broad that it catches numerous business models and services.

The set-top box provided by cable operators and IPTV providers is a form of platform, in that it serves as an intermediary between end-users and content and service providers. In France, these are often referred to simply as the "box". Set-top boxes have been subject to regulatory obligations to permit a third party access to conditional access systems, access to application programming interfaces, and regulation of electronic programming guides. Developed in the 1990s, these regulations were intended to ensure that a competing provider of satellite television programs would not have to provide a second set-top box to the consumer, which would constitute an insurmountable barrier for consumers who have already acquired a set-top box from the incumbent provider. This form of regulation is similar to the competition law obligations imposed on Microsoft to ensure that purchasers of a computer with a Microsoft operating system would not be locked into the Microsoft-supplied browser.

The regulations applicable to set-top boxes are not intended, however, to require a distributor of television program to include in its product package all services and programs that may request access to the platform. Audiovisual distributors are free to select the programs and services that they wish to distribute, subject only to national "must carry" obligations. The must carry obligations are intended to ensure that public service channels are available through any distribution platform. Under European law, the scope of the must carry regulation is limited to programming services that qualify as serving a public or general interest. For all other services, including online streaming services such as Netflix, operators that control the set-top box are free to negotiate commercial arrangements to include the service on their platform, or not. This freedom of negotiation permits the platforms to differentiate themselves and offer innovative packages to consumers. In some cases, the negotiations can result in anti-competitive practices. But in that case, competition law has provided an adequate remedy.

## **7. TERRITORIALITY OF LAWS**

One of the issues persistently mentioned in the debate on platforms is that certain US-based platforms manage to avoid application of French and European law. The avoidance of local law involves several distinct topics. One of the complaints relating to platforms is that they escape application of local law. In the field of taxation, this issue is linked to the broader question of base erosion and permanent establishment, and is being treated at the OECD. As regards audiovisual regulation, the problem concerns France's discomfort with the country of origin rule in the AVMS Directive. For all other questions (eg. competition law, data protection law, consumer protection law), there are no difficulties in applying local law to online service providers. Evidence shows that courts have no difficulty applying local law to platforms.

### **7.1 Territoriality of taxation**

The first topic relates to tax obligations. Many policymakers in Europe believe that US-based Internet service providers do not pay their fair share of taxes in the countries where their customers are located. On the VAT side, this question has been addressed through a reform of the territoriality rules for European value added tax. As from January 1st, 2015, European consumers pay value added tax based on their country of residence and not based on the country of residence of the service provider. In terms of corporate income tax, the question has been addressed in multilateral discussions at the OECD on base erosion and the concept of permanent establishment. In the meantime, some countries are enacting specific taxes that apply to Internet-based services. These new taxes are sometimes referred to as a broadband tax, or even as a "Google" tax.

### **7.2 Data protection law**

The application of European data protection law was also a persistent source of complaint by European policymakers. A number of US-based Internet service providers took the position that EU data protection rules were not applicable to them. However, this issue has been laid to rest by the European Court of Justice decision in *Google Spain vs AEPD*. The European Court of Justice held that a US-based Internet service provider with an affiliate in Spain could be subject to Spanish data protection law because the Spanish affiliate can be considered an "establishment" of the US data controller through which data is processed. The future EU general data protection regulation will also address this issue by subjecting to EU law any service that targets EU citizens. The problem of avoidance of EU data protection law therefore seems to have been solved.

### **7.3 Audiovisual regulation**

In the field of audiovisual law, the problem is not so much the application of European law to US-based service providers, but rather the ability of audiovisual service providers to benefit from the country of origin rule in Europe. The Audiovisual Media Services Directive sets a minimum baseline for regulation of audiovisual services, while allowing Member States to enact regulations that are stricter for service providers established in their Member State. Compared to other Member States, France has a relatively burdensome set of regulatory obligations for audiovisual media service providers.

However, under the country of origin rule, these French regulatory obligations cannot be imposed on a service provider established in another European Member State. Not surprisingly, a number of online audiovisual media service providers have established European headquarters in countries other than France. France is unhappy with this situation and wants to change the AVMS Directive so that each Member State is free to apply its national audiovisual regulations to online services that target citizens in that Member State. In essence, France wants to move to a "country of destination" rule, instead of the country of origin rule. The result would be to subject audiovisual media services to 28 different regulatory regimes in Europe. This would be a step backward in terms of creating a European digital single market. The issue will be discussed in the upcoming revision of the AVMS Directive.

As noted above, certain French policymakers have proposed a solution that, according to them, would allow France to apply local audiovisual regulations on service providers based in other EU Member States. As described in Section 2 above, the proposal, supported by the Chairman of the French broadcasting regulator, is to encourage service providers to enter into voluntary undertakings to finance French and European productions and comply with French regulatory quotas. In exchange for this voluntary commitment, the service provider would benefit from preferential distribution rights on digital platforms. Because this system is voluntary, the proponents of the system argue that it does not violate the AVMS Directive's country of origin rule. However, this analysis is flawed. Under the case law of the European Court of Justice, any action by a Member State that has the effect of making market access more difficult for service providers located in another Member State is a measure restricting the free flow of goods and services in the single market. It is a measure of "equivalent effect." Moreover, the rules on the audiovisual regulation have been harmonized at the European level under the AVMS Directive. Consequently, a Member State can no longer argue that a national measure is justified as a general interest exception to the rule on free circulation of services. The AVMS Directive specifically prohibits measures that restrict the freedom of citizens to receive audiovisual services emanating from another Member State. Imposing suboptimal distribution terms on service providers electing to rely on the country of origin rule would constitute an illegal restriction on retransmission under Article 3 of the AVMS Directive, even if the system is presented as a "voluntary" measure.

#### **7.4 Competition and consumer protection laws**

Competition and consumer protection law apply if there is harm to competition, or to consumers, in a relevant Member State. Consequently, courts and competition authorities have no difficulty applying local competition law and consumer protection law to services that target users in a particular Member State, regardless of where the service provider is located.

### **8. CONCLUSION**

Platforms facilitate multisided business models of all kinds. Platforms have existed for many years in the physical world. Examples include trade fairs and newspapers. Digital platforms simply make transactions easier, thereby facilitating the emergence of multisided business models in new contexts.

When analyzed from a legal and economic perspective, platforms are simply a collection of services offered to two or more different groups of customers. The services that are offered on different sides of the platform are generally subject to different legal rules. Services on the platform must comply with applicable laws, including competition law, data protection law and consumer protection law. Where providers of platform-based services do not comply with law, they are sanctioned.

In our view, the creation of a specific regulatory framework targeting digital platforms is premature. First, the target of the regulation, the digital platform, is so potentially vast as to cover a myriad of services and intermediaries that have very little in common. Second, no serious impact assessment has been done to define exactly why new regulation is necessary. We have seen no evidence of durable market failures that are not already addressed by existing law. Moreover, no evaluation has been done on the potential effects that a targeted regulation of platforms might have on competition and innovation. The justifications we have seen to date regarding platform regulation incorrectly assume that a platform with a large market share on at least one side of the market necessarily needs to be regulated. This assumption is wrong for several reasons. First, large market shares are not necessarily evidence of market power in digital markets. This is particularly true for audience-based business models with low switching costs. Second, the existence of market power is not a problem in itself. It is only the abuse that creates a problem, and that problem is already addressed by competition law.

Third, the services offered via platforms are in many cases already regulated as services, such as payment or insurance services.

Last, market failures in dynamic digital markets are often transitory in nature, leading to false positives and the premature imposition of regulation (so-called "type I" errors).

An important overriding concern is that digital markets are fast-moving and that attempts to regulate can create more harm than good. That is why both the OECD and the European Commission require careful impact assessments and cost-benefit analyses before envisaging new regulation, to ensure that the regulation addresses a true need that is not already satisfied either through the market or existing law.

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## **ANNEX 1 – AN OVERVIEW OF CURRENT REGULATORY PROPOSALS TARGETING PLATFORMS**

The idea of creating a specific regulation to deal with digital platforms has emerged in a number of contexts. This section will describe the current political proposals and the social and economic "harms" they are intended to address.

### **1. LESCURE REPORT.**

In 2012, the French minister of culture commissioned a report by Pierre Lescure to examine how France's "cultural exception" can be applied to new digital environments. The Lescure report proposed a number of measures to deter online copyright infringement, and promote legal content sites and French-produced content on digital platforms. One of the challenges identified by Lescure is the inability of France to impose regulation on platforms located outside of France.

#### **1.1 Country of origin rule in the AVMS Directive.**

The concern about application of French audiovisual regulation to non-French platforms stems from the Audiovisual Media Services (AVMS) Directive. The AVMS Directive sets a minimum baseline for audiovisual regulation in Europe. Each Member State has the flexibility to go beyond the minimum baseline contained in the directive. Using the flexibility offered by the Directive, France has created specific regulatory obligations that apply to on-demand audiovisual media service providers established in France. These obligations include proposing a minimum percentage of French-produced content, featuring French and European content on the service's homepage, and investing a minimum amount in French and EU production.

Under the AVMS Directive's country of origin rule, France is unable to apply these French obligations on AVMS providers established in another Member State of the EU. Consequently, an AVMS provider located in Luxembourg, for example, is free to offer an on-demand audiovisual media service to French citizens, while being subject only to Luxembourg audiovisual regulations, which are less stringent than French obligations. This provides an incentive for on-demand AVMS providers serving a European audience to establish themselves outside of France. France is therefore pushing for a revision of the AVMS Directive that would permit each Member State to apply its own audiovisual regulations to services that target customers in that Member State, even if the service is established in another Member State. This is called the "country of destination" rule, which contrasts with the "country of origin" rule in the current directive.

##### **(a) E-Commerce Directive.**

The second reason France cannot impose regulations on foreign-based platforms is the European E-Commerce Directive. Platforms whose services do not rise to the level of "on-demand audiovisual media service" under the AVMS directive cannot be made subject to audiovisual regulations designed to promote French culture. Such services are typically considered "information society services" that

fall under the European E-Commerce Directive.<sup>9</sup> Most digital platforms are considered Information Society Services. Under the E-Commerce Directive, a provider of Information Society Services that establishes itself in one Member State is free to provide its service to consumers throughout Europe without having to be concerned with special regulatory requirements in each Member State where it has users. There are number of exceptions to this rule, in particular for consumer protection legislation. However, the general rule is that an Information Society Service is subject to the laws of its country of establishment. Consequently, a service based in Ireland or in the United Kingdom but targeting French consumers would be subject to Irish or English law for many aspects of its business.

(b) Lescure's proposal for voluntary cultural promotion.

To overcome the problem of the applicability of French law, Lescure proposed a regime that would provide incentives for platforms to apply measures that promote French cultural policy (i.e. cultural exception). Lescure suggested that platforms voluntarily agreeing to French rules would benefit from preferential distribution rights in France. The distribution rights might include preferential visibility on content aggregators, or even preferential bandwidth on ISP networks. This proposal would likely violate the AVMS Directive's country-of-origin rule.

(c) Recommendation algorithms as a threat to content diversity.

The Lescure report also expressed concern about recommendation algorithms. According to Lescure, recommendation algorithms tend to promote content that is similar to what Internet users already like. Consequently, Lescure believes that recommendation algorithms could harm cultural diversity, and should be regulated so as to create a bias (or "non-neutrality") in favor of European content.

## 2. COUNCIL OF STATE REPORT RECOMMENDS A NEW CATEGORY OF INTERMEDIARY, AND A NEW DUTY OF FAIRNESS.

### 2.1 A new duty of fairness

In its September 2014 report on fundamental rights on the Internet, the French Council of State recommended that digital platforms be subject to a new duty of fairness. The Council of State identified several issues justifying a new approach to the regulation of platforms. First, the Council of State said that platforms that organize or rank content are fundamentally different from hosting providers who benefit from a special liability regime under the European E-Commerce Directive. The Council of State pointed to French and European case law to show that marketplace platforms and search engines do not always

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<sup>9</sup> An Information society service is defined as "any service normally provided for remuneration at a distance, by means of electronic equipment for the processing (including digital compression) and storage of data, at the individual request of a recipient of the service". [...] "It also covers services (insofar as they represent an economic activity) that are not directly remunerated by those who receive them, such as those offering online information or commercial communications (e.g. adverts) or providing tools allowing for search, access and retrieval of data". With such a definition, search engine or social network sites offers information society services both to the Internet users and the advertisers.

fulfill the necessary condition of playing a purely technical and passive role. Therefore they do not necessarily benefit from the liability safe harbor contained in the E-Commerce Directive. The Council of State points out that the liability safe harbor is important so that platforms do not apply excessive censorship to content posted on their service. However, the Council of State argues that a new legal category should be created for platforms that offer classification or listing services for content, goods or services placed online by third parties.

Once this new legal category has been created, the Council of State proposes that platforms should be subject to a general obligation of fairness, both to consumers and to online merchants who depend on the platform to reach users. The duty of fairness would consist of an obligation not to alter or distort information, search results or rankings for purposes contrary to the interests of the users. The listing and indexing criteria must be based on the objective of offering better service to the user.

## **2.2 Procedural rules when removing content.**

The Council of State also recommends that platforms be subject to procedural rules regarding the manner in which they develop acceptable use policies and enforce them against users. Persons whose content has been removed by a platform under the platform's internal content policies should have procedural rights to challenge the removal. The criteria for removing lawful content should be published and applied in a clear, nondiscriminatory manner. Moreover, users of platforms should have a role in defining the rules determining what kind of content may be published via the site.

## **2.3 Safeguards surrounding algorithms.**

The Council of State also identified risks associated with platforms' use of algorithms. The study proposes procedural and transparency safeguards that should apply to algorithms so that they do not create a risk for individuals. The use of algorithms should be accompanied by human intervention, says the report. The functioning of algorithms should be monitored to ensure there is no unlawful discrimination.

## **2.4 Imposing a "take down and stay down" obligation.**

Finally, the Council of State addressed the role of platforms in limiting access to unlawful content such as sites that propose illegal film or music downloads. According to the Council of State, platforms should have an obligation to prevent the reappearance, for a defined period, of content that has previously been withdrawn. This is tantamount to a "take down and stay down" obligation.

## **3. FRENCH NATIONAL DIGITAL COUNCIL (CNN).**

In May 2014, the French National Digital Council (CNN) submitted a report to the minister of the economy on the neutrality of platforms. The CNN report focused principally on anticompetitive behavior by platforms, including the unfair advantage that so-called "dominant" platforms have because of their access to information collected on the platform. The CNN report complains about the ability of platforms to modify their policies

and APIs in a manner that can hurt other merchants in the ecosystem. One of the recurring themes of the CNN report is that large platforms will tend to favor their own services over the services of independent service providers, thereby stifling competition and innovation. The report cites policies that prevent the development of cross platform services. According to the CNN, the large platforms have developed competing but incompatible ecosystems with their own data silos that can lock-in users and increase the dependence of third parties.

The report indicates that platforms have a tendency to blur the line between sponsored information and objective information presented to users (for instance between sponsored links and organic links in the case of a search engine). Users have difficulty knowing whether the information that is being presented results from an objective process, or whether the information is chosen because of a hidden financial benefit received by the platform.

One of the themes of the CNN report is that so-called "dominant" platforms pose a threat for innovation. According to the report, once platforms achieve a certain scale, they will attempt to prevent disruptive innovation that will threaten their established business model.

The report argues that current competition law is insufficient, and must be updated in order to deal with the specific market behavior of large platforms. According to the report, the essential facilities doctrine could be used with regard to so-called "dominant" platforms, which would have the result of guaranteeing competitors a right of access to certain aspects of the platform. The report asserts that the information accumulated by platforms on the functioning of the market and preferences of users cannot be duplicated. The reports believes that sponsored references will little by little squeeze out non-sponsored information and links, thereby making it more and more difficult for web merchants and providers of services to have access to end-users without paying a fee to the platform.

The CNN report warns that major platforms have a weight greater than that of a sovereign country, and may succeed in asphyxiating the open Internet environment that is so critical for innovation and progress.

When treating the issue of competition law, the CNN report (at page 28) cites an 2012 OECD paper, which mentions the idea of considering a digital economy actor as dominant if no competitor has been able to challenge the company's leadership for five years, and the company earns a profit.

One of the market failures cited in the CNN report relates to information asymmetries. A platform will hold much more information on a user than the user may hold about herself. Similarly, service providers who rely on the platform generally must share certain user information with the platform, while the reverse may not be true. This creates asymmetries in the flow of information, says the CNN. (Page 36). The report worries about the absence of competition and innovation that flows from the coexistence of a small handful of large platforms that compete with each other. Another concern relates to

the tendency of platforms to make acquisitions in order to reinforce their market power, and in some cases prevent disruptive innovation from emerging as a competitive threat.

The CNN's report does not contain actual examples of innovation and competition being hurt as a result of platform behavior. The focus of the report is on potential harms.

#### 4. FRENCH SENATE AMENDMENT

Several French Senators proposed an amendment to a recent economic bill that would impose several obligations on major search engines. They define a major search engine as one that has a "structuring effect on the digital economy." The new obligations would include:

- Making available to users three other unaffiliated search engines on the home page of the major search engine;<sup>10</sup>
- Providing to users information on the principles governing the search engine's algorithm;
- Ensuring that search results are fair and non-discriminatory, particularly vis-à-vis services affiliated with the operator of the major search engine;
- A prohibition of tying the use of a search engine to a given terminal or software.

The proposed amendment would insert these obligations in the French Electronic Communications and Post Code, and would empower ARCEP, the French regulatory authority for telecommunications, to enforce the principles.

The explanatory memo accompanying the amendment said that "the behavior of certain actors having a structural effect hurts pluralism of ideas and opinions, innovation and freedom to create businesses." The explanatory memo also cites the need to protect French and European businesses from dependency on US-based services:

*"Fears regarding the monopoly power of the large US Internet sites are increasing in France and in Europe.... Europe cannot remain a 'digital colony', and the moment has come to fight against the increased dependency of our companies on the Internet as it exists today, and which has become for them a factor of vulnerability."*

The explanatory memo also cites the "abusive level of confidence" that internet users give to search results, and the fact that Internet users may be tied to a single search engine:

*"Internet users tend to accord an abusive level of confidence in the results of algorithms, perceived as objective and infallible, in particular because the users have no information regarding the methods used and because they may only be able to use a single search engine because of exclusivity agreements."*

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<sup>10</sup> This is similar to one of the voluntary commitments proposed by Google to settle the antitrust investigation of the EU Commission in 2013.

Finally, the memo refers to the ability of search engines to dereference or downgrade the rankings of certain sites, citing harms that can result to the dynamism of the French economy:

*"In addition, through modifications to its algorithm, and in certain cases through its general terms and conditions, a search engine can refuse to reference or rank, or dereference, or downgrade the rankings of, any Internet site. This can be done in a potentially discriminatory and arbitrary manner. A risk of this kind for economic actors present on the Internet, and dependence vis-à-vis ultra-dominant actors, are harmful to the dynamism of the French economy."*

The explanatory memorandum cites potential actions that can be taken by platforms, but does not cite actual examples of harm.

## **5. EUROPEAN COMMISSION DIGITAL SINGLE MARKET STRATEGY**

In its May 6, 2015 communication on the digital single market, the European Commission identified the benefits, and potential harms, associated with digital platforms.

### **5.1 Benefits of platforms.**

The benefits of platforms are linked to increased efficiency and innovation, leading to growth, jobs and increased consumer choice. Platforms are "enablers" for the digital economy:

*"Online platforms (e.g. search engines, social media, e-commerce platforms, app stores, price comparison websites) are playing an ever more central role in social and economic life: they enable consumers to find online information and businesses to exploit the advantages of e-commerce. Europe has a strong potential in this area but is held back by fragmented markets which make it hard for businesses to scale-up.*

*Platforms generate, accumulate and control an enormous amount of data about their customers and use algorithms to turn this into usable information. The growth of such data is exponential – 90% of all data circulating on the Internet were created less than 2 years ago. Moreover, platforms have proven to be innovators in the digital economy, helping smaller businesses to move online and reach new markets. New platforms in mobility services, tourism, music, audiovisual, education, finance, accommodation and recruitment have rapidly and profoundly challenged traditional business models and have grown exponentially. The rise of the sharing economy also offers opportunities for increased efficiency, growth and jobs, through improved consumer choice, but also potentially raises new regulatory questions."*

### **5.2 Potential harm of platforms**

The potential harms cited by the Commission are linked essentially to market power and information asymmetries.

*Although their impact depends on the types of platform concerned and their market power, some platforms can control access to online markets and can exercise*

*significant influence over how various players in the market are remunerated. This has led to a number of concerns over the growing market power of some platforms. These include a lack of transparency as to how they use the information they acquire, their strong bargaining power compared to that of their clients, which may be reflected in their terms and conditions (particularly for SMEs), promotion of their own services to the disadvantage of competitors, and non-transparent pricing policies, or restrictions on pricing and sale conditions.*

*Some online platforms have evolved to become players competing in many sectors of the economy and the way they use their market power raises a number of issues that warrant further analysis beyond the application of competition law in specific cases."*

The Commission also referred to the need to improve mechanisms for the removal of illegal content on the Internet, including the idea of imposing some form of duty of care on Internet intermediaries.

The Commission concluded by announcing the launch of a comprehensive assessment on the role of platforms, focusing on transparency, use of information, contractual relations with suppliers, barriers to switching, and the fight against illegal content.

*"The Commission will launch before the end of 2015 a comprehensive assessment of the role of platforms, including in the sharing economy, and of online intermediaries, which will cover issues such as (i) transparency e.g. in search results (involving paid for links and/or advertisement), (ii) platforms' usage of the information they collect, (iii) relations between platforms and suppliers, (iv) constraints on the ability of individuals and businesses to move from one platform to another and will analyse, (v) how best to tackle illegal content on the Internet."*

## **6. TAXATION AND REFORM OF AUDIOVISUAL SUBSIDIES ARE BROADER ISSUES.**

Some proposals refer to cultural harms allegedly caused by platforms.

The complaint that platforms hurt cultural policy is linked to the broader debate of how national subsidy systems designed to support cinema and other cultural objectives can be modernized to take account of the increasing influence of Internet-based services. France's system for support of cinema is based on complex rules linked to over-the-air broadcast licenses. Broadcasters receive the right to use radioelectric spectrum free of charge. In exchange, broadcasters are subject to obligations linked to supporting French culture and cinema. The French system for subsidizing the motion picture industry has been criticized by the French accounting court (Cour des Comptes) as creating significant inefficiencies. As over-the-air broadcasting decreases in significance, the French system for subsidizing cinema will have to be modernized. The debate on imposing cultural obligations on digital platforms is a small aspect of a much larger issue.

The Lescure report seeks to impose cultural obligations on platforms. However, for platforms established outside of France, such an obligation would violate the AVMS Directive and E-Commerce Directive.