Economists Incorporated
Economists INK
A BRIEF ANALYSIS OF POLICY AND LITIGATION
SPRING 2014

Geographic Market Definition: Equivalence between Hypothetical Monopolist Test and *Tampa Electric*

Lona Fowdur

Lona Fowdur has analyzed geographic markets in the contexts of mergers, acquisitions and other antitrust litigation. She previously wrote about the district court decision in this case for the Spring 2012 issue of Economists Ink.

The Sixth Circuit Court of Appeals has reversed a district court decision to exclude an economic expert's testimony delineating the geographic market for milk in the Southeast United States. The District Court had ruled that the expert's methodology, a hypothetical monopolist test, was unreliable because it did not conform to the standard that the Supreme Court articulated in 1961 in *Tampa Electric Co. v. Nashville Coal Co. (Tampa Electric)*.

In *Tampa Electric*, the Supreme Court defined the relevant geographic market as "the area in which the seller operates, and to which the purchaser can practicably turn for supplies," and further explained that the relevant market must "correspond to the economic realities of the industry and be economically significant." The expert's testimony was based on an application of the hypothetical monopolist test, which rests on the principle that the geographic market corresponds to the smallest region in which a hypothetical monopolist, as the only supplier of the relevant product, could profitably impose a small but significant and non-transitory increase in price (SSNIP).

The appeals court reasoned that for the hypothetical monopolist construct to be of value in a case, the area under consideration must include the locations of at least some of the buyers and some of the sellers, including areas from which the buyer could procure alternative supplies if prices increased, given the commercial realities of the marketplace. The court further opined that, applied in such a way, the hypothetical monopolist test and the Tampa Electric standard were practically equivalent, thereby setting the legal precedent that the district court had found was lacking.

The appeals court decision also addressed the question of whether the district court had erred in its determination that plaintiffs had to define a geographic market if the alleged anticompetitive conduct were evaluated under the rule of reason. The appeals court affirmed that a full rule-of-reason inquiry would necessitate proper market definition while a per se analysis would not. In this case, although the district court had correctly relied upon a rule-of-reason analysis, the appeals court concluded that no consideration had been given to whether a quick-look analysis would have sufficed. The appeals court clarified that it had characterized quick-look analysis as a third approach under which a satisfactory showing of anticompetitive behavior could proceed without a detailed review of the surrounding marketplace and thus without defining a geographic market.

Also In This Issue

The *U.S. v. Bazaarvoice* Decision on the Role of Antitrust in High-Tech Markets

David D. Smith discusses a recent court decision that addressed whether mergers in high-tech, dynamic industries should receive special treatment under the antitrust laws. The U.S. Department of Justice (DOJ) alleged that Bazaarvoice's acquisition of PowerReviews was anticompetitive. Both firms offered Ratings and Reviews (R&R) platforms, a type of "social commerce" tool. The judge found that the product market was limited to those platforms. The judge relied heavily on documents and testimony to define the market and as evidence that the merger would likely increase prices. In finding for DOJ, the judge decided that the Court's role was to assess the alleged violations, not to debate the proper role of antitrust law in high-tech markets.

The Increasing Role of Economic Analysis in China's Antitrust Litigation

Su Sun describes three recent antitrust decisions by Chinese courts that show an increasing interest in economic evidence and analysis. In *Rainbow v. Johnson & Johnson*, the first resale price maintenance case in China, the Shanghai High Court's decision discussed economic evidence concerning market definition and competitive effects. In *Qihoo v. Tencent*, the Guangdong High Court used a hypothetical monopolist test that may not be well-suited to a two-sided market. In *Huawei v. InterDigital*, the Shenzhen Intermediate Court determined a fair reasonable and non-discriminatory (FRAND) royalty rate for a portfolio of standard-essential patents after considering issues, such as royalty stacking and comparable licenses.

The *U.S. v. Bazaarvoice* Decision on the Role of Antitrust in High-Tech Markets

David D. Smith

A recent decision by Judge Orrick of the U.S. District Court of the Northern District of California explicitly addressed the controversial issue of whether mergers in high-tech, dynamic industries should receive special treatment under the antitrust laws. The judge ultimately decided that the Court's role was to assess the alleged antitrust violations, not to debate the proper role of antitrust law in high-tech markets. Indeed, the judge applied a traditional Merger Guidelines approach in analyzing the competitive effects of this merger.

Bazaarvoice acquired a competitor, PowerReviews, on June 12, 2012. Two days later, the United States Department of Justice (DOJ) launched an investigation. DOJ filed suit on January 10, 2013, alleging that the transaction was anticompetitive and violated Section 7 of the Clayton Act. The judge found for DOJ. Although this ruling means the government "would be entitled to an injunction that requires Bazaarvoice to divest PowerReviews," he stated, "[t]his is not a simple proposition 18 months after the merger." He asked the parties to file a Joint Statement Regarding Remedy Phase on January 17, 2014, and attend a Case Management Conference on January 22, 2014 to discuss the remedy.

The judge found that the relevant product market was Ratings and Reviews (R&R) platforms, and that the relevant geographic market was the United States. R&R platforms provide software and services to Internet vendors to collect, organize, and display product reviews and ratings from consumers. These reviews and ratings appear on the vendors' websites for potential consumers to read before making purchases. R&R platforms are valuable to vendors because they tend to increase sales, decrease product returns, improve a website's ranking by Internet search engines, and provide consumer sentiment information. Even negative reviews improve sales because they confirm the authenticity of the reviewing process.

R&R platforms are one type of "social commerce" tool. Social commerce refers to the interaction of consumers in the shopping process, typically through a website. R&R platforms provide a user interface and review forum. They usually prompt consumers to rate products on a five-star basis, and they offer an option to write open-ended reviews of the product. The more sophisticated R&R platforms allow manufacturers to "syndicate" or share ratings and reviews with their retail partners. For example, Staples.com can display ratings and reviews for a Canon printer that Canon collected on Canon.com. Another important feature of R&R is called "moderation." Before a review is posted on the manufacturer's or retailer's website, it is given an automated scan and then reviewed by a human moderator to ensure that it complies with a particular website's standards. Moderation helps ensure that the review is credible and inoffensive.

EI Vice President David D. Smith has dealt with antitrust issues in a wide range of industries. Before joining EI, he was an economist at the Antitrust Division of the U.S. Department of Justice.

> "The judge did not find that products in a broader social commerce sector . . . competed with R&R platforms."

Bazaarvoice and PowerReviews both offered sophisticated R&R platforms to large enterprise manufacturers and retailers. Both platforms were full-featured, offering syndication and moderation. Each R&R platform sale was negotiated individually with the specific customer.

The judge did not find that products in a broader social commerce sector (e.g., customer commentary, blogs, pictures, Facebook shares and "likes,") competed with R&R platforms. The court did find that social commerce is a "constantly evolving space" and that the "future composition of the industry as a whole is unpredictable."

The judge relied heavily on documents and testimony from the merging parties to define the relevant product market. He wrote that "in the years preceding the acquisition, Bazaarvoice executives repeatedly expressed that Power Reviews was its most significant, and often only, R&R competitor." The judge also found evidence that PowerReviews disciplined Bazaarvoice's pricing. Bazaarvoice acknowledged "that many customers brought PowerReviews into negotiations as a 'lever to knock [Bazaarvoice] down on price.'" Recognizing heightened competition from PowerReviews, Bazaarvoice responded with "Project Menlogeddon," which

continued on page 4

The Increasing Role of Economic Analysis in China's Antitrust Litigation

Su Sun

Five years after China's Antimonopoly Law took effect, the pace of both antitrust enforcement and private litigation has increased. While many have focused on the merger reviews and cartel investigations conducted by the Chinese enforcement agencies, recent developments in private antitrust litigation in China also merit attention. In particular, the Chinese courts have shown an increasing interest in reviewing economic evidence and analysis in adjudicating antitrust disputes. Three recent cases stand out as the most prominent examples of this trend.

Rainbow v. Johnson & Johnson was the first resale price maintenance (RPM) case in China. Johnson & Johnson sold medical equipment and products, such as suture thread used in surgeries, to hospitals in China. Rainbow was a long-time distributor of Johnson & Johnson. When Rainbow submitted bids on suture thread to a hospital in Beijing that were lower than the minimum resale price Johnson & Johnson had stipulated in their distribution agreement, Johnson & Johnson revoked Rainbow's right to distribute its products. The Shanghai No. 1 Intermediate Court ruled for Johnson & Johnson in 2012, but the decision was reversed by the Shanghai High Court in 2013. Both sides hired economic experts who debated issues, such as product and geographic market definition, whether Johnson & Johnson had dominance in the relevant markets, and what the RPM agreement's effect was on intra-brand competition and inter-brand competition. Some academic studies done by U.S. scholars were cited by the plaintiff's expert. The experts on the two sides also provided different interpretations of the price data. In the Shanghai High Court's final decision, the judges discussed the merits of such economic evidence. Though there seemed to be room to sharpen and expand some of the economic analyses, both sides clearly realized the importance of economic evidence in this case, and the Shanghai High Court weighed both sides' economic analyses in adjudicating the dispute.

Another high profile case was *Qihoo v. Tencent. Qihoo* is a leading antivirus software provider, and Tencent offers QQ, a leading instant messaging software in China. In an earlier lawsuit, Tencent alleged that Qihoo's antivirus software interfered with the functionality of Tencent's QQ, for example, by blocking its pop-up advertisements, and thus competed unfairly and harmed Tencent's legitimate business interests. In an antitrust countersuit, Qihoo alleged that Tencent redesigned QQ to be incompatible with computers running Qihoo's antivirus software, forcing users to choose between the two, and by doing so, abused its market dominance. The two sides' economic experts submitted reports and also testified in court hearings on the definition of the relevant market, whether Tencent had a dominant position in the relevant market, and if so, whether Tencent abused such market dominance. In 2013, the Guangdong High Court ruled that Qihoo failed to define a narrow relevant market that only included QQ, MSN and Skype, and failed to prove Tencent's dominance in the relevant market. The very lengthy court decision reflects the complexity of the case. For example, instant messaging is a two-sided market, and such markets have been recognized to have different properties from traditional markets. The Guangdong High Court in its decision applied a hypothetical monopolist test to define a broad relevant market, even though such a price test may not be well suited for a two-sided market where the user of the software does not pay a monetary price for using the service. The court also evaluated a significant amount of factual evidence in defining the relevant market and analyzing the dominance issue. This antitrust case is currently under appeal at the Supreme People's Court. (In February 2014, the Supreme People's Court affirmed the Guangdong High Court's decision in favor of Tencent in the earlier unfair competition case.)

A case involving intellectual property that attracted a lot of attention was *Huawei v. InterDigital.* Huawei is a leading wireless communications device maker headquartered in Shenzhen in Guangdong province, and InterDigital is a non-practicing entity based in the United States. InterDigital holds a significant number of patents in wireless communications technology, including patents that are essential to the 2G, 3G and 4G wireless standards. The two parties failed to reach a licensing agreement after several rounds of negotiations. InterDigital filed lawsuits in 2011 against Huawei

Su Sun has worked on mergers reviewed by China's Ministry of Commerce (MOFCOM) and has conducted economic analysis on issues such as patents and standards on behalf of both Chinese and non-Chinese clients. He has published extensively on antitrust developments in China.

continued on page 4

Antitrust in High-Tech Markets

was described as "a special project to defeat our only meaningful competitor."

Other evidence of expected price effects came from pre-merger documents giving reasons for the merger. A Bazaarvoice executive wrote that one of the benefits of acquiring PowerReviews would be to "[e]liminate [Bazaarvoice's] primary competitor," and provide "relief from…price erosion." He also wrote that the acquisition would allow the combined company to "avoid margin erosion" caused by "tactical 'knife-fighting' over competitive deals." Another Bazaarvoice executive saw the acquisition as an opportunity to "take out [Bazaarvoice's] only competitor, who…suppress[ed] [Bazaarvoice] price points…by as much as 15%."

Bazaarvoice also had documents indicating the rationale for the acquisition was procompetitive. The judge, however, found this evidence less convincing than that consistent with anticompetitive effects. "The most plausible conclusion from the evidence presented at trial is that Bazaarvoice wanted to buy PowerReviews to use its enhanced market power in R&R platforms to keep competitors out of the R&R market and use its dominance to avoid competition in pricing and innovation while also pursuing the other long long-term objectives…"

The merging parties argued that the relevant geographic market is worldwide because technology knows no borders and R&R software is easily sold worldwide. The court, however, found evidence pointing to a U.S. market more convincing. First, R&R platform providers license their products for specific websites that are often limited by geography. Second, to offer a commercial syndication service in the United States, an R&R platform provider must have ratings and reviews written for the specific version of the product that is sold in the United States. Third, U.S. customers prefer reviews written by U.S. native English speakers.

Using several alternative measures, market concentration in the relevant market was found to exceed the standards of the Merger Guidelines. The judge also found that "syndication, switching costs, intellectual property/know how, and reputation" were formidable barriers to entry and the expansion of existing competitors. There was also additional economic evidence of unilateral anticompetitive effects.

With regard to the application of antitrust laws in rapidly changing high-tech markets, the judge wrote, "The Court's mission is to assess the alleged antitrust violations presented, irrespective of the dynamism of the market at issue.… [W]hile Bazaarvoice indisputably operates in a dynamic and evolving field, it did not present evidence that the evolving nature of the market itself precludes the merger's likely anticompetitive effects."

The judge provided extensive cites to company documents and testimony supporting his conclusions on market definition and competitive effects. The decision was intensely fact-based. He did not rule out the possibility of reaching a different conclusion in a different high-tech merger with different facts.

China's Antitrust Litigation

(and others) at the U.S. International Trade Commission and in U.S. district court for allegedly infringing seven of its U.S. patents related to 3G technologies. Huawei responded by suing InterDigital in the Shenzhen Intermediate Court. In one complaint, Huawei claimed that InterDigital abused its dominant position in licensing standard essential patents (SEPs) in the 3G wireless communications standard by imposing tying and discriminatory and other unreasonable conditions, and by initiating lawsuits seeking injunctions against Huawei in the United States. Separately, in another complaint, Huawei alleged that InterDigital violated its commitments to license SEPs at a fair reasonable and nondiscriminatory (FRAND) royalty rate and asked the court to determine the appropriate FRAND rate. In February 2013, the Shenzhen Intermediate Court ruled that InterDigital abused its market dominance in licensing its standard essential patents, and the FRAND rate should not be more than 0.019% of Huawei's product price. Upon InterDigital's appeal, the Guangdong High Court affirmed the lower court's decision in December 2013. The parties have since reached a settlement agreement on their global patent disputes. The Shenzhen Intermediate Court's decision on the FRAND rate was about two months before April 2013, when a U.S. court for the first time determined a FRAND rate. (That determination was in *Microsoft v. Motorola*.) The Shenzhen court recognized some issues the U.S. court considered as important in determining FRAND rates for SEPs, such as royalty stacking, and tried to find comparable licenses to calculate the appropriate FRAND rates.

China's judiciary has become more confident in deciding difficult antitrust cases that involve a significant amount of factual evidence and complex economic analyses. The courts' increasing reliance on economic evidence and expert opinions in adjudicating antitrust disputes should be considered by parties planning strategies for antitrust litigation in China.

EI News and Notes

Merger Defense Described as Innovative

The Financial Times recently commended White & Case for its particularly innovative defense of Toyota Industry Corporation's acquisition of Cascade Corporation. According to *The Financial Times*, White & Case "successfully challenged the Department of Justice's new economic modeling for antitrust in vertical mergers." EI provided the economic modeling used in this defense. The EI economists who worked on the matter were Michael G. Baumann, Su Sun, Barry C. Harris, and Matthew B. Wright.

MidAmerican Energy Holdings Company's Acquisition of NV Energy

In December 2013 MidAmerican Energy Holdings Company (MidAmerican), owned by Berkshire Hathaway, completed its acquisition of NV Energy. John R. Morris filed testimony before the Federal Energy Regulatory Commission indicating that MidAmerican's affiliations with the Kern River Gas Transmission Company and BNSF Railroad would not result in an increase in vertical market power due to the acquisition. Dr. Morris also worked closely with outside counsel at Gibson Dunn on presentations to the Antitrust Division of the U.S. Department of Justice.

Trademark Infringement Litigation

The U.S. District Court for the Central District of California recently ruled in a trademark infringement suit involving Quiksilver, Inc. (and its subsidiary QS Wholesale, Inc.) and World Marketing, Inc. (WMI). A unanimous jury found that Quiksilver had infringed WMI's trademark and awarded actual damages, punitive damages, and attorneys' fees. The decision established new case law for measuring actual damages through a reasonable royalty theory in trademark infringement cases. Thomas R. Varner testified for WMI concerning reasonable royalties. He was assisted by Erica E. Greulich. WMI was represented by the firm of Covington & Burling LLP.

Economists
INCORPORATED

OFFICES:

2121 K Street, NW
Suite 1100
Washington, DC 20037
phone: (202) 223-4700
fax: (202) 296-7138

100 Spear Street
Suite 1000
San Francisco, CA 94105
phone: (415) 975-5510
fax: (415) 281-9151

www.ei.com

in association with
The Allen Consulting Group in Australia