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March 17, 2022

<u>Submitted via regulations.gov</u>

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Re: Request for Information on Merger Enforcement

Chairman Khan and Assistant Attorney General Kanter:

Washington Legal Foundation submits this comment about the Federal Trade Commission's and Department of Justice's merger guidelines. As explained below, the FTC's and DOJ's request for information pretends the Supreme Court has not decided a single antitrust case in the past forty-eight years. This is, of course, untrue. The Court has changed antitrust for the better during the past five decades. Refusing to acknowledge this reality will lead to merger guidelines that are not worth the paper they are printed on.

WLF is a nonprofit, public-interest law firm and policy center with supporters nationwide. It defends free enterprise, individual rights, limited government, and the rule of law. WLF often submits comments on merger issues. *See, e.g.*, WLF Comment, *In re Antitrust Standards for Pharmaceutical Mergers* (June 25, 2021); WLF Comment, *In re FTC Study Of Digital Technology Market Merger Review* (Nov. 19, 2018); WLF Comment, *In re Consent Agreement Regarding Alleged Anticompetitive Effects Of Perrigo's Acquisition of Paddock Laboratories,* (Aug. 25, 2011); WLF Comment, *In re Proposed Horizonal Merger Guidelines* (June 4, 2010).

WLF's Legal Studies Division also educates practitioners and the public about the FTC's and DOJ's continued disregard for federal antitrust laws. Over the past six months, it has hosted two webinars warning that the FTC and DOJ are preparing to act in a way contrary to federal law and court decisions interpreting those laws. *See Merger Guideline Revision: What Does Agencies' Proposal Portend for Consumers & Competition*, WLF Webinar (Feb. 9, 2022); *Navigating the Shifting, Chill Winds of Federal Merger Enforcement*, WLF Webinar (Nov. 16, 2021).

The request for information asks for answers to over 100 questions. Rather than file a comment that is hundreds of pages long and explains the many errors in the request for information, WLF focuses on three questions. It explains why the premises of the three questions are wrong and why the current merger guidelines correctly address all three areas. Finally, it explains the disastrous consequences that would follow if the FTC and DOJ continue down the path telegraphed in the request for information.

I. The FTC and DOJ Should Recognize That Rapid Innovation In Digital Markets Cautions Against Antitrust Enforcement.

The FTC and DOJ think that they can predict the evolution of digital markets. This is pure hubris that conflicts with reality and misunderstands how digital markets work. As in other markets, companies in digital markets maximize profits. History also shows that the FTC and DOJ have no clue how digital markets will change. What once looked like a monopolist who should be barred from merging with any competitor may file for bankruptcy only five years later. And a company no one heard of three years ago can go on to overtake the fourth most valuable company in the world in web traffic. In short, the FTC and DOJ should be very cautious when considering challenges to mergers in digital markets.

The FTC "has no qualms about going too far given [its] quest to stop what [it] sees as an endless stream of corporate abuse." Richard Epstein & Adam Mossoff, *FTC enforcement stifles biotech innovation*, N.Y. Daily News (Jan. 30, 2022), https://bit.ly/3ur0ZPK. It believes "that digitization affects the profit motive" as a company can "predatorily subsidize[] its business line expansion." Mark Jamison, *Applying Antitrust in Digital Markets: Foundations and Approaches*, 2020 B.C. Intell. Prop. & Tech. F. 1, 17 (2020).

This argument "is flawed in its premises and in its logic." Jamison, 2020 B.C. Intell. Prop. & Tech. F. at 17. First, the evidence supposedly supporting this argument shows why companies in digital markets prefer profits—just like companies in other markets. *Id.* at 18. As the FTC and DOJ do in the request for information, supporters of the absurd theory omit key language from a quote to support their position. *See id.* (Supporters ignore language from companies in the digital market that states "[m]arket leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.").

That is not the only flaw in the FTC's argument. The argument that companies act "predatorily in adding lines of business and building an ecommerce infrastructure to economically serve multiple lines is misplaced." Jamison, 2020 B.C. Intell. Prop. & Tech. F. at 18. The fact that combining two companies' businesses "is more economical than separate production processes is simply an example of economies of scope." *Id.* Again, this shows that there is no rationale for more stringent antitrust enforcement in digital markets than other markets.

Besides the theoretical flaws, history shows why more caution is needed for intervention in digital markets. In 2005, the FTC sued to stop Blockbuster's acquisition of Hollywood Entertainment. *See* Compl., *FTC v. Blockbuster, Inc.*, No. 05cv463 (D.D.C. Mar. 4, 2005). The FTC succeeded. Later that same month Blockbuster dropped its bid to buy Hollywood. Tom Zeller Jr., *Blockbuster Ends Bid for Rival*, N.Y. Times, Mar. 26, 2005, at C1. Blockbuster dropped its challenge because it did not want to expend the resources necessary to prove that acquiring Hollywood would not give it too much market power. What the FTC could not predict was that Netflix would soon upend the market for video rental services.

Less than two years after the FTC misjudged the market for video rental services, Netflix announced that people could subscribe and rent an unlimited number of movies through streaming. Miguel Helft, *Netflix to Deliver Movies to the PC*, N.Y. Times, Jan. 16, 2007, https://nyti.ms/3Jc36eb. So people no longer had to trek to the nearest Blockbuster to rent a movie during a snowstorm. Rather, they could relax in the comfort of their homes and have the movie streamed to their personal computer.

That was not the only benefit of Netflix's service. When someone went to Blockbuster, the video selection was limited. For popular movies, there was a decent chance that all the store's copies would already be in circulation. So people had to settle for their third or fourth choice movies. But with Netflix, the selection was much larger. There was no risk of the movie being out of stock. This was a massive advantage for Netflix in its movie-rental market fight.

So it shocked no one when, only five years after the FTC decided Blockbuster was so large that it could not acquire Hollywood, Blockbuster filed for bankruptcy. Pet., *In re Blockbuster Inc.*, 441 B.R. 239 (Bankr. S.D.N.Y. 2011) (No. 10-14997). Then a decade after Netflix began offering its streaming service, the final nail in Blockbuster's coffin was the court's order finalizing Blockbuster's liquidation. *In re Blockbuster, Inc.*, No. 10-14997 (Bankr. S.D.N.Y. June 29, 2017).

In 2005, it was unthinking that Blockbuster would file for bankruptcy in five years, much less that it would be dissolved twelve years later. Yet that is what happened. The reason was simple; it's impossible to predict what will happen in the digital market. If it were possible to envision Netflix's emergence, the FTC would not have sought to decrease competition by ensuring Blockbuster's demise. But that is what happened because the FTC is lousy at predicting future market share.

Around the same time, DOJ took a different approach to another merger. Sirius and XM, the only two providers of satellite radio, proposed a merger. Unsurprisingly, those who like less consumer welfare opposed the merger. *E.g.* J. Gregory Sidak, *Expert Declaration of J. Gregory Sidak Concerning the Competitive Consequences of the Proposed Merger of Sirius Satellite Radio, Inc. and XM Satellite Radio, Inc.* 2 (March 16, 2007), http://ssrn.com/abstract=977318. These opponents based their arguments on assumptions that mirror those underlying the current request for information.

Opponents, of course, were wrong. Rather than increasing prices and decreasing quality of service, which would be expected with a monopoly, prices fell sharply and the quality of service increased. All satellite radio consumers now get the full panoply of sports play-by-play channels—not half. And consumers can now listen to satellite radio for under $7 per month, including access to streaming. In other words, the doomsday scenario never materialized. Why?

The answer is simple: This digital market surprised many economists. Luckily for consumers, DOJ economists and lawyers did not fall for the ivory-tower analyses. DOJ realized that "product lines" in this digital market were just "emerging, and [were] rapidly changing," so "technological innovation, not price competition[would drive] inter-firm rivalry." *See* Thomas W. Hazlett, *Some Dynamics of High-Tech Merger Analysis in General and with Respect to XM-Sirius*, 4 J. Competition L. & Econ. 753, 764 (2008). DOJ also used a proper market for its analysis, recognizing that the relevant market was broader than just satellite radio. *See id.* at 764-65. In short, DOJ had a slow trigger finger when it came to this digital market. This hesitancy to challenge the merger led to the best results for everyone but the economists who had offered flawed analyses.

Of course, the pace of development in digital markets has only increased since then. In September 2017, TikTok launched outside China. The app soon began making headway in the United States. This year, more marketers plan to use TikTok to advertise goods than plan to use Twitter, Snapchat, or YouTube. Sarah Lebow, *Marketers increasingly turn to TikTok for influencer marketing* (Jan. 19, 2022), https://bit.ly/3ul8bNe. Again, a company that few in the United States even knew about in early 2018 is now outpacing well-established social media platforms for advertising revenue.

If there was any question about TikTok's rise, it's overtaking Google as the world's most popular domain should put those to rest. In 2020, Google was the top domain in the world while TikTok was number seven. Abrar Al-Heeti, *TikTok dethrones Google as this year's most popular domain* (Dec. 21, 2021), https://cnet.co/3AYaKGs. But this past year, TikTok zoomed up the rankings and overtook Google. *See id.*

It is extraordinary that a domain that offers very little in terms of user productivity has surpassed a company that offers consumers several services to increase productivity. It would have been impossible to guess that a site dedicated to odd dances and other short videos would become the most popular website. This again shows why the FTC and DOJ should think twice before trying to stop mergers in the digital market. The markets move too quickly for the FTC or DOJ to predict what will happen next.

II. The Use Of Advanced Statistical Modeling Makes It Easier To Identify Anticompetitive Mergers.

The FTC and DOJ suggest that the merger guidelines should place less weight on advanced statistical modeling because it makes it harder for them to show that a proposed merger will have anticompetitive effects. In other words, the FTC and DOJ are complaining that the best available evidence does not support their priors about mergers being bad for competition. But rather than discourage the use of econometrics, the FTC and DOJ should embrace it. This way, mergers with future procompetitive effects may be consummated while mergers with anticompetitive effects may be blocked.

"[S]imple observational evidence regarding changes in price levels over time" can be misleading when undertaking antitrust analysis. Phillip Johnson et al., *Statistical Significance and Statistical Error in Antitrust Analysis*, 81 Antitrust L.J. 641, 641 (2017). "This is because changes in economic conditions unrelated to the behavior at issue also may play a role in observed outcomes." *Id.* So econometrics plays a key role in helping to sort out mere correlation from causation. *See id.* A few examples of how econometrics is used in merger analysis shows why it is important.

As discussed in § III *infra*, all antitrust analysis must begin with market definition. To define the relevant market, the FTC and DOJ must identify and estimate relevant demand elasticities. "[T]here are many situations in which" simple economics is not able to calculate these elasticities. Daniel L. Rubinfeld, *Econometric Issues in Antitrust Analysis*, 166 J. of Institutional and Theoretical Economics 62, 63 (2010). But "[t]he great promise of econometric methods is that they permit a systematic synthesis of the quantitative evidence, weighing the most informative data the heaviest." *Id.* at 64. In other words, econometric analysis can separate the wheat from the chaff.

Mere theoretical work cannot replace this advanced econometric work. Particularly when defining markets in today's complicated economy, it is impossible to predict demand elasticities based on theory alone. Theory might be "missing" some important market reality that affects the demand elasticities. The data, however, can reveal that hidden reality. One example is Uber's surge pricing. Theory would suggest that a 20% change in price would have a larger effect than a 5.3% change in price. But the data showed otherwise. *See* Alison Griswold, *People are more likely to take Uber at 2.1x surge pricing than 2x* (May 18, 2016), https://bit.ly/3LjVIzA. The reason? Psychology. *See id.* Although one may have expected different demand elasticities across price surges, the degree of that differentiation could not be calculated using theory. Rather, econometrics was necessary to calculate these elasticities.

Market definition is not the only area of merger analysis that benefits from advanced quantitative analysis. Unilateral effects is a key issue in merger anaylsis. One way to calculate unilateral effects is merger simulation, "a set of quantitative techniques that are used to predict price effects of mergers in markets with differentiated goods." Rubinfeld, 166 J. of Institutional and Theoretical Economics at 68. During the first stage of simulation, a demand model is calculated. And "[t]he more sophisticated and complex the demand model, the more likely it is that an appropriate[]

calibrated model can give accurate predictions of the price effects of a merger." *Id.* at 69.

Again, it is simply not possible to make these demand calculations using very simple economic techniques or theory. Even somewhat complicated econometric models fail at producing accurate results for unilateral effects. Very sophisticated and complex models are necessary for the simulations to have accurate results. The FTC and DOJ, however, don't want to acknowledge that many times these more accurate models produce results they do not like.

The FTC's and DOJ's proposed approach can be compared to a patent case. It would be inconceivable for a court to construe complicated patent claims without expert testimony offered by both sides. Despite keeping up with legal developments, generalist judges are mostly ignorant about terms of art in electrical engineering and pharmaceuticals patents That is what the experts are for. Without expert testimony, courts would be throwing darts when construing the claims.

The same is true in the antitrust sphere. Even economists have trouble defining markets or calculating unilateral effects without using advanced quantitative economics. Generalist judges are even more lost without the help of expert econometricians offering evidence about the proper market definition. But that is what the FTC and DOJ propose in their request for information. They don't want to use this knowledge because they understand that most of the time it will support letting mergers go through. Rather than letting the outcome dictate the analysis, the FTC and DOJ should follow the economic evidence and allow the analysis to determine the outcome.

III. Antitrust Enforcement Without Market Definition Makes No Sense.

One of the questions on which the FTC and DOJ seek input is whether it is necessary to define the market in every case. To support the assertion that market definition is unnecessary in every case, the FTC and DOJ cite *United States v. Phila. Nat. Bank*, 374 U.S. 321, 363 (1963). But this quote is taken out of context. A review of the full paragraph shows that *Philadelphia National Bank* demands that courts define the relevant market.

In the paragraph the request for information cites, the Court was applying its decision in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). *See Phila. Nat. Bank*, 374 U.S. at 362-63. *Brown Shoe* held that "determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition within the area of effective competition." *Brown Shoe*, 370 U.S. at 324 (cleaned up). The Court was thus not retreating from *Brown Shoe*. Rather, it was reaffirming that holding.

The next sentence eliminates any doubt about the need for market definition. The Court explained that a "merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined" unless there is "evidence clearly showing that the merger is not likely to have such anticompetitive effects." *Phila. Nat. Bank*, 374 U.S. at 363 (citing *United States v. Koppers Co.*, 202 F. Supp. 437 (W.D. Pa. 1962)).

So the FTC's and DOJ's use of the compare signal in the request for information is wildly inappropriate. *Brown Shoe* and *Philadelphia National Bank* both require defining the market before further antitrust analysis occurs. There is nothing to "compare." Rather, both hold that courts must first define the market. The request for information does not cite one Supreme Court decision from the past forty-eight years. But even pretending that the Supreme Court has not decided an antitrust case in the past five decades does not get the FTC and DOJ to the result they want.

But looking to this outdated case law is not the proper approach. The FTC and DOJ should look to more recent decisions from the Supreme Court and antitrust scholar-judges when evaluating potential changes to the merger guidelines. Those decisions paint a clear picture; market definition is integral to any antitrust analysis.

Judge Bork famously emphasized that the market must be defined before even deciding on what type of scrutiny a deal deserves. When two firms propose a merger and the resulting company will control about six percent of the market, then a quick look is sufficient. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 217 (D.C. Cir. 1986). He was not the only antitrust scholar on the federal bench to recognize the importance of market definition at the start of the antitrust inquiry. Judge Easterbrook acknowledged the same reality one year earlier. *Polk Bros., Inc. v. Forest City Enterprises, Inc.*, 776 F.2d 185, 191 (7th Cir. 1985); *see* 7 Phillip Areeda & Herbert Hovenkamp ¶ 1507a, 444 (2017).

The FTC and DOJ seemingly assume that the Supreme Court's antitrust jurisprudence screeched to a halt in 1974. But less than nine months ago, the Court decided one of the most important antitrust cases in memory—*Nat'l Collegiate Athletic Ass'n v. Alston*, 141 S. Ct. 2141 (2021). The case upended the entire collegiate athletic landscape and forever changed how we watch football on Saturdays and college basketball in Cameron Indoor Stadium. But what it did not change is the starting point for all antitrust analysis.

The Court began its analysis by discussing the relevant market. *See Alston*, 141 S. Ct. at 2154. The remaining analysis hinged on this market definition. For example, the Court explained that "[w]hether an antitrust violation exists necessarily depends on a careful analysis of" the realities of that market. *Id.* at 2158 (citing *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2285 (2018); 2B Areeda & Hovenkamp, ¶ 500, 107 (2014)).

Alston did not break new ground. It just continued an unbroken string of cases requiring that courts first define the relevant market in an antitrust case. *Am. Express*, 138 S. Ct. at 2285 n.7 (citing *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 898 (2007)). The Court's decision in *United States v. Phillipsburg Nat. Bank & Tr. Co.*, 399 U.S. 350 (1970) is another good example of how courts (and agencies) must walk through antitrust issues. The first seven pages of analysis were dedicated to defining the relevant market. *Id.* at 359-65. It was only after completing this step that the Court could move on to see whether a proposed merger had anticompetitive effects.

So from the early 1960s—when the cases cited by the FTC and DOJ were decided—to the present, the Supreme Court and courts of appeals have consistently required a market definition before proceeding with further antitrust analysis. There has been no change in law rendering these decisions obsolete. Rather, the law has remained as constant as the Court's decisions. Thus, the merger guidelines should require a market definition before further enforcement proceedings occur.

Scholars also recognize that under current law courts must first define the relevant market. *E.g.,* Steven Semeraro, *Worse Than the Tower of Babel? Remedying Antitrust's False Dichotomy Through De Novo Appellate Review*, 5 Wm. & Mary Bus. L. Rev. 413, 413 (2014); Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 Ariz. L. Rev. 609, 633 (2005). This overwhelming consensus among academics shows how well-established the Court's decisions are on this issue. The FTC's and DOJ's contention that the issue is unsettled thus fails.

Debate about whether market definition is necessary in every antitrust case is a proper subject of policy debate. But the merger guidelines are not supposed to be about making policy. Our Constitution charges Congress—not the FTC and DOJ—with making policy. The Court has recognized that Congress has spoken loudly about the need for market definition in antitrust enforcement actions. If the current FTC and DOJ do not like this policy decision, they should lobby Congress to change the law. Yet they lack both the constitutional and statutory authority to disregard statutes and court decisions they disagree with by adopting merger guidelines that depart from current legal principles.

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The FTC and DOJ don't like what our antitrust laws say and how the Supreme Court has interpreted them. But they knowthey cannot achieve change through the political branches. Congress knows better than to adopt the FTC's and DOJ's extreme antitrust views. So the FTC and DOJ have turned their attention to the merger guidelines. They are trying to obtain policy change through administrative fiat. As this attempt is both legally and economically flawed, the FTC and DOJ should stand down and adopt merger guidelines that are both legal and economically wise.

Respectfully submitted,

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