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Hearings on Competition and Consumer Protection in the 21st Century

Topic 3

The identification and measurement of market power and entry barrier, and the evaluation of collusive, exclusionary, or predatory conduct or conduct that violates the consumer protection statutes enforced by the FTC, in markets featuring "platform" businesses

Comment

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In response to the increasing popularity and economic impact of companies in the Internet ecosystem, the Federal Trade Commission is being implored with vocal but factually vacant calls to revisit its approach to antitrust, and in particular market power, barriers to entry and anti-competitive practices including exclusionary and predatory conduct.

The Commission has wisely ignored the invitation to radically alter its approach, and should continue to do so.

The vague hypothesis of what former FTC Commissioner Joshua Wright has called "hipster antitrust"[2] is that traditional economic analysis fails to account for the market power of platform

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[2] Leonid Bershidsky, "Break Up the Tech Giants? No, Just Level the Field," BLOOMBERG, Sept. 10, 2017, *available at* https://www.bloomberg.com/view/articles/2017-09-11/break-up-the-tech-giants-no-just-level-the-field; *see also* George Ford, "'Hipster' Antitrust Meets Two-Sided Markets," BLOOMBERG BNA, April 17, 2017, *available at* https://www.bna.com/hipster-antitrust-meets-n57982091307/.

companies, who rely on two-sided markets to offer consumers their products and services at highly-subsidized prices, if not for free.

On the hipster view, modern antitrust analysis fails to account for other, undefined harms to competitors and the market generally. The source of those harms, somehow, are the network effects that benefit platform companies—which host the content of, or facilitate transactions among, their users. Big is bad, even if it can't be shown to be.

The hipsters have it backwards. For the last forty years, antitrust analysis has sensibly focused on measurable consumer harm, and in particular evidence of price increases, as a pre-condition for enforcement. It is highly flexible, and its appointed enforcers have proven fully capable of evaluating market power and anticompetitive conduct in all kinds of industries.

The long-stranding approach of traditional enforcement, applied throughout the Internet ecosystem, has and will continue to provide balanced protection in the event of market abuses that generate demonstrable consumer harm.

In particular, two features of platform businesses, discussed below, underscore both the value and dynamism of traditional antitrust enforcement:

1. In two-sided markets, the more users a platform can deliver—and the more engaged those users are—the more revenue it can derive from facilitating interactions with other users and with third-party affiliates. The larger the platform, the more consumers benefit.[3]

2. Even in situations where network effects generate market leverage for the platform operator, potentially devastating competition is just a generation or two of new technology away--—and arriving faster all the time.

I have been studying the distinct economic properties of the commercial Internet for over twenty years, and first identified the combination of forces that drive these features in 1998: Moore's Law, Metcalfe's Law, and the realization of economist Ronald Coase's work on transaction costs and their relationship to the size and complexity of firms.[4]

Moore's Law, Gordon Moore's prediction that the physics of semiconductor production translated to core computing components continuing to get faster, cheaper, and smaller, has

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[3] *See* FTC Staff, THE "SHARING" ECONOMY: ISSUES FACING PLATFORMS, PARTICIPANTS& REGULATORS, Federal Trade Commission, Nov. 2016, at page 27, *available at* https://www.ftc.gov/system/files/documents/reports/sharing-economy-issues-facing-platforms-participants-regulators-federal-trade-commission-staff/p151200_ftc_staff_report_on_the_sharing_economy.pdf.

[4] *See* Larry Downes, UNLEASHING THE KILLER APP: DIGITAL STRATEGIES FOR MARKET DOMINANCE (Harvard Business School Press 1998), chapter 2; *idem.*, THE STRATEGY MACHINE: BUILDING YOUR BUSINESS ONE IDEA AT A TIME (HarperBusiness 2001), chapter 2; THE LAWS OF DISRUPTION: HARNESSING THE NEW FORCES THAT GOVERN LIFE AND BUSINESS IN THE DIGITAL AGE (Basic Books 2010), chapter 2; BIG BANG DISRUPTION: STRATEGY IN AN AGE OF DEVASTATING INNOVATION (Portfolio 2014), chapter 2.

been in force since the 1960's.[5] Metcalfe's Law, Robert Metcalfe's observation that network adoption followed an exponential rather than incremental value curve, is in essence a digital application of the general theory of network effects.

And Coase's observations on the nature of the firm, finally, suggest that as markets driven by Moore's Law and Metcalfe's Law become more efficient, the size and complexity of traditional business enterprises would naturally shrink.[6]

Putting these three principles together explains much of how the digital economy has worked. Because software-based products and services can be marketed, distributed and updated at minimal marginal cost, transaction costs in digital markets are dramatically reduced overall. This means developers can create, launch, and support new platform products and services much more cheaply than for traditional networked goods.

That reduced cost makes it possible for developers to offer digital goods at very low costs. Consumers, moreover, can be highly-informed about product availability and quality, also at dramatically lower costs.

Together, these factors encourage rapid uptake for the most useful innovations, creating positive returns to scale. The more users who adopt the platform, and the more time and attention they devote to it, the more it attracts other consumers, both because of the capacity to interact with a larger group of other users and because a fast-growing platform signals value and further reduces search and other transaction costs.

As digital technology has become ubiquitous with the deployment of high-speed broadband networks, mobile devices, and cloud-based services, the historical adoption curve for disruptive innovations, first described by sociologist Everett Rogers, has been accordingly reshaped. Instead of a bell curve, the new adoption paradigm more closely resembles a shark fin, emphasizing rapid consumer adoption across market segments and, almost as quickly, consumer abandonment in anticipation of the next technology-fueled disruptor.[7] (See Figure 1)

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[5] Some engineers argue the specific formula of Moore--that miniaturization and production economies of scale translate to a doubling of processing power every 12-18 months while price holds constant—is nearing the limits of physics. This is by no means a consensus view, however. Meanwhile, other economic factors, including globalization, continue to push core component prices down. *See* Dean Takahashi, "Intel: Moore's Law isn't Slowing Down," VENTUREBEAT, March 28, 2017, *available at* https://venturebeat.com/2017/03/28/intel-moores-law-isnt-slowing-down/; Christopher Mims, "How Chip Designers are Breaking Moore's Law," THE WALL STREET JOURNAL, March 19, 2017, *available at* https://www.wsj.com/articles/how-chip-designers-are-breaking-moores-law-1489924804?tesla=y,

[6] Larry Downes, UNLEASHING THE KILLER APP, *supra* note 4 at Chapter Two. *Idem.*, THE LAWS OF DISRUPTION, *supra* note 4, at Chapter Two; BIG BANG DISRUPTION, *supra* note 4, at Chapter Two.

[7] Finding Your Company's Second Act," HARVARD BUSINESS REVIEW, Jan-Feb, 2018, pp. 98-107, *available at* https://hbr.org/2018/01/finding-your-companys-second-act?utm_campaign=hbr&utm_source=facebook&utm_medium=social.

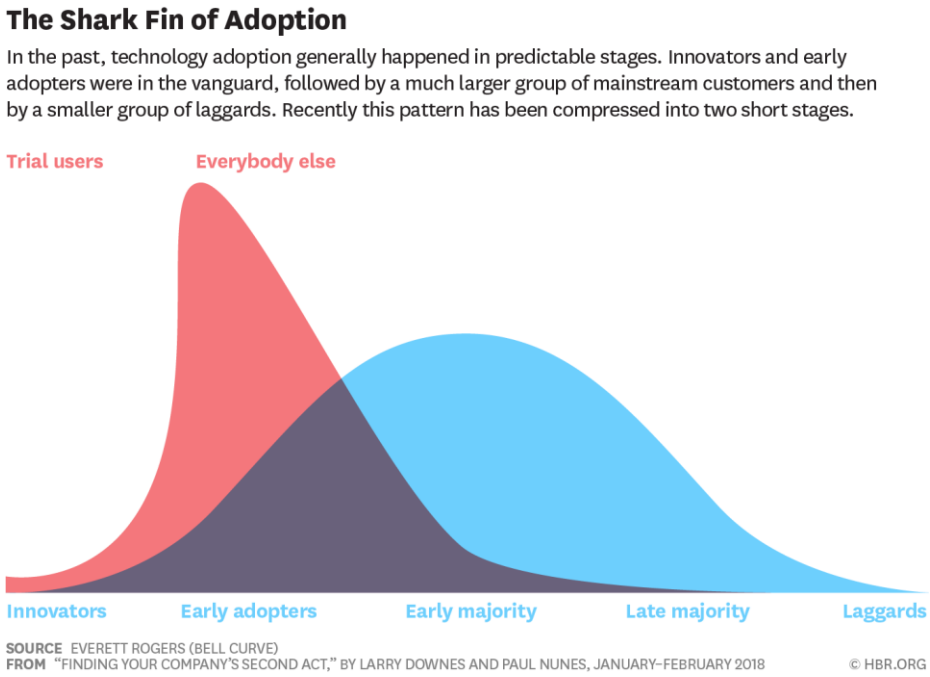

Figure 1

The shark fin pattern strongly encourages producers to give away as much of their content and services as possible to quickly establish high market penetration and consumer acceptance, making the platform that much more attractive for users. To support platform development and operations, revenue is often derived from third-party advertising or transaction fees levied on other affiliates who value access to the platform's user base. The more consumers who adopt the platform, the faster the platform grows, increasing its value both to other consumers and to affiliates.[8]

Network effects may create temporary market leverage for a platform company at the top of the new adoption curve, but the period during which they can exploit it gets shorter all the time. Even wildly successful technology start-ups have fallen victim to a surprising drop-off in user attention and a failure to prepare in time with a next-generation innovation.[9]

So while it is true that the combined effect of these engineering and economic principles often translates to significant if not dominant market leverage for platforms that first achieve a critical mass of consumers, it does not follow that such leverage requires intervention based on principles of antitrust.

First, as noted, the continued reliance on two-sided markets means that platform owners have little incentive or ability to raise prices for consumers. A robust platform, in everything from social networks to auctions to sharing economy applications, means more opportunities to interact, more liquid markets, and more reliable user reviews. Platform operators thus have

[8] Larry Downes, Unleashing the Killer App, *supra* note 4 at Chapter Two.
[9] Larry Downes and Paul Nunes, "Finding Your Company's Second Act," *supra* note 7.

every incentive both to improve the quality of the platform and to keep prices and transaction costs as low as possible for users.

Indeed, as platform growth inevitably slows, the owner's incentive is to provide even more free or subsidized services and user features, updated interfaces, and better content, essential for a business reliant on network effects for both growth and revenue.

The result: prices do not rise. Indeed, for most of today's most valuable platforms, they remain stubbornly at zero. In many examples, consumers benefit rather than being harmed by even the dominant market share of a single platform.[10] As former FTC Chairwoman Edith Ramirez correctly observed during the Commission's 2015 workshop on the sharing economy—a type of platform ecosystem—"[I]ncreased concentration does not always harm consumers; sometimes it benefits them, particularly where network externalities are substantial."[11]

Second, market leverage is always fleeting. So long as core computing components continue to get faster, cheaper, and smaller, digital markets are constantly being roiled from the entrance of new and even more disruptive technologies—what my co-author Paul Nunes and I have termed "Big Bang Disruptions."[12]

We note four distinct economic properties of these disruptors that signal a short life for even the most powerful digital "monopolies:"

- Price Deflation—The continuing and predictable decline in the price of core technologies, not only in computing, and the decline in related costs that that drives;

- Platform Exploitation—The increasing ability to use spare capacity on existing infrastructures like smartphones, security cameras, cloud-based software services, etc.;

- Cross-Subsidization— Increasing opportunities to supplement revenue through other sources, such as advertising and the sale of business insights from so-called "big data," allowing producers to offer platform services very cheap or even for free; and

[10] *See also* FTC Staff, THE "SHARING" ECONOMY: ISSUES FACING PLATFORMS, PARTICIPANTS& REGULATORS, *supra* note 3 at 26-28.
[11] *Id.* at 27.
[12] Larry Downes and Paul Nunes, BIG BANG DISRUPTION: STRATEGY IN AN AGE OF DEVASTATING INNOVATION (Portfolio 2014); *see also idem.,* "Big-Bang Disruption," HARVARD BUSINESS REVIEW, March, 2013, pp. 44-56, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2709801*;* "Finding Your Company's Second Act," HARVARD BUSINESS REVIEW, Jan-Feb, 2018, pp. 98-107, *available at* https://hbr.org/2018/01/finding-your-companys-second-act?utm_campaign=hbr&utm_source=facebook&utm_medium=social.

- Marginal-Cost Elimination – The growing number of products and surfaces susceptible to the power of zero digital production costs, making it possible to offer products and services with very low marginal costs at very low prices.[13]

Market realities provide ample evidence of these principles exerting a potent, external form of discipline. Even in its short history, for example, the Internet landscape has been littered with the corpses of supposedly-unbeatable digital powerhouses who were undone not by incumbents or competitors but by new entrants--often venture-backed entrepreneurs.[14]

In search alone, the "dominance" of Yahoo, Lycos, Alta Vista, MSN and others all fell to the current platform leader, Google. Ditto for Internet browsers—and despite, not because of, the government's antitrust case against Microsoft.[15] Early Internet policy advocates once bemoaned the gatekeeping potential of America On-Line.[16] At one time the social network market was "monopolized" by something called MySpace, which was backed by powerful media mogul Rupert Murdoch.[17]

In fact, the short life of digital products and services that, at their peak, seemed irresistible to consumers, is actually getting shorter. As Paul Nunes and I have observed in our on-going research on digital market behavior, the disruptive power of new technologies continues to accelerate, upsetting the business plans not only but of start-ups but even the most established enterprises:

> Even the most respected and successful companies in the world today rarely survive their first crisis, whenever it arrives. The average life span of companies on the Standard & Poor's 500 has fallen from 67 years in the 1920s to just 15 years today. According to Richard Foster, an executive in residence at the Yale Entrepreneurial Institute, in 2020 as many as three-quarters of companies in the index will be companies that were unheard of in 2010.
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> This shortened life cycle is primarily the result of rapidly spreading digital disruption in industries largely untouched by the first wave of internet

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[13] Paul Nunes and Larry Downes, "Four Reasons Today's Disruptive Innovations are Better and Cheaper, and What to do About it," FORBES, March 7, 2016, *available at* https://www.forbes.com/sites/bigbangdisruption/2016/03/07/four-reasons-todays-disruptive-innovations-are-better-and-cheaper-and-what-to-do-about-it/#1867c88c49ab. *See also* Larry Downes, "Why the Public Utility Model is the Wrong Approach for Internet Regulation," HARVARD BUSINESS REVIEW, Nov. 11, 2014, *available at* https://hbr.org/2014/11/why-the-public-utility-model-is-the-wrong-approach-for-internet-regulation.

[14] Larry Downes, Larry Downes, "How More Regulation for U.S. Tech Could Backfire," HARVARD BUSINESS REVIEW, Feb. 8, 2018, *available at* https://hbr.org/2018/02/how-more-regulation-for-u-s-tech-could-backfire..

[15] Larry Downes, "Oops, They Did it Again: What We Didn't Learn from U.S. v. Microsoft," ANTITRUST CHRONICLE, Oct. 2011, *available at* https://www.theguardian.com/technology/2007/feb/08/business.comment.

[16] Adam Thierer, "Unfounded Fear of Media Monopolies," FORBES, Mar 26, 2011, *available at* https://www.forbes.com/2011/03/25/apple-amazon-monopolies-opinions-adam-thierer.html#49c433b160cf.

[17] Victor Keegan, "Will MySpace Ever Lose its Monopoly?" THE GUARDIAN, Feb. 8, 2007, *available at* https://www.theguardian.com/technology/2007/feb/08/business.comment.

> transformation—including manufacturing (disrupted by 3-D printing and the internet of things), agriculture (drones and sensors), transportation (autonomous vehicles), and professional services (artificial intelligence). Even if second-act crises are most acute among start-ups, incumbents would do well to understand why they occur and how to avoid them.[18]

In situations where antitrust intervention may be justifiable, as the Microsoft case amply demonstrates, the relatively slow speed of litigation creates a dangerous mismatch with dynamic, fast-changing digital markets. The periodicity of the shark fin varies by technology and market, but in most cases it is already much shorter than the time needed to pursue public or private lawsuits. Efforts to "break up" or otherwise punish market dominance in the Internet ecosystem both in the U.S. and abroad have largely failed, and often result in more damage to consumer welfare from severe unintended side-effects.[19]

So rather than expand antitrust along vague, platform-specific criteria, consumer protection is best served by continuing to enforce the law only in situations where there is not only demonstrable consumer harm, but also strong evidence suggesting the absence of imminent disruptions that will likely address it more quickly and efficiently than engaging traditional enforcement mechanisms.

I have written several articles that explore these arguments in more detail, and in particular the impact of technological disruption on the need for and nature of enforcing antitrust and consumer protection law in dynamic industries. In two articles for ***Democracy Journal,*** for example, I explain how markets undergoing Big Bang Disruption largely resolve anti-competitive and anti-consumer behaviors organically--if not perfectly than at least more efficiently and more quickly than antitrust intervention. [20]

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[18] Downes and Nunes, "Finding Your Company's Second Act," *supra* note 7.

[19] Larry Downes, "How More Regulation for U.S. Tech Could Backfire," *supra* note 14; *idem.*, "Oops, They Did it Again: What We Didn't Learn from the U.S. v Microsoft," *supra* note 15. The EU has pursued a very different and expansive approach to antitrust for digital platforms. But it is underpinned not by updated economic theory and fact-based analysis but rather very old-fashioned forms of market barriers and protectionism. *See* Larry Downes, "Google and Facebook Delivery Zero Economic Value: That's a Big Problem for Trade," THE WASHINGTON POST, Oct. 24, 2016, *available at* https://www.washingtonpost.com/news/innovations/wp/2016/10/24/google-and-facebook-contribute-zero-economic-value-thats-a-big-problem-for-trade/?utm_term=.738dd9c74fec; *idem.*, "The EU's $5B Google Fine Escalates an Undeclared Trade War with Silicon Valley," THE WASHINGTON POST, July 25, 2018, *available at* https://www.washingtonpost.com/technology/2018/07/25/eus-b-google-fine-escalates-an-undeclared-trade-war-with-silicon-valley/?noredirect=on&utm_term=.772c8ff276fa.

[20] *See* Larry Downes, "Managing the Big Bang: The Regulator's Dilemma," DEMOCRACY, Fall 2014, *available at* https://democracyjournal.org/magazine/34/managing-the-big-bang-the-regulators-dilemma/*; idem.,* "Fewer, Faster, Smarter," DEMOCRACY, Fall, 2015, *available at* https://democracyjournal.org/magazine/38/fewer-faster-smarter/?page=all. *See also* Larry Downes and John W. Mayo, "The Evolution of Innovation and the Evolution of Regulation: Emerging Tensions and Emerging Opportunities in Communications," COMMLAW CONSPECTUS, Vol 23, No 1 (2014), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2542362.

This reality validates Commissioner Ohlhausen's frequent call for "regulatory humility" in markets driven by digital innovation.[21] But it is not to suggest, that there is no role for antitrust and, in particular, the consumer protection authority of the FTC.

In both articles, I describe features of a pro-innovation policy agenda, and note the importance of targeted interventions by the Commission, particularly in applying consumer protection law to the data collection and use practices of digital entrepreneurs (the subject of another topic in this proceeding).

To summarize these articles briefly, I believe that regulation of digital markets should be guided by eight principles that reflect the economic properties of platform businesses:

1. Resist the temptation to intervene in response to a perceived crisis or "techno-panic" driven by public unfamiliarity or anxiety with new applications.[22]
2. Work with innovators to build true public/private partnerships that avoid the need for regulatory interventions in the first place.[23]
3. Beware of incumbents in "consumer" clothing calling for intervention only to buy them more time to respond to disruption, especially in industries that have long been regulated, such as local transportation and accommodations.[24]
4. Encourage experimentation in safe sandboxes, particularly for technology, such as drones and ingestible technologies, with significant consumer safety and security implications.[25]

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[21] Commissioner Maureen K. Ohlhausen, "Regulatory Humility in Practice, FEDERAL TRADE COMMISSION, April 1, 2015, *available at* https://www.ftc.gov/public-statements/2015/04/regulatory-humility-practice-remarks-ftc-commissioner-maureen-k-ohlhausen.

[22] Larry Downes, "Is the Drone's Potential Being Shot Down Too Fast?" HARVARD BUSINESS REVIEW, April 23, 2013, *available at* https://hbr.org/2013/04/is-the-potential-of-the-drone.

[23] Blair Levin and Larry Downes, "How Some Cities Are Attracting 5G Investments Ahead of Others," THE WASHINGTON POST, Feb 2, 2018, *available at* https://www.washingtonpost.com/news/innovations/wp/2018/02/08/how-some-cities-are-attracting-5g-investments-ahead-of-others/?utm_term=.f1cab44440ba

[24] Larry Downes, "Lessons from Uber: Why Innovation and Regulation Don't Mix," FORBES, Feb. 6, 2013, *available at* https://www.forbes.com/sites/larrydownes/2013/02/06/lessons-from-uber-why-innovation-and-regulation-dont-mix/#70409892de94.

[25] Larry Downes, "America Can't Lead the World in Innovation if the FAA Keeps Dragging its Feet on Drone Rules," THE WASHINGTON POST, Oct. 8, 2014, *available at* https://www.washingtonpost.com/news/innovations/wp/2014/10/08/america-cant-lead-the-world-in-innovation-if-the-faa-keeps-dragging-its-feet-on-drone-rules/?utm_term=.75fccfcc6ba6; *idem.*, "Save the Internet by Doing Nothing," SLATE, Jan, 2011, *available at* http://www.slate.com/articles/technology/future_tense/2011/01/save_the_internet_by_doing_nothing.html.

5. Intervene only when the public interest is truly at stake, based on a return to first principles of the purpose and continuing need for consumer protection in the particular industry.[26]

6. Narrowly focus remedies to target demonstrable and measurable consumer harms.[27]

7. Let technological innovation substitute for regulation where possible and likely more efficient and effective.[28]

8. When regulation is necessary, ensure at the time of enactment that it sunsets quickly.[29]

Happily, that's the approach that has largely characterized U.S. Internet policy for the last twenty years, following Congress's bi-partisan guidance in 1996 to leave the digital economy "unfettered by Federal or State regulation."[30] More specifically, it aligns closely with long-standing FTC staff advocacies, as reflected, for example, in the Commission's analysis of and approach to the sharing economy.[31]

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[26] Larry Downes, "Seven Innovations at Risk from Overzealous Regulation," THE WASHINGTON POST, Oct. 5, 2015, *available at* https://www.washingtonpost.com/news/innovations/wp/2015/10/05/the-top-7-innovations-at-risk-from-overzealous-regulation/?utm_term=.3ffa15a4b452; *idem.,* "Uber's Battle in Seattle Highlights the Irony of Regulation Hurting the Consumers it was Designed to Help," THE WASHINGTON POST, March 24, 2014, *available at* https://www.washingtonpost.com/news/innovations/wp/2014/03/24/ubers-battle-in-seattle-highlights-the-irony-of-regulation-hurting-the-consumers-it-was-designed-to-help/?utm_term=.e7312536a90c.

[27] Larry Downes, "Toward a Technology Watchful Waiting Principle, TECH LIBERATION FRONT, Jan 17, 2013, *available at* https://techliberation.com/2013/01/17/toward-a-technology-watchful-waiting-principle/#more-43462.

[28] Larry Downes, "At CES, the Only Law that Matters is Moore's Law," FORBES Jan 16, 2012, *available at* https://www.forbes.com/sites/larrydownes/2012/01/16/at-ces-the-only-law-that-matters/#4be89c8a7c57.

[29] LARRY DOWNES, "Take Note, Republicans and Democrats: This is What a Pro-Innovation Platform Looks Like," THE WASHINGTON POST, Jan 7, 2015, *available at* https://www.washingtonpost.com/news/innovations/wp/2015/01/07/take-note-republicans-and-democrats-this-is-what-a-pro-innovation-platform-looks-like/?utm_term=.ff136841c1ee/. *See also* "Hearing on "Improving FCC Process," SUBCOMMITTEE ON COMMUNICATIONS AND TECHNOLOGY, U.S. House of Representatives, WRITTEN TESTIMONY OF LARRY DOWNES, July 11, 2013, *available at* https://docs.house.gov/meetings/IF/IF16/20130711/101107/HHRG-113-IF16-Wstate-DownesL-20130711.pdf. ("In short, as those of us in the technology industries have learned the hard way, the pace of change has long-since outrun our ability to predict the future, even in the short-term. The FCC must be cured of its counter-productive habit of micromanaging markets that are evolving even as the Commission deliberates. It must weigh the costs of intervention against the likelihood that even demonstrable market failures are increasingly resolved by the imminent next generation of technology, often deployed by enterprises, entrepreneurs and competitors that didn't exist when the agency began its review. And it must focus its remedial and regulatory efforts on relevant consumer harms that are tangible and solvable with both precision and measurable efficacy.")

[30] Larry Downes, "On Internet Regulation, The FCC Goes Back to the Future," FORBES, Marc 12, 2018, *available at* https://www.forbes.com/sites/larrydownes/2018/03/12/the-fcc-goes-back-to-the-future/#6b4a94ff5b2e.

[31] *See* FTC Staff, THE "SHARING" ECONOMY: ISSUES FACING PLATFORMS, PARTICIPANTS& REGULATORS, *supra* note 3 at 51-87.

Overall, the federal government's prescient wisdom has worked spectacularly, not only in protecting consumers but providing them a profound choice of new products and services that generate immeasurable consumer surplus. As I have repeatedly observed:

> The best regulator of technology, it seems, is simply more technology. And despite fears that channels are blocked, markets are locked up, and gatekeepers have closed networks that the next generation of entrepreneurs need to reach their audience, somehow they do it anyway — often embarrassingly fast, whether the presumed tyrant being deposed is a long-time incumbent or last year's startup darling.
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> That, in any case, is the theory on which U.S. policymakers across the political spectrum have nurtured technology-based innovation since the founding of the Republic. Taking the long view, it's clearly been a winning strategy, especially when compared to the more invasive, command-and-control approach taken by the European Union, which continues to lag on every measure of the Internet economy.[32]

In markets characterized by network effects and platform businesses, in short, the FTC should continue to build on the solid foundation of nearly half a century of proven economic principles. If markets do not display traditional signs of monopolization, and no measurable consumer harm is occurring, do not intervene.

When intervention is justifiable, moreover, the Commission should pause, at least in the short-term, to consider the potential for current or near-term future technology-driven disruptors to resolve the harm more quickly than traditional forms of enforcement, and do so with fewer unintended negative side-effects.

[32] Larry Downes, "How More Regulation for Tech Companies Could Backfire," *supra* note 14.