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Bazaarvoice: Protecting Consumers by Silencing the Customer?

Tim Muris & Christine Wilson[1]

When the Department of Justice challenged as unlawful the proposed merger of Oracle Corp. and Peoplesoft Inc., it relied heavily on customer testimony in presenting its case. The U.S. District Court for the Northern District of California in 2004 discounted the reliability of the customer testimony and, in a stinging defeat for DOJ, allowed the deal to proceed.[2] Ten years later, the DOJ challenged the legality of the consummated merger of Bazaarvoice and PowerReviews in the same federal district court. Making lemonade out of lemons, DOJ invoked *Oracle* in urging the court to discount the testimony of more than 100 customers favorable to the deal. Extending the lineage of *Oracle*, *Arch Coal*,[3] and the Baby Foods case,[4] the *Bazaarvoice* court earlier this month stated, "it would be a mistake to rely on customer testimony about effects of the merger," and ruled for the DOJ.[5]

Prior to their merger in June 2012, Bazaarvoice and PowerReviews had been the two leading providers of Rating and Review Platforms ("RR Platforms"), packages of software and services that manufacturers and retailers purchase to allow their customers to write and post product reviews. The DOJ alleged, and the court agreed, that Bazaarvoice's purchase of PowerReviews eliminated its "only meaningful commercial competitor" in the U.S. market for RR Platforms. Finding (i) that the merger granted Bazaarvoice market power by raising its market share from approximately 40 percent to 60 percent, (ii) that entry and expansion were unlikely to dilute Bazaarvoice's newfound market power, and (iii) that the efficiencies would be insufficient to offset likely consumer harm, the court concluded that the merger violated Section 7 of the Clayton Act.

Bazaarvoice is remarkable more for its reasoning rather than its result. Typically, the antitrust agencies find customer reactions probative of the likely competitive effects of a merger. In the wake of the *Oracle* decision, the heads of both federal antitrust agencies expressed strong support for the use of customer statements when evaluating a merger, and the *Horizontal Merger*

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[2] *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

[3] *FTC v. Arch Coal*, 329 F. Supp. 2d 109 (D.D.C. 2004).

[4] *FTC v. H.J. Heinz Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000).

[5] *U.S. v. Bazaarvoice Inc.*, 13-cv-00133-WHO, slip op. at 8 (N.D. Cal., Jan. 8, 2014).

Guidelines issued jointly by the DOJ and FTC in 2010 explicitly endorse the usefulness of "[t]he conclusions of well-informed and sophisticated customers."[6]

Moreover, merger challenge data released by the FTC reveal that strong complaints from customers almost always lead to a government challenge. Although the data do not permit us to test the point, most antitrust lawyers would agree that strong support from sophisticated customers generally leads to a merger's approval. In fact, aside from the number of significant competitors in the relevant market (with 4 to 3 being the marginal case in most industries), one of the most important factors in gauging likely government reaction to a merger is the response of sophisticated customers.

Nevertheless, some judges have been quite hostile to customer testimony. Their extreme skepticism differs notably from that of the typical antitrust lawyer. Antitrust enforcers—who routinely assess the competitive effects of mergers, and consequently should be viewed as experts—invariably seek the reactions of customers when evaluating mergers. Judges, in contrast, have very limited experience in evaluating mergers. We believe the experts are more correct than the judges, especially about the general role of customers.

This is not to say that the experts cannot, and should not, be second-guessed. Indeed, Judge Walker's dismissal of the customer testimony in *Oracle* had a solid foundation, a point to which we return below. But the *Oracle*, *Arch Coal*, and *Baby Foods* judges were doing more than questioning whether the particular customers before them had a point. Instead, they attacked fundamentally government reliance on customer complaints.

Take, for instance, the judge in *Baby Foods*. While ruling against the government, he precluded as speculative the best evidence that he had to approve what was, on the surface at least, a three-to-two merger. The customers, in this case large grocery store chains, overwhelmingly supported the merger of the second and third largest baby foods manufacturers, in large part because they thought that the merger would, at last, create substantial competition for Gerber. Gerber held over 60 percent of the market, and, in the views of these customers, was "milking" the business and making the category stagnant. When the government objected to customer testimony on what they expected competitive effects to be, the judge agreed and excluded the testimony. In line with the thinking of the *Oracle* and *Arch* judges four years later, he did not understand why these customers should be allowed to speculate.

One answer, of course, is that the whole merger review enterprise is speculative. Indeed, it is—and despite the advances in economic analysis, lawyers are rightly uncomfortable with the *ad hoc* nature of current competitive effects analysis. Perhaps for this reason they reach for the security blanket of customer testimony. The issue for us is whether they are like Linus in the Peanuts cartoon, clutching his blanket against a large and difficult world. Or, instead, does relying on customer testimony provide an important source of evidence and a sound input in assessing a merger's ultimate effects?

Obviously, the views of the customers must be tested. Thus, in *Oracle*, if there was a market, it was one involving large enterprise customers. Because there are hundreds of such

[6] DOJ/FTC Horizontal Merger Guidelines §2.2.2 (Aug. 19, 2010).

enterprises, customer views must be handled with care. With even 20 such customers, how do we know they are a representative sample? While we are sympathetic to this part of Judge Walker's opinion, he went even further. He implied, in striking language, that some of the largest businesses in the world did not know of what they spoke.

We agree with those who argue that it is important to ensure that customer testimony is informed and not based on anticompetitive incentives. The court in *Bazaarvoice* arguably sought to screen the views of testifying customers in this way. In declining to rely on customer testimony, the court cited the opaque pricing structure of the industry (which limits a customer's ability to "discern what is actually happening in the market"), the fact that Bazaarvoice's post-merger conduct was "likely tempered by the government's immediate [post-merger] investigation," the customers' lack of access to economic evidence, the fact that few customers followed the merger, and the existence of "different levels of knowledge, sophistication, and experience."[7] Furthermore, although not explicitly mentioned, the judge may have viewed the presence of many inflammatory internal documents as weakening the credibility of contrary customer evidence.

Nevertheless, we also have great respect for the invisible hand of the market, and for the ability of businesses to create wealth, if not always to be able to explain themselves in a courtroom. For these reasons, we believe that once customers have passed sufficient screens, their views regarding the ultimate competitive effects of a merger should be given great weight.

One basis for our conclusion concerns the policy judgment that underlies the so-called business judgment rule. This rule essentially requires judicial abstention from second-guessing corporate decisions based in part on the relative expertise of corporate boards *vis à vis* judges and courts. The business judgment rule creates the presumption that corporate directors and officers act on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation.[8] If, however, a court finds that a corporation's directors or officers acted with gross negligence, in bad faith, or based on fraud or self-dealing, they lose the protections of the business judgment rule. States have adopted the business judgment rule based on varying standards—the Delaware common law standard, the American Law Institute principle, and the Model Business Corporation Act. These standards provide significant deference to boards of directors and officers based on their greater knowledge and experience in directing the affairs of a corporation.

As early as 1919, in the famous *Dodge v. Ford Motor Company* case, the Michigan Supreme Court recognized its lack of business expertise and refused to enjoin Henry Ford's plans to expand production. The business judgment rule explicitly recognizes the difficulties that judges face in determining whether judgments are in the corporation's or shareholders' best interests, and in evaluating the many factors weighed in making business decisions that may be unknown or unclear to the court.

This rationale for the business judgment rule applies to customer testimony on mergers. It is certainly appropriate to assess whether customer views are representative, informed, and

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[7] *Bazaarvoice, supra* n. 5, at *8, *116-18.

[8] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

unbiased. If they meet these qualifiers, it is hard to see how judges can reasonably choose to rely on their own or economists' intuitions at the expense of customers' relative experience and expertise, absent strong evidence to the contrary. It is the customers who will most directly experience the effects of a merger; their self-interest, combined with their experience in the industry, ensures that their views will provide informative evidence.

We return to *Baby Foods* as an illustration. In that case, the customers—whose stores sell hundreds of products—were well-positioned to perceive that the dominant firm did not face sufficient competition and to conclude that the proposed merger likely would have the beneficial effect of shaking up the stagnant category. In fact, a retrospective analysis conducted several years later provides support for the customers' views.[9] In the absence of the merger, the product category has remained "stale" and the share of the dominant firm has grown.

In *Baby Foods* and *Bazaarvoice*, the customers supported the merging parties, while in *Arch Coal* and *Oracle* they opposed them. Because customers will bear the brunt of any anticompetitive effects, there may be even more reason to trust them when they support a merger. But customers who voice opposition to a merger, again assuming they pass proper screens (including screening for the possibility that they may be trying to "hold up" the merging parties) deserve our consideration as well. It is not always easy to oppose a transaction that, if approved, will force the customer to deal with the new reality of an even larger supplier.

We are ***not*** saying that economists cannot develop reliable evidence sufficient to persuade us that those closest to the market are wrong. We ***are*** saying that the intuition of antitrust enforcement lawyers to rely on the views of those customers is correct. Customer reactions provide crucial evidence of likely competitive effects, and should be given great weight by both the agencies and the courts.

[9] Viola Chen, *The Evolution of the Baby Food Industry 2000-2008*, FTC Working Paper 297 (April 2009).