iLINC Legal & Technology Briefs

Competition Law and the Start-Up Community – An Overview

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Competition law aims to govern efficient market participation by ensuring a level-playing-field. Although often linked to big corporations, this field of law may be of considerable importance to start-ups. On the one hand competition law can be used as a shield against anti-competitive behaviour of established market participants. On the other hand, start-ups themselves may be subject to competition law. The latter may for instance be the case when a start-up has created a new market, has a dominant position therein and abuses this position. This legal brief aims to guide start-ups towards a better understanding of the major concepts governing competition law, but it should by no means be regarded as an exhaustive source of information.

I. Competition Law

Within a free market, competition encourages undertakings to be innovative and to offer consumers goods and services at the most favourable terms. EU competition law aims to maintain free and fair competition. In order to do so, it seeks to achieve the creation of a level-playing field, i.e. every entity active within the market should play by the same set of rules.

Often regarded as a field of law exclusively relevant for big corporations, competition law actually concerns every undertaking, start-ups included. EU competition law is a vast and complex area of law. Its main components are: antitrust law; merger control rules; and state aid rules. Antitrust law is built upon two central rules: article 101 and 102 of the Treaty on the functioning of the EU (TFEU). These articles target two potentially anti-competitive types of market behaviour.

Article 101 TFEU – Anti-competitive agreements between undertakings

Article 101 (1) TFEU states that all **agreements between undertakings** and **concerted practices** which may affect trade between Member States and which have as their **object or effect the prevention, restriction or distortion of competition within the internal market** are prohibited. For instance, closing agreements with competitors or distributors on the following business aspects is deemed anti-competitive: the direct or indirect fixing of purchase or selling prices or any other trading conditions, the limitation or control of production, the sharing of markets or sources of supply, the application of dissimilar conditions to equivalent transactions of competitors…

According to article 101 (2) TFEU, any agreement or decision prohibited by article 101 (1) TFEU shall be automatically void.

Article 101 (3) declares that certain agreements with an anti-competitive intent or effect may nonetheless be allowed when they contribute to a better production or distribution of goods, or to technical or economic progress. Consumers should, however, get a fair share of the resulting benefits (such as cheaper prices resulting from increased distribution efficiency). Also, the agreements should not restrict competition more than necessary to achieve those benefits, nor should they enable the undertakings to eliminate competition entirely in certain market areas.

Of course, article 101 TFEU should not be read as prohibiting start-ups from closing any agreement at all. Competition law only targets those agreements and concerted practices that have an anti-competitive effect!

Art. 102 TFEU – Abuse of dominant position

This provision targets the **anti-competitive use of market power**.

Article 102 states that any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of the internal market shall be prohibited when this behaviour affects trade between Member States.

The European Commission will first investigate whether or not an undertaking should be considered dominant or not. Crucial in their assessment is the definition of the relevant market in which the undertaking operates. A dominant position can only exist on a particular market. When defining dominance in the relevant market, the following elements are taken into consideration:

- The product market: all products and services which the consumer considers to be a substitute for each other due to their characteristics, prices and intended use.
- The geographic market: the area in which the conditions of competition for a given product are homogenous.

Market shares are often used as an indicator of the importance of an undertaking in a given market. For instance, if a company has a market share of less than 40%, that company is unlikely to be dominant.

Dominance in itself does not infringe competition rules, but the *abuse* of that dominance does, i.e. if an undertaking uses its market power to distort competition within the relevant market. Article 102 gives some examples as to which behaviour is considered abusive.

- Imposing unfair purchase or selling prices or trading conditions
- Limiting the production, markets or technical developments to the prejudice of consumers

- Applying dissimilar conditions to equivalent transactions, thereby place competitors at a disadvantage
- Making contracts subject to the acceptance of supplementary obligations that have no connection with the actual subject of the contracts.

Although some might think that start-ups are unlikely to be in a **dominant position**, jurisprudence shows that this may not necessarily be the case. Start-ups may create new markets by introducing new/disruptive technologies or new services. As a result, start-ups may hold an instantaneous dominant position. Therefore, start-ups, specifically those within recently established, innovative markets, should be aware of the rules governing the market, competition law in particular.

Nevertheless, due to rapid advancements in the tech sector, it may be difficult for a start-up to both retain a dominant position and abuse it.

Sanctions

Depending on the kind of anti-competitive practices set up by companies, competition law could lead to various sanctions, such as:

- Fines
- Injunctions
- Behavioural or structural commitments
- Nullity of agreements
- Criminal charges

In light of these potential sanctions, it is necessary for start-ups to have a good understanding of competition law. For instance, concluding arrangements, contracting or entering into agreements with fellow entrepreneurs is not without any danger, as this may be qualified as a concerted practice covered by Art 101 TFEU.

II. Competition Law and Enforcement

Competition authorities are responsible for the enforcement of competition law (public enforcement). At the European level, the European Commission acts as the competition authority. At national level, each EU Member State has its own National Competition Authority. Beside, national courts may also enforce competition law (private enforcement).

Whereas the European Commission only applies European competition rules, national competition authorities and courts can enforce both national and European law:

- National competition law rules only apply to agreements, decisions or practices which do not affect trade between EU Member States.
- EU competition law applies to agreements, decisions or practices which affect trade between EU Member State.

For start-ups developing activities in countries outside Europe, foreign competition law may apply as well.

The European Commission has been granted a number of investigative powers to ensure the application of competition rules, such as the inspection at business and non-business premises (including unannounced inspections, called "dawn raids"). The Commission may also impose fines for the violation of competition rules.

III. Competition Law as a Strategy

Competition law could also be used as a shield. **Digital start-ups may encounter difficulties when they wish to enter a market dominated by tech giants.** Digital start-ups often wish to deploy activities within areas in which well established players operate. For instance, start-ups may develop VoIP services that are in competition with traditional telecom operators. Similarly, new social media platforms might compete with platform giants such as Twitter and Facebook.

If start-ups are under the impression that their market entry is prevented/blocked by the anti-competitive behaviour of those undertakings, they could alert competition authorities about these practices.

Some national competition authorities have provided a complaint form on their website. The European Commission has a specific online complaint form for breaches of the state aid provisions.

Forcing changes in behaviour

Competition law can be used by start-ups in order to force an incumbent, i.e. the long-established market player, to change (anti-competitive) terms of contract, to sanction non-cooperative behaviour or to erase market-entry barriers.

Illegal state aid

Articles 107, 108 and 109 TFEU prohibit governments to grant certain types of aid to companies. State aid is generally defined as an advantage granted on a selective basis to undertakings by national public authorities. If an undertaking receives such government support this may put them at a competitive advantage compared with their rivals. Consequently, governments are prohibited from providing state aid, unless this would be justified by reasons of general economic interest.

IV. High Tech Markets, Network Effects & Lock-in

Due to rapid advancements in the technology sectors, high-tech markets constantly raise new questions for competition law. Although this may result in uncertainty with regards to the application of competition law, in some instances start-ups may benefit from these developments.

Competition authorities often consider that high-tech markets are characterized by the presence of strong network effects and lock-in. The presence of a network effect entails that the value of a product or service will depend on the number of others using it. Take Facebook for instance: the more members Facebook has, the more valuable Facebook becomes for each individual user. Because Facebook has become the default social media platform, it offers the most valuable tool to connect with others. Consequently, individuals are less inclined to move to other social platforms, because these cannot guarantee the same degree of connectedness. It would also entail a considerable burden for consumers to move all the content they have once uploaded to their Facebook profile to another platform. This is the lock-in effect: once a service has reached a certain mass, and there is no smooth switching process, people stick to that service.

In these instances, competition authorities are more likely to consider the established companies to have great market power or even dominance. According to this view, start-ups face a high barrier when entering these markets, and competent authorities will be more inclined to help them to move forward. Of course, undertakings cannot be blamed for enjoying network effects. Nevertheless, if these undertakings were to abuse their market power, for instance, by blocking a technology that might facilitate a smooth switching process, competition authorities could step in.

Case Example: Microsoft

In 2004, the European Commission found that Microsoft had infringed EU competition law. Microsoft had abused its near monopoly by leveraging its market position for PC operating systems to markets for work group server operating systems and media players. Microsoft deliberately restricted the interoperability between Windows PCs and third-party group servers. Additionally, Microsoft tied its Windows Media Player with its Windows operating system. These actions allowed Microsoft to obtain a dominant position in the area of work group servers, risking the elimination of all competition in that market. Tying windows media player to the windows operating system significantly weakened competition on the media plater market. The Commission imposed several remedies on Microsoft. Next to the payment of an enormous fine (561 million euros), Microsoft had to

Patent Assertion Entities (PAEs)[11]

Also known as "Patent Trolls" or "Non-Practicing Entities" (NPEs), PAEs typically do not make or sell any goods or services. They are firms which acquire patents to enforce them or to obtain licensing agreement from operating companies (OCs – firms that practice patents). PAEs are essentially a US phenomenon fairly concentrated in the IT sector. Nonetheless, concerns are rising that they will soon appear in the EU market, notably due to the up-coming "Unitary Patent Package".

Strategy: PAEs rely on the threat of patent litigation to obtain settlement or licensing agreements from OCs already using a technology. Usually, PAEs go after large OCs in the software industry. However, SMEs and start-ups are not immune. In fact, a US study showed that PAEs attack start-ups in more than half of the cases.
Typically, PAEs send demand letters to small businesses and start-ups claiming patent infringement on one or more patents and request the payment of licensing fees. PAEs litigation is particularly challenging and imposes a cost on OCs through litigation, which shift resources away from productive activities like R&D. In the US, victims of such nuisance suits have the tendency to settle rather than to litigate, as settlements and licensing agreements are generally cheaper.

Competition law concerns: PAEs are implementing many anti-competitive practices that could be challenged under competition law. According to the US Federal Trade Commission, they "can distort competition in technology markets, raise prices and decrease incentives to innovate".
A particular concern is the practice of "privateering". Under this strategy, an OC transfers patents that may be implemented in a competitor's products to a PAE. The PAE then initiates a lawsuit against the competitors of the original OC for infringing on the patent, or reaches out for a licensing agreement. This allows OCs to win a tactical advantage in the marketplace that could not be gained with a direct attack. Traditionally, in order to avoid patent litigation, cross-licenses and exchange of knowledge is possible between two OCs holding patents – this is the so-called "mutually assured destruction". However, the situation is fairly different with PAEs. They are not interested in a cross-licensing agreement but try to obtain from their victims licensing royalties, litigation settlements, or damage awards. In this set of circumstances, PAEs use patents as a weapon to e.g. raise rivals' costs for the original OC or evade FRAND and other licensing commitments.
Such arrangements can harm not only rivals, but also competition, consumers, and innovation. Therefore, competition law has an important role to play in reducing the harm associated with PAEs.

ensure interoperability and had to offer pc manufacturers a version of its Windows client operating system without windows media player.

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ILINC is the European Network of Law Incubators. Its main objective is to facilitate the provision of free legal support to start-ups while, at the same time, offering postgraduate law students the opportunity to engage in professional practice in the fast-moving and highly exciting world of technology start-ups.

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