ECONOMIC EVIDENCE AND MODERN ANTITRUST

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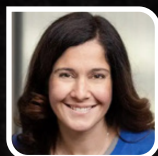

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Economic Evidence and Modern Antitrust

By Rebecca Kirk Fair, Emily Cotton & Philipp Tillmann

The question of the continued relevance, persuasiveness, and sufficiency of economic evidence in assessments of antitrust matters in the digital age has become of increasing interest to commentators, academics, and regulatory and legislative bodies. A closely related question is the contention by some commentators that the courts' narrow focus on the consumer welfare standard is ill-suited for dealing with the complexities of today's world. In our view, the consumer welfare standard remains the gold standard for the analysis of antitrust concerns in the digital age. Beyond using consumer welfare as a metric for evaluating potential anticompetitive impact, the use of rigorous, fact-based economic analysis, matched to today's market complexities, is more important than ever in helping develop a better understanding of the evolving digital world. A better understanding, in turn, will be crucial in helping the appropriate authorities legislate and regulate in ways that ensure strong competition without jeopardizing the benefits that result from the digital revolution.

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I. INTRODUCTION

Many questions have been raised in the press,[2] by academics,[3] and even by legislative bodies[4] about the continued relevance, persuasiveness, and sufficiency of economic evidence in assessments of antitrust matters in the digital age. These questions cut across both regulation and litigation. Are judges starting to find the discovery record or executive testimony more persuasive than economic analyses? Do the consumer welfare standard and the associated empirical analyses remain sufficient for evaluating competition in the digital economy? Are economists still relevant in helping agencies correctly assess potential competitive effects, for example, in the case of a proposed merger?

Similar questions featured prominently in the report released in October 2020 by the Antitrust Subcommittee of the U.S. House Judiciary Committee, *Investigation of Competition in Digital Markets* (the House report). For example, in castigating Congress for becoming lax in its oversight of antitrust matters, the report's authors write that the legislative body's inaction "has contributed to antitrust becoming 'overly technical and primarily dependent on economics.'"[5]

The fairly overt implication, and one that runs throughout the 400-page report, is that dependency on economics is a bad thing. A closely related argument is that the economic tools and measures used in antitrust analysis, and in particular the courts' narrow, if not exclusive, focus on the consumer welfare standard, are ill-suited for dealing with the complexities of today's world. Again, from the House report: "Through adopting a narrow construction of 'consumer welfare' as the sole goal of the antitrust laws, the Supreme Court has limited the analysis of competitive harm to focus primarily on price and output rather than the competitive process—contravening legislative history and legislative intent."[6] [footnotes omitted]

Ultimately, the underlying theme in all these questions is whether the modern antitrust landscape is structurally different from what it has been over the last 50 or more years and, therefore, whether different tools and analytical methods are needed.

In our opinion, the answer is an emphatic "no." As we have written and spoken about on other occasions, the consumer welfare standard is robust to changes in the economy or the emergence of new technologies and, in our view, it remains the gold standard for the analysis of any antitrust concerns.[7] Beyond consumer welfare as a metric to evaluate potential anticompetitive impact, the use of rigorous, fact-based economic analysis is more important than ever in helping develop a better understanding of the evolving digital world. A better understanding, in turn, will be crucial in helping the appropriate authorities legislate and regulate in ways that ensure competition without jeopardizing the benefits that result from the digital revolution.

Interpretations of recent court opinions suggest that we are not alone in this opinion. As we will discuss in the remainder of this article, the claim that economic evidence and the consumer welfare standard have become less relevant is belied by ongoing regulatory activity, merger analyses, and litigation. And beneath the dramatic rhetoric, even the House report rests on a foundation of classical economic analyses of market share and concentration,[8] including a recommendation that the U.S. Federal Trade Commission (FTC) be required to "regularly collect data and report on economic concentration and competition in sectors across the economy."[9]

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2 See, for example, https://www.nytimes.com/2020/10/07/technology/congress-big-tech.html.

3 See, for example, https://cdn.vanderbilt.edu/vu-wp0/wp-content/uploads/sites/278/2019/10/11172710/Antitrust-in-Digital-Markets-1.pdf; https://marshallsteinbaum.org/assets/steinbaum-and-stucke-2020-effective-competition-standard-uchicago-law-review-.pdf.

4 See, for example, https://www.nytimes.com/2020/10/07/technology/congress-big-tech.html.

5 U.S. House of Representatives Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary, *Investigation of Competition in Digital Markets*, 2020, p. 399 (quoting First and Waller in FN2511).

6 House report, p. 390.

7 See, for example, James Bernard, Rebecca Kirk Fair & D. Daniel Sokol, "Why Does the Consumer Welfare Standard Work? Matching Methods to Markets," *CPI Antitrust Chronicle*, November 2019.

8 For example: "Furthermore, the Subcommittee should examine the creation of a statutory presumption that a market share of 30% or more constitutes a rebuttable presumption of dominance by a seller, and a market share of 25% or more constitute[s] a rebuttable presumption of dominance by a buyer." House report, p. 395.

9 House report, p. 402.

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Rather than asking whether economics, welfare standards, and analytical tools should be thrown out in favor of some yet-to-be-described new framework, we prefer to focus on determining which of the analytical tools we have available to us are most useful, and how best to match them to today's market complexities. This will allow us to develop robust and fact-based assessments of competitive conditions and to present clear, compelling analyses to regulators and courts. The remainder of this article provides examples from agency and court activity underscoring the continuing importance of economic evidence and the specific tools and analytics — some new, many tried and true — used to address antitrust issues.

II. AGENCY ACTIVITIES HIGHLIGHT THE ONGOING RELEVANCE OF ECONOMIC EVIDENCE

We need look no further for support than the numerous hearings, programs, and workshops on antitrust, innovation, big data, and the digital economy that have been hosted over the past couple of years by both the U.S. Department of Justice's ("DOJ's") Antitrust Division and the FTC. In particular, at the FTC's Hearings on Competition and Consumer Protection, held throughout the fall of 2018 and the spring of 2019, prominent academics joined agency officials and industry experts in exploring the economics of multi-sided platforms, discussing the implications of artificial intelligence ("AI") and algorithms (e.g. algorithmic collusion), sharing economic perspectives on innovation, and more.[10]

Importantly, these programs were not mere theoretical exercises. Rather, they explicitly sought to marry economic theory with marketplace facts. For example, some of the sessions explored the effects that fixed costs and network effects have on market concentration, while others assessed contracts and vertical merger review in light of the rapid evolution of business models and distribution chains in the digital economy. These programs and others like them highlight a recognition that economic theory and careful empirical analyses remain fundamental to unpacking how conduct may or may not cause markets to deviate from natural and welfare-enhancing equilibriums. The FTC itself, in pursuing its stated intent "[t]hrough these hearings … to help formulate an enduring approach to current questions about antitrust and consumer protection enforcement,"[11] also acknowledged that one of its key outputs would be "guidance on how the consumer welfare prescription has been interpreted by the courts and whether it is sufficient to prevent anticompetitive mergers and prohibit anticompetitive conduct."[12]

Thus, despite growing concerns regarding the relevance of the consumer welfare standard among some antitrust authorities and scholars, there continues to be support for this method of analysis for antitrust. In fact, it is the flexibility of the consumer welfare standard and the ongoing evolution of economic thinking that makes the standard so well suited to assessing competition and conduct. As the U.S. Supreme Court stated in 2015, "We have therefore felt relatively free to revise our legal analysis as economic understanding evolves and … to reverse antitrust precedents that misperceived a practice's competitive consequences."[13]

Courts' commitment to flexibility in antitrust analysis underscores the importance of economic evidence for evaluating market structure, prospective mergers, and conduct, especially since changes in the economics underlying markets and business models over time may well lead to different and more relevant legal presumptions. For example, as discussed in the next section, the FTC's recently released Vertical Merger Guidelines call out the relevance of economic models, merger simulation, and theory to the assessment of potential competitive effects from an acquisition.

Further, litigation and merger reviews reflect how shifts in economic understanding and market dynamics have led to a reevaluation of legal presumptions and a more nuanced treatment of vertical restraints, such as minimum resale price maintenance, maximum resale price maintenance, and territorial restrictions. With the rule of reason better suited than categorical per se prescriptions to evaluating competition in today's complex business environment, it is even more critical that the economic analysis be done correctly and reflect market outcomes accurately.

10 U.S. Federal Trade Commission (FTC), *Hearings on Competition and Consumer Protection in the 21st Century*, https://www.ftc.gov/policy/hearings-competition-consumer-protection?utm_source=slider.

11 FTC, *Prepared Statement of the Federal Trade Commission Before the Subcommittee on Antitrust, Commercial and Administrative Law of the Judiciary Committee, United States House of Representatives*, "Online Platforms and Market Power, Part 4: Perspectives of the Antitrust Agencies," November 13, 2019.

12 FTC, *Prepared Statement of the Federal Trade Commission Before the U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights*, "Oversight of the Federal Antitrust Laws," September 17, 2019.

13 *Kimble v. Marvel Entertainment*, 135 S. Ct. 2401, 2412-13 (2015).

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III. MERGER REVIEW PROCESSES AND GUIDELINES CONTINUE TO REFLECT THE RELEVANCE OF ECONOMIC EVIDENCE

Theoretical and empirical economists have provided a diverse and flexible set of tools and methodologies to be used in examining markets and conduct. The evaluation process for proposed mergers provides a useful illustration. Economists can employ, variously and in combination, market data, survey data, business documents, and natural experiments to assess market concentration and current and future diversion rates, and to forecast price and quantity outcomes to evaluate the competitive effects of any proposed merger.

Importantly, these tools are only as relevant as the inputs and assumptions they rely upon, both of which must match the economics and dynamics of the industry at issue.

While e-commerce, digital advertising, and other facets of modern technology present new challenges to antitrust enforcement, economic models provide bespoke tools and approaches to defining markets, evaluating market power, and weighing the potential procompetitive and anticompetitive effects of particular contractual arrangements or proposed vertical integrations.[14] When they were introduced in June 2020,[15] the new Vertical Merger Guidelines stated that they "detail the techniques and main types of evidence that the agencies typically use to predict whether vertical mergers may substantially lessen competition. The Guidelines will help businesses, antitrust practitioners, and other interested persons by increasing transparency into the agencies' principal analytical techniques, practices, and enforcement policies for evaluating vertical transactions."[16]

Notably, these guidelines emphasize the point that "where sufficient relevant data are available, the Agencies may construct economic models designed to quantify the net effect on competition." [17] The guidelines also acknowledge that simulation models (whether partial or full) cannot be taken in isolation, and that qualitative evidence will also be considered alongside quantitative in evaluating the net effects of a proposed vertical merger. This is one reason, although hardly the only reason, why it is critical to make sure that the economic methods match the empirical evidence provided by the markets.

For instance, efficiencies in vertical integrations have long been studied by economists and recognized as important by regulators. Eliminating double marginalization ("EDM") through vertical integration may allow a merged entity to have access to its inputs at a lower cost than the premerger market price of the inputs. For example, in United Technologies Corporation's ("UTC's") acquisition of Goodrich in 2012, UTC was able to internalize Goodrich's markups and reduce the relative costs of overall input. This should argue in favor of a likely lower market price for customers and higher associated quantity, as long as the elimination of the double marginalization is not outweighed by potential anticompetitive effects. At its heart, this is an economic question as relevant for digital enterprises as it is for good, old-fashioned tire manufacturers.

For the new economy as well as for the old, the economic incentives of the parties, which are largely dependent on market dynamics, will play a critical role in determining the likely procompetitive and anticompetitive effects of a vertical merger. The Vertical Merger Guidelines highlight several prospective anticompetitive considerations, including raising rivals' costs, refusing to supply downstream providers, customer foreclosure, and higher barriers to entry.

Examining each of these questions requires both empirical and qualitative economic and marketplace evidence. Whether assessing the potential procompetitive and anticompetitive effects of either a vertical or a horizontal merger, economic theory, simulation models, and business realities may all provide useful insights. Given that theory suggests that firms in a competitive environment would have an incentive both to pass on efficiencies in the presence of competition and to raise rivals' costs, the net effects given reasonable assumptions, available data, and simulation inputs must be considered alongside the stated objectives for the proposed merger and the nature of competition in the pre-

14 Rebecca Kirk Fair, Nikita Piankov & Emmanuel Frot, "United States – E-commerce Economics: Market Power and Enforcement in Vertical Markets," *Global Competition Review E-Commerce Competition Enforcement Guide*, January 2019, Law Business Research Ltd.

15 FTC, *Vertical Merger Guidelines*, June 30, 2020, https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

16 FTC, *FTC and DOJ Issue Antitrust Guidelines for Evaluating Vertical Mergers*, June 30, 2020, https://www.ftc.gov/news-events/press-releases/2020/06/ftc-doj-issue-antitrust-guidelines-evaluating-vertical-mergers.

17 *Vertical Merger Guidelines*, p. 6, https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

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and post-merger marketplaces. Ultimately, the agencies will need to carefully reflect on internal business documents, along with the economic evidence, in their assessments of proposed acquisitions. In the digital sector, the absence of price, the balance of short-term versus long-term incentives, and the presence of network effects may all affect the analysis, but none of them change the fundamental question and the necessary reliance on well-trodden economic methods. These questions are likely to be carefully examined in the ongoing FTC and DOJ "Big Tech" merger and other antitrust investigations and lawsuits into Facebook, Google, and others. Notably, the issue of platform economics and the impact it has on market definition came up in the past year in the DOJ review of the proposed *Farelogix/Sabre* merger.

This does not mean that assessing the future impact of a vertical or horizontal merger is easy. It often requires a combination of art and science, especially in a highly dynamic industry such as the digital sector. The retrospective assessments of major technology acquisitions, litigations related to consummated mergers, and concerns raised in the popular press prior to acquisitions highlight the challenges any regulator faces in predicting the future.

Such concerns were illustrated by Amazon's vertical acquisition of Kiva Systems. Kiva, a robotics company, provided machines that allowed fulfillment centers to operate in a more automated fashion. Amazon, familiar with the benefits of this automation system following its acquisition of Zappos.com, announced its acquisition of Kiva in 2012. For the first few years following the merger, and as part of its merger assessment, Amazon promised to continue to service its rivals' robots and to sell their aftermarket products. However, by the end of 2015, Amazon had fully integrated Kiva's systems and began offering Amazon Robotics.

This integration has led some critics of Amazon to argue that the changes compelled rivals and customers of Kiva to use Amazon's own fulfillment services, thereby protecting and extending its power over the e-commerce space and raising rivals' cost.[18] On the other hand, a careful examination of investments and innovations following the merger reveals a rush of funding to Kiva's competitors.[19] For that reason, many have asked whether Amazon's leading position in online retail is due in part to its ability to decrease access to a critical input to fulfillment. But it may be just as valid to ask whether the Kiva acquisition reduced Amazon's fulfillment cost while enhancing dynamic investment in innovation throughout the industry. If the latter, were the regulators then right to let the merger through?

Another recent example of a vertical merger for which assessment of the future impact was anything but simple was the 2018 CVS-Aetna transaction. This transaction involved the merger of a health insurer and pharmacy benefits manager ("PBM") on the one hand and a chain of retail pharmacies and minute clinics (as well as other services) on the other.

This merger led some commentators to worry that the merged entity could foreclose both competing insurers and competing retail pharmacies, leading to less competitive markets in this space.[20] However, other commentators emphasized the potential procompetitive effects of this transaction, including better coordination of medical and pharmacy insurance benefits, as well as increased use of lower-priced health care providers, resulting in lower medical spending.[21]

Both of these vertical mergers highlight the challenges involved in forecasting net competitive effects, or even in identifying them in hindsight, in order to understand whether the vertical integration enhanced or reduced competitive conditions and consumer welfare.

18 Lina M. Kahn, "The Separation of Platforms and Commerce," *Columbia Law Review*, Vol. 119, No. 4, May 2019, https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/.

19 Adam Putz, "M&A flashback: Amazon announces $775M Kiva Systems acquisition," Pitchbook.com, March 19, 2018. https://pitchbook.com/news/articles/ma-flashback-amazon-announces-775m-kiva-systems-acquisition.

20 See, for example, https://www.openmarketsinstitute.org/publications/the-corner-net-neutrality-disney-time-warner.

21 See, for example, https://docs.house.gov/meetings/JU/JU05/20180227/106898/HHRG-115-JU05-Wstate-GarthwaiteC-20180227.pdf.

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IV. ROBUST AND FACT-BASED ECONOMIC EVIDENCE IS AS RELEVANT AS EVER

History and ongoing statements by regulators affirm that economic evidence and analyses are relevant to the assessment of competitive effects in merger analyses and beyond. What, then, are we to think of the skepticism with respect to economic modeling that is sometimes expressed in courts and in high-profile merger litigation cases? In our view, this skepticism is misdirected if it questions the utility of economic analysis overall. Instead, the real question should be how to ensure that valid economic analyses are appropriately understood and considered when regulators or courts are assessing competition.

Economic evidence is most relevant and most compelling when theory, analyses, and experience converge on the same answer. It is not surprising that testimony that is based on theoretical models, but does not match to factual witness testimony or internal strategic documents, receives little consideration by courts. The model and theory may be perfectly accurate in some circumstances, but the underlying necessary market structure may not be applicable in the industry in question, or the inputs and data may be unreliable.

The 2014 U.S. District Court's ruling on Bazaarvoice's acquisition of PowerReviews highlighted the importance of ensuring that economic modeling is supported by business facts.[22] During the trial, the DOJ presented extensive evidence that "Bazaarvoice executives clearly intended to eliminate competition by acquiring PowerReviews."[23] Thus, while economists both for the DOJ and for Bazaarvoice presented reasonable theoretical interpretations of the market, ultimately, Bazaarvoice's own premerger view of the marketplace mapped best to the economic evidence presented at trial by the DOJ. The analysis of the DOJ expert demonstrated that PowerReviews was a significant threat to Bazaarvoice and the merger, and that the merger would ultimately raise prices, thereby offering an empirical demonstration that matched the *ex ante* expectations of the acquirer.

In other circumstances, the lack of marketplace experience sufficiently comparable to the proposed merger may make mapping economic theory to market realities challenging. For example, Judge Richard J. Leon questioned the models presented in the DOJ's challenge of the *AT&T/ Time Warner* merger, in part because the industry had never experienced a blackout of the magnitude considered in the economic models. Ultimately, of course, the blockbuster merger was allowed. However, the passage of time has caused some observers to question whether Judge Leon was right after all. Subscribers to AT&T and to its competitor cable and satellite providers in fact experienced blackouts of some major television channels. As the University of Pennsylvania's Herbert Hovenkamp has explained, "When you start seeing blackouts, it's obvious you're looking at a merger that's not serving consumers very well."[24]

The rapid evolution of markets, competition, and economic thinking in the modern economy requires ongoing assessment of competitive conditions and merger review. It is therefore more important, not less, to bring the best economic evidence to assess competition.[25] This requires that economists, industry participants, and lawyers work together to understand the fundamental relationships in the marketplace, the key nodes of competition, and the dynamics of entry, exit, pricing, production, and innovation. A failure to fully account for the market dynamics will lead to the wrong economic models and a disconnect between market evidence and theoretical outcomes. In such circumstances, courts are right to be skeptical. But such skepticism is not a reflection of a lack of relevance; instead, it may be a failure in exposition or in model specification.

22 U.S. DOJ, *U.S. v. Bazaarvoice Inc., Memorandum Opinion, Public Redacted Version*, January 8, 2014, https://www.justice.gov/atr/case-document/file/488846/download.

23 U.S. DOJ, "Justice Department Issues Statement on U.S. District Court Ruling That Bazaarvoice's Acquisition of PowerReviews Violated Antitrust Laws," January 10, 2014, https://www.justice.gov/opa/pr/justice-department-issues-statement-us-district-court-ruling-bazaarvoice-s-acquisition.

24 David Lazarus, "Consumer Confidential: AT&T's promise of better pay-TV prices and service is 'bordering on the absurd,'" *Los Angeles Times*, August 10, 2019, https://www.latimes.com/business/story/2019-08-05/pay-tv-companies-are-too-powerful.

25 For example, the agencies have continued to highlight the importance of retrospective merger review. As noted by Farrell, Pautler, and Vita (2009), retrospective merger analysis "is [intended] to determine *ex post* how, if at all, a particular merger affected equilibrium behavior in one or more markets." See https://www.ftc.gov/policy/studies/merger-retrospectives/overview; Joseph Farrell, Paul Pautler & Michael Vita, "Economics at the FTC: Retrospective Merger Analysis with a Focus on Hospitals," *Review of Industrial Organization*, 35, 2009, 369-85.

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