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Antitrust Investigations: Is Facebook Next?

Law360, New York (August 2, 2011) -- In the almost hyper-dynamic world of software, competitive positions can and do change within a matter of months. Just as the U.S. antitrust agencies' investigation of Google's search algorithm and practices is getting started, the Facebook platform reaches half a billion users worldwide. And now Facebook has been accused of anti-competitive conduct in a complaint filed with the U.S. Federal Trade Commission by the nonprofit group Consumer Watchdog.

Consumer Watchdog's complaint involves the market for social games, like Zynga's hugely popular Farmville, and the purchase of so-called "virtual goods" in those games, like tractors and chickens. Specifically, the complaint concerns recent revisions to terms regarding Facebook Credits, a virtual currency used to purchase virtual goods in the increasingly popular realms of social networks and social network gaming.

Consumer Watchdog alleges that Facebook's new rules, which went into effect July 1, 2011, (1) require developers to use Facebook Credits exclusively to sell their virtual goods, and (2) charge developers a 30-percent fee for each transaction. Under the previous rules, developers could sell virtual goods using methods other than Facebook Credits, such as credit cards or PayPal.

According to the complaint, the Facebook platform consists of more than 50 percent of the market for virtual goods, so much of the business related to that market — estimated at $2.1 billion in the U.S. for this year alone — will now be conducted using Facebook Credits. According to Consumer Watchdog, the revised terms are monopolistic, exorbitant and unfairly restrict how game developers charge for their virtual goods.

One difficulty in Consumer Watchdog's complaint is its claim that Facebook has monopolized "the market for virtual goods purchased in social games." Complaint ¶ 74. The complaint, however, does not allege that Facebook competes in that market. To the contrary, the complaint alleges how the "vast majority" of Facebook applications, including social games, are created by independent developers. Id. ¶ 14.

Nor does the complaint allege that Facebook has monopolized the market for payment for virtual goods, because there are a variety of payment methods with which to purchase Facebook Credits. Thus, the 30-percent fee is merely a price that Facebook charges social game developers for the use of Facebook's platform to sell virtual goods. Excepting very limited situations not present here, the antitrust laws allow even dominant firms to price their products as high they choose.

The Supreme Court has expressed this policy in strong terms:

"The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices — at least for a short period — is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anti-competitive conduct." Verizon Comm'cns Inc. v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398, 407 (2004).

The complaint also alleges that Facebook has worked out a five-year deal with the largest social game developer, Zynga Inc., that includes incentives for Zynga to use Facebook Credits. Consumer Watchdog argues that this deal amounts to a conspiracy between competitors because Zynga is the only developer "powerful enough to draw its followers away from Facebook." Complaint ¶ 88.

More plausible, however, is that Zynga's market strength enabled it to negotiate a discount that smaller game developers could not. Facebook would not be acting rationally if it were conspiring with Zynga to enable Zynga to dominate the social gaming market — for that would only serve to undermine Facebook's competitive position.

As the complaint alleges, Zynga, with its estimated 250 million social gamers, "is potentially the only social game developer powerful enough to draw its followers away from Facebook to a different social network" — or its own. Complaint ¶¶ 32, 88.[1]

Conclusion

One question raised by these recent allegations against Facebook and Zynga is the (relatively) age-old question of whether the antitrust laws can keep pace with the rapidly morphing competitive landscape in the software industry. In an industry where access to an installed base of users is the single most valuable and effective means of entering new markets and launching new products and services, competition can come from any source with such an installed base.

While the question of whether antitrust can keep pace has not definitively been answered, the antitrust laws and antitrust enforcers have been accounting for potential competition for decades. The trick will be enforcers' ability to perceive sources of potential competition, for which enforcers must be on constant lookout, and enforcers' careful analysis of the market and economic realities of each case.

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[1] Facebook's original revisions to its rules also included a more problematic prohibition on developers selling virtual goods outside the Facebook platform at lower prices, including on other social networking platforms such as Myspace. After the complaint was filed, however, Facebook amended its revised rules to omit that prohibition. Now, Facebook permits developers to offer lower prices for virtual goods for sale on other platforms, so long as the purchaser is not logged into Facebook at the time of purchase.