

**SPOTLIGHT REPORT**

February 14, 2018

## Antitrust Policy at the FTC

**What's Happening:** The Senate Commerce, Science, and Transportation Committee held the confirmation hearing today for the four nominees selected by President Trump to serve on the five-member Federal Trade Commission (FTC). Set to take over as the new head of the agency is former director of the FTC's Bureau of Competition under President George W. Bush and Paul Weiss attorney Joseph Simons. The other three nominees are chief counsel to Senate Majority Whip John Cornyn (R-TX), Noah Phillips; Delta Air Lines regulatory counsel, Christine Wilson; and senior fellow at the Consumer Federation of America, Rohit Chopra.

**Why it Matters:** Since February of last year, the FTC has been operating with only two of its five seats filled – a situation that has not happened before in the agency's more than 100-year history. This has left the commission with little bandwidth to take up substantial action on antitrust matters and has led to significant uncertainty about what to expect from the FTC when dealing with competition issues under the Trump administration. With major deals already underway, and more expected to get announced over the next year, today's hearing gave lawmakers the chance to probe the next leadership at the FTC about what to expect in the future. Although the expected surge in M&A activity this year was a major focus at the hearing, even more interesting were the concerns lawmakers echoed in regard to big tech and antitrust – so much so that Committee Chairman John Thune (R-SD) jokingly referred to the FTC as the “Federal Technology Commission” in his opening remarks. While there is growing and bipartisan resentment in Washington of big tech companies like Amazon (**AMZN**), Google (**GOOGL**), and Facebook (**FB**), and the ongoing debate that has followed about whether the FTC's own analysis of post-merger competitiveness is robust enough to pose valid concerns for investors, we remain skeptical that a Republican-controlled FTC or Department of Justice (DOJ) will take substantial action against Silicon Valley. Despite our view that the new FTC under the leadership of Joseph Simons will be more aggressive when dealing with M&A proceedings, for non-merger enforcement action to be taken against big tech, there would have to be clear evidence of violations of the consumer welfare principle. This means that size alone will not be a sufficient enough reason for Simons to go after companies like Amazon, Google or Facebook. Rather, we believe Simons is only likely to take substantial action against one of the large tech companies in the case that market dominance is abused to the point where the

consumer welfare principle is violated.

**What's Next:** The two sitting commissioners at the FTC are expected to depart once the four new nominees are confirmed, which we believe will likely happen within the next three months, and before the Senate's August recess at the latest. While there have been bipartisan calls to amend US antitrust law in order to better reflect the changing market dynamics brought on by the digital age, including legislation that the Judiciary Committee's Subcommittee on Antitrust, Competition Policy and Consumer Rights Chairman Mike Lee (R-UT) and Ranking Member Amy Klobuchar (D-MN) are currently working on, we do not see anything getting passed this year, as partisan tensions remain high and the election in November will cut the legislative calendar short. Furthermore, many officials at the FTC and DOJ believe the broad scope of US antitrust law is adequate to adapt to changing markets.

## Simons's Lengthy Experience in Antitrust

Having begun his career at the FTC in the late 1980s, Joseph Simons is no stranger to the US antitrust process. Although he left the agency for a brief stint in the private sector, Simons later rejoined the FTC to serve as its chief antitrust enforcer in 2001. In this capacity, Simons pursued a strong bipartisan enforcement agenda, taking up more than 70 antitrust enforcement actions, with only one of them not decided by unanimous vote. Simons was also a key figure behind the FTC's new emphasis on administrative litigation at the time and was responsible for substantially increasing the number of trials before the agency. In addition, Simons helped develop the "Critical Loss Analysis," a technique for market definition that has since been incorporated into the DOJ/FTC Merger Guidelines.

After leaving the FTC in 2003, Simons joined the antitrust practice at Paul Weiss where he represented a number of clients across a variety of different industries. Most notably, Simons represented Rockstar – a consortium made up of Microsoft, Ericsson, RIM, and Sony – in its efforts to acquire the patent portfolio of Nortel Networks in a bankruptcy court approved auction. Other past clients include the Sharp Corporation, News Corp., MasterCard Inc., and the Lightstone Group.

We expect that Simons will continue where he left off at the FTC and be aggressive when dealing with M&A proceedings as well as non-merger enforcement actions. In his [prepared documents](#) to Congress, Simons raised concerns that the FTC has been "too permissive" in dealing with M&A, and says this has resulted "in harm to consumer welfare via increased prices, limited consumer choice, and harm to workers." He also pointed out that merger remedies imposed by the FTC in "cases involving divestitures of asset packages not involving stand-alone businesses had a 30 [percent] failure rate," which he believes is far "too high and needs to be lowered substantially or, ideally, zeroed out altogether."

## Simons's Overall Enforcement Philosophy

We expect Simons will follow very much the same approach to antitrust enforcement that he took when he served as director of the FTC's Bureau of Competition. [Some of the criteria](#) that the FTC is expected to adhere to when evaluating possible cases includes:

- “Whether the conduct allegedly involved is of a type (such as agreements among competitors about price or other elements of competition) that poses the greatest threat to consumer welfare”
- “Whether the matter involves a sector of the economy that significantly affects consumers' budgets (e.g., health care, including prescription drugs; energy; food, and e-commerce)”
- “Whether the agency has enforcement experience in an area that will enable us to make an impact quickly and efficiently”
- “Whether the matter presents a legal issue that might benefit from further study and illumination”

**Vertical mergers:** Since vertical mergers are less common than horizontal mergers, we expect vertical merger enforcement will be a small part of the FTC's overall merger workload going forward. Nonetheless, when dealing with vertical mergers, we expect that the FTC under Simons will favor structural over behavioral remedies, much like DOJ Assistant Attorney General for Antitrust Makan Delrahim.

Delrahim famously has taken AT&T (**T**) and Time Warner (**TWX**) to court to prevent the companies from completing a vertical merger without structural remedies. The outcome of that case, expected in April or May, will affect Simons's practice at the head of the FTC, but is unlikely to have nearly the same effect it will on the DOJ. If the DOJ loses its case, Delrahim will look weak when negotiating agreements with merging companies, but Simons has a long history of successful cases and will be able to point to those to bolster his hand. If the DOJ wins its case, that will allow Simons to push the boundaries a bit more, since the precedent for future cases will be in his favor.

**Non-merger enforcement:** We also expect the FTC to continue to focus on non-merger enforcement actions, though the agency's emphasis on this could be scaled back given the number of major M&A deals currently in the works and the expectation such activity will only increase over the next year. This is where Simons is most likely to deviate from current acting Chair Maureen Ohlhausen, though we do not expect him to step outside the traditional antitrust bounds in doing so. Instead, we believe Simons will only take action when companies abuse their market dominance by way of restricting competition.

In a [2003 speech](#), Simons laid out a hypothetical example where this might happen. “If a case is about the legality of conduct that would permit a branded drug manufacturer to squeeze out another year or two of monopoly status after the patent expires for a billion dollar a year drug, there is an incentive to fight.”

There is also a chance that, once confirmed, Simons might choose to pursue charges against Qualcomm (**QCOM**) for allegedly using anticompetitive tactics to maintain its monopoly in the supply of a key semiconductor device used in cell phones and other consumer products. The charges were [originally filed by the FTC](#) days before President Obama left office, with acting Chair Ohlhausen vigorously dissenting.

The current two-commissioner makeup of the FTC has resulted in a deadlock on this matter, though this could soon change once the three Republican commissioners and the one Democrat commissioner get confirmed. While it is too early to determine what Simons's position on the Qualcomm case will be, it is likely that he will have more of a desire to stick with the case than Ohlhausen. It should be noted that in a [similar case involving Rambus, Inc.](#) back in 2002, when Simons was still at the FTC, the agency charged that the memory chip maker was "deliberately engaging in a pattern of anticompetitive acts and practices that served to deceive an industry-wide standard-setting organization, resulting in adverse effects on competition and consumers." Rambus eventually won the case in 2008 after a federal appeals court threw out the FTC's ruling.

## **Silicon Valley: The Big, the Good, and the Ugly**

Coinciding with the immense growth in market capitalization that companies like Amazon, Google, and Facebook have enjoyed over the past year, there has been the emergence of a somewhat bipartisan, populist movement calling for greater antitrust action and oversight of the roles that big tech plays in the lives of average Americans. The negative sentiment towards Silicon Valley at the moment has only been exacerbated by the constant press coverage about Russia's meddling in the 2016 presidential election, the tax avoidance measures Amazon and Apple (**AAPL**) engage in, and the allegations, particularly from those on the right, that Facebook and Twitter (**TWTR**) are pushing a liberal bias through their respective platforms.

The recent actions taken up by European regulators against Google and Amazon for engaging in anticompetitive and monopolistic behaviors have also led many in the US to call for stronger action. But while it might seem like the tides are changing for big tech, we remain skeptical that US regulators take any substantial action against Silicon Valley so long as Republicans are in control of the DOJ, the FTC, and the Congress.

**Big Tech and the FTC:** A number of committee members – both Republican and Democrat – used their time at today's hearing to probe the four nominees about how they might deal with big tech. Although somewhat vague, the responses Simons gave are worth noting. When asked by Committee Chairman John Thune (R-SD) whether "a more nuanced" approach that "is not based on size alone" would be appropriate in dealing with big tech, Simons said that he believes big can either be bad or good. "Often times, companies get big because they are successful with the consumer. They offer a good service at [a] low price. And that's a good thing, and we don't want to interfere with that," he added. "On the other hand, companies that are already big and influential can sometimes use inappropriate means – anticompetitive means – to get big or to stay big.

And if that's the case, then we should be vigorously enforcing the antitrust laws and attacking the conduct and prohibit it."

Senator Ted Cruz (R-TX) also asked Simons about his stance on big tech. Simons indicated that the firms with the greatest market power are the ones "most likely to have antitrust problems." When "anticompetitive conduct is occurring there, that's where you get a big bang for the taxpayer buck, by enforcement in those areas," he added.

Simons's answers suggest that, like Ohlhausen, substantial action against a company like Amazon will only be taken up in the case that market dominance is abused to the point where the consumer welfare principle is violated.

Noah Phillips, another Republican nominee, seemed to agree. In his testimony, he described the significant role social media platforms play in his life and even in the lives of his young children.

Phillips's remarks can explain why the tech giants of today are some of the American public's most beloved brands. As a recent [Esquire article](#) explained, the reliance that Western societies place on Google is why so many people have come to see it as "our immediate, all-knowing oracle of answers from trivial to profound" and as if it were "our modern-day God." Facebook, on the other hand, "appeals to the heart." This can explain why the social media network has more than 2.1 billion monthly active users. When it comes to online shopping, E-commerce giants like Amazon allows anyone with Internet access to purchase practically anything they want with the click of a button. Greater consumer choice and for the most part, lower prices, are why Amazon has done so well in the past couple of years. As long as regulators continue to believe these reasons are the basis for the companies' market dominance, we do not expect them to take action.

**Net Neutrality and the FTC:** Although not discussed in very much detail at today's hearing, the recent decision by the Federal Communications Commission (FCC) to eliminate Obama-era rules and reclassify broadband as a "lightly regulated" Title I information service is important, as the FTC will now take the lead when policing Internet service providers (ISPs). It is unclear whether Simons has an appetite to take significant action on this front, but it should be noted that he has direct experience dealing with the FCC and the wireless industry in general. In 2000, while in private practice, Simons was chosen by the DOJ, and later approved by the FCC, to serve as a trustee of four wireless telephone businesses relating to the GTE/Bell Atlantic/Vodafone transaction. As the temporary holder of the FCC spectrum licenses, he was effectively the 10th largest wireless carrier in the US, and assisted in managing as well as divesting these businesses valued at over \$2 billion.

However, Democrats and consumer groups have long expressed skepticism over the FTC's ability to police ISPs' conduct. Some of the more vocal opponents, like Senator Elizabeth Warren (D-MA), believe the FCC's recent decision could have "the potential to make vertical media consolidation like the AT&T/Time Warner deal even more dangerous."

Since throttling, blocking, and paid prioritization practices will now be permitted, so long as they are properly disclosed, it is likely that the FTC's antitrust purview will expand into the business operations of major ISPs like Verizon (**VZ**), T-Mobile (**TMUS**), and AT&T. At least for the next year however, ISPs are not expected to violate the newly enacted Restoring Internet Freedom Order or deliberately engage in anticompetitive behavior that would warrant an antitrust investigation by the FTC. But if ISPs choose to engage in such conduct later down the road, the more hands-off approach of the FTC and the slow-moving process of antitrust litigation will likely turn out to be beneficial for ISPs in the long run.

## **Price-Fixing and Algorithmic Pricing**

Recent advances in technology and the growth of e-commerce has led both the FTC and the DOJ to take a fresh look at their approach to competition policy in the digital era. This is especially relevant in terms of federal regulatory agencies' efforts to mitigate "the risks associated with the use of data and computer algorithms in enabling new forms of collusion," as outlined in a [June 2017 paper](#) submitted by the DOJ's Antitrust Division and the FTC.

Many online-centered firms, and in particular Amazon, use sophisticated algorithms to set pricing due to the vast amount of pricing data that is available. This allows firms to change prices very quickly and it is relatively inexpensive. While such dynamic pricing mechanisms are generally seen in the eyes of US antitrust law as being pro-competitive because they can facilitate firms to respond competitively when adjusting their prices, "the speed and ease of algorithmic pricing may affect an individual firm's behavior where such systems are widely used." As the DOJ and FTC's report notes, "rapid automated pricing programs likely reduce the benefit that a firm would otherwise enjoy from either discounting (in a free market) or defecting from collusive pricing (in a cartelized market)."

Because US antitrust laws "are not price-control statutes and do not provide any basis for price regulation," there are times when monopoly power is permitted. While this is considered an important element of the free-market system, it also leads to some ambiguities that can make it difficult for antitrust regulators to bring a case against a firm or a group of firms for engaging in parallel pricing conduct.

As the report suggests, it is likely that probes involving parallel pricing are outside the reach of the antitrust laws, and even more so when there lacks "proof of collusion or evidence that the knowing parallel adoption of pricing formulas narrowed the range of prices over time."

One company that recently was subject to a probe conducted by the FTC involving pricing strategies as a condition of its acquisition of Whole Foods was Amazon. Deciding that the deal would benefit consumers through lower prices and greater choice, the FTC chose not pursue this matter further despite an outcry from Democrats and consumer groups.

As “the first practicing attorney to evaluate monopolization and vertical restraints under the theory of ‘Raising Rivals Costs’” – an approach that now plays a crucial role in the antitrust analysis at the FTC and the DOJ – we believe Simons will likely prioritize efforts to go after companies that engage in harmful pricing strategies. However, as Bruce Hoffman, the acting director of the FTC’s Bureau of Competition, has noted, the FTC will not act as if it were the “price police.” Instead, the FTC under Simons’s leadership will continue to take action on a case-by-case basis and “apply antitrust policy to fit changing markets.”

This might mean taking up cases like the one that the DOJ successfully tried against a former executive and e-commerce retailer for conspiring to fix the prices of posters sold on the Amazon Marketplace in 2015. Like eBay, the Amazon Marketplace is structured so that Amazon itself determines the order in which to display the products in response to a customer query. Amazon was never charged in the 2015 case, and it is unlikely that the e-commerce giant would get knocked with substantial penalties for something like this in the foreseeable future.



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