RESPONSES FROM JOHN KWOKA

Finnegan Professor of Economics
Northeastern University

TO THE REQUEST FOR COMMENTS FROM CHAIRMAN CICILLINE AND RANKING MEMBER SENSENBRENNER OF THE HOUSE SUBCOMMITTEE ON ANTITRUST

April 17, 2020

QUERY (1): The adequacy of existing laws that prohibit monopolization and monopolistic conduct, including whether current statutes and case law are suitable to address any potentially anticompetitive conduct.

The law prohibiting monopolization and monopolistic conduct--Section 2 of the Sherman Act–reads in its entirety as follows: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a [felony]." Characteristic of most U.S. antitrust statutes, this brevity has made U.S. enforcement against monopolization flexible and adaptable to changing circumstances and to new learning about the nature of anticompetitive practices. On the other hand, brevity risks undue focus on issues that have already arisen and been adjudicated by the courts, and overlooking novel issues not easily read into the statute and not well addressed by the courts.

I believe this is the case with respect to the adequacy of current statutes and case law affecting the competition issues raised by the major tech companies. I take as baseline evidence of this problem that the current antitrust regime–the Sherman Act as interpreted by the courts and enforced by the antitrust agencies--has resulted in a digital marketplace dominated by an exceedingly small number of companies with unprecedented power over prices and quality of goods, consumer choice, and entry and growth of competitors. I do not believe we should be satisfied with this outcome or with an antitrust regime that has produced, or at least tolerated, it.

While there have been distinct and troubling weaknesses of antitrust enforcement over the past twenty years–weaknesses that also need to be corrected–enforcement by itself cannot overcome certain underlying structural obstacles to addressing competition issues with respect to the major tech companies. In my view, these structural obstacles are as follows:

First, the competitive consequences of conduct in the digital marketplace are characterized by an unusual degree of speed, unpredictability, and irreversibility. A digital platform that begins selling a product in competition with a hosted product, for example, can effectively choke off demand for the latter very quickly and permanently harm that seller. A dominant platform can attract new sellers and therefore new customers in a never-ending and irreversible feedback loop.

The pace of change and the fungibility of technology often make predicting the outcome of a dominant tech company's actions or acquisitions much more difficult than in the case of more typical companies. As a result, by the time antitrust acts, competitive concerns may well have already played out in favor of the dominant companies and cannot easily–or perhaps at all–be reversed or corrected by standard policy measures. By itself, speed and irreversibility mean that established antitrust institutions and procedures may face faits accomplis rather than remediable offenses.

Second, case law interpreting monopolization offenses has arisen in traditional settings, making application to the digital marketplace difficult or impossible. Perhaps most notably, the conventional antitrust focus on the effects of dominant firm conduct or mergers on "price" is of little help for products that are ostensibly provided "free," as is the case for several of the dominant tech companies. Rather, the companies extract a "price" from consumers in the form of personal data that is harvested and sold to advertisers and others. The economics of data acquisition, compilation, and usage, and their relationship to the service provided to customers, create novel antitrust issues.

Relatedly, conventional standards for evaluating certain business strategies involving price–such as strategically lowering price to harm rivals–would appear to give carte blanche to the tech companies in the case of zero-cost service. Moreover, even if price could be meaningfully evaluated, that focus of concern would likely overlook the fact that many merger and much conduct by the tech firms have their principle anticompetitive effects on other dimensions of competition, such as consumer choice, entry conditions, and innovation.

Third, the typical difficulties of assessing and controlling anticompetitive conduct are compounded in the case of the tech companies due to the difficulties of understanding the technologies, the subtle interactions between the technology and consumer behavior, and the ability of the companies to quickly and strategically alter the manner in which the technology operates. Assessing the competitive effects of most favored customer clauses, for example, is made more difficult by the fact that their effects may depend in part on a setting subject to rapid change by the tech company.

Similarly, a rule prohibiting certain actions such as self-preferencing by platforms that both directly serve end users and host rivals that do so may be evaded by apparently neutral algorithmic changes best (or only) understood by the hosting platform that stands to benefit. Here, too, conventional tools of antitrust–investigations, analysis, legal challenges–operate in a time frame inconsistent with the rapid pace of underlying change, and with the ability of the companies to alter the product to stay ahead of the antitrust process.

To be sure, each of the dominant tech companies has in its own way been innovative, has produced new and valuable goods and services, and deserves both credit and market success for its core business. Competitive concerns arise less with their core businesses–though there are some concerns there as well--than with the manner in which those core businesses have been used to (a) leverage or extend their market power and (b) handicap or exclude nascent and potential competitors. For the reasons I have already mentioned, I do not believe that current law and enforcement are adequate to separate out these latter practices and subject them to necessary antitrust scrutiny. Accordingly, I would urge consideration of a digital competition act that would do three things:

(a) Define a category of large tech firms which would be subject to an adverse presumption for certain practices. The relevant category of tech firms might most easily depend on their size. The list of practices would be non-exhaustive and in any event only carry a presumption of illegality, thereby codifying what is now ambiguous or obscure in the Sherman Act as applied to these companies and shifting the burden to them to reverse that preumption;

(b) Provide enhanced authority for enforcement of the expanded statute by the antitrust agencies and require annual reporting to Congress on their activity. This will help ensure the agencies' ability to act against anticompetitive conduct in whatever manner is required, and also ensure congressional oversight of their activity and actions; and

(c) Create a Digital Competition Authority with powers to set ex ante rules of conduct by the tech companies. This would help avoid the current scenario in which the antitrust agencies can only act after anticompetitive conduct and harm have occurred, and must investigate each such allegation regardless of how conclusive the evidence about a practice overall may be.

I believe that legislative action along these lines, together with the necessary resources for and dedication of the antitrust agencies would go far toward re-establishing a more competitive landscape in the digital marketplace.

Query (2): The adequacy of existing laws that prohibit anticompetitive transactions, including whether current statutes and case law are sufficient to address potentially anticompetitive vertical and conglomerate mergers, serial acquisitions, data acquisitions, or acquisitions of potential competitors.

The five major tech companies–Amazon, Apple, Facebook, Google, and Microsoft–have been responsible for nearly 700 mergers and acquisitions over the past twenty or so years. Many of these have been beneficial or at least benign, but others have warranted scrutiny by the antitrust agencies for their possible anticompetitive effects. But out of this total of hundreds of transactions, only one has been challenged--and that one was resolved by a remedy of dubious effectiveness. The result of this permissive agency posture has been the virtually unchecked growth of these companies, and only now, well after their acquisitive conduct has transformed whole industries, has public and policy concern manifested themselves.

Many aspects of merger standards and enforcement need strengthening. Some of these would address omissions or inadequacies of existing antitrust statutes and/or court opinions,, and are clear candidates for legislative remedies, as I will discuss below. Others weaknesses, however, are due to agency enforcement standards and practices, and in principle could be addressed by the agencies themselves. In the continuing absence of such actions, however, I believe that these, too, would benefit from legislation to clarify agency responsibility.

Here I list several areas involving corporate transactions, especially with respect to the tech sector, where I believe legislative action is advisable.[1]

The first of these involves the very standard for what constitutes an anticompetitive merger or acquisition. The governing Clayton Act, as amended, prohibits mergers and acquisitions where the effect "may be substantially to lessen competition, or to tend to create a monopoly." Over time this standard has been enforced in a manner that has progressively narrowed the type of merger subject to challenge by the agencies.

While there are several reasons for this weakening, one area that should–and can readily--be addressed is to modify the threshold for a merger challenge as follows: Instead of requiring a "substantial lessening of competition," the threshold should be a "material lessening of competition."[2] Substitution of the term "material" for "substantial" would make clear that the antitrust laws will not tolerate anticompetitive mergers up to the point where their harms become truly substantial. Rather, anticompetitive effects beyond the immaterial or inconsequential would be subject to prohibition–conditional, of course, on the other considerations well established in

---

[1] Many of these are discussed in my forthcoming book, *Controlling Mergers and Market Power: A Program for Reviving Antitrust in America,* CPI Publishing, forthcoming, May 2020.

[2] This recommendation is mirrored in the proposed Consolidation Prevention and Competition Promotion Act of 2017.

case law and the merger guidelines.

A second change in standards and practices that would strengthen both merger enforcement would involve the legislative establishment of the so-called "structural presumption." At present the enforcement process involves, and seemingly requires, the antitrust agency to evaluate each and every possibly anticompetitive merger for its unique and likely anticompetitive effect. This in turn means that even the most obviously anticompetitive mergers are investigated with much the same degree of attention as more problematic cases. This consumes resources, provides a template for counterarguments by the parties, and runs increased risk of Type II errors–that is, the mistake of permitting an anticompetitive merger.

Case law provides an alternative approach. The Supreme Court in the 1963 *Philadelphia National Bank* case stated that, because of the predictive and uncertain nature of merger review, such a process is not always necessary or even appropriate. Rather, it said,

> a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence that the merger is not likely to have such anticompetitive effects.

This so-called "structural presumption" is well-founded in decision theory and supported by empirical evidence.[3] It should be codified into law and used by the agencies to relieve themselves of the burden of proving the obvious–or at least, shifting the burden to the prospective merging parties–in cases to which it applies.

A third area requiring legislative changes involves transactions in the tech and other sectors that eliminate potential or nascent competitors. Permitting a tech company to acquire a firm that is capable of entering into the tech company's market, or that could constrain or limit its extension into new markets, or that might represent the foundation for an alternative platform or technology represents clear harm to competition. While the economic issues involved in evaluating a tech company's acquisition of an outside firm are analogous to those in the case of an acquisition of an actual rival, there are additional legal hurdles in the case of potential competitors.

In its 1974 *Marinebancorporation* case. the Supreme Court has stated that establishing the anticompetitive effect of an acquisition of a potential–as opposed to an actual--competitor requires evidence that the target firm "in fact tempered oligopolistic behavior" by incumbents. This requirement of concrete evidence of past effects is a standard that exceeds that for challenging a merger between actual incumbent firms and imposes an often insurmountable evidentiary standard on the agency. Moreover, it overlooks entirely the case of a nascent

---

[3] J. Kwoka, "The Structural Presumption and the Safe Harbor," *Antitrust Law Journal*, 2017.

competitor–that is, one that presently has no such capability but might evolve into a threatening alternative to the dominant tech company in the future.

The Supreme Court's standard of proof has long been at odds with the underlying economics of potential competition, but it now represents a substantial barrier to agency actions against such acquisitions in the tech sector since fungible and rapidly evolving technology compounds the difficulty of identifying a potential competitor by the court standard. Correcting this requires both legislative and agency initiatives. New legislation should first make clear that mergers involving potential competition are generally to be evaluated by the same standards as mergers between incumbents. It should also state that in the case of tech, digital, and platform companies, acquisitions of companies that "might plausibly" become rivals or alternatives–not just those that would predictably do so–are subject to challenge.

Fourth, the nature of what constitutes a competitive harm should be clarified and broadened. The focus of current attention in the Merger Guidelines and hence the law is on price effects, and while these are very important, in many settings price effects are not the key strategic variable or the paramount policy concern. In some sectors R&D, innovation, or quality may be most important. In the case of certain tech companies, an especially important competitive concern is how mergers and acquisitions affect the resulting consumer choice of products and services which they may host, as well as the ability and opportunity for entry or growth of smaller competitors. And of course, for many tech companies, the "price" that they charge for their core service is the data that they acquire, rather than an explicit payment.

Legislation might be helpful, or even necessary, in this connection in order to make clear the broad range of competitive harms that lie within the scope of the antitrust mission. Such a statement would underscore the importance of these issues to the judiciary, put companies on notice that these issues are taken equally seriously, and encourage the agencies to pursue cases where these concerns are paramount–based, of course, on rigorous analysis.

Fifth, increasingly the agencies do not act to prohibit mergers or acquisitions that they determine will likely result in competitive harm. Rather, they more often permit such mergers while imposing conditions that strive to remedy or prevent the anticompetitive conduct they have determined would result. Divestitures of overlapping operations have long been used with some success but more recently remedies have taken on new forms that are much less likely to succeed. Conduct-based provisions and conduct remedies have proliferated: there now are dozens if not hundreds of such rules and regulations that instruct merged firms in major industries not to engage in certain anticompetitive actions made possible--and profitable--by the merger.

Attempts by the antitrust agencies to regulate business behavior in this manner–essentially by prohibiting or requiring certain behavior, then monitoring for compliance--have encountered substantial practical problems. Simple economic logic and growing statistical evidence now show that remedies that try to get firms to act against their own interests often do not succeed and instead result in the very competitive harms at issue.[4] Use of these remedies must be sharply curtailed. Legislative actions or other methods should limit the agencies' use of such remedies only where they "plausibly and predictably" will be successful.

Additional helpful legislative action would grant explicit authority for the agencies to undo consummated mergers and acquisitions that have proven to be anticompetitive. The basis for doing so would simply be that initial approval of the merger was based on the belief –undoubtedly advanced by the parties--that the merger would not have such consequences. If that proved to be untrue, then the action predicated on that argument-–namely, approval of the merger– would also be subject to revision. In addition to rectifying an erroneous approval of a merger, this policy would have the therapeutic effect of putting prospective merging parties on notice of the drastic consequences of anticompetitive conduct after the merger, and indeed, of misrepresenting the likely effects of the merger to the agencies in advance.

The conventional argument against such a policy is the practical difficulty of undoing a merger. While there is some truth to that argument, it proves too much. There are many examples of breakups from public policy–the AT&T case in antitrust, electricity companies undergoing deregulation–as well as private sector actions like spinoffs, that make clear these actions can be taken. Moreover, the threat of such action should itself limit the frequency with which companies propose mergers or take actions that would need subsequent dissolution.

I believe these legislative changes, if vigorously enforced by the antitrust agencies would make a substantial difference in the strength of competition in the digital marketplace.

[4] J. Kwoka, *Controlling Mergers and Market Power*.

Query (3): Whether the institutional structure of antitrust enforcement–including the current levels of appropriations to the antitrust agencies, existing antitrust authorities, congressional oversight of enforcement, and current statutes and case law–is adequate to promote the robust enforcement of the antitrust laws.

Substantial institutional impediments have handicapped antitrust enforcement. In my answer to Question 2, I noted several practices of the agencies and patterns of enforcement that I believe need to be addressed. A number of these could be achieved through an agency commitment to a robust view of the antitrust mission, but since that has not been the case, legislation that would explicitly grant responsibility for such initiatives may well be necessary.

Candidate areas for such legislation were noted above and include adoption of the structural presumption in merger review, recognition of competitive concern over entry barriers and nonprice effects from mergers, and the need for more restrained use of remedies. Other issues noted above would clearly require legislative action. These include revising the standard for an anticompetitive outcome to be a "material" rather than a "substantial" effect, restoration of the doctrine of potential competition and its extension to nascent competition, and authority to resolve consummated mergers with breakups as necessary.

Here I will discuss several other needed reforms requiring legislative action. The first concerns the adequacy of agency resources. By way of background, I would note that the number of mergers reported under that Hart-Scott-Rodino Act has expanded dramatically in the last few years. Between 2010 and 2018, that number nearly tripled, rising from 716 to 2111. (Since 2010 might be viewed as an anomaly due to the great recession, I note that from 2011 to 2018, the increase was from 1116 to 2111.) During this same period of time as the caseload doubled or tripled, the nominal FTC antitrust budget increased by exactly 11 percent, while that of the DOJ Antitrust Division rose by 1 percent. In inflation-adjusted terms, both actually declined, so that the overall budget for the antitrust mission–that is, the total of both budgets--fell by 8 percent.

Compounding this sharp deficiency in funding, the costs of merger investigations have been rising substantially. The reasons include the failure to rely on presumptions that would reduce the cost burden, the increased complexity of merger analysis, and the resulting need for greater (and more expensive) staff expertise. The result is that the agencies are no longer able to conduct the investigations on the same fraction of the merger cases as in an earlier time period. Rather, as the number of reported mergers subject to investigation has risen substantially over the past decade, the percent actually investigated has fallen. That percent was about 3.8 to 3.9 percent in 2010-2011, but that fell to the range of 3.2-3.6 percent in the following three years, and then to 2.1 to 3.0 percent in the latest three year period. Put differently, a reported merger now has a 30 percent better chance of not even being subject to investigation than in the early 2010s.

This problem can be addressed through two related and straightforward legislative actions. The first would be to substantially increase the filing fees required of merging parties under the HSR law. These are presently nominal for all mergers, but could be increased substantially for very large mergers. This increase should be paired with a legislative change to have these fees flow directly to the agencies' budgets, instead of–as they do at present--offsetting appropriations. This would help ensure that the resources available to the antitrust agencies would rise and fall with the changing requirements imposed by the number of mergers reported.

Legislative action should also be employed to require the agencies to conduct and publish ex post reviews–retrospectives–of the outcomes of mergers and acquisitions that come before them. An on-going program of retrospectives of permitted, challenged and abandoned mergers would, over time, result in a data base of crucial evidence about agency decisions, business responses, and competitive outcomes. This would complement other sources of evidence and evaluation, including economic theory, statistical evidence, and some studies conducted by academics and others. The agencies' own experience is a large, and largely untapped, source of information that would improve enforcement.

There are, of course, questions concerning about the number and choice of which mergers and acquisitions to study each year, and how to conduct the studies and report the results. These are practical issues that have practical solutions and should not prevent implementation of this important policy. For example, it might be required that each agency select five important matters on which to conduct such reviews annually. Their choices might be reviewed by an independent agency or board. Both agencies would need the authority to compel production of essential information from companies, as well as the resources to conduct such studies. The product of their analysis should be put on the record, subject to the usual confidentiality restrictions. Within a relatively short period of time, these retrospectives would comprise an important new basis for improving ongoing agency decisions and actions.

Given their growing importance, a particular focus on these retrospectives should be on merger remedies. These would not only help determine their overall effectiveness but also the circumstances under which they are more or less effective, and the types of remedies most appropriate to those circumstances. There have been occasional efforts by the agencies (notably, the Federal Trade Commission) to review their remedy experience and policy, but those efforts have been flawed and risk seriously misguiding future actions.

A final legislative proposal would be to establish a Digital Competition Authority. Such an agency would not deal with mergers and acquisitions in the tech sector, nor would it supercede the antitrust agencies in addressing monopoly practices. Rather, it would be a rule-making body, similar to other independent regulatory agencies that set out impermissable conduct by the tech companies in advance, in contrast to the antitrust process that addresses conduct that has occurred. Thus, it might establish criteria for permissable use of most favored customer clauses, or for self-preferencing algorithms. Such rule-making represents the comparative advantage of regulatory bodies, clarifying the acceptability of actions ex ante, and thereby reducing the need for antitrust actions ex post.

I believe this package of legislative actions would substantially strengthen the institutional structure of antitrust enforcement focused on the digital sector.