Pardon the Interruption: Competition and Disruptive Business Models

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It seems fitting that in this time of innovation I've

discuss a subject matter that animates virtually every competition investigatio

the role of disruptive business models in U.S. antitrust analysis.

Of course, the antitrust laws have been the touchstone of America's econ

125 years, starting with the enactment of the Sherman Act in 1890. Together

Trade Commission Act and the Clayton Act, the antitrust laws remain a central fe

national economic policy, setting standards for vigorous competition and preven

accumulation of market power that threatens consumer welfare and stymies e

may be tempting to think that century-old laws can't keep pace with the rate of c

paced, dynamic markets. Yet despite profound changes in the American econo

laws have stood the test of time by relying on a fact-based, analytically sound ap

accounts for changing market environments and new economic learning

Today I'd like to discuss the various ways in which so-called disruptive business models play a role in our investigations and enforcement decisions. While the term "disruptive business model" is a term that might mean something slightly different to different people, I consider a disruptive business model to mean a relatively new and efficient form of production, marketing, or distribution that provides an alternative to, and potentially threatens to erode the sales of, incumbent firms.

I will discuss how the emergence of disruptive business models may affect our analysis of a proposed merger—and indicate situations in which arguments about the likely impact of such models were pressed to no avail. I will also discuss our view of business conduct that is designed to forestall emerging threats from newcomers, and finally mention a couple of the FTC's competition advocacy efforts aimed at reducing regulatory barriers to new platforms or business models in markets characterized by long-standing (and possibly outdated) regulatory regimes.

Merger Analysis: Assessing the Impact of Disruptive Competition

In a typical merger transaction, the FTC investigates whether the proposed combination of two direct competitors is likely to substantially reduce competition in any market by eliminating one of those competitors. The central question of merger review in this situation is whether the elimination of that direct competition is likely substantially to lessen competition. As part of that analysis, we look at whether the transaction will affect not only competition on antitrust enforcers focused their efforts. But today's economy looks very different. Many of the markets we encounter today are not simple, commodity markets. Rather, most producers of finished goods actually compete with each other multi-dimensionally, and this is even more true in service markets, which can be highly differentiated. In these markets, price is just one dimension of the competitive rivalry, along with quality, service, reputation, innovation, and a host of other factors that distinguishes the offering of one competitor from another.[1]

To analyze a merger between two long-standing competitors, we typically start by examining historical facts. We look at what market shares have been in past years, whether the companies have marketed or bid against each other before and what factors influenced the prices they set. In a market where competitive conditions are stable, those historical facts may provide most if not all the informossc(t)-2(i)-2(o(w)2(e)4(one)4he)4(d(t)-2((f)-7ne)4he)4(l)-2((c)4( )-10(m)-2nf)3(or)3u

ssre)3n(y)22(p(s)0..35o)-()1(,2)(a)2(s)0.9A2.81(ta)6(rrt if) hisai(c)6w0 Td [0 Tc 0 T(0i.9(aio)2(n)2(ill,)2(th invariably, we are encouraged to examine some development lurking at the fringes of the market that creates uncertainty about competition in the future. For instance, we often hear claims that new or existing competitors are competing with a different mix of products or delivery options in a way that that threatens to upend current market dynamics. And where the facts bear that out, we are likely to close a merger investigation without action.

For instance, several years ago, when we reviewed Google's proposed acquisition of AdMob, we were initially concerned that the loss of head-to-head competition between the two leading mobile advertising networks would harm competition. At the time, the market for the development of advertising on mobile devices was just emerging, with changes occurring on many fronts, and our initial concerns ultimately were overshadowed by two subsequent developments in the market: (1) Apple's acquisition of the third largest mobile ad network, Quattro Wireless, and (2) Apple's introduction of its own mobile advertising network, iAd, as part of its iPhone applications package. Because of these changing circumstances, the Commission concluded that Apple quickly would become a strong mobile advertising network. The timing and impact of Apple's entry in the market led the Commission to conclude that AdMob's success to date on the iPhone platform was unlikely to be an accurate predictor of AdMob's competitive significance going forward, whether AdMob was owned by Google or not. Accordingly, the Commission unanimously voted to close its investigation without taking action against the merger.[2]

In the retail sector, we often hear that pressure from online businesses is shifting sales away from traditional brick-and-mortar stores, and this dynamic can affect our market analysis in certain retail sectors. For example, last year, the Commission modified an existing 1998 conduct

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[2]FTC Press Release, *FTC Closes its Investigation of Google AdMob Deal*, (May 21, 2010), *available at* https://www.ftc.gov/news-events/press-releases/2010/05/ftc-closes-its-investigation-google-admob-deal.

food distributors, the companies claimed that a combined Sysco/US Foods would face growing competition from a disruptive business model called “cash and carry” outlets succeed, they claimed, if the hospital employed a critical mass of doctors.

estimate repair costs for property damage claims.[12] Until 2008 – when EagleView first offered its roof reports using proprietary software to analyze aerial images – insurance adjusters climbed on

Both companies were developing cross-platform measurement services, which measure viewership across TV, the Internet, and other platforms. Both firms had developed plans, invested money and reached out to customers to begin marketing those products, albeit in beta form.

Customers confirmed that while other companies can provide estimates of aggregate cross-platform viewership, only Nielsen and Arbitron provide individual demographic data that is valuable to measure effective advertising spends. Moreover, each firm was approaching a complete solution from its unique competitive position. Nielsen already offered products that combined television and online viewing. Arbitron was collaborating to combine demographic data from its radio panel with data from set-top boxes and online measurements. Based on these independent efforts, customers believed that Nielsen and Arbitron eventually would compete directly in any national syndicated cross-platform measurement services.[13] The Commission based its decision not on crystal-ball gazing about what might happen, but on evidence from the merging firms about what they were doing and from customers about their expectations of those development plans. From this fact-based analysis, the Commission concluded that each company could be considered a likely future entrant, and that the elimination of the future offering of one would likely result in a lessening of competition.

To resolve these competitive concerns, the Commission required Arbitron to divest assets related to its ongoing development efforts, including audience data with individual-level

[13] A national syndicated cross-platform audience measurement service is one that provides all subscribers with the same universe of data, showing the relative national audiences for various programming and advertising. Complaint, *In the Matter of Nielsen Holdings, N.V. and Arbitron Inc.*, Dkt. C-4439 (F.T.C. Sept. 20, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/09/130920nielsenarbitroncmpt.pdf.

showed. The outcome of this latest case reminds us that it can be hard to prove what is likely to happen in the future, and the farther out into the future, the harder that task is. Notwithstanding this loss, the Commission will continue to challenge transactions that eliminate future competition in violation of Section 7.

Preserving existing and emerging competition in technology sectors can be especially important to ensure that technological advances continue to drive growth in the economy, creating jobs and introducing more efficient products and processes into the marketplace. It is therefore important that we examine dynamic industries as we do any others – with rigorous fact-finding and analysis. Some firms may need to expend more effort, either in terms of time or sunk costs, to begin making sales in the relevant market, and the competitive significance of such firms will depend on how far along they are in the variety of concrete steps needed to begin actual sales and the likelihood such entry will occur.[16] This is a fact-specific inquiry, with the outcome of the analysis highly dependent on how far along the newcomer is with its plans to enter. We ask: What are firms doing? Are they developing new products? What do the firms' documents say about those developments? What are third parties doing? Compared to the merging parties, are third parties advantaged or disadvantaged in their efforts to develop a product and then compete in the future? What do customers say about competition in the future based on what 2(s)-1(d44(2(s.edbTw 16.08 85s)-1(h)-1n4(s)-i)i-(,)-4(1(act[.1 b[.1 b[.1 b[.1 b[.1 b[n .19 -2.3 T

raised concerns about its proposed

methods to perform tasks that once were the exclusive domain of brokers, there was increased demand for innovative, non-traditional brokerage services. In a typical limited-service brokerage package, a home seller might choose to pay a broker only for the service of listing the home in the local Multiple Listing Service and placing advertisements, while the seller would handle negotiations and paperwork with the buyer. These limitedamounted to a concerted refusal to deal with nontraditional listings on substantially equal terms, which likely protected full-service brokers from competitive pricing pressure on commissions. According to the court, "[r]estricting the online dissemination of home listings is especially pernicious because of the emerging competitive impact of the internet and of discounted brokerage services on the residential real-estate market."[19]

More recently, the FTC challenged the conduct of a professional licensing board for attempts to exclude competition from non-dentists for teeth-whitening services. In 2010, the Commission charged that the North Carolina State Board of Dental Examiners violated the federal antitrust laws by sending cease-and-desist letters to non-dentists providing teeth whitening services in competition with the state's licensed dentists.[20] NC Board is a state agency established under North Carolina law and charged with administering and enforcing a licensing system for dentists. A majority of the members of the Board are themselves practicing dentists, and thus they have a private incentive to limit competition from non-dentist providers of teeth whitening services. When non-licensed teeth whitening practitioners began offering teeth whitening services at a lower prices than dentists, the Board took action, declaring that teeth whitening constitutes the practice of dentistry, and informing the non-licensed practitioners that they must stop providing those services.

The Board argued that, because it is a state agency, its actions were shielded from federal antitrust law by the state action doctrine. Earlier this year, the Supreme Court rejected that argument, and allowed the Commission's decision to stand: because the Board was not actively supervised by uninterested state officials, deny would-be competitors access to the market.[21] Consumers in North Carolina can once again choose to use non-dentist providers of teeth whitening services.

As a final note, it is important to remember that even though new products and new business models seem far removed from the smoke-stack industries that animated early antitrust enforcement, the antitrust laws still apply to businesses and individuals competing for customers in the marketplace no matter how or where they do business. This spring, DOJ announced its first criminal case involving wholly online commerce, charging a former executive of an e-commerce seller of art with fixing prices for certain posters sold through Amazon Marketplace.[22] In a similar case last year, the FTC ordered two Internet resellers of UPC barcodes to stop inviting competitors to join in a collusive scheme to raise the prices charged for barcodes sold online.[23]

Advocacy Initiatives

The FTC has tools other than enforcement—namely, research and advocacy—to advance free market principles and encourage competition and innovation. We conduct studies, host workshops, and provide comments to state and local governments about the benefits of vigorous competition and the pitfalls of adopting policies that favor one group of competitors over another. As a general rule, the Commission strongly believes that competition should only be restricted when clearly necessary to achieve some countervailing benefit such as protecting the public from significant harm. That principle should apply when considering new regulations, but it should also motivate policymakers to review existing restrictions on competition to ensure that

[21] *N.C. State Bd. of Dental Exam'rs v. FTC*, 135 S. Ct. 1101 (2015).
[22] DOJ Press Release, "*Former E-Commerce Executive Charged with Price Fixing in the Antitrust Division's First Online Marketplace Prosecution,*" Apr. 6, 2015, available at http://www.justice.gov/opa/pr/former-e-commerce-executive-charged-price-fixing-antitrust-divisions-first-online-marketplace.
[23] *In re 680 Digital, Inc., d/b/a/ Nationwide Barcode*, C-4484 (F.T.C. Jul. 21, 2014) and *In re Jacob J. Alifraghis, d/b/a/ InstantUPCCodes.com*, C-4483 (F.T.C. Jul. 21, 2014).

enough to allow new forms of competition. Often, the existing regulations governing the traditional industry (e.g., taxicabs or hotels) have been in place for decades without much change. In our advocacy letters, we often encourage policymakers to periodically review and, if necessary, revise their regulatory schemes to facilitate and encourage the emergence of new forms of competition that would benefit consumers.

In addition, any regulatory response should be narrowly tailored to the specific public policy goals that have been identified. In general, we recommend that regulations should allow for flexibility and adaptation in response to new and innovative methods of competition, while still maintaining appropriate consumer protections. For instance, regulation of vehicle transportation, including those that use new computer and phone-based applications to arrange rides, should focus primarily on ensuring qualified drivers, safe and clean vehicles, sufficient

dealers as the best method of distribution for their products based on consumer preferences and other business considerations. But other manufacturers might decide to develop new distribution models that offer potential efficiencies that could be passed on to consumers in the form of better pricing or quality of service. As in other areas of the economy, without a blanket restriction on direct distribution, we would likely see a combination of dealer distribution and direct sales—or perhaps some entirely different mode of distribution that is only now on the drawing board.

Our advocacy in this area appears to be paying off—at least for Tesla and at least in New Jersey. The state legislature there recently passed legislation that specifically allows Tesla to operate a handful of direct sales outlets in the state. Time will tell if other states reexamine their restrictions on direct-to-consumer sales, especially if consumer interest in that option grows.

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It has been a pleasure speaking in front of you today. Thank you.