

**Comments of the Electronic Frontier Foundation
on the Department of Justice / Federal Trade Commission
Draft Vertical Merger Guidelines**

The Electronic Frontier Foundation (EFF) is the leading nonprofit organization defending civil liberties in the digital world. Founded in 1990, EFF champions user privacy, free expression, and innovation through impact litigation, policy analysis, grassroots activism, and technology development. With over 30,000 dues-paying members and well over 1 million followers on social networks, we focus on promoting policies that benefit Internet users. We work to ensure that rights and freedoms are enhanced and protected as the use of technology grows.

EFF commends the Department of Justice and the Federal Trade Commission (the Agencies) for working to replace the outdated 1984 Non-Horizontal Merger Guidelines, which are not at all suited to modern economic realities. Vertical mergers abound today in many important segments of the economy, including digital technology and Internet access markets. In many instances, these mergers raise anticompetitive concerns the prior guidelines neither anticipate nor address.

We are pleased that the new draft rightly disposes of the presumption that vertical mergers are procompetitive, a presumption that cannot stand in the light of recent history. But there is more to be done. In particular, the draft guidelines do not fully address how vertical mergers can distort the competitive process and harm consumers. In addition, the proposed 20% market share threshold would raise an arbitrary barrier to necessary scrutiny of some vertical mergers. In this comment, we recommend several additions to the draft guidelines, as well as the deletion of arbitrary and unjustified limitations.

I. Addressing the Harms of Vertical Integration in High-Tech Industries Requires a New Approach.

Like much of the U.S. economy, Internet-related businesses have experienced a rise in market concentration. Markets for Internet access, creative content accessed via the Internet, and platforms for communication via the Internet are now dominated by small groups of firms. These firms have, in many instances, achieved their scale and market position through a series of vertical mergers and acquisitions. Over time, these acquisitions have given the largest Internet firms non-replicable advantages, including outsized control over interconnection and interoperability, and an extraordinary ability to collect and use data from and about Internet users. In the aggregate, this growth through vertical acquisition has substantially lessened competition across many traditionally defined markets, in ways that will often escape scrutiny under the proposed Non-Horizontal Merger Guidelines. The following examples are illustrative.

A. Vertical Acquisitions by Internet Platforms

Among the major Internet application and platform companies, such as Google, Facebook, Amazon, Apple, and Microsoft, vertical mergers have been a major driver of growth over the past decade.¹ According to Dr. Diana Moss of the American Antitrust Institute (AAI), the number of

¹ See generally Katie Jones, *The Big Five: Largest Acquisitions by Tech Company*, VISUAL CAPITALIST (Oct. 11, 2019), <https://www.visualcapitalist.com/the-big-five-largest-acquisitions-by-tech-company/>.

mergers engaged in by these companies is large, and has been on the rise year after year.² Unfortunately, mergers in this sector have faced fewer challenges from the Agencies than other sectors. Moreover, these mergers have several features that have not been well accounted for in the Agencies' analysis.

1. Data-Related Mergers

A defining feature of many vertical acquisitions by major Internet companies is the acquisition of massive amounts of consumer data. One example of this is the merging of third-party advertising networks with search and social networking businesses. The acquisition of Doubleclick by Google, and the acquisition of Onavo by Facebook, effectively combined data about the behavior of billions of Internet users on the websites and apps they use most with data about the same identifiable users while they use *other* websites and apps. Later actual and proposed acquisitions seek to extend the data collection to users' real-world activities, from health clubs (Fitbit) to the home (Nest). These storehouses of data about individuals' Internet use are not replicable by any potential competitor, unless that competitor can simultaneously enter the many markets in which the incumbents compete.

In addition to raising barriers to entry, the amassing of data by incumbent tech companies through mergers gives them an information advantage that enables additional competition-limiting acquisitions. Facebook's acquisition of Instagram for \$1B and WhatsApp for \$22B appeared to overvalue those companies, and appeared from the outside to be vertical acquisitions. In fact, Facebook had detailed data about its users' use of these other applications, which it gathered through another acquisition, the VPN software maker Onavo. That data showed Instagram and Whatsapp to be gaining users at the expense of Facebook's competing apps, and also showed those companies' potential to evolve into horizontal competitors of Facebook in several of its core markets. This information was not apparent to regulators or financial markets at the time.

2. Long Periods of Foregoing Profit While Locking In Users

Internet platform companies have defied the conventional economic assumption that predatory conduct is irrational without the possibility of recoupment in a short timeframe. Instead, because these platforms experience strong network effects, firms that acquire a large user base quickly gain an almost insurmountable advantage. This has led firms like Amazon to forego profits for many years as they grow and lock in their user base.³ Today, Amazon controls over 47% of the online retail market, giving it significant price-setting power.⁴

² Diana Moss, *Competition in Digital Technology Markets: Examining Acquisitions of Nascent or Potential Competitors by Digital Platforms* (Sept. 24, 2019), <https://www.judiciary.senate.gov/imo/media/doc/Moss%20Testimony1.pdf>.

³ Jon Markman, *The Amazon Era: No Profits, No Problem*, FORBES (May 23, 2017), <https://www.forbes.com/sites/jonmarkman/2017/05/23/the-amazon-era-no-profits-no-problem/>.

⁴ J. Clement, *Projected retail e-commerce GMV share of Amazon in the United States from 2016 to 2021*, STATISTA (Aug. 19, 2019), <https://www.statista.com/statistics/788109/amazon-retail-market-share-usa/>.

3. *Innovation Skews Towards Incumbents' Business Advantages*

The growth of incumbent Internet platform companies through acquisitions has skewed investment and innovation towards those companies' business priorities and away from fulfilling market needs that don't match those priorities. Venture capital investors, who are instrumental in funding new technology companies, speak of a "kill zone" in market niches that are already served by the incumbents, or may soon be. These investors attend the big Internet platforms' annual conferences to find out which markets *not* to invest in, because the incumbents' advantages in those markets is insurmountable.⁵

Conversely, new Internet applications and digital appliances that do receive funding are increasingly being positioned for acquisition by the incumbent giants, rather than for public or private investment as an independent competitor. The market for high-tech startup capital is thus being directed towards growing the incumbents while diminishing competition. This effect transcends individual product and geographic markets.

B. Vertical Acquisitions by Telecommunications Providers

The acquisition of content companies by wireline and wireless telecommunications providers that sell broadband access also illustrate how vertical integration can substantially lessen competition. As the Trump Administration's Department of Justice noted, a vertically integrated distributor in the broadband access market has "the incentive and ability to use that control as a weapon to hinder competition."⁶ They have used that control whenever and wherever they can. Vertically integrated entities in wireless and wireline broadband consistently engage in anticompetitive behavior that non-vertically-integrated broadband providers do not. This is because a stand-alone broadband access provider benefits by providing its customers access to all corners of the Internet. Once it owns a vertical supplier, however, the provider can benefit by shaping traffic towards its own products at the expense of rivals who lack their own distribution channel.

Vertical mergers in broadband markets are especially dangerous because it is difficult to develop meaningful distribution alternatives. High-speed competition that rivals established incumbents is isolated and uneven across the national market, typically coming from substantially smaller private providers or local governments. Both wireless and wireline companies face significantly high fixed upfront costs to launch as a service, and not all network technologies are created equal. In fact, only fiber to the home (FTTH) wireline service can outperform cable systems today⁷ and only a paltry estimated 20 percent of American households have FTTH available as a competitive

⁵American tech giants are making life tough for startups, THE ECONOMIST (June 2, 2018),

<https://www.economist.com/business/2018/06/02/american-tech-giants-are-making-life-tough-for-startups>.

⁶ Complaint at 1, United States v. AT&T, Inc., 916 F.3d 1029 (D.C. Cir. 2019) (No. 1:17-cv-02511) (available at <https://www.justice.gov/atr/case-document/file/1012916/download>) (internal quotation omitted); *see generally* Ernesto Falcon, *Senate Antitrust Hearing Explores Big Tech's Merger Mania*, ELECTRONIC FRONTIER FOUNDATION (Sept. 30, 2019), <https://www.eff.org/deeplinks/2019/09/senate-antitrust-hearing-explores-big-techs-merger-mania>.

⁷ Bennett Cyphers, *The Case for Fiber to the Home, Today: Why Fiber is a Superior Medium for 21st Century Broadband*, ELECTRONIC FRONTIER FOUNDATION (Oct 11, 2019), https://www.eff.org/files/2019/10/15/why_fiber_is_a_superior_medium_for_21st_century_broadband.pdf.

alternative to their cable providers.⁸ This means that in many markets companies like Comcast have no concerns with subscribers switching to superior alternatives.

Wireless companies depend on spectrum allocated by the FCC, and different spectrum licenses have different performance capabilities suitable for certain types of broadband services. In the absence of strong sharing obligations on incumbent spectrum licensees, companies with the most spectrum assets in the most useful frequencies enjoy significant non-replicable competitive advantages. As a result, allowing a major wireless provider to vertically merge, with irreplaceable spectrum assets, has resulted in major distortions to the wireless Internet. For example, wireless companies that are vertically integrated with sources of content, like AT&T-Time Warner, regularly engage in zero rating to disadvantage their content rivals and favor their own content portfolio.

Both AT&T-Time Warner⁹ and Comcast-NBCUniversal¹⁰ have limited their customers' use of the Internet through a data cap, despite a drastic reduction in marginal costs.¹¹ Indeed, as far back as 2011, Netflix estimated that the cost of delivering one hour of video over a broadband provider's last mile network to be "less than a penny" and dropping.¹² These data cap practices are exacerbated by the fact that tens of millions of households lack a meaningful way to switch between telecommunications providers of high-speed access.¹³

Today, Comcast continues to use data caps to impose overage charges on its consumers who opt to use its rivals.¹⁴ At the same time, Comcast can favor its own upcoming streaming services,¹⁵ once they launch, by exempting them from its data cap.¹⁶ In the few markets where Comcast faces high-speed access competition, their stand-alone fiber competitors do not apply data caps, with one CEO noting that "the cost of increasing capacity has declined much faster than the increase in data traffic."¹⁷

⁸ *Internet Access Services: Status as of December 31, 2017*, FEDERAL COMMUNICATIONS COMMISSION (Aug. 2019), <https://docs.fcc.gov/public/attachments/DOC-359342A1.pdf>.

⁹ Dwight Silverman, *AT&T charging extra for unlimited U-verse Internet [Updated]*, HOUSTON CHRONICLE (Mar. 29, 2016), <https://blog.chron.com/techblog/2016/03/att-charging-extra-for-unlimited-u-verse-internet/>.

¹⁰ Jon Brodtkin, *A Comcastic miracle: Data caps will go from 300GB to a terabyte*, ARS TECHNICA (Apr. 27, 2016), <https://arstechnica.com/information-technology/2016/04/comcast-boosts-data-cap-from-300gb-to-1-tb-unlimited-data-will-cost-50/>.

¹¹ Ryan Lawler, *Netflix: ISPs Overcharging Subs With Tiered Data Plans*, GIGAOM (Jan. 26, 2011), <https://gigaom.com/2011/01/26/netflix-tiered-data/>.

¹² *Id.*

¹³ High-speed access refers to broadband speeds in excess of 100 mbps download where legacy networks such as DSL simply are unable to achieve whereas cable systems remain dominant. Consumers are regularly switching to these high-speed systems as their usage of the Internet grows and the absence of fiber providers results in cable holding a regional monopoly.

¹⁴ Gerry Smith, *Netflix's biggest bingers get hit with higher internet costs*, LOS ANGELES TIMES (Aug. 13, 2019), <https://www.latimes.com/business/story/2019-08-13/netflixs-biggest-bingers-get-hit-with-higher-internet-costs>.

¹⁵ <https://www.theverge.com/2020/1/23/21075172/cats-comcast-box-office-peacock-nbcuniversal>.

¹⁶ See Katharine Trendacosta, *In the Internet Streaming Wars, Viewers Always Lose*, SLATE (Feb. 21, 2020), <https://slate.com/technology/2020/02/netflix-hulu-disney-hbo-peacock-streaming-wars.html>.

¹⁷ Karl Bode, *Broadband CEOs Admit Usage Caps Are Nothing More Than A Toll On Uncompetitive Markets*, TECHDIRT (June 7, 2016), <https://www.techdirt.com/articles/20160603/06530234613/broadband-ceos-admit-usage-caps-are-nothing-more-than-toll-uncompetitive-markets.shtml>.

As the quality of online video continues to improve, vertically merged ISPs are likely to follow Comcast's lead, and use overage charges to drive traffic toward both their own services and their own content.

II. The Proposed Vertical Merger Guidelines Should Identify and Address the Harms of Today's High-Tech Markets.

In light of these new market realities, we recommend the following changes to the proposed Vertical Merger Guidelines.

A. The Guidelines Should Address the Loss of Potential Competitors Through Acquisition.

Facebook's history of acquisitions shows that acquisitions of small firms with little apparent *present* impact on competition can nonetheless lessen competition and innovation *in the longer term*, and that such impact is predictable with sufficient information. That's why we agree with Commissioner Slaughter that the Guidelines should honor the mandate of Section 7 of the Clayton Act to stop anticompetitive mergers in their incipiency. The guidelines should reflect that the Agencies will look at the real-world performance and decisions of similar firms to help determine whether a seemingly small acquisition target could grow, without acquisition, into a material competitor to the acquiring firm.

For the same reasons, the Guidelines should not include a safe harbor exempting mergers where the parties' market share falls below a certain threshold. The 20% threshold in the draft Guidelines does not appear to be based on any empirical analysis.

B. Analysis of Potential Anticompetitive and Procompetitive Effects Should Be Treated With Equal Dignity.

The Guidelines should make clear that the Agencies will treat evidence of procompetitive and anticompetitive effects of a merger with equal dignity, applying the same level of skepticism and empirical rigor to each. The Agencies should not rely on promises or predictions of future procompetitive benefits flowing from a merger unless they are economically sound, reasonably likely, and flow directly from the merger. In evaluating both procompetitive and anticompetitive effects, the prior conduct of the merging firms and similar firms and the real-world results of comparable mergers should weigh as much or more than the predictions of abstract economic models. Any models used should be measured against prior mergers to ensure accuracy.

C. The Guidelines Should Specifically Address Data-Related Mergers.

Analysis of mergers between firms with large quantities of data about their users or customers should include looking at whether the combination of that data raises non-replicable barriers to competition in a range of related markets. In other words, the effects of data aggregation should be considered beyond the relevant markets identified for measuring the direct effect of the merger on market concentration. In particular, the effects of data aggregation should be considered in

markets characterized by the use of machine learning and other artificial intelligence technologies, which rely on large volumes of training data from diverse sources to reach useful results.¹⁸

D. The Guidelines Should Include Analysis of Innovation Effects

The Agencies should not discount or overlook the potential effects of vertical mergers on innovation, despite the difficulty of measuring such effects. The types of innovation produced by smaller firms and new entrants in a market are qualitatively different from those that occur within the four walls of a large incumbent, or innovation directed towards the goal of being purchased by an incumbent. In high-tech markets, innovation from unexpected quarters drives competition by dislodging monopolists. For example, innovations in operating system and application software, coupled with open interfaces, allowed Microsoft to eclipse IBM in the early 1990s as the preeminent maker of personal computer software.¹⁹ Similarly, innovation in Internet applications, given breathing room by the 2002 judgment against Microsoft,²⁰ allowed the rise of today's Internet platforms. But over the past 15 years, that cycle of monopoly disruption has broken down. This is due in part to an abundance of mergers that eliminate nascent competition, followed by the reluctance of venture capital markets to fund potential competitors to the incumbent technology giants. The risk of competing against the incumbents leads to fewer new companies being funded, while those that are funded are positioned for acquisition rather than competition.²¹

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¹⁸ See Charles Miller, *Big Data and the Non-Horizontal Merger Guidelines*, 107 Cal L. Rev. 309, 327-28 (2019).

¹⁹ Cory Doctorow, *'IBM PC Compatible': How Adversarial Interoperability Saved PCs From Monopolization*, ELECTRONIC FRONTIER FOUNDATION (Aug. 5, 2019), <https://www.eff.org/deeplinks/2019/08/ibm-pc-compatible-how-adversarial-interoperability-saved-pcs-monopolization>.

²⁰ *US v. Microsoft Corp.*, 253 F. 3d 34 (D.C. Cir. 2001).

²¹ Ernesto Falcon, *Senate Antitrust Hearing Explores Big Tech's Merger Mania*, ELECTRONIC FRONTIER FOUNDATION (Sept. 30, 2019), <https://www.eff.org/deeplinks/2019/09/senate-antitrust-hearing-explores-big-techs-merger-mania>.