

UNDERSTANDING INNOVATION AND ITS ROLE IN U.S. MERGER REVIEW
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Remarks of FTC Commissioner Terrell McSweeney

I am pleased to be here today to join this discussion about the conditions that drive innovation and how best to foster them. My remarks are my own and do not necessarily reflect the views of the Commission or any other Commissioner.

With that said, my position is a relatively unsurprising one for a competition enforcer: I believe that competition generally provides a strong foundation for innovation.

For the past half century, economists have examined the relationship between market structure and innovation. Joseph Schumpeter claimed that an innovator required some market power.¹ Schumpeter's view was based on the observation that innovation requires money. Schumpeter reasoned that firms without market power would find it more difficult to fund costly research and development.

By contrast, Kenneth J. Arrow argued that competition best promotes innovation.² Arrow focused on a firm's incentives to innovate. If a firm in a competitive market develops a better product, it can make money by taking share away from its competitors. A monopolist, however, has no share left to take and will only make money from an innovation to the extent that it expands the entire market.³

Even if it is possible, in theory, for "too much" competition to exist, there seems to be increasing empirical evidence that most industries are not close to the point at which less

¹ See JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY*, VIII (3d ed. 1950).

² Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, in *THE RATE AND DIRECTION OF INVENTIVE ACTIVITY: ECONOMIC AND SOCIAL FACTORS* 609 (1962), as cited in David McGowan, *Innovation, Uncertainty, and Stability in Antitrust Law*, 16 *BERKELEY TECH. L.J.* 729, 732 (2001).

³ Note that a monopolist would still have an incentive to innovate defensively if it anticipates that another firm could successfully innovate and displace its current market position. At the same time, depending on market characteristics, a monopolist may believe that it has sufficient time to identify innovative competitive threats and copy or coopt them before an entrant gains a substantial market presence.

competition would foster more innovation. A panel of prominent economists discussed these issues at the FTC's 9th Annual Microeconomics Conference last November. Professor Chad Syverson explained that the general pattern is that "competition tends to increase innovative activity."⁴ That view was largely shared by the other panelists.

So what does that mean for merger review? Quite simply, a merger that would not produce immediate effects on prices or quality can still harm consumers by decreasing the rate of innovation. The U.S. antitrust agencies' 2010 *Horizontal Merger Guidelines* include a section that specifically addresses innovation effects.⁵

The FTC routinely challenges mergers that would harm competition in the research and development of new drugs and treatments. In some situations, we may specifically define a relevant "research and development market."⁶ These cases focus on protecting incentives for incremental innovation along a fairly well-defined path. But innovation can also be a key factor when a merger might eliminate an independent disruptive innovator. This is particularly true when a firm is planning to enter a market with a new technology. Protecting this innovation has been a key factor in two recent FTC merger challenges.

In late 2014, the FTC challenged the proposed acquisition of EagleView Technology by Verisk Analytics. EagleView was the leading U.S. provider of "roof reports," rooftop aerial measurement products used by insurance carriers. Verisk was the leading provider of downstream software platforms, but had recently taken steps to offer roof reports itself. The FTC closely examined whether likely future competition between the merging parties would offer customers ever more innovative products and concluded that Verisk was uniquely well positioned to compete against EagleView.⁷ Verisk had invested in capturing higher-resolution

⁴ Chad Syverson, as quoted in Charles McConnell, *Top Economists Debate Competition-Innovation Connection*, GLOBAL COMPETITION REV., Nov. 4, 2016, <http://globalcompetitionreview.com/article/1073077/top-economists-debate-competition-innovation-connection>.

⁵ See U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, 2010 HORIZONTAL MERGER GUIDELINES § 6.4.

⁶ See *id.* § 2.2.1 (listing "explicit or implicit evidence that the merging parties intend to . . . curtail research and development efforts" as one of the factors that can be "highly informative in evaluating the likely effects of merger").

⁷ Complaint, In the Matter of Verisk Analytics, Inc., and EagleView Technology Corp., Dkt. No. 9363 ¶ 40 (Dec. 16, 2014), <http://www.ftc.gov/system/files/documents/cases/141216veriskcmpt.pdf>.

aerial images than those used by EagleView, which promised even more accurate measurement tools for customers.⁸ So while the FTC did not define an “innovation” market, innovation nonetheless played a crucial role in staff’s analysis and in the decision to challenge the merger.

A year later, in 2015, the FTC challenged the merger between the second and third-largest sterilization companies in the world, Steris and Synergy. The FTC alleged that the merger would harm future competition by putting an end to Synergy’s plans to enter the U.S. market with a promising new x-ray sterilization technology.⁹ Ultimately, a district court judge disagreed that Synergy would have entered the U.S. market but for its acquisition.¹⁰ The case underscores the FTC’s willingness to take innovation and quality competition seriously by considering the potentially disruptive effects of new technologies in merger analysis. But it also shows the challenges associated with proving the likelihood of disruptive entry.

The U.S. Department of Justice has also focused on innovation in recent merger enforcement actions. In 2014, the DOJ successfully challenged Bazaarvoice’s consummated acquisition of PowerReviews – a case that involved online product reviews and ratings platforms. The DOJ alleged that the two companies had previously engaged in “feature driven one-upmanship,” and that the transaction “significantly reduced incentives to . . . invest in innovation.”¹¹ One exhibit featured company executives commenting on how Bazaarvoice and

⁸ After the FTC filed for an injunction, the parties promptly abandoned the deal. Developments since that time have demonstrated the wisdom of the Commission’s action. Verisk announced the following year that it was accelerating its collection of high-resolution aerial images. In its press release, Verisk characterized its initiative as merely “the most recent step [in the company’s] ongoing efforts” in the area, and cited Verisk’s “long-term commitment to the highest-quality imagery and data.” Verisk Press Release, Verisk Insurance Solutions Announces Expansion of Imagery Database (Aug. 4, 2015), <http://www.verisk.com/press-releases-verisk/2015/august-2015/verisk-insurance-solutions-announces-expansion-of-imagery-database.html>.

⁹ Complaint, In the Matter of Steris Corp. and Synergy Health PLC, Dkt. No. 9365 ¶¶ 68-70 (May 29, 2015), <https://www.ftc.gov/system/files/documents/cases/150529sterissynergypart3cmpt.pdf>.

¹⁰ *FTC v. Steris Corp.*, No. 15-cv-1080, 2015 WL 5657294 (N.D. Ohio Sept. 24, 2015) (“In the end, the evidence unequivocally shows that the problems that plagued development of x-ray sterilization as a viable alternative to gamma sterilization in 2012, when Dr. Steeves purchased Daniken, were the same problems that justified termination of the project in 2014; the failure to obtain customer commitments and the inability to lower capital costs.”)

¹¹ Complaint, *U.S. v. Bazaarvoice, Inc.*, C-13-0133 ¶¶ 8, 62 (N.D. Cal. Jan. 10, 2013), <https://www.justice.gov/atr/case-document/file/488911/download>.

PowerReviews had “pushed each other to innovate in ways that help[ed] consumers and retailers.”¹²

The DOJ’s challenge to AT&T’s proposed acquisition of T-Mobile in 2011 also featured innovation effects prominently. The DOJ alleged that consumers would face not only higher prices and less variety – but less innovation post-merger.¹³ The complaint observed that T-Mobile had “been responsible for numerous ‘firsts’ in the U.S. mobile wireless industry,” that T-Mobile had “been an innovator in terms of network development and deployment,” and that “AT&T [had] felt competitive pressure from T-Mobile’s innovation.”¹⁴ Since 2011, T-Mobile has built an expansive LTE network and disrupted the standard service plan model by eliminating the two-year contract and offering unlimited data plans.¹⁵ Today, T-Mobile’s website advertises T-Mobile as “#1 in network innovations for customers” with “more LTE technologies launched in the last three years than anyone in the industry.”¹⁶

Innovation can play an important role in the analysis of mergers in digital markets, particularly in two-sided markets where a traditional price-based approach to competition analysis may be ineffective. The *Horizontal Merger Guidelines*’ discussion of innovation makes clear that we look at both sides of a market in the merger enforcement context. The FTC confronted this issue directly in its analysis of the Zillow-Trulia merger in 2015. Zillow and Trulia both operated websites and mobile apps that provided consumers with free access to residential real estate listings and information. The sites earned revenues by selling advertising to real estate agents. Staff investigated whether the merger would reduce competition on the paying side of the market. But staff also examined whether the merger would reduce the

¹² Plaintiff United States of America’s Post-Trial Proposed Findings of Fact, ¶ 198, *United States v. Bazaarvoice*, No.13-cv-00133 (N.D. Cal. Jan. 8, 2014) (filed Oct. 31, 2013), <http://www.justice.gov/atr/cases/f301400/301437.pdf>.

¹³ Complaint, *U.S. v. AT&T*, 1:11-cv-01560 ¶ 1 (D.D.C. Aug. 31, 2011), <https://www.justice.gov/atr/case-document/file/487776/download>.

¹⁴ *Id.* ¶¶ 28-30 (D.D.C. Aug. 31, 2011).

¹⁵ Farhad Manjoo, *T-Mobile Turns and Industry on its Ear*, N.Y. TIMES, Feb.26, 2014, <https://www.nytimes.com/2014/02/27/technology/personaltech/t-mobile-turns-an-industry-on-its-ear-in-a-fight-for-its-life.html>; Scott Moritz, *T-Mobile Posts Profit Gain Amid Price War With Verizon, AT&T*, Bloomberg.com, Feb. 14, 2007, <https://www.bloomberg.com/news/articles/2017-02-14/t-mobile-beats-profit-estimates-as-subscriber-surge-continues>.

¹⁶ T-Mobile.com, <https://explore.t-mobile.com/4g-lte-network> (last accessed Mar. 13, 2017).

combined entity's incentives to innovate by developing new features attractive to consumers on the free side of the market.¹⁷ Although staff did not find reason for concern in that matter, the investigation is an example of how we look at these issues under the *Guidelines*.

I believe it is very important for antitrust enforcers to continue to carefully consider innovation effects in merger review in order to foster competitive and innovative markets. I look forward to our discussion this afternoon.

¹⁷ See Statement of Commissioners Ohlhausen, Wright, and McSweeney Concerning Zillow, Inc. / Trulia, Inc., File No. 141-0214 (Feb. 19, 2015), https://www.ftc.gov/system/files/documents/public_statements/625671/150219zillowmko-jdw-tmstmt.pdf,