Docket No. FTC-2018-0088

IN THE
FEDERAL TRADE COMMISSION

Hearings on Competition and Consumer Protection in the 21st Century

COMMENT OF

WASHINGTON LEGAL FOUNDATION

ON

ACQUISITION OF NASCENT AND POTENTIAL COMPETITORS IN DIGITAL TECHNOLOGY MARKETS

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Washington Legal Foundation is a nonprofit, public-interest law firm and policy center that promotes free enterprise, limited government, and the rule of law. We are pleased to contribute to the Federal Trade Commission's *Hearings on Competition and Consumer Protection in the 21st Century*. Here we respond to FTC's request for comment on a question posed by Hearing #3 in the area of "Acquisitions of Nascent and Potential Competitors in Digital Technology Markets": "What is the appropriate antitrust framework to evaluate acquisitions of potential or nascent competitors in high-technology markets?"

An appropriate framework for those situations would rely upon the Commission's existing statutory tools and review methodologies to consider mergers and acquisitions involving potential and nascent competitors. In this comment, WLF will argue that when utilizing those existing tools, FTC's review must be forward-looking, especially when assessing acquisitions involving or competitive with new technologies.

The specific wording of § 7 of the Clayton Antitrust Act requires that merger review be forward-looking. That section contemplates a focus on whether the effect of a merger "may be substantially to lessen competition or tend to create a monopoly."[1] Under that standard, antitrust agencies must examine not only the structure and history of an industry, but also its "probable future," when assessing whether the effect of a proposed merger is substantially likely to lessen competition in any relevant market.[2]

A forward-looking approach is particularly important in markets that are changing rapidly in the face of growing competition from new technologies. The market at issue in the merger between AT&T and Time Warner, video programming and distribution, provides an excellent example. DOJ's failure to consider the probable future in which a merged entity would compete led to Judge Richard Leon's June 12, 2018 opinion that rejected the government's

[1] 15 U.S.C. § 18.

[2] *See United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); *see also United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990) ("Section 7 vests courts with the 'uncertain task' of 'making a prediction about the future.'"); *accord, United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, 191 (D.D.C. 2017)).

challenge.[3] As Judge Leon noted in the introduction to his opinion, the market for video programming and distribution "has been, and is, in the middle of a revolution where high-speed internet access has facilitated a 'veritable explosion' of new, innovative video content and advertising offerings over the past five years."[4]

Judge Leon recognized that because of these "tectonic changes," traditional video programmers and distributors now "fac[e] two stark realities: declining video subscriptions and flat-lining advertising revenues."[5] AT&T and Time Warner felt a merger was the only way to meet the growing competition they face for both viewers and advertisers from these newer, rapidly growing rivals.

The "tectonic changes" taking place in the market for video programming and distribution became the cornerstone of Judge Leon's opinion. While he accepted DOJ's definition of the relevant market as limited to traditional video programmers and distributors for purposes of evaluating the merger, Judge Leon said that he could not ignore the broader industry trends and could "not evaluate the Government's theories and predictions of harm . . . without factoring in the dramatic changes that are transforming how consumers view video content." [6]

The opinion framed the merger in light of trends reshaping the video programming and distribution market. Within the last decade, subscription video-on-demand services, such as Netflix and Hulu, have entered the market. In 2015, the year before Time Warner and AT&T announced the merger, more nontraditional, vertically-integrated video services, including Hulu Live, DISH's Sling, and Google's YouTube TV, as well as AT&T's own DirectTV Now, began providing competing services. Traditional providers—cable and satellite TV operators—have lost subscribers as customers "cut" or "shave" the cord. Advertisers have also shifted their focus from classic broadcast commercials toward digital ads.

In contrast to this dynamic market, the government's case was decidedly old-school. DOJ based its challenge largely on economic models that the court found did not adequately consider how the real world functioning of the market. For example, DOJ's expert economist used the "Nash bargaining model" to predict that the merger would likely lead to substantial price increases. But the expert had to admit during cross examination that the merged company would likely be unable to withhold its channels from competing distributors and make a profit given the growing competition it faced from online video streaming services, thus undercutting the central premise of his testimony.[7] This admission led Judge Leon to conclude that the

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[3] Memorandum Opinion, *United States v. AT&T Inc. et al.*, 17-cv-2511 (D.D.C. June 12, 2018).

[4] *Id.* at 2.

[5] *Id*.

[6] *Id*. at 62-63, 65.

[7] *Id*. at 97-98; *see also* 115-17.

economic model the expert used to conclude the merger would be anticompetitive—that under Nash bargaining, Time Warner's leverage in fee negotiations with distributers would increase—was not supported by the evidence in the record.[8]

DOJ's refusal to factor in the changes occurring in video programming and distribution when evaluating the likely effects of the AT&T/Time Warner merger on competition is emblematic of the Department's nearsightedness. In its challenges to mergers in the newspaper industry—which faces challenges similar to AT&T and Time Warner due to growing competition from newer technologies—DOJ has also ignored dramatic changes that influenced the merging parties' desire to combine their forces.

Almost every week brings stories of more layoffs in newsrooms, even in cities with growing populations like Denver and Salt Lake City, as newspapers continue to lose both readers and advertisers to newer digital media.[9] During the 21st century, newspapers have lost nearly half of their readership and three-quarters of their advertising revenues to these new competitors.[10] As a result, the number of newsroom employees has fallen by nearly half since 2006, and newspapers have cut back both the size of their papers and number of days they publish.[11]

Notwithstanding these "tectonic changes," DOJ treats newspapers as a separate relevant market for antitrust purposes and continues to challenge or threaten to challenge newspaper mergers in the handful of metropolitan areas that still have two daily newspapers, such as Minneapolis-St. Paul, Charleston, West Virginia, Salt Lake City, and, most recently, Orange County.[12] In each case, the predictable result has been further cutbacks in these papers'

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[8] *Id*. at 147.

[9] *See, e.g.*, Katherine Rosman and Jaclyn Peiser, *Denver Post Journalists Go to New York to Protest Their Owner*," N.Y. TIMES (May 8, 2018); Tony Semerad, *The Salt Lake Tribune Faces Layoffs, Cuts to Print Offerings*, SALT LAKE TRIB. (May 11, 2018).

[10] Gerry Smith, *Newspapers Gobble Up One Another So survive Digital Apocalypse*, CHICAGO TRIB. (Mar. 29, 2016) (reporting that "[a]dvertising revenue at U.S. newspapers has plunged to $12 billion [in 2016] from $50 billion in 2000" and "[p]rint circulation has dropped by half on average since 2005"). *But see* Pew Research Center, State of the News Media: Newspapers Fact Sheet (June 13, 2018), http://www.journalism.org/fact-sheet/newspapers/ (estimating that newspapers' advertising revenue has fallen by two-thirds, from $49.435 million in 2005 to $16.476 million in 2017, and estimating that weekday circulation has fallen by almost half, from 55,773,000 in 2000 to 30,948,419 in 2017).

[11] *See* Pew Research, *id*. (estimating that the total number of newsroom employees has fallen by nearly half since 2006; falling from 74,410 in 2006 to 39,210 in 2016); *see also* ASNE, 2015 Census (July 28, 2015) (reporting that the total number of employees at newspapers with circulations between 100,000 and 250,000 fell by 21.58% between 2013 and 2014).

[12] Final Judgment, *United States v. The McClatchey Co. and Knight-Ridder, Inc.*, 06-cv-01175 (D.D.C. Nov. 6, 2006) (requiring divestiture of the *St. Paul Pioneer Press*, which competed with the *Star Tribune*, in order to reduce concentration in the number of newspapers held in Minneapolis/St, Paul); Final Judgment, *United States v. Daily Gazette*, 2:07-cv-0329 (S.D. W.Va. July 19, 2010) (requiring continued publication of the *Charleston Daily Mail*, which competed with the *Charleston Gazette* in West Virginia); Dean Starkman, *A Newspaper Deal Threatens*

newsrooms, as were recently announced in Salt Lake, and even driving some award-winning newspapers into bankruptcy, as happened in Charleston.[13]

FTC has its own examples of an aversion to considering market trends and how mergers, and the failure to allow combinations, will affect future competition. In 2008, for example, FTC successfully challenged Whole Foods' proposed acquisition of a rival chain of premium organic food stores, Wild Oats.[14] The district court initially denied FTC's motion for a preliminary injunction, finding, among other things, that conventional supermarket chains, such as Safeway and Albertsons, were already repositioning to carry more high quality organic meats and produce and many of the same natural and organic brands of groceries as Whole Foods and Wild Oats.[15] The D.C. Circuit reversed. The court discounted the argument that larger conventional supermarket chains' repositioning toward more organics would constrain Whole Foods' pricing. Instead, it focused on the possibility that the merged store might be able to price-discriminate against the core customers for premium organic and natural groceries.[16]

History, of course, reflects the wisdom of the district court's perspective. Faced with growing competition from traditional supermarket chains, most of the Wild Oats stores Whole Foods was forced to divest have since closed and Whole Foods itself has suffered declining revenues and profits, which eventually forced it into the arms of Amazon.[17]

The lesson is that the agencies must pay more attention to the long-term trends affecting competitive conditions in the markets they examine. It makes no sense to challenge mergers in markets in which the incumbent firms face increased competition from new technologies that are fast eroding incumbent firms' revenues based on overly narrow market definitions that exclude these new competitors. Instead, the agencies should factor that growing competition into their analysis, even if a rigid application of the Horizontal Merger Guidelines might justify defining a

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Utah's Main Non-Mormon-Owned Daily, Critics Say, and the Justice Department is Looking into it," COLUMBIA JOURNALISM REV. (Apr. 25, 2015), https://archives.cjr.org/the_audit/a_newspaper_deal_threatens_uta.php (noting DOJ was investigating the joint operating agreement between the Salt Lake Tribune and the Deseret New); *United States v. Tribune Publishing Co.*, 2:16-cv-01822 (C.D. Cal. Mar. 17, 2016) (seeking to enjoin the acquisition of the Orange County *Register* and the Riverside County *Press-Enterprise* by the *Los Angeles Times*).

[13] *See* Rich Archer, *W.Va. Newspaper Hits Bankruptcy, Has Planned Buyer*," LAW360 (Feb. 1, 2018) (describing the *Charleston Gazette-Mail*).

[14] *Fed. Trade Comm'n v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007), *rev'd*, 548 F.3d 1028 (D.C. Cir. 2008).

[15] 502 F. Supp. 2d at 42-49.

[16] 548 F.3d at 1039-1040; *see also* 548 F.3d at 1048-1049 (Tatel, J., concurring).

[17] *See* Derek Thompson, *Why Amazon Bought Whole Foods*, THE ATLANTIC (June 16, 2017), https://www.theatlantic.com/business/archive/2017/06/why-amazon-bought-whole-foods/530652/.

narrow market boundary that excludes these newer competitors.[18] Doing so will expand the field of competitors to the benefit of consumer welfare.

Two former chief economists at FTC and DOJ, Howard Shelanski and Michael Katz, have written that FTC and DOJ both need to recognize that in industries undergoing rapid technological change, market boundaries are necessarily fuzzy and can often be quite permeable.[19] The agencies must therefore take into account growing competition from outside the traditional market boundaries in any forward-looking merger analysis.

As Judge Leon wrote in *United States v. AT&T Inc. et al.*:

> In assessing the Government's Section 7 case, the court must engage in a 'comprehensive inquiry into the future competitive conditions in a given market,' keeping in mind that 'the Clayton Act protects competition, rather than any particular competitor.' 'Only examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.' 'Hence, antitrust theory and speculation cannot trump facts'; the Government must make its case 'on the basis of the record evidence relating to the market and its probable future.'[20]

This is indeed the task for the government and the courts in assessing mergers, particularly in markets experiencing rapid technological change.

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[18] *See* U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Aug. 19, 2010), § 4.1.

[19] Michael L. Katz & Howard A. Shelanski, *Mergers and Innovation,* 74 ANTITRUST L.J. 1, 14 (2007).

[20] *AT&T*, 17-cv-2511, slip op. at 53.