

19 December 2017

Background information on the Facebook proceeding

1. What is an abuse of dominance proceeding?

Antitrust enforcement is largely based on three tools. One is the prosecution of cartel agreements which are sanctioned with high fines and in some countries even with prison sentences. The second tool is merger control which examines whether a merger project will result in an impediment of competition. The third tool is the control of abusive practices which examines whether a company is abusing its market power. Not every company that is "big" or economically significant is also a "dominant undertaking" within the meaning of antitrust law. Dominant companies are subject to stricter obligations than companies that are active in a competitive environment. Among other things, they may not discriminate against or exploit their customers or suppliers, or demand excessive prices or unfair contract terms.

The Bundeskartellamt frequently conducts its abuse of dominance proceedings in the form of an administrative proceeding rather than a fine proceeding. Administrative proceedings are more appropriate for complex cases that raise difficult legal and economic questions, and for pilot proceedings to clarify the interpretation of the law in a (new) case constellation. The main objective of such proceedings is not to impose a fine but to re-establish pro-competitive conditions as fast as possible. The Bundeskartellamt may, however, very well decide to initiate a fine proceeding in the case of recurrent abusive behaviour or in cases with a high potential for significant harm.

2. Facebook is a US American company. Why does the Bundeskartellamt have competence to investigate in this case?

Irrespective of where a company has its seat, German antitrust law applies in all cases where the company's actions lead to a competition restraint that also has effects in Germany. Besides, Facebook has a German subsidiary.

The Bundeskartellamt does, however, liaise with the European Commission and other competition authorities on the matter on account of the cross-border dimension of the case.

3. Data protection and competition law: why is this a case for a competition authority?

Social networks are data-driven products. Where access to the personal data of users is essential for the market position of a company, the question of how that company handles the personal data of

its users is no longer only relevant for data protection authorities. It becomes a relevant question for the competition authorities, too.

The competition authority is responsible for monitoring the market activities of dominant companies. In the digital economy, the collection and processing of data is an entrepreneurial activity that has great relevance for the competitive performance of a company. The legislator has acknowledged this relevance and in § 18(3a) of the German Competition Act made access to personal data a criterion for market power, especially in the case of online platforms and networks. Monitoring the data processing activities of dominant companies is therefore an essential task of the competition authority which cannot be fulfilled by a data protection authority. In its assessment of whether the company's terms and conditions on data processing are unfair, the competition authority does, however, take account of the legal principles of data protection laws. For this purpose, the Bundeskartellamt works closely with data protection authorities.

4. Why should users be protected if they themselves post every detail of their lives on the social network?

The Bundeskartellamt is presently examining whether Facebook imposes unfair conditions on its users by making them choose between accepting "the whole Facebook package", including an extensive disclosure of personal data, or not using Facebook at all.

The Bundeskartellamt differentiates between user data that are generated through the use of Facebook ("on Facebook") and user data obtained from third party sources ("off Facebook").

The current proceeding examines the terms and conditions Facebook is enforcing with regard to data from third party sources. These are on the one hand data generated by the use of services owned by Facebook, such as WhatsApp or Instagram, and on the other data generated by the use of third party websites and apps. If a third-party website has embedded Facebook products such as the 'like' button or a 'Facebook login' option or analytical services such as 'Facebook Analytics', data will be transmitted to Facebook via APIs the moment the user calls up that third party's website for the first time. These data can be merged with data from the user's Facebook account, even if the user has blocked web tracking in his browser or device settings. In the authority's preliminary assessment, Facebook's terms and conditions in this regard are neither justified under data protection principles nor are they appropriate under competition law standards.

With the current proceeding the Bundeskartellamt is *not* examining the use of data generated by the use of Facebook's social network itself. Whether Facebook's use of such data violates data protection rules and is possibly also an abusive practice has so far explicitly not been the subject of the Bundeskartellamt's investigations.

The Bundeskartellamt is aware of the fact that a social network needs the activity of its users and an efficient data-based product design to prosper. On principle, competition concerns do not arise where, as part of a business model which is based on a company offering a product or service for free and monetising this through targeted advertising, data that are generated through the use of the product or service are used for advertising activities. Users have to expect a certain processing of their data if they use such a free service. *Within the network* they can considerably influence the

extent to which their data are being collected by paying attention to the way they use the network and the content they post.

5. Does Facebook have a dominant market position?

The Bundeskartellamt's preliminary findings are that Facebook has a dominant market position in the German market for social networks. Facebook has around 30 million users per month in Germany of which 23 million use Facebook on a daily basis.

Several smaller German operators of social networks as well as providers such as Google+ also belong to this market. On account of direct network effects, the substitutability of their products with Facebook is, however, limited, despite the fundamental comparability of the products. From the users' perspective, decisive criteria for the choice of a social network are its size and the possibility to find the persons they want to be in contact with on it (so-called "identity-based network effects"). Professional networks such as LinkedIn and Xing, as well as messaging services such as WhatsApp and Snapchat or other social media such as YouTube or Twitter are not part of the relevant product market. Even though these services are in parts competitive substitutes for Facebook, from the users' perspective they serve a complementary need.

The relevant geographical market is national. According to the Bundeskartellamt's investigations, German users predominantly use social networks to stay in touch with friends and acquaintances within Germany.

One sign of Facebook's dominance are its high market shares. This dominant position on the market is further enhanced by the identity-based direct network effects mentioned above. There are high barriers to entry. On account of the network effects, users are practically "locked in" and find it extremely difficult to switch to one of Facebook's competitors. The market entry of new competitors is further impeded by indirect network effects. In the case of advertising-financed services (which can also be referred to as "audience providing platforms"), the advertising side profits from a large private user base (positive indirect network effects). A competitor has to have reached a critical number of private users to successfully enter the market with an ad-financed product. Without such a critical number the product will not be sufficiently attractive for the advertising side. Direct network effects make it, however, difficult to reach such a critical number of users. In the Facebook case, the direct network effects lead to economies of scale which, in turn, lead to cost savings which give Facebook a far greater scope for strategic decisions than its competitors have. A parallel use of social networks ("multi-homing"), which could have a deconcentration effect, could not be found by the Bundeskartellamt. Facebook has a quasi-monopoly with more than 90 per cent of user-based market shares.

Facebook has superior access to the personal data of its users and other competition-relevant data. Because social networks are data-driven products, access to such data is an essential factor for competition in the market. The data are relevant for both, the product design and the possibility to monetise the service. If other companies lack access to comparable data resources, this can be an additional barrier to market entry.

6. In what way could Facebook have committed an "abuse of market power"? Based on which rules?

If a dominant company makes the use of its service conditional upon the user granting the company extensive permission to use his or her personal data, this can be taken up by the competition authority as a case of "exploitative business terms". The use of exploitative business terms is a type of exploitative abuse under German competition law. With the provision on exploitative abuses the law aims to protect the opposite market side from being exploited by a dominant company. Such exploitation can take the form of excessive prices (price abuse) or unfair business terms (exploitative business terms).

According to the case-law of the German Federal Court of Justice, civil law principles can also be applied to determine whether business terms are exploitative. On principle, any legal principle that aims to protect a contract party in an imbalanced negotiation position can be applied for this purpose. Often, such principles stem from the legislation on unfair contract terms or the German Basic Law. Following the Federal Court of Justice's approach, the Bundeskartellamt also applies data protection principles in its assessment of Facebook's terms and conditions. In this regard, data protection law has the same objective as competition law, which is to protect individuals from having their personal data exploited by the opposite market side. Data protection legislation seeks to ensure that users can decide freely and without coercion on how their personal data are used.

7. Where is the harm for users and for competition?

Facebook offers its service for free. Its users therefore do not suffer a direct financial loss from the fact that Facebook uses exploitative business terms. The damage for the users lies in a loss of control: they are no longer able to control how their personal data are used. Facebook's users are oblivious as to which data from which sources are being merged to develop a detailed profile of them and their online activities. On account of the merging of the data, individual data gain a significance the user cannot foresee. Because of Facebook's market power users have no option to avoid the merging of their data, either. Facebook's merging of the data thus also constitutes a violation of the users' constitutionally protected right to informational self-determination.

From Facebook's perspective, the data are of great economic value. Based on its dominant position, Facebook can use them to optimise its offer and tie more users to its network. With the merging of the data the "identity-based network effects" and, consequently, the "locking-in" of users increase, to the detriment of other providers of social networks. In addition, with the help of the user profiles generated, Facebook is able to improve its targeted advertising activities. As a consequence, Facebook is becoming more and more indispensable for advertising customers. This is also reflected in the rapidly increasing turnover Facebook has been able to generate in the past years. There is also potential for competitive harm on the side of the advertising customers who are faced with a dominant supplier of advertising space.

8. What happens now?

Facebook now has the opportunity to comment on the Bundeskartellamt's preliminary assessment notice and provide justifications for its conduct or offer possible solutions. The proceeding is thus entering into a second phase of negotiations with Facebook.

Possible outcomes of the proceeding are the termination of the case, the offer of commitments by the company or a prohibition by the competition authority. A decision on the case is not expected before early summer 2018.

9. In more detail: on which principles bases the Bundeskartellamt its antitrust assessment?

In the current proceeding the Bundeskartellamt closely examines the relation between the competition law provisions under § 19 GWB and the harmonised European data protection principles which are mainly enforced by data protection authorities. When assessing a big data business model with regard to its compatibility with antitrust law, it seems indispensable to apply the European data protection rules and their underlying principle of ensuring a protection of constitutional rights for an assessment of whether the data processing terms of this business model are admissible. To this purpose, the Bundeskartellamt cooperates closely with the data protection authorities.

The application of data protection principles for the competition law assessment in the current case is backed by case-law of the German Federal Court of Justice on § 19(1) GWB. This concerns in particular two decisions by the Federal Court of Justice in which the Court ruled that the general clause of § 19(1) GWB can also be used to establish that a company is using exploitative business terms. The relevant decisions are the rulings in the „VBL *Gegenwert II*“ case and the „*Pechstein*“ case.

According to the ruling in the *VBL-Gegenwert* case, exploitative business terms cannot only be established on the basis of § 19(2) no. 2 GWB and the comparative market concept applied therein, but can also be established on the basis of the general clause of Section 19(1) GWB. This is the case where the business terms are a manifestation of market dominance or superior market power and would be deemed inadmissible business terms under the principles of §§ 307 ff. of the German Civil Code. In the *Pechstein* case the Court left open whether the business terms used were exploitative under § 19(1) or (2) no. 2 GWB, but demanded an extensive balancing of interests which also took account of constitutionally protected rights. Accordingly, to protect constitutional rights, § 19 GWB must be applied in cases where one contractual party is so powerful that it is practically able to dictate the terms of the contract and the contractual autonomy of the other party is abolished. If, the Court held, in such a case a dominant company disposed of constitutional rights of its contractual partners, the law had to intervene to uphold the protection of such rights. Relevant legal provisions in this regard were, according to the Court, the general clauses under civil law, one of which is § 19 GWB. The Court held that these clauses should be applied with a view to balancing the conflicting positions of the contractual parties in such a way that the constitutional rights of all parties were, as far as possible, maintained.

Based on these principles, the Bundeskartellamt is examining whether Facebook's data processing terms are admissible. In its assessment the Bundeskartellamt includes the principles of the harmonised European data protection rules, in particular the EU General Data Protection Regulation

(GDPR), which will enter into force in May 2018, but also the currently applicable 95/46 EC Data Protection Directive, which can be directly applied to cases under § 19(1) GWB.