Understanding Innovation and Its Role In U.S. Merger Review

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Remarks of FTC Commissioner Terrell McSweeny

I am pleased to be here today to join this discussion about the conditions that drive innovation and how best to foster them. My remarks are my own and do not necessarily reflect the views of the Commission or any other Commissioner.

With that said, my position is a relatively unsurprising one for a competition enforcahe v.oon e-1(a)a2 (s

For the past half century, economists have examined the relationship between market structure and innovation. Joseph Schumpeter claimed that an innovator required some market power.½Ë Ä'¤ .NB ¢3*g äÒ¤! Bä""¾A#"ä ¤"ì¬Ò2Arrow focused on a firm's incentives to innov
better product, it can make money by taking share away from its competitors. A monopolist, however, has no share left to take and will only make money from an innovation to the extent that it expands the entire market.

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Even if it is possible, in theory, for "too much" competition to exist, there seems to be increasing empirical evidence that most industries are not close to the point at which less

[1] *See* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY, VIII (3d ed. 1950).

[2] Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, *in* THE RATE AND DIRECTION OF INVENTIVE A

competition would foster more innovation. A panel of prominent economists discussed these issues at the FTC's 9th Annual Microeconomics Conference last November. Professor Chad Syverson explained that the general pattern is that "competition tends to increase innovative activity."[4] That view was largely shared by the other panelists.

So what does that mean for merger review? Quite simply, a merger that would not produce immediate effects on prices or quality can still harm consumers by decreasing the rate of innovation. The U.S. antitrust agencies' 2010 *Horizontal Merger Guidelines* include a section that specifically addresses innovation effects.[5]

The FTC routinely challenges mergers that would harm competition in the research and development of new drugs and treatments. In some situations, we may specifically define a relevant "research and development market."[6] These cases focus on protecting incentives for incremental innovation along a fairly well-defined path. But innovation can also be a key factor when a merger might eliminate an independent disruptive innovator. This is particularly true when a firm is planning to enter a market with a new technology. Protecting this innovation has been a key factor in two recent FTC merger challenges.

In late 2014, the FTC challenged the proposed acquisition of EagleView Technology by Verisk Analytics. EagleView was the leading U.S. provider of "roof reports," rooftop aerial measurement products used by insurance carriers. Verisk was the leading provider of downstream software platforms, but had recently taken steps to offer roof reports itself. The FTC closely examined whether likely future competition between the merging parties would offer customers ever more innovative products and concluded that Verisk was uniquely well positioned to compete against EagleView.[7] Verisk had invested in capturing higher-resolution

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[4] Chad Syverson, as quoted in Charles McConnell, *Top Economists Debate Competition-Innovation Connection*, GLOBAL COMPETITION REV., Nov. 4, 2016, http://globalcompetitionreview.com/article/1073077/top-economists-debate-competition-innovation-connection.

[5] *See* U.S. DEP'

aerial images than those used by EagleView, which promised even more accurate measurement tools for customers.[8] So while the FTC did not define an "innovation" market, innovation nonetheless played a crucial role in staff's analysis and in the decision to challenge the merger.

A year later, in 2015, the FTC challenged the merger between the second and third-largest sterilization companies in the world, Steris and Synergy. The FTC alleged that the merger would harm future competition by putting an end to Synergy's plans to enter the U.S. market with a promising new x-

PowerReviews had "pushed each other to innovate in ways that help[ed] consumers and retailers."[12]

The DOJ's challenge to AT&T's proposed acquisition of T-Mobile in 2011 also featured innovation effects prominently. The DOJ alleged that consumers would face not only higher prices and less variety – but less innovation post-merger.[13] The complaint observed that T-Mobile had "been responsible for numerous 'firsts' in the U.S. mobile wireless industry," that T-Mobile had "been an innovator in terms of network development and deployment," and that "AT&T [had] felt competitive pressure from T-Mobile's innovation."[14] Since 2011, T-Mobile has built an expansive LTE network and disrupted the standard service plan model by eliminating the two-year contract and offering unlimited data plans.[15] Today, T-Mobile's website advertises T-Mobile as "#1 in network innovations for customers" with "more LTE technologies launched in the last three years than anyone in the industry."[16]

Innovation can play an important role in the analysis of mergers in digital markets, particularly in two-sided markets where a tradit6(t)e p4(as)]TJ 0 Tc 0 Tw 1.. 0.008 Tc -0.008 Tw 8.04 3t.00l4

combined entity's incentives to innovate by developing new features attractive to consumers on the free side of the market.[17] Although staff did not find reason for concern in that matter, the investigation is an example of how we look at these issues under the *Guidelines*.

I believe it is very important for antitrust enforcers to continue to carefully consider innovation effects in merger review in order to foster competitive and innovative markets. I look forward to our discussion this afternoon.