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*Price Restrictions in  
Multi-sided  
Platforms: Practices  
and Responses*

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**I**n connecting buyers to sellers, some two-sided platforms require that sellers offer their lowest prices through the platform, disallowing lower prices for direct sales or sales through competing platforms. In this article, we explore the various contexts where such restrictions have arisen, then consider effects on competition, entry, and efficiency. Where there are plausible mitigating factors, such as efficiencies from platforms' price restrictions, we explore those rationales and compare them to the harms. We identify a set of responses for competition policy, look at experiences to date, and suggest some future attempts to improve the functioning of these markets.

### I. INTRODUCTION

In classic models of multi-sided platforms,<sup>2</sup> users rely on platforms to find transaction counterparts. In some contexts this is a natural modeling approach, as it captures transactions that could not have occurred without the platform. But if buyers and sellers can deal directly (perhaps thanks to the internet and other modern information technology), they may prefer to circumvent a platform, avoid its fees, and split the savings.

Against this backdrop, intermediaries have found ways to ensure that users prefer to buy through their platforms. In the most laudable cases, an intermediary offers genuine benefits for purchases through a platform. For example, if a buyer and seller do business within the eBay marketplace, they enjoy guarantees, dispute resolution assistance, and the ability to rate each other (which reinforces incentives for good behavior). Take a transaction off eBay and all of these disappear, which makes eBay's fee more palatable. Similar benefits keep guests and hosts on the Airbnb booking service. For passengers needing pickups from transportation services Uber and Lyft, circumventing the platform becomes infeasible due to time-sensitive requirements and unpredictable transaction counterparts.

Few would oppose intermediaries that offer genuine benefits to keep buyers and sellers on a platform. But other intermediaries invoke controversial strategies to obtain additional transactions. Consider the American Express "no steering" rules currently challenged by the Department of Justice.<sup>3</sup> Since Amex fees are understood to be roughly 0.5 percent more than competitors,<sup>4</sup> merchants have every incentive to push buyers towards other payment cards or even cash. But American Express contracts prohibit merchants from encouraging consumers to pay with less expensive cards, providing incentives for consumers to use less expensive cards, or even informing customers of the costs of accepting various cards.<sup>5</sup>

Though merchants may dislike them, Amex fees are critical to Amex's strategy for attracting consumers: With larger payments from merchants, Amex can offer consumers larger benefits such as additional rebates. Notably, consumers are largely shielded from the direct cost of the payment mechanism they choose. Of

available payment methods, Amex carries the highest fees to most merchants, but it also provides the highest benefits to consumers. Savvy consumers choose accordingly.

A similar structure permeates platforms, marketplaces, and other intermediaries that let sellers set prices. From travel booking to online marketplaces and myriad others, consumers often have a choice of distribution channel. Usually, prices are equal no matter the mechanism chosen, but some offer greater benefits than others. Sophisticated consumers systematically choose the channel with the most benefits—even if, as is often the case, the channel provides those benefits by charging higher fees to sellers.

Markets with this structure raise challenging questions for competition policy. Rather than driving prices down, competition among platforms often drives benefits up, then asks sellers to pay the resulting costs. While improvements in information technology often make it cheaper to provide a platform's service, sellers see little of the savings. More efficient competitors typically struggle to gain market share as the benefits of their offerings are concealed from consumers who see no savings.

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In our working paper *Price Coherence and Excessive Intermediation*,<sup>6</sup> we examine the mechanisms at issue in these markets and identify a theory of harm. Our analysis indicates that platforms will indeed want to restrict sellers from charging more for intermediated transactions. That restriction causes inflated retail prices, excessive adoption of platform services, over-investment in benefits to buyers, and a reduction in consumer surplus and sometimes welfare. This paper draws out the competition policy lessons from such price restrictions in multi-sided platforms.

We proceed as follows. After an introduction to affected markets, we explore the types of restrictions at issue, then consider effects on competition, entry, and efficiency. Where there are plausible mitigating factors, such as efficiencies from platforms' price restrictions, we explore those rationales and compare them to the harms. We identify a set of responses for competition policy, look at experiences to date, and suggest some future attempts to improve the functioning of these markets.

## II. AFFECTED MARKETS

### A. *The Key Effects as Seen in Credit Cards*

Payment card networks are well-known and in some ways epitomize the impact of platforms' price restrictions. In most transactions, consumers face the same price when paying through a payment card with high seller fees (such as a credit card with significant rewards), a card with low seller fees (such as a PIN-based debit card), or cash. Sophisticated consumers sensibly choose the first in light of its benefits. Consumers may recognize that

cash and PIN-based debit cards are often cheaper for merchants. But the savings flow entirely to merchants, so consumers have no reason to direct their spending to these channels.

The resulting incentives cause overuse of premium payment cards. Consider a card that provides a consumer with one frequent flier point per dollar spent. Based on prevailing flight costs and redemption options, a consumer might reasonably value this benefit at \$0.01 per point, or \$1 for 100 points earned on a \$100 purchase. If the consumer faced a 2 percent higher price to pay with such a card—presenting the consumer with the approximate cost the merchant incurs to accept that card—the consumer would obviously decline, as it would be unattractive to pay \$2 in fees to obtain \$1 in benefit. But with prices predictably equal whether a consumer chooses cash or credit, the consumer instead compares the \$1 in benefit with \$0 of cost to the consumer.

This market structure can reduce consumer welfare and total surplus. Consumers incur costs to sign up for and use cards they would not otherwise want. Card networks incur costs to offer benefits beyond the efficient level. Sellers end up raising their retail prices to cover fees to card networks.

## 1. Blocking Lower-Cost Alternatives

One might imagine a competing payment system that charges lower fees to merchants to get more merchants on board. Beginning in 2007, several “decoupled debit” issuers proposed to collect funds from customers by automated clearinghouse (“ACH”) withdrawals, charging merchants much lower fees than credit cards, often as little as 0.5 percent to process transactions. But consumers had little incentive to shift to decoupled debit. With just 0.5 percent from merchants, these cards could not match the rebates and benefits provided by typical credit cards.

Despite the failure of decoupled debit, others persist in this general approach. A consortium of retailers, including Best Buy and Walmart, in 2012 announced the Merchant Customer Exchange (MCX) a lower-cost payment mechanism intended to supplant credit cards. Recognizing that consumers would compare MCX benefits with other payment methods, MCX touted all manner of benefits including merchant-specific promotions and integration with merchants’ existing loyalty programs. Nonetheless, lower payments from merchants to MCX imply lower rebates from MCX to consumers (compared to credit card cashback and points). It remains unclear whether occasional merchant-specific promotions can match comprehensive credit card benefits. Greater coordination among merchants could help MCX, but the consortium model raises predictable competition concerns that necessarily limit such coordination. Notably, despite its announcement and publicity in 2012, MCX has failed to begin public operations. We suspect that this reflects not only technical difficulties but also uncertainty about the merits of the underlying offer.

ONE MIGHT IMAGINE A COMPETING PAYMENT SYSTEM THAT CHARGES LOWER FEES TO MERCHANTS TO GET MORE MERCHANTS ON BOARD.

A similar challenge faces Bitcoin, a cryptographic payment service that (among other uses) could let consumers send funds to merchants with low transaction costs. For merchants considering accepting Bitcoin, lower transaction processing costs are a key selling point. But if the posted price is the same whether a consumer pays by credit card or by Bitcoin, why would a consumer ever choose Bitcoin? With equal prices, paying by credit card is always cheaper for consumers thanks to points and rebates.

### ***B. Parallel Experiences in Airline Distribution***

Less familiar to most readers, global distribution systems (“GDSs”) connect airlines to travel agents and online travel agents. GDSs effectively require that participating airlines offer “full content”—all their fares, including their lowest fares. An airline might prefer to sell its cheapest tickets only on its own site to avoid GDS charges. But GDSs charge particularly high fees to airlines that participate only in part.

Thanks to GDSs, a consumer can visit any travel agent and be reasonably confident that the price will match the airline’s own website or call center. (This equality excludes special fees for telephone service.)

Despite sharp drops in IT and communication costs, GDS fees have increased over time. In 1995, an airline paid a GDS approximately \$3 per flight segment, on average.<sup>7</sup> By 2002, this had increased to \$4.25.<sup>8</sup> If an airline withheld its cheapest fares from a GDS, it paid \$4.38 per segment as of 2002,<sup>9</sup> but \$7.31 as of 2010.<sup>10</sup>

When airlines pay GDSs, most of the fees flow through to travel agents. These payments allow online travel agents to offer service at no additional charge to consumers and defray some costs for retail travel agents. But the resulting costs weigh heavily on airlines. Indeed, GDS expenses exceeded airline profits for approximately two-thirds of the last ten years for the three largest U.S. airlines. (Authors’ calculations based on financial statements and estimated GDS costs.)

The resulting market structure deters disintermediation of GDSs. New entrants have devised “Direct Connect” alternatives that link airlines more closely to travel agents, allowing them to circumvent GDS intermediaries. But travel agents hesitate to make the change because moving to Direct Connect means foregoing a GDS payment. In principle airlines could pay travel agents to move to Direct Connect, but such payments negate the savings they intend to achieve from Direct Connect. The obvious strategy is to make the airline’s cheapest fares available only through Direct Connect, so that a travel agent has to switch in order to provide customers with the lowest possible prices. But GDS rules require full content and hence prohibit this approach.

THE RESULTING MARKET STRUCTURE  
DETERS DISINTERMEDIATION OF GDSS.

### ***C. Online Marketplaces and the Risk of Showrooming***

Some online marketplaces, most notably Amazon Marketplace, prohibit sellers from offering lower prices on their own sites or any other online channel. In particular, Amazon’s General Pricing Rule requires that “the item

price and total price of an item [a seller] list[s] on Amazon.com [must be] at or below the item price and total price at which [the seller] offer[s] the item via any other online sales channel.” Some competition authorities have taken a dim view of this practice: In 2013, German and U.K. regulators questioned Amazon’s rule, and Amazon responded by removing this policy from its marketplace contracts in the European Union. However, the rule remains in effect elsewhere.

When marketplaces defend this restriction, they flag the risk of opportunistic “showrooming” by buyers. One might imagine a buyer finding a product and a suitable seller on an online marketplace. But if the buyer anticipates a lower price on the seller’s own website, the buyer may go there to finish the purchase and thereby deny the marketplace a fee for a transaction it facilitated. By prohibiting the seller from setting a direct price below the price it charges on the marketplace, the marketplace discourages such behavior.

But the cure could be worse than the disease. Suppose that, in addition to its search benefit of assisting buyers finding sellers, an online marketplace also offers other significant benefits commensurate with its fee—perhaps customer service, guarantees, or overall convenience. Such

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benefits reduce or eliminate the incentive for showrooming. (Consider the numerous benefits buyers and sellers receive when transacting at eBay or Airbnb.) Conversely, if a platform’s fees sharply exceed the non-search value it provides, showrooming by savvy customers imposes discipline to keep the platform’s prices low.

Notably, the costs of most online marketplaces are relatively modest. Compared to the huge costs of rent and staff at a bricks-and-mortar showroom, online marketplaces have it easy. Meanwhile, even where the risk of showrooming exists, some sellers find ways to protect themselves and their distributors. For example, most commercial insurers require consumers to submit name, address, and other details to obtain a price quote. If the insurer’s records indicate that a customer has already obtained a quote from one broker, the insurer’s systems will not provide a second quote to that customer for the same type of coverage.

Online marketplaces can similarly discourage showrooming. For example, both Amazon Marketplace and eBay provide no area on a seller profile page where a seller can link to an external store that bypasses the marketplace. Airbnb goes so far as to screen pre-booking communications between host and guest to remove email addresses and phone numbers, preventing the parties from doing business directly and avoiding Airbnb fees.

MEANWHILE A MARKETPLACE’S PROHIBITION ON LOWER PRICES ELSEWHERE SERVES TO SUPPRESS COMPETITION ON THE CRUCIAL DIMENSION OF PRICE.

Meanwhile a marketplace’s prohibition on lower prices elsewhere serves to suppress competition on the crucial dimension of price. A new entrant would be unlikely to match the selection at Amazon Marketplace, and Amazon’s renowned customer service would also defy easy copying.

But an entrant could easily undercut Amazon’s 15 percent fee. But for Amazon’s restriction, buyers would see the lower fee and post lower prices, attracting buyers to

this new marketplace and facilitating competition. By prohibiting sellers from offering lower prices elsewhere, through another marketplace or on their own sites, Amazon's price restriction on sellers prevents this form of competition.

#### ***D. Hotel Booking Services Restricting Discounts***

Leading hotel booking services similarly ban hotels from offering lower prices on their own websites or through competing booking services. European regulators<sup>11</sup> and U.S. private litigation<sup>12</sup> have alleged that these provisions prevent price competition, including preventing booking services from using a portion of their booking fee to fund discounts to consumers. For example, Germany's Bundeskartellamt alleged that the restrictions "virtually eliminat[ed] competition for lower room prices between ... hotel booking portals."

In ongoing U.S. litigation and in public discussions prior to the U.K. settlement, hotel booking services have vigorously defended the restriction at issue. They noted customer dissatisfaction resulting from comparison shopping, including time required to search and the perception of not getting "the best deal." They claimed that their approach would eliminate these problems and assure that every consumer always got the best price.

Hotel booking services may also face problems of showrooming; consumers search for hotels on a booking service, then book directly (if that is cheaper). With prices constrained to be equal across booking services, consumers have no incentive to engage in this behavior. On the other hand, that constraint also suppresses price competition among booking services.

### **III. THEORIES OF HARM AND EFFICIENCIES**

These markets reveal three ways that platforms' price restrictions on sellers can impede or distort competition. First, such provisions can limit or suppress direct sellers, e.g. by limiting or preventing disintermediation. Second, such provisions can limit or suppress competition between platforms on the basis of costs and efficiency. Finally, such provisions deter entry by more efficient platforms that do not or cannot impose price restrictions on sellers.

We model these harms in our working paper Price Coherence and Excessive Intermediation.<sup>13</sup> We show there that by restricting sellers from passing on the platform's fees, a platform can profitably raise demand for its service. The restriction operates by raising the relative price of direct purchases and purchases from platforms that do not impose the restriction. The restriction causes more buyers to use platforms that impose price restrictions. Moreover, with price restrictions in place, we show that these platforms over-invest in benefits to buyers funded through higher fees to sellers. The result is that low-cost platforms are driven out by high-cost platforms. Unlike resale price maintenance ("RPM"), these vertical restraints restrict

WE SHOW THERE THAT BY RESTRICTING SELLERS FROM PASSING ON THE PLATFORM'S FEES, A PLATFORM CAN PROFITABLY RAISE DEMAND FOR ITS SERVICE.

relative prices rather than absolute prices. Unlike Most Favored Nation Clauses (“MFNs”), these vertical restraints restrict prices to be the same across different channels rather than across different buyers.

Notably, these vertical restraints can harm competition even if a platform does not have a large market share. Having attracted some buyers, a platform has market power with respect to sellers wanting to access those buyers, even if the platform’s share of buyers is small. Indeed, we show that the harm arising from a platform’s price restrictions on sellers is magnified when there is intense platform competition.<sup>14</sup>

Our theory of harm also considers the multi-sided structure of these markets. A simplistic approach would argue that these restrictions create harm because the restrictions allow platforms to impose higher fees on sellers. In contrast, our theory of harm takes into account that some buyers want to use the platform anyway and benefit from the price restriction on sellers. Considering the effects on both sides, we find an unambiguous harm: greater benefits to buyers that purchase through platforms are offset by sellers setting higher prices, leaving inefficiencies from excessive usage of platforms and over-investment in buyer-side benefits. More generally, the restrictions prevent competition from favoring low-cost platforms or direct purchases that create greater total surplus.

GREATER BENEFITS TO BUYERS THAT PURCHASE THROUGH PLATFORMS ARE OFFSET BY SELLERS SETTING HIGHER PRICES, LEAVING INEFFICIENCIES FROM EXCESSIVE USAGE OF PLATFORMS AND OVER-INVESTMENT IN BUYER-SIDE BENEFITS

Despite the potential concerns raised by platforms’ price restrictions, there are possible efficiencies. Above, we noted a possible offsetting efficiency in that restrictions can discourage showrooming. Another possible efficiency, which we discuss below, is preventing excessive surcharging of platform services. In both contexts, it may be possible to achieve these benefits through less restrictive means, short of a complete ban on

sellers setting differential prices.

#### IV. POLICY RESPONSES

Seeing the problems of price restrictions on sellers, some competition regulators have tried to intervene. Early responses focused on payment card networks, though policy-makers subsequently broadened their efforts. In this section, we present three broad policy responses and their effectiveness to date.

##### A. *Granting Sellers More Flexibility in Pricing*

Regulatory interventions often begin by observing that platforms limit sellers’ pricing choices. A natural response is to loosen those restraints.

##### 1. **Allowing And Encouraging Surcharges For Transactions Through Platforms**



If a buyer chooses to buy through a platform, a seller may wish to pass the resulting cost through to the buyer in order to encourage the buyer to consider cheaper alternatives. Platforms' rules often ban such surcharges, but regulatory interventions can disallow any such bans. For example, the Netherlands and Sweden have long disallowed both no-surcharge rules and no-discrimination rules.

Though credit card surcharges are permitted in most jurisdictions (notable exceptions being ten U.S. states including California and New York), surcharges remain unusual in most places. In response, a few regulators have taken further steps to encourage sellers to revisit the prospect of surcharges. Most notably, Australia has allowed the use of surcharges for purchases paid by credit card. In 2003, Australia required card networks to inform merchants of their right to impose surcharges on credit card purchases. Many Australian merchants subsequently added surcharges.

While Australia's intervention may have discouraged excessive card usage, it created a new problem: Australian merchants charged credit card surcharges that were, on average, double what card acquirers charged merchants. Rather than passing costs through to consumers, the surcharges became a profit center—particularly troubling when consumers fail to anticipate the fees. In 2013, the Reserve Bank of Australia allowed card networks to limit merchant surcharges to the reasonable cost of card acceptance.<sup>15</sup> Disputes continued as to what costs could be considered in that calculation, and some consumers continued to complain that card surcharges were excessive.

Meanwhile, sellers in other sectors have also applied surcharges to discourage use of high-fee platforms. For example, in 2004 to 2006, Northwest Airlines and American Airlines imposed surcharges on tickets booked through high-fee GDSs, encouraging travel agents to switch to alternatives.<sup>16</sup> The recent Australian case *Flight Centre*<sup>17</sup> challenged a travel agent's efforts to block similar tactics: Flight Centre attempted to require airlines to offer the same prices through Flight Centre that they offered via their respective direct bookings, an approach that was found to block the distribution of cheaper airfares through other channels.

A FEW REGULATORS HAVE TAKEN FURTHER STEPS TO ENCOURAGE SELLERS TO REVISIT THE PROSPECT OF SURCHARGES

## 2. Allowing Sellers to Offer Discounts for Purchases That Bypass High-Fee Platforms

In some markets, discounting may help shift consumers away from platforms with high seller fees. At first glance, it may appear to be equivalent for sellers to discount when buyers come through favored platforms or purchase directly, versus for sellers to surcharge when buyers choose high-fee platforms. In fact the approaches differ.

Bourguignon et al.<sup>18</sup> shows the difference in the context of payments when consumers are imperfectly informed about the price differentials associated with using different payment instruments. In particular, a cash

discount is a windfall to consumers who are already in the shop and planning to pay with cash. In contrast, a surcharge enables a retailer to exploit a consumer who has made an investment to come to the store. Thus, sellers are more likely to use surcharges than discounts. Moreover, when there are several different platforms, adding a surcharge for the highest-cost channel has a different effect than discounting the lowest-cost channel

For these reasons, allowing only for discounts but not surcharges is likely to be a less effective policy approach to shift buyers away from alternatives with high seller fees. This may explain why card platforms have generally allowed cash discounts but such discounts have rarely been used.

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Several cases have considered whether a platform may prevent a seller from steering buyers to other lower-fee platforms. Recent U.S. Department of Justice (“DOJ”) settlements with Visa and MasterCard banned any contract provisions disallowing incentives for consumers to use favored payment mechanisms.<sup>19</sup> Similar DOJ litigation against American Express is ongoing.<sup>20</sup>

Discounts were also the core of a recent U.K. intervention as to hotel booking services. In 2014 commitments to the U.K. Office of Fair Trading (which, in mid-2014, was folded into the new Competition and Markets Authority, “CMA”), leading hotel booking services and hotel chains agreed to allow discounts for a customer who joins a membership program run by a hotel or booking service. The OFT explained:

The commitments mean that all [booking services] and hotels ... will be able to offer discounts off headline room-only rates so long as customers: 1) sign up to the membership scheme of an OTA or hotel to be able to view specific discounts, and 2) make one undiscounted booking with the OTA or hotel in question to be eligible for future discounts.<sup>21</sup>

On one view, the OFT intervention could help reduce the net cost of hotel booking: Through discounts to members of their respective membership programs, booking services may compete away some of their booking commissions, thereby reducing net prices to consumers. Of the consumers who stay in hotels, most do so frequently, so the single full-price booking may not cause much consumer harm.

That said, the OFT’s approach raises other complications. First, it remains unclear how membership discounts will fit with comparison shopping. Sophisticated travelers ordinarily impose discipline on booking services, in part by using tools like Kayak to compare prices across hotel booking services. But if discount prices are only available through membership programs, comparison shopping tools may be unable to tabulate the prices that consumers care most about.

Furthermore, the OFT’s approach appears to encourage consumers to use booking services, particularly when visiting a small hotel. A given consumer is unlikely to have previously stayed at a given small hotel and

joined that hotel’s membership program (especially for an independent facility not part of a chain). As a result, most consumers would not qualify for the membership discount permitted under the OFT’s settlement. In contrast, many consumers have already joined a booking service and made at least one reservation through such a service. Thus, when staying at a small hotel, a consumer is likely to be able to obtain a discount only through a booking service but not directly from the hotel. If more consumers choose to use booking services, this may increase small hotels’ dependence on booking services, which would ultimately yield higher booking fees and higher prices.

Experience in other markets yields a mixed prognosis for using discounts to pull consumers towards platforms with low seller fees. Consider buyers’ agents showing residential real estate. In the United States, buyers’ agents are typically paid 2.5 percent to 3 percent by sellers’ agents, a market structure that encourages every buyer to use an agent since there is no savings from a direct purchase. But *United States v. National Association of Realtors*<sup>22</sup> required sellers’ agents to “cooperate with”—and pay commission to—“limited service buyers’ agents” who provide significant refunds to buyers. As of 2014, sophisticated buyers can typically negotiate at least a one percent rebate from a buyer’s agent—a discount for consumers who forego some personal service in favor of online listings or other alternatives.

EXPERIENCE IN OTHER MARKETS YIELDS A MIXED PROGNOSIS FOR USING DISCOUNTS TO PULL CONSUMERS TOWARDS PLATFORMS WITH LOW SELLER FEES

The market for private motor insurance in the United Kingdom offers a means to facilitate discounts while addressing concerns about the side effects of such an intervention. In an investigation in 2014, the CMA noted contractual agreements between price comparison websites and insurance issuers that disallowed issuers from offering lower prices through competing comparison sites. Thus, if a new comparison site was prepared to reduce its advertising fee in order to offer lower prices to consumers, these agreements would prohibit the insurer from joining that new site—unless it was willing to lose marketing through existing sites. The CMA banned such provisions, rejecting contracts that require insurers to offer the same prices on all price comparison sites. That said, the CMA allowed continued restrictions prohibiting insurers from undercutting comparison sites through direct purchases, finding that direct purchases could undermine comparison sites (due to showrooming), and thereby reducing price competition.

#### ***A. Regulating Platforms’ Fees***

With buyers choosing platforms and sellers paying the cost, regulators often worry that fees exceed the efficient level. A natural response is to regulate fees directly, i.e. by setting a maximum fee that a platform may charge a seller.

Payment card interchange fees (the main determinant of the fees that merchants pay) have been regulated in Australia (debit and credit cards) and the United States (debit cards), among other jurisdictions. (European regulations are pending, for both debit and credit.) Regulations have required substantial reductions in interchange fees. For credit cards in Australia and Europe and for debit cards in the United

States, regulations cut interchange fees by approximately half. The lower fees anticipate eliminating rebates to consumers, ending consumers' incentives to use payment cards merely to obtain such benefits.

How should fees be regulated? One approach sets interchange fees based on the costs that issuing banks incur in handling card transactions. This approach has been adopted in Australia and the United States. However, it is not clear why issuers' costs should be recovered from merchants rather than from cardholders directly.

In contrast, the European Commission has chosen a different approach, seeking to make merchants indifferent between cards and cash so that buyers choose efficiently. Based on Rochet & Tirole,<sup>23</sup> this

ALTHOUGH THE APPLICATION OF THE MERCHANT INDIFFERENCE TEST REMAINS CONTROVERSIAL, IT POTENTIALLY PROVIDES A COHERENT WAY FORWARD FOR REGULATING SELLERS' FEES IN OTHER CONTEXTS.<sup>24</sup>

“Merchant Indifference Test” considers the fact that when consumers pay by card, merchants save the costs of handling cash. A positive fee to merchants can be efficient in such a setting if it allows the fee to cardholders to be reduced (or benefits increased) to reflect the merchant's benefit, so that cardholders internalize merchant benefits when deciding

whether to pay by card. Although the application of the Merchant Indifference Test remains controversial, it potentially provides a coherent way forward for regulating sellers' fees in other contexts.<sup>24</sup>

When some sellers and firms are vertically integrated, a parity provision can induce firms to avoid excessive fees. Consider airline GDS reservation systems in the United States in the 1990's. Non-vertically integrated airlines claimed that GDS fees were excessive. But the U.S. Department of Transportation (“DOT”) hesitated to set exact permissible fees or even ranges of fees, as such an intervention would run counter to its deregulatory mandate. Instead, 1993 rules required that any airline that owned a reservation system was required to make its flights available through competitors' reservation systems.<sup>25</sup>

Crucially, participation was required only in systems with “commercially reasonable” fees. The DOT declared fees to be presumed commercially reasonable if they did not exceed the amount a given airline pays to another reservation system, or if they did not exceed the amount a given airline's reservation system charges to other airlines. This rule discouraged reservation systems from raising their fees; an airline owning a reservation system anticipated that if it raised fees to other airlines, it would then have to pay increased fees to other reservation systems. (Note that these rules ceased to apply when airlines divested their reservation systems.)

## ***B. Requiring That Buyers, Not Sellers, Pay Platform Fees***

Alternatively, regulation may simply require that platforms not charge sellers anything—a price of zero. Unlike in a one-sided setting, a price cap of zero does not necessarily prevent the platform from recovering its costs, as the platform's costs could be covered by buyers. This could be efficient if sellers obtain no convenience or technological benefits from having a platform handle transactions. (The Merchant Indifference Test would call

for no fee to sellers in this case.)

On the other hand, if sellers obtain benefits when a platform handles transactions, a positive seller fee may be efficient if it reduces the fee to buyers and thereby encourages buyers to internalize sellers' benefits when deciding whether to use the platform. Thus, a price of zero may be too low. Additionally, requiring that buyers pay the platform for its transactions may be inefficient if this increases transaction costs, for example where the buyer does not transact directly with the platform. (Consider the prospect of Google charging users when they run searches or click ads, which would require that users pay Google and then separately pay the seller when they purchase.)

A price of zero can also offer salutary incentive effects. Consider a financial advisor evaluating investment options for a client. The advisor's recommendations typically combine both a client's best interests (in a suitable investment product) and the advisor's own interests (encouraging the client to choose an investment with a high referral fee or commission). To block the latter incentive so that advisors focus on client interests only, U.K. regulators have required that financial advisors' fees be separately itemized to customers, not paid by investment funds.<sup>26</sup> Some investment advisors sought workarounds, though regulators specifically admonished them not to do so. Meanwhile, surveys of investors and advisors indicate gaps in willingness to pay for advising service. Evaluating outcomes in the United Kingdom, Clare suggests that the restriction on payments to advisors may create a shortfall in available advisors.<sup>27</sup>

A PRICE OF ZERO CAN ALSO OFFER SALUTARY INCENTIVE EFFECTS.

Australia passed similar legislation in 2012.<sup>28</sup> These changes took effect in 2013, but 2014 amendments tentatively removed various requirements including relaxing the ban on conflicted remuneration.<sup>29</sup> As of November 2014, requirements in Australia remain in flux.

### ***C. Changing Market Structure to Facilitate Disintermediation***

In some markets, it is impossible to make purchases directly from a seller; these sellers direct all purchases through intermediaries. (This could be because sellers are unable to undercut their own distributors, and direct sales at equal prices would not attract many buyers.) A buyer who places little value on the intermediary's service is nonetheless forced to pay associated costs.

Regulation may address this concern by requiring sellers to offer a direct service and to require these be priced without the intermediaries' commissions. For example, in regulations to take effect in 2015, the Monetary Authority of Singapore will require that "basic" life insurance be offered through direct online sales, bypassing broker and advisors, with no allowance for the commissions ordinarily paid to those intermediaries.<sup>30</sup> Consumers seeking such insurance are encouraged to buy it online, and news articles tout the resulting savings.<sup>31</sup>

To date, such efforts have been limited. For example, the Singapore intervention covers only certain classes of “basic” life insurance. A consumer seeking other insurance or other financial services has no easy means to avoid paying a commission to a broker or advisor, even if the consumer seeks no assistance from the broker. Nor have other regulators widely pushed sellers to offer direct sales; some sellers have moved in this direction, often citing excessive costs in intermediation, but the decision is usually initiated by the firm rather than a regulator.

## V. LOOKING AHEAD

In addition to their broader effects on competition and prices, the restrictions at issue have distinctive distributional effects. Sophisticated users are typically the beneficiaries, including through their advantage in learning how to collect rebates and otherwise claim benefits from platforms. For example, credit card users enjoy the points and rebates that card issuers provide.

But Schuh et al.<sup>32</sup> notes the harm to non-users, estimating that each non-card-using household pays \$149 to card-using households. These funds distinctly flow from low-income households to high-income households, making the structure regressive. Similar benefits flow to sophisticated users in hotel booking services (“Expedia+ Rewards”), home-buying (savvy shoppers better positioned to negotiate a rebate from a buyer’s agent), and myriad other affected markets. Because sophisticated customers are more likely to have high incomes, these benefits tend to be regressive.

IN ADDITION TO THEIR BROADER EFFECTS ON COMPETITION AND PRICES, THE RESTRICTIONS AT ISSUE HAVE DISTINCTIVE DISTRIBUTIONAL EFFECTS.

A regulator seeking to intervene in such markets faces several challenges. First, affected markets at issue are distinctively complex. At best, they feature three parties, but sometimes more. (Sometimes multiple intermediaries sequentially facilitate a single transaction.) Meanwhile, in a static analysis holding prices fixed, platforms appear to provide benefits to buyers without offsetting price increases. Yet, in practice, prices are not fixed; to the contrary, industry-wide cost shocks are substantially passed through to consumers, and benefits must be funded.

Effective interventions require considering these dynamic effects and working creatively to find adjustments that offset such problems. In the context of payment cards, these efforts are well underway. But in other markets with similar restrictions causing similar problems, such scrutiny is limited or missing altogether.

Drawing on experience from payments, as well as the analysis in Edelman & Wright<sup>33</sup> and the competition concerns explored here, we think platforms’ price restrictions on sellers deserve a careful and critical look. ▲

- <sup>1</sup> Benjamin Edelman is Associate Professor of Business Administration at Harvard Business School; Julian Wright is Professor, Department of Economics, National University of Singapore.
- <sup>2</sup> Mark Armstrong, *Competition in Two-Sided Markets*, 37(3) RAND J. ECON. 37(3), 668-691 (2006); BERNARD CAILLAUD & BRUNO JULLIEN, *Chicken and Egg: Competition among Intermediation Service Providers*, 34(2) RAND J. ECON. 521-552 (2003); JEAN-CHARLES ROCHET & JEAN TIROLE, *Platform Competition in Two-Sided Markets*, 1(4) J. EUR. ECON. ASS'N, 990-1029 (2003); PAPER REPRINTED IN THIS ISSUE OF *Competition Policy International*.
- <sup>3</sup> United States of America, et al., v. American Express Co., et al. – Complaint, Case 1:10-cv-04496-NGG-RER, E.D.NY, 2010.
- <sup>4</sup> United States of America, et al., v. American Express Co., et al. – Plaintiffs' Post-Trial Memorandum, Document 606, Case 1:10-cv-04496-NGG-RER, E.D.NY, 2010.
- <sup>5</sup> *Id.*
- <sup>6</sup> Benjamin Edelman & Julian Wright, *Price Coherence and Excessive Intermediation*, HBS Working Paper No. 15-030 (October 2014), *available at* <http://www.benedelman.org/publications/pricecoherence-2014-10-21.pdf>.
- <sup>7</sup> Global Aviation Associates, Ltd., *An Analysis of Distribution Costs: Orbitz vs. Sabre-Based GDS Travel Agency*, (April 2003).
- <sup>8</sup> CRS Regulations, Final Rule, RIN 2105-AC65, January 7, 2004.
- <sup>9</sup> *Id.*
- <sup>10</sup> American Airlines, Inc., v. Sabre, Inc., et al. Trial Transcript, October 24, 2012, Trial Court Cause No. 067-249214-10, Tarrant County, Texas, 67th Judicial District.
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- <sup>12</sup> Turik, et al., v. Expedia, Inc., et al., Complaint, N.D.CA Case No. 12-4365-DMR, 2012.
- <sup>13</sup> *Supra* note 6
- <sup>14</sup> *Id.*
- <sup>15</sup> Reserve Bank of Australia, *A Variation to the Surcharging Standards: Final Reports and Regulation Impact Statement* (June 2012).
- <sup>16</sup> Jay Campbell, *Northwest Tackles GDS Costs*, THE BEAT (AUGUST 24, 2004); AMERICAN AIRLINES, *Source Premium Policy* (2006), *available at* [HTTP://WWW.AA.COM/II8N/AGENCY/AGENCY/SP\\_MASTER/SP.JSP](HTTP://WWW.AA.COM/II8N/AGENCY/AGENCY/SP_MASTER/SP.JSP).
- <sup>17</sup> Australian Competition and Consumer Commission v. Flight Centre Limited (No 2), QUD 177 of 2012.
- <sup>18</sup> Hélène Bourguignon, Renato Gomes, & Jean Tirole, *Card Surcharges and Cash Discounts: Simple Economics and Regulatory Lessons*, 10 (2) COMPETITION POL'Y INT'L (FALL, 2014)
- <sup>19</sup> United States of America, et al., v. American Express Co., et al. – Final Judgment as to Defendants MasterCard International Incorporated and Visa Inc., Document 143, Case 1:10-cv-04496-NGG-RER, E.D.NY, 2010.
- <sup>20</sup> *Supra* note 3.
- <sup>21</sup> OFT, *supra* note 11.

- <sup>22</sup> United States of America v. National Association of Realtors, Case No. 05C-5140, E.D.Ill., 2005.
- <sup>23</sup> Jean-Charles Rochet & Jean Tirole, *Must-take cards: merchant discounts and avoided costs*, 9(3) J. EUR. ECON. ASS'N, 462-495 (2011); SCOTT SCHUH, Oz Shy, & Joanna Stavins, *Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations*, Federal Reserve Bank of Boston Consumer Payments Research Center Public Policy Discussion Papers, No. 10-03 (August 2010).
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- <sup>25</sup> 14 CFR § 255.7, “System owner participation in each others’ systems,” 1993.
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- <sup>29</sup> Australian Corporations Amendment (Streamlining Future of Financial Advice) Bill, 2014.
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