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Cloud Computing: regulatory/anti-trust risks and solutions

16 June 2010

We drill into more detail on regulatory and anti-trust issues referring particularly to a speech earlier this month by EU Commissioner Kroes on interoperability. This paper is linked to three others: (a) *Cloud Computing the reality; government procurement; and regulation/anti-trust: Address at Communicasia Singapore* (b) *Public Sector procurement and cloud computing* and (c) *Cloud Computing for public sector lawyers*.

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Introduction

In our paper for Communicasia in Singapore on 14 June 2010 we overviewed regulatory and anti-trust issues. This paper deals with the detail.

While cloud computing offers the prospect of innovative and competition-enhancing solutions, there is a risk of ICT customers being locked into proprietary solutions – whether legacy or cloud computing.

For that and other reasons, some aspects of cloud computing could have anti-competitive effects. Should regulators do something about this, particularly as cloud computing is a relatively new type of service? (Well, it's been around for years one way or another, but it is going through a rapid phase of growth).

In our Communicasia paper we gave the example of FTC's investigation of Apple and its walled garden product, the iPhone. This may provide lessons for cloud computing.

Whether to act as to an innovative yet relatively short-lived service such as the iPhone (and therefore as to innovative services within the cloud computing umbrella), is neatly summed up in the 12 June edition of the Wall Street Journal:

> "The iPhone was just introduced three years ago, and all of a sudden (Apple is) being accused of being a monopolist? To me, it's absurd," said Gary Shapiro, president of the Consumer Electronics Association, in an interview. "They don't even have a dominant position in smart phones—that's Blackberry."

> However, some antitrust enforcers say that if they wait until a tech company has cornered a market it may be too late. The technology sector has powerful "network effects" that, some say grant outsize advantages to first movers and make it particularly difficult for competitors to break in.

A European view

A speech earlier this month by European Union Commissioner Kroes is illuminating on cloud computing regulatory and anti-trust issues, within its focus on interoperability. The 10 June speech is *How to get more interoperability in Europe*.[1]

The observations might apply in many other countries too.

Commissioner Kroes, who is responsible for the EU's Digital Agenda, has every reason to be interested in interoperability and anti-trust issues in ICT. In her last Commission role, she was the Commissioner responsible in relation to the EU anti-trust action against Microsoft over lack of interoperability. This was an anti-trust case that took many years and resulted in record fines.

Solving market problems by expensive and protracted litigation, such as the Microsoft and Intel cases, is by no means the entire solution notes Commissioner Kroes. But if ex post action is not enough, what ex ante steps can be taken, without adversely impacting the market?

She focuses on an ex ante approach to interoperability, which is also a key consideration for cloud computing. The ability of various cloud computing solutions to interoperate (among themselves and with legacy apps) will be a fundamental issue.

Commissioner Kroes promotes open standards (real open standards, not just ineffective ones). She considers that "choosing open standards is a very smart business decision", but outlines regulatory considerations as well.

What constitutes open standards, typically reflected in specifications, should, she says be based on an open, transparent and non-discriminatory process. The optimal approach differs according to circumstances. She notes:

> We don't want uniform rules everywhere: we want smart rules that are adapted to their respective fields. Standard-setting for software interoperability is not the same as setting a new standard for, say, digital television or mobile telephony. We should have the right rules in the right contexts.

For Europe, this calls for introduction of new internet-related standards rather than the legacy standards mandated in Europe.

Avoiding anti-competitive collusion in standard setting

Standard making among market players raises the risk of collusive behaviour in breach of anti-trust legislation (Article 101(1) in the case of the EU just as there are collusion provisions in other jurisdictions).[2] That is an issue internationally.

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[1] http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/300&format=HTML (accessed 24 June 2010).

[2] **Article 101** of the Treaty on the Functioning of the European Union reads:

> 1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of 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 common market, and in particular those which:
>
> > (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> > (b) limit or control production, markets, technical development, or investment;
> > (c) share markets or sources of supply;
> > (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> > (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
>
> 2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.
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> 3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
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> > - any agreement or category of agreements between undertakings, (cont)

EUROPEAN COMMISSION

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Draft

COMMUNICATION FROM THE COMMISSION

Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements

Commissioner Kroes notes the draft EU guidelines that have been released, which would clarify how anti-trust rules apply to horizontal agreements. She notes that the proposed guidelines would:

> …promote an efficient and competitive standard-setting process that is protected against misuse. The draft, which is currently available for public comment, relies on the well-established concepts of non-discrimination, transparency and availability and specifies minimum requirements that distinguish standard-setting from a cartel.

The discussion about standard making in the draft guidelines – to ensure pro- rather than anti-competitive outcomes – provides valuable guidance for other jurisdictions.

The problem with ex post action

In noting the limitations of ex post anti-trust litigation, the Commissioner says:

> I have some experience with reticent high-tech companies: I had to fight hard and for several years until Microsoft began to license missing interoperability information. Complex anti-trust investigations followed by court proceedings are perhaps not the only way to increase interoperability. The Commission should not need to run an epic antitrust case every time software lacks interoperability. Wouldn't it be nice to solve all such problems in one go?

Ex Ante options

Recognising the challenge in getting ex ante requirements right, the Commissioner suggests further options. For example, she says that, for specified IT products (i.e. not all IT products) suppliers should offer required information for licensing (to enable inter-operability). This requires real care as she notes:

> Whereas in ex-post investigations we have all sorts of case-specific evidence and economic analysis on which to base our decisions, we are forced to look at more general data and arguments when assessing the impact of ex-ante legislation. Just to be clear, while it is still early days, it is certainly possible that I will go for a legislative proposal. This could have a profound impact on the industry concerned so it is not a decision taken lightly.

Important to get it right

This illustrates just how hard it is to get this right. But Commissioner Kroes concludes it is important to do so:

> Of course interoperability and standards are important concepts across almost all parts of the Digital Agenda. For example, we want to achieve interoperability for cross-border eHealth applications and for smart energy meters. The benefits of these actions will not

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> - any decision or category of decisions by associations of undertakings,
> - any concerted practice or category of concerted practices,
>
> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
>
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

only be economic, they will also fundamentally shape our future quality of life.

Getting this right, in Europe and elsewhere, will be decidedly challenging, whether or not the optimal solutions are as outlined by the Commissioner.

Net Neutrality

We outline net neutrality in our articles *Mobile Services and Net Neutrality* and *Net Neutrality: The Plot Thickens Internationally*.

Net neutrality issues classically arise – so far – as between high volume content providers (and their ISPs) and predominantly the dominant Telco. Cloud computing, in a business context, is unlikely to generate the same high data volumes. But that doesn't mean that net neutrality concerns are irrelevant to cloud computing. For example, a need for high Quality of Service commitments may raise the relevant position of the Telcos and others. These issues will evolve over time.

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.
