

RESEARCH INDICATES LONG LASTING HARM AND BARRIERS TO COMPETITION FROM UNFAIR SOFTWARE LICENSING PRACTICES IN EUROPE

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The adoption of cloud services is fundamental to the digital transformation of business, government and societies everywhere. It is vital to the growth, resilience and development of the EU and its member nations that Europe creates not only consumers of cloud services, but providers. Since 2017 the size of the European cloud market has almost tripled in size, reaching nearly €6 billion by Q3 2020. However, the market remains nascent with compound annual growth of 15% predicted from now to 2026. To meet the self-declared aspirations of the Digital Decade, and to enable a green transformation of the economy, it is clear that Europe needs to ensure fair and competitive markets for cloud infrastructure in which services are allowed to flourish. The Digital Markets Act is key element in creating this favourable environment for growth.

UNFAIR SOFTWARE LICENCES ARE DAMAGING CLOUD COMPETITION

In a study conducted earlier this year, I identified a range of practices in markets adjacent to the cloud that, if left unchecked, could seriously damage the ability of the DMA to protect this nascent market from capture by a small number of players with predominance in the markets for important software applications. I was commissioned by CISPE, the association of cloud infrastructure service providers in Europe to examine the competitive impact of certain licensing practices its members had seen from some legacy software providers over the past several years. As cloud infrastructure vendors they felt these practices unfairly excluded them from fair competition, and from their customers they heard of inflated costs, unfair lock-in and forced restriction of choice. Together, these negative impacts deliver significant harm to innovation, growth and vibrancy of many European cloud service providers and the wider digital economy they support. Increased costs not only force out competing players but drive-up prices for consumers. My economic study sought to understand the extent, prevalence and potential impact of these unfair licensing practices across Europe.

DOMINANT LEGACY SOFTWARE FIRMS CAN BE GATEKEEPERS

The study provides insights into how the cloud market structure has changed over the last few years and highlights the powerful connection between dominant suppliers of legacy software and emerging market power in the cloud. For clarity, the term legacy software covers the range of productivity, communications, enterprise and database software on which most organisations rely to conduct business as usual. Traditionally it resided on individual computers, or within data centres owned and operated by the businesses themselves. The great promise of the cloud is the flexibility and reduced costs that come from shifting these on-premises capital costs to usage-based operational costs in the cloud. However, perhaps in an attempt to retain guaranteed income streams, some legacy software companies are seeking to leverage license agreements to ensure that customers remain within their cloud infrastructure ecosystems.

My findings, which are reinforced by the comments of many businesses I interviewed in the course of research, suggest that potentially anti-competitive practices of these legacy software providers may already be causing significant financial harm to European business software users, and could threaten the capture of the entire European cloud infrastructure market by just a handful of software providers which also offer their own cloud infrastructure.

NEW MARKET, SAME OLD ANTI-COMPETITIVE PRACTICES

Wrapped up in the dense legal language of software license agreements, over which most have no opportunity to negotiate, are the typical anti-competitive practices we've seen many times before. They include bundling and tying products to either exclude competing products by offering a 'free' alternative or offering lower prices if several products are purchased together. One respondent told us that 'unwinding' one of these bundles to purchase products individually led to cost increases of nearly 70%!

Interoperability can be limited, either with proprietary languages and technical specifications within licenses, or more subtly by 'optimising' products to work better on specific cloud infrastructures. Less subtle are some of the support clauses enforced by license agreements that either drastically raise costs or leave customers without technical support and updates if they choose to use an alternative provider.

Perhaps most concerning are the claims of after-the-fact license changes that some made to us. Prices that rise once contracts are signed, exclusionary clauses, aggressive audits and different calculation metrics all raise costs for those that seek to switch cloud infrastructure providers.

FEAR OF RETALIATION HIDES UNFAIR LICENSING

These could all be found to be anti-competitive practices, but business software users are forced to sign these license agreements because they have no alternatives and are terrified of retaliation from the mega corporations that enforce them. My research provides preliminary but important indications that could be taken by competition authorities to begin investigations into these actors. The presence of lock-in effects, high switching costs, barriers to entry and economies of scale with potential network effect all point to anti-competitive markets. My study documents them all as present and potentially threatening to the emerging cloud marketplace.

The Commission's Digital Market Act represents a golden opportunity to tackle these unfair software licensing practices and protect the contestability of cloud infrastructure to the benefit of all parties. The Parliament has tabled a number of amendments that seek to include ex ante obligations to prevent unfair software licenses to capture the cloud infrastructure market as they did with the market for software. With CISPE, I will be sending a copy of my findings to all MEPs and relevant Commission officers to aid in their deliberation on the final content of the DMA.

The time to act is now, and I urge all stakeholders to take the findings of this report seriously as they consider their next steps.