DEPARTMENT OF JUSTICE

Preserving Competition
The Only Solution, Evolve

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I wish to thank Spencer for inviting me to speak at this year's Loyola Antitrust Colloquium. It is a privilege for me to be with you here today to share some thoughts about the Antitrust Division's enforcement mission.

Today I would like to talk about the goal of antitrust enforcement. My focus will be on mergers but similar concepts apply in non-merger areas as well. So what is our objective in enforcing the antitrust laws? You might think the answer is obvious. The purpose of antitrust law is to preserve competition. But in the fog of analysis that often accompanies the parties' defense of a merger, we are sometimes asked to focus more on the preservation of existing commercial outcomes than on protecting the competitive process itself.

We need to be on guard against such arguments. Competition is not static. It can lead to disruptive and often unpredictable changes in a market. It can lead to product innovation and to falling – rather than stable – prices. If we were to make our enforcement decisions only on the basis of near-term demonstrable effects on trading terms, we would leave unaddressed those transactions that may have a less quantifiable but still very real impact on competitive dynamics in an industry.

Our recent challenge to National CineMedia's acquisition of Screenvision is one variant of what I am describing. First, the facts of the case. Each party operates a cinema advertising network that connects advertisers to movie theaters so that advertisements can be shown during pre-shows that lead up to the beginning of a motion picture. Advertisers benefit from this because they get to show their ads in an attractive setting – with high quality video and sound and an audience that cannot change the channel. And movie exhibitors benefit from being able to monetize their screens further through ad revenue. The defendants enter into contracts with exhibitors under which the parties split the revenue that is generated from ad sales, and then sell access to advertisers to show their ads across the network of theaters that are under contract with the particular network. National CineMedia and Screenvision are the only two significant cinema advertising networks in the United States, with an extremely high combined revenue share.

Our complaint alleged two relevant markets – one for the sale of cinema ad slots to advertisers and the other for exhibitor services that allow movie theaters to obtain ad revenues. We alleged that the transaction would result in a monopoly or near-monopoly in each of these markets.[1] The defendants contested our alleged advertising market, arguing that cinema ads compete in a broader market that includes television and online video ads. If the defendants were correct about this market – a point on which we strongly disagreed – then their combined shares would have been relatively small since television and online ads account for a much larger amount of ad spending than cinema ads. If we were correct, then the

[1] *See generally*, Complaint, U.S. v. National CineMedia, Inc. et al., No.14 CV-8732 (S.D.N.Y. Nov. 3, 2014), *available at* http://www.justice.gov/atr/cases/f309600/309659.pdf.

merger would have essentially created a monopoly in this market. We were confident we would prevail on this issue, but that is not my focus today.

With respect to exhibitor services, the defense made a different point. They argued that exhibitors were protected by existing contracts and would actually benefit from increased ad revenue under their revenue sharing agreements. Moreover, as alleged in our complaint, the defendants had gone into the market after announcing their merger and offered exhibitors the opportunity to extend their existing contracts by five years. Some exhibitors took them up on the offer. Thus, argued the defendants, customers were protected against less favorable contract terms arising out of the merger for a number of years into the future. In other words, although exhibitors would lose the benefits of competition going forward – in fact, would have to deal with a monopolist – they would be just as well off or better off relative to the current commercial situation.

We were not persuaded by this argument. To begin with, this was a merger to monopoly. It is hard to imagine a circumstance in which we would allow a merger to monopoly based on a defense that customers are protected by contracts and might benefit from increased revenue in a related market, especially one we also view as merging to monopoly. As noted in the Horizontal Merger Guidelines, "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."[2] The defendants' efficiency argument didn't come close to persuading us that we should allow the creation of a monopoly here.

More to the point for present purposes, however, long-term contracts do not replicate the benefits that competition brings to a market. They might lock in commercial terms but they do not preserve competition. Competition can drive suppliers to offer better terms when contracts come up for renewal. And while it may be less apparent, the presence of competitors during the life of a contract can matter. Service and cooperation during the term of a contract can be critical. Having competitors out there ready to move in when contracts expire may confer substantial benefits on existing customers. Competition can also drive innovation in business models, products, service, and quality. As rival suppliers seek to distinguish themselves, it can lead to differentiated offerings that provide valuable choice to customers. This was certainly observable in cinema ads, where the defendants had been improving their products and adjusting their contract terms in competition with each other and where the smaller competitor, Screenvision, was offering more flexibility in how cinema ads were delivered to theaters.

If we were satisfied to let long-term contracts solve our competitive concerns, customers would be locked into existing arrangements and lose these

[2] U.S. Dept of Justice and Fed. Trade Comm'n, HORIZONTAL MERGER GUIDELINES §10 (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf .

future benefits. Much like the platypus and the South American lungfish – famously described by Charles Darwin as "living fossils" because "they have endured to the present day, from having inhabited a confined area, and thus having been exposed to less severe competition" – the competitive outcome would be frozen in time.[3] We must preserve the evolutionary process by which gazelles and dolphins emerge in a market rather than permanently stick customers with only platypuses and lungfish.

Moreover, confronted with the possibility of dealing with a monopolist or a substantially less competitive market in the future, many customers will choose to protect themselves through contract extensions while a merger is pending, rather than risk an even worse situation in the future. But placing customers in such a Catch-22 does little to inform us about whether they are protected against the anticompetitive effects of a merger. In addition, as noted in Section 2.2.2 of the Horizontal Merger Guidelines, "[a] customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger's harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals."[4] So in short, parties to anticompetitive mergers should not expect us to be persuaded by such contractual solutions.

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[3] CHARLES DARWIN, ON THE ORIGIN OF SPECIES 120 (4th ed. 1866).

[4] HMG, *supra* note 2, § 2.2.2.

This is not a novel concept. In considering remedies where horizontal competition is lost as a result of a merger, the agencies have long insisted on structural relief that restores competition permanently. It is surprising how often we hear suggestions that our competitive concerns in such transactions can be addressed by mechanisms such as contract extensions, supply contracts or behavioral conditions.

The parties to the Anheuser-Busch InBev (ABI)/Grupo Modelo beer merger attempted to go down this path. They proposed to divest Grupo Modelo's stake in its U.S. distributor, and to enter into a 10-year agreement to supply Modelo beers to that distributor. The Antitrust Division rejected this vertical "fix" to the horizontal combination of ABI and Grupo Modelo, and sued to block the deal. Ultimately, ABI agreed to divest Grupo Modelo's newest and most technologically advanced brewery along with a perpetual license to the Corona and other Modelo brands. This remedy enabled the divestiture buyer to serve as an independent, fully-integrated brewer with every incentive to compete aggressively in the United States.[5] Today, sales of Modelo branded beers in the United States are at an all-time high and growing at a rate that exceeds the industry average.[6]

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[5] *See*, Competitive Impact Statement at 9-18, U.S. v. Anheuser-Busch In Bev SA/NV, et al., No. 13-127 (D.D.C., Apr. 19, 2013), *available at* http://www.justice.gov/atr/cases/f296000/296027.pdf.

[6] *See e.g.* Press Release, Constellation Brands, Constellation Brands Reports Fiscal 2015 Results and Fiscal 2016 Outlook (Apr. 9, 2015) ("'We have completed another year of impressive results propelled by our Mexican beer business, which continues its incredible momentum and remains strongly positioned to generate ongoing sustainable

The exhibitor services market in the cinema advertising case is an example where it was relatively easy to predict significant price effects since it was a merger to monopoly, but the defendants sought to neutralize those price effects through long-term contracts. What if price effects are not predictable or quantifiable in the first place? What if the evidence shows there will be a significant loss of competition but the impact that will have is difficult or impossible to model? We must still be able to address a loss of competition in these situations.

The Horizontal Merger Guidelines reflect this. Section 1 recognizes "the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal."[7] That section also notes that enhanced market power can be "manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation."[8] These things are obviously harder to measure and predict than, say, price effects in a well-established market with a long history of bidding patterns. But they can be

growth. We outperformed the U.S. beer industry …' said Rob Sands, president and chief executive officer, Constellation Brands.")

[7] HMG, *supra* note 2, § 1.

[8] *Id.*

every bit as harmful to consumers and we must have tools in our toolkit to prevent these sorts of anticompetitive outcomes.

In discussing unilateral effects, the Merger Guidelines further observe that "[w]here a merger substantially reduces competition by bringing two close substitute products under common ownership… the merger will often lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect."[9] And with respect to coordinated effects, Section 7.1 of the Merger Guidelines notes that there are "numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof."[10] That section further explains that, "[p]ursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place."[11]

So, it is embedded in the genes of U.S. merger control that we might not be able to predict the form or extent of competitive harm in a particular transaction

[9] *Id.* § 6.4.

[10] *Id.* § 7.1.

[11] *Id.*

with much certainty.[12] One area in which we sometimes confront this is innovation competition. What if merging parties are the only two firms, or two of a small number of firms, with a broad R&D program developing new products or solutions to meet evolving customer demands? Maybe some of the products don't even exist yet. We do not know what the outcome of this innovation race will be because it is inherently unpredictable. But as rival firms try to improve technology and leap frog each other, it is likely that consumers will benefit in the long run from this dynamic. It would be a mistake to think that we disregard anticompetitive effects in a transaction combining two innovative firms simply because we cannot pin those effects to a specific product or predict or quantify what the impact on prices or output will be.

At the same time, we need to be careful to focus our attention on anticompetitive outcomes and not on competitively neutral or procompetitive transactions. Simply because two parties to a transaction make significant investments in R&D does not mean a merger between them violates the law. Indeed, combining R&D programs can produce synergies that enable firms to speed up the development of innovative products and compete more effectively with remaining rivals. We obviously do not want to stand in the way of those

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[12] *See also* U.S. v. Philadelphia National Bank, 374 U.S. 321, 362 (1963) ("[W]e come to the ultimate question under § 7: whether the effect of the merger 'may be substantially to lessen competition' in the relevant market. Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their 'incipiency.'")

transactions. Distinguishing these situations is a highly fact-based exercise. And in most transactions we review, we do not have a concern about innovation unless it is tied to a specific product overlap that also causes us concern. Our Antitrust Guidelines for Collaborations Among Competitors, for example, provide a "safety zone" for combinations of R&D programs where there are at least three other independently controlled R&D programs with the assets and incentive needed to engage in R&D competition with the collaborating firms.[13]

Moreover, where a merger is likely to cause harm under a more traditional theory, the Division will not fold its tent merely because it might be difficult to quantify a price or output effect with precision and certainty. This brings me to my next question. Is there a "*CSI* effect" in antitrust? Most of you are probably familiar with the concept of the *CSI* effect. Wikipedia defines it as the "exaggerated portrayal of forensic science on crime television shows such as *CSI: Crime Scene Investigation* influenc[ing] public perception. The term most often refers to the belief that jurors have come to demand more forensic evidence in criminal trials, thereby raising the effective standard of proof for prosecutors."[14]

In the field of antitrust, and in merger control in particular, we have developed wonderful economic tools over the past couple decades to analyze and

[13] *See* U.S. Dept of Justice and Fed. Trade Comm'n, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS §4 (2000), *available at* https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

[14] Wikipedia, http://en.wikipedia.org/wiki/CSI_effect (visited Apr. 20, 2015).

measure the likely competitive effects of a transaction. These tools work very effectively in many cases. In markets with differentiated products and a history of competition in which diversion ratios can be measured or inferred, we can use upward pricing pressure models. In commodity product markets with inelastic demand curves and supply curves that can be constructed from plant-level cost positions, we can measure with considerable accuracy how a merger might affect incentives of the merged firm to remove capacity from the market. Cournot models, Bertrand models, regressions, merger simulations – they are all very powerful tools for predicting the competitive effects of many of the transactions that come before us.

But what about those transactions where these methodologies cannot be applied reliably, or cannot be applied at all? Or those transactions where the economic science is open to debate and the experts cannot agree on how to apply the models? Or the data is not available to apply the models? Do we have to stand down in these situations?

Obviously not. We must be able to look at all sources of evidence about competitive effects, including industry structure, history of competition, history of innovation, testimony from knowledgeable witnesses, company documents, and the like. If this evidence leads us to conclude that competition will be harmed, we need to be able to challenge a transaction even without microscopic DNA evidence that shows up under ultraviolet light.

Parties often argue to us that we cannot prove a near-term effect on prices or output. They often bring us their own *CSI* evidence purporting to show that prices will stay the same or go down, that customers will not be hurt – using methods that might be untested and unique to the situation at hand. While these arguments are certainly relevant to our consideration of whether to take enforcement action in a transaction, and are sometimes persuasive in particular cases, they are only one part of the puzzle. Merger review is a predictive exercise and we look at all evidence and all circumstances in making these decisions. In other words, we cannot allow there to be a *CSI* effect on our decision-making.

As Attorney General Eric Holder noted last week, the antitrust laws' promises of competition, innovation, and growth are woven into the fabric of our country. As antitrust enforcers, it is not our job to pick winners or losers, to set prices, regulate output, or to lock in today's commercial arrangements. Nor do we need to be able to calculate with certainty an expected price increase from a transaction or business practice. Instead, by remaining focused on protecting the competitive process itself, we ensure that customers will profit from the dynamic and unpredictable benefits that inevitably spring from commercial rivalry. Open and vibrant competition is the engine of our free-market economy and it is the touchstone of effective antitrust enforcement.