Economists Incorporated
Economists INK
FALL 2018
A BRIEF ANALYSIS OF POLICY AND LITIGATION

European Commission Fines Google for Illegal Tying

Stephanie M. Mirrow

Stephanie M. Mirrow has worked on numerous issues involving monopolization claims, including tying claims. She previously was an economist in the Antitrust Division of the U.S. Department of Justice.

The European Commission ("EC") recently fined Google €4.34 billion, stating that "Google has imposed illegal restrictions on Android device manufacturers and mobile network operators to cement its dominant position in general internet search." The EC focuses on Google's pre-installation and default search requirements and argues that Google is dominant in three markets: general internet search services, licensable smart mobile operating systems, and app stores for the Android mobile operating system. The Missouri Attorney General has sent Google a civil investigative demand to further investigate these issues.

Google has stated that it plans to appeal the EC's decision. The EC limits the extent of competition from non-Android developers in defining its relevant markets. For example, the EC claims that vertically integrated developers, such as Apple iOS and Blackberry, should not be included in the alleged market for licensable smart mobile operating systems. The EC argues that these vertically integrated developers are not available for license by third-party device manufacturers. The EC further claims, even if it considers end-user competition between Android and Apple devices, Apple cannot act as a sufficient constraint on Google's contracts because of purchasing decision factors, price differentials, and switching costs and because Apple devices set Google Search as the default search engine. However, these reasons do not address Apple's growth in sales of smart mobile operating systems in Europe or Apple's efforts to attract Android users (including its "Move to iOS" Android app).

Google openly publishes its Android source code, covering basic features of the operating system, which allows third parties to create "Android forks." Whether Google's open-source platform has resulted in more choices for manufacturers, network operators and consumers and whether Android fork developers can continue to enter and compete also is a point of contention. Google argues that phone makers can use or modify Android, resulting in more choices for consumers such as Amazon's Fire tablets. However, the EC alleges that Google prevented manufacturers who pre-installed Google apps from selling even a single smart mobile device running on alternative versions of Android that were not approved by Google and that this prevented a number of large manufacturers from developing and selling devices based on Amazon's Fire OS.

The Supreme Court's American Express Decision – Two-sided Platforms and Harm to Consumers

Robert D. Stoner

EI Principal Robert Stoner has provided expert economic assistance in a number of matters involving credit and debit card fees.

The Supreme Court determined, in its June 2018 decision, that American Express ("Amex") did not violate the antitrust laws by requiring merchants to refrain from encouraging patrons *at the point of sale* to use other cards for which merchants paid lower "swipe" fees on each transaction. The Justice Department and more than a dozen states argued that this contract requirement was anticompetitive, since it discouraged competition between credit card networks on swipe fees and resulted in higher consumer prices when merchants passed along the higher swipe fees through higher store prices. The Supreme Court majority disagreed, arguing that credit card networks need to be analyzed in the context of a "two-sided" platform where one cannot simply look in isolation at competition on "swipe fees" at the merchant level.

"Swipe" fees, sometimes referred to as interchange fees, are the fees that Amex (and other credit card competitors) charge merchants for processing a credit card transaction. Amex uses a different business model to compete with Visa and MasterCard. Amex's swipe fees generally are higher than those of rivals Visa and MasterCard. Amex encourages cardholder spending through generous rewards packages financed from these merchant fee revenues. This, in turn, enables Amex to recruit merchants who benefit from Amex's high-spending customers despite Amex's higher swipe fees. Visa and MasterCard compete with Amex by offering lower merchant fees and promoting their broader acceptance, but Amex's alternative business model also has led Visa and MasterCard to introduce card options not unlike the Amex card. The Supreme Court's decision raises several important antitrust issues concerning how different business models compete in a two-sided platform marketplace.

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First, in a two-sided platform marketplace, credit cards compete both for merchants to accept their cards as well as for consumers to use their cards. These two "sides" are connected, since merchants are more likely to accept cards that many consumers use, and consumers are likely to use cards that merchants widely accept. Cards compete for merchants both by offering a stable of users as well as through the "swipe" fees they charge merchants. Presumably there can be a tradeoff here –– cards that can deliver users that are likely to make more substantial purchases may be able to charge higher "swipe" fees and still have merchants accept the card. Cards also compete for consumers, both through the fees the cards charge (e.g., annual fees, interest, late fees) and rewards the cards offer consumers, as well as through the number of outlets where the card is accepted. In such a two-sided platform setting, it is necessary to consider whether (a) merchants have other means to put pressure on Amex to lower its swipe fees, e.g., simply refusing to accept the Amex card, and (b) consumers can turn to other cards to the extent they are unhappy with a card that, while it offers high rewards, is not accepted in as many stores due to high merchant fees. The fact that many merchants do not accept Amex cards suggests that Amex's competitors have taken advantage of Amex's higher merchant fees to limit the reach of the Amex card.

A second issue concerns the ability of Amex to exercise market power in a two-sided platform marketplace. Amex is one of four major credit card networks. According to the Supreme Court decision, the value of *transactions* on Amex cards is about one-third the value on Visa and MasterCard combined. However, when comparing the number of *cards* in circulation, Amex has only about one-eighth as many as Visa and MasterCard. With a relatively small share of cards, it is unlikely that Amex can raise swipe fees anti-competitively, since merchants have alternative card choices with substantially more users. Additionally, evidence indicates that Amex has been lowering its swipe fees somewhat in recent years, particularly for small businesses, in an effort to get more merchants to accept its cards.

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The Two-Stage Model of Competition in Hospital Merger Analysis May be Due for an Update

Lona Fowdur

Lona Fowdur has worked on numerous hospital mergers and other antitrust issues pertaining to healthcare. This article is based on written materials for a panel discussion held during the 2018 Antitrust in Healthcare Conference.

Cutting-edge economic theories and econometric methods are likely to play an increasingly important role in healthcare antitrust analysis. In recent hospital merger litigation, the FTC and courts have looked to the "two-stage model of competition" as a framework for evaluating competitive effects. While this model sometimes performs better than HHIs or other share-based indices, it has several limitations. New research and empirical findings highlight some of those limitations and demonstrate the existence of mechanisms that market participants can use to counter post-merger pricing increases. These findings suggest that cutting-edge modeling may need to extend beyond the basic two-stage construct.

In the past few years, circuit courts have relied on the tenets of the two-stage model of competition and the model's corollary – the willingness-to-pay construct – in their decisions to reverse the district court opinions in the Penn State Hershey-Pinnacle and Advocate-NorthShore mergers between providers of general acute care hospital services. More recently, a federal court in North Dakota granted a preliminary injunction against Sanford Health's proposed acquisition of Mid Dakota Clinic, relying on arguments that were based on the two-stage model in the context of physician services.

"… a study … finds that the two-stage model does not lead to a correct prediction in about one of every three merger cases…"

The two-stage model relies on the premise that competition between healthcare providers occurs, as the name suggests, in two stages. In the first stage, health plans and providers negotiate to determine the prices at which each provider will be included in the health plan's network. The model assumes that each party's bargaining leverage is a primary determinant of the negotiated rates between the provider and the health plan. As for bargaining leverage itself, the model assumes that it is a function of each party's respective threat point, or how well each party would fare if it walked away from the negotiations. In the second stage, in-network providers compete for the health plan's enrollees. The model assumes that competition in the second stage is based primarily on non-price factors, since patients pay only a small portion of the provider's rates and out-of-pocket payments tend to be invariant to their choice of in-network provider. The attractiveness of a provider to an individual patient depends on the patient's location relative to that of the provider, as well as other provider characteristics such as reputation, quality, and range of services.

The model itself first generates estimates of consumer preferences or demand for providers which are revealed through patient choices among in-network providers. The necessary data inputs for the first step of the modeling exercise (which focuses on the second stage of competition between in-network providers) pertain to patients' choice of provider as well as individual patients' demographics, type of insurance coverage, medical needs, and the distance from each patient's home to the locations of each provider in the patient's choice set. In addition, the model incorporates controls for characteristics of the providers, including size, ownership and proxies for quality or reputation when available. In the case of inpatient hospital services, the requisite data often are available from various state agencies.

The estimates from the first step of the modeling exercise can be used to deduce the incremental value that each provider contributes to the health plan's network, or the "willingness to pay" for the provider. Importantly, the model assumes that patients' actual choices can be used to reveal the extent to which providers are substitutes for one another. When in-network substitutes for a provider are readily available, that provider will contribute less incremental value to the network and, hence, both its bargaining leverage and the plan's willingness to pay for its services will be lower. When two close substitutes merge, the model estimates that the willingness to pay for the two providers combined will be significantly greater than the

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The Supreme Court's American Express Decision

A third issue relates to possible pro-competitive justifications for Amex's anti-steering provisions. One possibility is that these provisions can mitigate "free rider" effects. While a consumer who is being "steered" may correctly gauge the potential loss of his own Amex benefits if he does not make his purchases with an Amex card, he is unlikely to account for the larger network effect of his decision. If enough consumers are steered away from Amex by merchants at the point of sale, this would cause a substantial reduction in the swipe fees paid to Amex by merchants. As a result, Amex may have to lower the high reward benefits it offers to consumers, which would decrease its ability to compete for additional customers under its current business model. The Supreme Court appears to have recognized the role of the anti-steering provision in Amex's business model and that an elimination of Amex's anti-steering provision could end up stifling competition among the credit card networks for customers and merchants, not increasing it.

In sum, the Supreme Court decision in the Amex case arguably may allow Amex to maintain higher swipe fees *to merchants* than if Amex's anti-steering rules had been disallowed. Even this outcome may not occur, and in the context of a broader, two-sided platform marketplace, any such higher fees may not be anticompetitive. Merchants have tools besides point-of-sale steering to encourage Amex to lower its swipe fees. As the Supreme Court concluded, the credit card market had experienced expanding output and vigorous competition among different types of card networks, indicating that Amex's anti-steering provisions have not had a substantial anticompetitive effect that harmed consumers (as opposed to merchants) when seen in the context of a broader relevant market.

Two-Stage Model of Competition

sum of the willingness to pay for the two providers individually. This results in higher bargaining leverage for the combined entity post-merger.

The second step of the modeling exercise attempts to predict the price effects of the merger. This step requires pricing data which are available from health plans' claims databases. To generate predicted post-merger price changes, the model uses regression analysis to estimate the relationship between willingness to pay and prices. Once this relationship is estimated, the change in willingness to pay from the first modeling step can be used to estimate predicted post-merger price changes.

Proponents of the two-stage model claim that the model captures bargaining dynamics between payors and healthcare providers and that the model permits more accurate antitrust analyses by placing less weight on patient-travel patterns. Critics of the model point to reasons that the model only imperfectly captures competitive dynamics: it does not incorporate the ability of health plans to use in-network steerage, does not capture competitive responses by rival healthcare providers, and does not explicitly model the ability of consumers to switch health plans in the face of network restrictions or premium increases, among other reasons. For example, a study by Christopher Garmon, using real-world data, finds that the two-stage model does not lead to a correct prediction in about one of every three merger cases included in the study.

Additionally, a recent article in *Econometrica* by Kate Ho and Robin Lee supports the proposition that the two-stage model does not always provide a complete picture of the competitive dynamics in a healthcare marketplace. These authors extend the two-stage framework to consider the impact of health plan competition and large employers' ability to influence health plans' bargaining leverage with providers. Employers control the number of health plans that they decide to offer to their employees. The authors show how employers can exercise such control to influence the degree of bargaining leverage that their chosen health plans have vis-à-vis providers in their regions. For example, if the employer's enrollee volume is concentrated across two plans instead of three, the remaining two plans may gain an ability to negotiate better rates from providers. These findings suggest that the two-stage model may need to be extended to better predict price effects resulting from horizontal provider mergers.

EI News and Notes

Paul Godek Joins EI

Paul E. Godek recently joined EI's Washington DC office. Dr. Godek has 30 years of experience in litigation consulting – in the areas of antitrust, class certification, commercial damages, and securities fraud. Dr. Godek also served at both the federal antitrust agencies. He was the Economic Advisor to the Director of the Bureau of Competition at the Federal Trade Commission. Prior to that, he was a staff economist with the Antitrust Division of the Department of Justice.

Jury Rejects Direct Purchaser Class Action Claims

A jury in the United States District Court for the Eastern District of Pennsylvania found that egg producers were not liable for allegedly restricting supply and raising prices in the purported "U.S. commodity, shell egg market." EI President Jonathan Walker testified on behalf of the defendants regarding the procompetitive benefits of the challenged conduct, absence of injury to competition, and lack of proof of damages. Porter Wright Morris & Arthur LLP, Keating Muething & Klekamp PLL, Stevens & Lee, and Dechert LLP represented the defendants.

Study on Music Industries

EI Principal Stephen E. Siwek recently authored a study, "The U.S. Music Industries: Jobs & Benefits." This study examines the economic footprint of the United States music industry as a whole, including businesses like music publishing, internet and radio listening platforms, instrument manufacturing, musicians and music teachers, agents, concert promoters, and many others.

Shareholder Class Certified

The Court of Common Pleas of Cuyahoga County, Ohio recently certified a shareholder class in a case alleging that Centerior Energy Corporation provided incorrect shareholder information from 1986 through 1993 which harmed shareholders. EI Vice President John M. Gale provided testimony for the class. Plaintiffs were represented by Zagrans Law Firm, LLC; Gary, Naegele & Theado, LLC; Cohen Milstein Sellers & Toll, PLLC; and, Dennis P. Barron, Esq.

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