

Amazon is not essential, except to the EU's flawed investigations

*An examination of the EU's misguided application of "essential facilities"
theories to Amazon's e-Commerce platform*

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Introduction

Amazon has largely avoided the crosshairs of antitrust enforcers to date (leaving aside the embarrassingly dangerous¹ threats of arbitrary enforcement² by some US presidential candidates). The reasons seem obvious: in the US it handles a mere 5%³ of all retail sales (with lower shares⁴ in the EU), and it consistently provides access to a wide array of affordable goods. Yet even with Amazon's obvious lack of dominance in the general retail market, the EU and some of its member states are opening investigations.

This isn't new: the EU and its member states have pursued many competition claims against the big tech platforms. In the last two years alone, the EU imposed⁵ over \$9B USD in fines on Google for "harms" that were highly speculative and hard to square with concern for consumers.⁶

¹ Geoffrey Manne & Alec Stapp, *Elizabeth Warren wants to turn the internet into a literal sewer (service)*, TRUTH ON THE MARKET, Mar. 9, 2019, <https://truthonthemarket.com/author/manneandstapp/>.

² Elizabeth Warren, *Here's how we can break up Big Tech*, MEDIUM, Mar. 8, 2019, <https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-9ad9e0da324c>.

³ Ingrid Lunden, *Amazon's share of the US e-Commerce market is now 49%, or 5% of all retail spend*, TECHCRUNCH, Jul. 13, 2018, <https://techcrunch.com/2018/07/13/amazons-share-of-the-us-e-commerce-market-is-now-49-or-5-of-all-retail-spend/>.

⁴ In the EU, Amazon accounts for 22 percent of online sales by value according to a report by Euromonitor. *Why Amazon struggles in Europe*, ECOMMERCE NEWS, May 4, 2018, <https://ecommercenews.eu/why-amazon-struggles-in-europe/> Even in the country with the highest proportion of online retail in the World, the UK, online sales currently account for less than 20% of total retail sales. CENTRE FOR RETAIL RESEARCH, *ONLINE RETAILING: BRITAIN, EUROPE, US AND CANADA 2017*, Fig. 2 (2018). In most other European countries, online represents less than 10% of retail. *Id.* Even if online retail were 20% throughout Europe, Amazon would therefore represent less than 5% of all retail.

⁵ Natasha Lomas, *Google gets slapped with \$5BN EU fine for Android antitrust abuse*, TECHCRUNCH, Jul. 18, 2018, <https://techcrunch.com/2018/07/18/google-gets-slapped-5bn-by-eu-for-android-antitrust-abuse/>.

⁶ See, e.g., Julian Morris, *The European Commission's Google Android decision takes a mistaken ahistorical view on the smartphone market*, TRUTH ON THE MARKET, Jul. 23, 2018, <https://truthonthemarket.com/2018/07/23/the-european-commissions-google-android-decision-takes-a-mistaken-ahistorical-view-of-the-smartphone-market/>; See also Geoffrey A. Manne, *The Washington Post editorial board understands online competition better than the European Commission does*, TRUTH ON THE MARKET, Jul. 10, 2018, <https://truthonthemarket.com/2017/07/10/the-washington-post-editorial-board-understands-online-competition-better-than-the-european-commission-does/>; Antitrust: Commission fines Google €1.49 billion for abusive practices in online advertising, European Commission, Mar. 20, 2019, http://europa.eu/rapid/press-release_IP-19-1770_en.htm

The theories of harm in the pending investigations of Amazon demonstrate some of the same confused antitrust theories that cropped up in the EU *Google Shopping* case. Platforms like Amazon and Google are criticized for allegedly discriminating against certain platform users who are also competitors or potential competitors of one or more of the platform's services (or, in some cases, the platform itself).

Commissioner Margarethe Vestager's probe into Amazon came to light in September, and centers on whether Amazon is illegally using its dominant position vis-à-vis third party merchants on its platforms in order to obtain data that it then uses either to promote its own direct sales, or else to develop competing products under its private label brands.⁷ More recently, Austria⁸ and Germany⁹ have launched separate investigations of Amazon rooted in much the same concerns as those of the European Commission.

The Austrian investigation will examine "whether Amazon abused its dominant position against retailers, that are active on the Amazon market place."¹⁰ According to Andreas Mundt, president of the German competition authority, "Amazon functions as a kind of 'gatekeeper' [for sellers' access] to customers. Its double role as the largest retailer and largest marketplace has the potential to hinder other sellers on its platform."¹¹ The German investigation also focuses on whether the terms of the contractual relationships that third-party sellers enter into with Amazon are unfair because these sellers are "dependent" on it.¹²

⁷ Isobel Asher Hamilton, *The EU is now going after Amazon after slapping Google and Apple with giant fines*, BUSINESS INSIDER, Sep. 19, 2018, <https://www.businessinsider.com/amazon-investigated-by-eu-commissioner-margrethe-vestager-2018-9>

⁸ Bundeswettbewerbsbehörde [BWB] [Federal Competition Authority], *Austrian Federal Competition Authority initiates investigation proceedings against Amazon*, Feb. 14, 2019, <https://www.bwb.gv.at/en/news/detail/news/austrian-federal-competition-authority-initiates-investigation-proceedings-against-amazon/> (Austria).

⁹ Emma Thomasson & Matthias Inverardi, *Amazon's treatment of sellers comes under scrutiny in Germany*, REUTERS, Nov. 29, 2018, <https://www.reuters.com/article/us-amazon-com-germany/german-antitrust-watchdog-launches-probe-into-amazon-idUSKCN1NY10H>.

¹⁰ BWB, *supra* note 10.

¹¹ Bundeskartellamt [FCO] [Federal Cartel Office], *Bundeskartellamt initiates abuse proceeding against Amazon*, Nov. 29, 2018, https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Pressemitteilungen/2018/29_11_2018_Verfahrenseinleitung_Amazon.pdf?__blob=publicationFile&v=2 (Ger.).

¹² *Id.*

Claims of competitive harm arising from this so-called vertical discrimination or bias are light on both theory and empirics. One of the fundamental, erroneous assumptions upon which they are built is the alleged “essentiality” of the underlying platform or input. But these cases are more often based on stories of firms that, unfortunately, *chose* to build their businesses to rely on a specific platform. In other words, their own decisions – from which they substantially benefited – made their investments highly “asset specific” and thus vulnerable to otherwise avoidable risks.¹³ When a platform on which these businesses rely makes a disruptive move, the third parties cry foul, even though the platform was not – nor should have been – under any obligation to preserve the status quo on behalf of third parties.

Essential or not, that is the question

All three investigations are effectively (if not all explicitly) premised on the assertion that Amazon has an obligation to run its platform on terms that facilitate the existing business models of particular sellers. The fundamental basis for this claim is a version of an “essential facilities” theory – the claim that Amazon is essential to these companies’ ability to do business. Indeed, the Bundeskartellamt is up front that this is a primary part of its theory:

A criterion for the relevance of this conduct under competition law is that Amazon holds a dominant position or that the sellers are dependent on Amazon.¹⁴

Under US law a case based on an essential facilities theory would be virtually unwinnable. But EU law on essential facilities is somewhat broader than in the US. According to the Commission’s guidance document on the application of Article 82 TFEU to dominant undertakings,

[t]he concept of refusal to supply covers a broad range of practices, [including] a refusal to grant access to an essential facility or a network.

¹³ For a discussion of a similar set of problems in the context of the EU’s Google Shopping, see GEOFFREY A. MANNE, *THE REASON FOUNDEM FOUNDERED*, INTERNATIONAL CENTER FOR LAW & ECONOMICS (2018), available at <https://laweconcenter.org/wp-content/uploads/2018/05/manne-the-real-reason-foundem-founded-2018-05-02-1.pdf>.

¹⁴ FCO, *supra* note 11, ¶ 4.

“constructive refusal’ is sufficient [for violating Article 82]. Constructive refusal could... involve the imposition of unreasonable conditions in return for the supply.¹⁵

There are good reasons that the US has tightly circumscribed the scope of permissible claims invoking the essential facilities doctrine. Such “duty to deal” claims are “at or near the outer boundary”¹⁶ of US antitrust law, and

as a general matter, the Sherman Act “does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”¹⁷

And there are good reasons why the EU and its member states should be similarly skeptical.

Characterizing one firm as essential to the operation of other firms is a tricky business because it could subvert the very incentives that encourage the production of valuable new enterprises:

Firms may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers. Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.¹⁸

It also poses a significant risk of erroneous decision-making:

Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited.¹⁹

The key difficulty is that alleged “essentiality” actually falls on a spectrum. On one end is something like a true monopoly utility that is *actually* essential to all firms that

¹⁵ Communication from the Commission: Guidance on the Commission’s Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, at 78-79, O.J. C 45, (February 24, 2009).

¹⁶ *Verizon Comm. Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 409 (2004) [*Trinko*].

¹⁷ *United States v. Colgate & Co.*, 250 U. S. 300, 307 (1919).

¹⁸ *Trinko*, 540 U.S. at 407-08.

¹⁹ *Id.* at 408.

use its service as a necessary input into their only viable mode of operation; on the other is a firm that offers *highly convenient* services that make it much *easier* for firms to operate, and, without which, they would face higher costs or be required to alter their preferred mode of operation. In the first case, one can imagine something like a water company that, by law, controls access to all the commercially available water in a given area. Arguably, firms that require water as part of their production processes could regard the services of the water company as essential.

On the other side of the spectrum are firms, like Google or Amazon, that are uniquely good at offering – and dramatically lowering the cost of – certain services (like distribution and marketing). In some cases it could be more expensive, or significantly less effective, to use a firm other than Amazon or Google for services similar to what they provide (although not in *all* cases: see, e.g., the retail apparel market in the EU, where Amazon struggles to attract third-party sellers²⁰); in other cases certain firms simply couldn't replicate the services if they operated independently or with a different sort of intermediary, at least not without changing the way they have chosen to arrange their businesses.

It is this second sense of claimed “essentiality” that underlies the EU investigations. However, it is not accurate to characterize such highly efficient and effective firms as truly “essential.” Instead, companies that *choose* to take advantage of the benefits such platforms offer, and to tailor their business models around them, suffer from an asset specificity problem:

A content provider that makes itself dependent upon another company for distribution (or vice versa, of course) takes a significant risk. Although it may benefit from greater access to users, it places itself at the mercy of the other – or at least faces great difficulty (and great cost) adapting to unanticipated, crucial changes in distribution over which it has no control.

Of course, the risk may be a calculated one: Firms occupy specialized positions in supply chains throughout the economy, and they make risky, asset-specific investments all the time. In most circumstances, firms use contracts to allocate both risk and responsibility in a way that makes the relationship viable. When it is too costly or too difficult to manage

²⁰ Ecommerce News Europe, *Why Amazon struggles in Europe*, ECOMMERCE NEWS, May 4, 2018. <https://ecommercenews.eu/why-amazon-struggles-in-europe/>.

risk by contract, firms may vertically integrate (thus aligning their incentives) or simply go their separate ways.²¹

An essential facilities doctrine applied in cases such as the pending Amazon investigations would effectively insulate “edge” firms from the typical obligation to adjust to certain costs imposed by a platform, and would prohibit the platform from adapting when doing so would impose these costs on edge firms.

Third-party sellers that rely upon Amazon without a contingency plan are engaging in a calculated risk that, as business owners, they would typically be expected to be capable of managing.²² The investigations by European authorities are based on the notion that antitrust law might require Amazon to remove that risk by prohibiting it from undertaking certain conduct that might raise costs for its third-party sellers.

The distribution channel is not the market

One reason the EU investigations are so jarring is that EU law *appears* to recognize the problem with deeming tech platforms as essential facilities. If we apply Commission guidance to Amazon’s marketplace, for example, asset specific investments by third-party merchants would seem insufficient to justify an abuse of dominance finding:

Competition is a dynamic process and an assessment of the competitive constraints on an undertaking cannot be based solely on the existing market situation. The potential impact of expansion by actual competitors or entry by potential competitors, including the threat of such expansion or entry, is also relevant.²³

The current Amazon investigations are premised on the assumption that third-party merchants can’t, or shouldn’t have to, maintain their businesses using a different mode of distribution if access to Amazon’s platform becomes too costly or too difficult. Thus, the implication of these investigations is that enforcement officials either

²¹ Manne, *supra* note 13, at 6-7.

²² And recent research backs up the idea that these firms *can* intelligently execute integration with Amazon that reduces the likelihood of displacement from the platform. See Feng Zhu & Qihong Liu, *Competing with complementors: An empirical look at Amazon.com*, (Harv. Bus. Sch. Tech. & Operations Mgt. Unit, Working Paper No. 15-044, 2018).

²³ EUROPEAN COMMISSION, GUIDANCE ON THE COMMISSION'S ENFORCEMENT PRIORITIES IN APPLYING ARTICLE 82 OF THE EC TREATY TO ABUSIVE EXCLUSIONARY CONDUCT BY DOMINANT UNDERTAKINGS, 2009/C 45/02, [https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52009XC0224\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52009XC0224(01)&from=EN).

1) discount the plentiful competition, both potential and actual, for merchants to access particular markets, both online and offline; or 2) believe that merchants shouldn't be required to bear the risk that their preferred business practices might be disrupted.

Arguably, in other words, the Commission and its allies will consider actual and potential competition, *unless* doing so entails the merchants changing their business model and bearing different risks – even if they aren't *greater* risks – or incurring additional costs – even if they aren't sufficient to foreclose the merchants from maintaining minimum viable scale. If they were to adopt such a position, the competition authorities will have effectively decided that the *distribution mechanism* of Amazon's Internet platform defines the boundaries of the relevant market.

But such a conclusion would be alarming. A claim based on some flavor of Amazon-as-essential-facility should be untenable given today's market realities because Amazon is, in fact, just one *mode of distribution among many*. Commerce on the Internet is still just commerce. If Amazon imposes undesirable conditions on third-party merchants that use its platform to reach consumers, those merchants have access to a plethora of other distribution and marketing channels for their goods. Among other things, a minimally savvy firm can build its own online presence, sell through Amazon's online retail platform competitors, market (and/or sell) through Facebook or Google, or concentrate its sales and marketing offline. The only thing preventing a merchant from operating a viable business using these mechanisms is the transaction costs it would incur adjusting to a different mode of doing business.

Further, by seemingly grouping all third-party merchants – with their widely varied goods, services, brand recognition, marketing savvy, etc. – and their consumers into a single undifferentiated mass, the competition authorities compound their error. It's true that Amazon accounts for an important share of online commerce in the EU, and that selling or marketing online could be more difficult if that share of commerce were effectively closed to a merchant. But Amazon still accounts for only 22%²⁴ of EU online commerce, and most businesses don't need access to *all* (or even a quarter of) potential online shoppers. Moreover, Amazon doesn't actually "own" its share of online shoppers; it merely wins them in the end because of the attractiveness of its platform – including, of course, the number and identity of the merchants that choose to sell through Amazon.

²⁴ Ecommerce News Europe *supra* note 20.

If merchants were to sell their products elsewhere, some portion of Amazon’s shoppers would decamp in order to continue to purchase from them; certainly *all* of Amazon’s current shoppers *could* decamp to do so. And for shoppers indifferent to particular retailers, presumably there exists a wide range of platform and offline shopping options – outlets offering various combinations of price, location, features, user interface, customer service, loyalty programs, etc. – that would be as attractive to them as Amazon.

Theoretically, all individuals who shop online are available to any firm smart enough to figure out how to attract them. By contrast, it defies reality to imagine that easy access to the particular pool of shoppers aggregated together on Amazon *today* is either fixed or *necessary* for a firm to operate.

Refusing to learn the real lesson of *Microsoft*

Conceptualizing Amazon’s marketplace as an essential facility in these terms would, moreover, commit the same logical fallacy²⁵ that the US *Microsoft* decision committed, but on a much larger scale. In *Microsoft*, the DC Circuit condemned Microsoft’s conduct in part by describing Microsoft as having constructed an impenetrable moat with an “applications barrier to entry”:

the “applications barrier to entry”... stems from two characteristics of the software market: (1) most consumers prefer operating systems for which a large number of applications have already been written; and (2) most developers prefer to write for operating systems that already have a substantial consumer base... This “chicken-and-egg” situation ensures that applications will continue to be written for the already dominant Windows, which in turn ensures that consumers will continue to prefer it over other operating systems.²⁶

This familiar description of the power of network effects completely misses an important reality in the dynamics underlying the PC software market, however. Microsoft was surely the 800 pound gorilla in the operating system market circa 1998, but it got there only by investing in the creation of an ecosystem – with massive positive externalities for all future competitors – capable of sustainably finding,

²⁵ See DIRK AUER, GEOFFREY MANNE, AURELIEN PORTUESE, & THIBAUT SCHREPEL, ICLE RESPONSE TO THE EUROPEAN COMMISSION’S PUBLIC CONSULTATION ON “SHAPING COMPETITION POLICY IN THE ERA OF DIGITIZATION, 9-10 (2018), available at <https://laweconcenter.org/wp-content/uploads/2018/10/ICLE-EU-Comments.pdf>.

²⁶ U.S. v. Microsoft Corp., 253 F.3d 34, 55 (D.C. Cir. 2001).

attracting, educating, and networking a huge number of people to *become* developers in the first place.

Before the ascendancy of Windows, the pool of developers for general computing applications was considerably smaller. Just by virtue of the opportunities Microsoft created, but also as a result of enormous conscious effort and investment, Microsoft was responsible for dramatically expanding and focusing the pipeline of human capital required to sustain the entire industry. By taking that reality as given the court erroneously ignored both a much higher barrier to entry that new firms would never face (and that *Microsoft alone* had faced), as well as a massive entry-enabling benefit that new firms enjoyed because of Microsoft's ascendancy: a highly talented pipeline of developers who could write code for new platforms and applications.

With Amazon this error is repeated. Not only is there a huge number of competing distribution channels for third-party merchants to use (unlike the relatively smaller number of competitors that Microsoft faced in 1998 (e.g. Apple, Linux, various UNIX flavors, etc.)), but Amazon's creation and maintenance of its online marketplace *creates* a viable competitor to the more traditional distribution methods, and its preeminence online exerts competitive discipline²⁷ on these other channels. Similarly, Amazon has had to sink enormous resources into establishing the reputability and competitiveness of its platform and brand. But this, too, has created enormous positive externalities. Amazon's reputation has inured to the benefit of merchants that would likely otherwise languish in brand obscurity and suffer from consumers' online shopping security fears. This has enabled new competitors to enter into a market, instead, where consumers are familiar with their mode of distribution and in which they are not skeptical of the viability of online commerce.

To blindly stumble into a claim that Amazon is abusing its dominance with an essential facilities argument is to ignore these realities, and, worse, to threaten to disrupt the incentives for Amazon and firms like it not only to maintain their platforms, but to innovate into unfamiliar business models in which they face the same initial barriers.

Conclusion

At root these EU investigations are probing the "fairness" of the terms under which Amazon provides access to its platform to third-party retailers. But these are,

²⁷ Tae Kim, *New Fed chairman says Amazon helped keep inflation low*, CNBC, Mar. 1, 2018, <https://www.cnbc.com/2018/03/01/new-fed-chairman-says-amazon-helped-keep-inflation-low.html>.

presumably, relatively sophisticated parties (or at least should be if they expect to be able to run a business). Their decisions to rely – in some cases exclusively – on Amazon to distribute and market their goods are presumably taken with full knowledge of the tradeoff: gaining the enormous benefits of Amazon’s platform in exchange for giving up some control. Stepping in under the guise of antitrust to re-write those agreements to impose a “fairer” allocation of risks and benefits threatens to undermine the very benefits that Amazon can offer.

Commerce is nothing new and offline distribution channels and retail outlets – which compete perfectly capably with online – are well developed. Granting retailers access to Amazon’s platform on artificially favorable terms is no more justifiable than granting them access to a supermarket end cap, or a particular unit at a shopping mall. There is, in other words, no business or economic justification for granting retailers in the time-tested and massive retail market an entitlement to use a particular mode of marketing and distribution just because they find it more convenient.