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A BRIEF ANALYSIS OF POLICY AND LITIGATION

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Third Circuit Rules in Uber's Favor over Philadelphia Taxi Association

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Vice President Allison Holt specializes in empirical microeconomic analysis in the assessment of liability and damages in antitrust and class action matters.

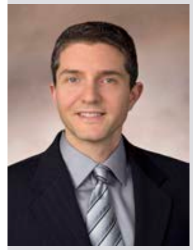
In a recent decision, the Third Circuit upheld a November 2016 district court decision to dismiss a complaint by the Philadelphia Taxi Association and 80 taxi companies, finding that there was no violation of antitrust laws. The Third Circuit found that the entrance of ride-sharing firms such as Uber and Lyft actually increased competition in the Philadelphia market, citing lower costs and increased rides available to consumers.

Taxi cabs and taxi cab companies in Philadelphia operate under the Philadelphia Parking Authority ("PPA"), which issues medallions and sets standards for vehicle safety and driver regulations. When Uber entered the market in October 2014, a medallion was worth approximately $545,000. Uber operated illegally for the next two years without acquiring medallions or submitting to the regulation of the PPA. This allowed Uber to operate at a substantially lower cost according to the appellant cab companies. By the time Pennsylvania approved legislation that would allow Uber to operate under the oversight of the PPA, the value of a medallion had dropped to about $80,000 and more than 1,000 cab drivers had left their cab companies to become Uber drivers.

The Third Circuit found that, while Uber may have hurt the profitability of the cab companies and decreased the value of the medallions, Uber actually increased competition in the market. The Third Circuit also noted that although Uber was operating illegally (not under the oversight of the PPA), this did not mean that it was violating antitrust laws or harming competition. Specifically, the Third Circuit found that the appellants failed to prove their attempted monopolization claim and that (1) as long as lower prices are not predatory they are beneficial to consumers; (2) Uber's ability to operate at lower costs was the result of greater efficiency and therefore not anticompetitive; and (3) cab drivers switching to become Uber drivers did not decrease competition in the market because they were continuing to work as drivers in the same market. The Third Circuit further found that nothing in Uber's business model "reflect[ed] specific intent to monopolize." Finally, the Third Circuit found no evidence based on market share that Uber could establish monopoly power, because there are no barriers to entry into the market and other ride-hailing apps, such as Lyft, would act as a check on any attempt to establish a monopoly. In sum, the Third Circuit upheld that there was no attempt to monopolize the market and that harm to a business competitor does not equal harm to competition.

Applied Econometrics: When Can an Omitted Variable Invalidate a Regression?

Hal J. Singer and Kevin W. Caves



*Kevin W. Caves and Hal J. Singer have worked on antitrust issues in a number of industries, including issues involving regression analyses and omitted variable bias. This article is based on a paper published in the***antitrust***source in December 2017.*

Omitted variable bias is a fundamental regression concept that frequently arises in antitrust litigation. Every regression has omitted some variable. The relevant question is whether the omission generates bias that significantly compromises the reliability of the regression model.

The essence of regression analysis is to use variation in X (the independent variable) to explain variation in Y (the dependent variable). Intuitively, omitted variable bias occurs when the independent variable (the X) that we have included in our model picks up the effect of some other variable that we have omitted from the model. The reason for the bias is that we are attributing effects to X that should be attributed to the omitted variable. Specifically, if the omitted variable has an effect on the dependent variable (Y) and is correlated with the explanatory variable (X), the regression will mistakenly attribute the effects of the omitted variable to the explanatory variable, resulting in omitted variable bias. When an omitted variable is uncorrelated with X, then it generally does not present any problems.

"A plausible omitted variable is … something that affects the dependent variable."

It is easy to claim, in the abstract, that a regression has failed to account for some unspecified factor. Omitted variable bias is therefore most effective as a methodological critique when one can (1) identify a plausible candidate for the omitted variable; (2) predict the direction of the bias based on its expected correlation with X and Y; and (3) (ideally) demonstrate this effect empirically by controlling for the omitted variable, and showing that the results change substantially.

Consider an example of a horizontal price-fixing conspiracy in which the defendants allegedly entered into an agreement as of a certain date. Suppose that the plaintiffs present a regression indicating that prices increased by 30 percent on average after the start date of the alleged conspiracy, relative to beforehand. An economist for the defense might argue that the plaintiffs' regression model suffers from omitted variable bias, because the plaintiffs' economist neglected to control for changes in the defendants' costs that took place around the time of the alleged conspiracy.

Note that the direction of the bias is important here, and depends critically on whether and how the omitted variable (cost) is correlated with the challenged conduct. If costs are positively correlated with the conduct, then the direction of the bias is positive, implying that the plaintiffs' model has overstated the effect of the conspiracy on prices. This would imply that the plaintiffs' regression was mistakenly attributing an observed price increase to the conspiracy, when in fact some or all of the increase was driven by higher costs. But if costs are negatively correlated with the conduct, then the direction of the bias is negative, implying that the plaintiffs' model has understated the effect of the conspiracy on prices. That is, but for falling costs, the conspiracy would have driven prices still higher. Finally, if costs are uncorrelated with the conduct, then omitting them from the regression model does not bias the plaintiffs' regression model.

The ideal solution would be to obtain cost data from the defendants, so that costs can be directly controlled for in the regression model. If the plaintiffs' regression still detects a positive and significant effect of the conspiracy on prices, the defense can no longer plausibly argue that the plaintiffs' estimate of the effect of the conduct is biased (unless some other omitted variable is identified). But if the plaintiffs' regression no longer shows a significant effect of the conspiracy, then the plaintiffs cannot plausibly prove liability or claim damages based on their regression model. If suitable cost data are unavailable, other forms of record evidence (e.g., testimony from input suppliers) could be used to investigate the likely direction of the correlation

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FTC Alleges “Global Fleets” in Challenge to Wilhelmsen’s Acquisition of Drew Marine

Stephanie M. Mirrow

Stephanie M. Mirrow has worked on numerous mergers and acquisitions across a broad range of industries. She previously was an economist in the Antitrust Division of the U.S. Department of Justice.

The Federal Trade Commission (“FTC”) recently issued an administrative complaint and amended complaint challenging the proposed acquisition of Drew Marine Group (“Drew”) by Wilhelmsen Maritime Services (“Wilhelmsen”). The FTC also filed suit in United States District Court for the District of Columbia (“District Court”), seeking a preliminary injunction to stop the deal pending the outcome of the administrative proceeding. The District Court granted the FTC’s request for a temporary restraining order.

The products at issue in this case are marine water treatment chemicals, which the FTC states include chemicals used by ships “to prevent corrosion, remove impurities, and enhance the operation of the ship – primarily, the ship’s boiler water or engine cooling water systems.” The FTC alleges a narrower market of these products sold to Global Fleets, stating that the relevant market is “the global supply of marine water treatment chemicals and services to Global Fleets.” The FTC defines Global Fleets as “owners and operators of fleets of globally-trading vessels that call in ports around the world” and alleges that these customers “seek marine water treatment chemical suppliers with global sales, delivery, and service presence.” This alleged market is similar to the markets alleged by the FTC in other recent merger cases, specifically those in which the FTC alleged price discrimination markets. For example, the FTC alleged the following relevant market in its 2015 complaint against Staples and Office Depot: “The relevant market is the sale and distribution of consumable office supplies to large B-to-B customers in the United States. Large B-to-B customers are particularly vulnerable to the proposed Merger because many have nationwide or multi-regional operations and require an office supplies vendor that can provide low pricing, high levels of service, and delivery across all of their operations.”

> “[T]he antitrust agencies continue to focus on national or global customers ... to define the alleged relevant market.”

In this case, the FTC again focuses on the largest customers, Global Fleets, as the ones most vulnerable to the proposed merger. The FTC alleges that the Global Fleets have distinct characteristics and distinct demands that limit competition from other suppliers of marine water treatment chemicals and services. The FTC argues that Global Fleets can be targeted, because they seek suppliers with global capability, want to standardize operations across their fleet by relying on only one or two suppliers, value suppliers with proven water treatment chemicals (and are thus unlikely to risk turning to an untested supplier), and desire cost-effective water treatment “programs” or “solutions” with available technical and customer service.

The FTC alleges that Wilhelmsen would control at least 60 percent of the alleged market post-acquisition and further argues that the distinct demands of Global Fleets impose substantial entry barriers and limit the ability of other suppliers to expand or reposition. Additionally, the FTC argues that Wilhelmsen and Drew are each other’s closest competitors and that they compete aggressively on both price and non-price terms, such as technical service, network breadth and product quality and innovation.

Although the FTC alleges that Global Fleets can be targeted based on key attributes including those discussed above, the merging parties counter that “there is no basis for carving Global Fleets out of the larger market for maritime vessels and offshore platforms in which the two companies actually compete.” In Respondents’ Answer to Amended Complaint, the merging parties argue that the single alleged product market does not make sense, because there is not a set package of water treatment chemicals sold to fleets. The merging parties highlight that there are different types of water treatment chemicals, one type of water treatment chemical cannot be substituted for another, and the types of water treatment chemicals chosen vary from customer to customer and from vessel to vessel. Moreover, the merging parties indicate that Wilhelmsen and Drew do not segment customers in the normal course of business as alleged by the FTC – rather, the merging parties “consider any

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between the omitted variable and the conduct, and thus, the likely direction of the bias.

Claims of omitted variable bias were raised by the defense in *In re High-Tech Employee Antitrust Litigation*. In that case, the plaintiffs alleged that top executives at some of Silicon Valley's most prominent companies, including Apple, Google, Intel, and Adobe, conspired to restrict the recruiting and hiring of high-tech workers as a mechanism for suppressing compensation. To quantify this effect, the plaintiffs' economist used an econometric model in which the dependent variable was real annual employee compensation, and the independent variable was a measure of the challenged conduct, calculated as the proportion of months within a given year during which a given employer was subject to one or more of the anti-solicitation agreements challenged by the plaintiffs. The results of the regression indicated that the compensation paid to class members was negatively related to the challenged conduct.

The defendants' economists argued in the abstract that the plaintiffs' regression model might suffer from omitted variable bias. By invoking omitted variable bias, the defense was asserting that the plaintiffs' measure of the challenged conduct was correlated with some other variable, which the plaintiffs had omitted from their model, and that it was this omitted variable that was actually causing lower compensation to be paid to class members. As the court observed in its class certification order, the defense had failed to specify what the omitted variable might be, or to explain why excluding it from the model would have biased the plaintiffs' regression in the manner claimed by defendants.

Both points are important. A plausible omitted variable is, first and foremost, something that affects the dependent variable. In this context, defendants' experts would have had to offer up some factor that would be expected to have a significant effect on class member compensation, yet was not already controlled for in plaintiffs' regression model. Second, one would have to be able to plausibly claim that the omitted variable had the correct correlation with the challenged conduct. Without a specified omitted variable, the court was unpersuaded that the alleged omission generated a bias that significantly compromised the reliability of the plaintiffs' regression model.

Challenge to Wilhelmsen's Acquisition

vessel over 1,000 gross tons ('g.t.') regardless of trading patterns (i.e., global, regional, or local) to be part of the global customer base for which they compete."

The merging parties also argue that the FTC's alleged market share of at least 60 percent is not sufficient to presume harm to competition. The merging parties highlight that other current competitors provide marine water treatment chemicals and services to Global Fleets, these competitors are not limited in their service capabilities, and Wilhelmsen's and Drew's lost sales divert to these other competitors more frequently than they divert to each other. Further, the merging parties argue that one of the FTC's key attributes, worldwide operations, is not important to Global Fleets. Water treatment chemicals are sold in stackable containers that last for 20-30 days. For this reason, large vessels such as those in the alleged Global Fleets market "can easily stock enough containers to cover the periods between visits to larger ports where the FTC appears to concede there is no concern about a potential price increase." The merging parties argue that vessels can readily purchase marine water treatment chemicals in this manner (reducing the ports in which they purchase), because they already do this for other goods that they purchase.

In sum, this case highlights that the antitrust agencies continue to focus on national or global customers requiring a purported set of products and services to define the alleged relevant market. Additionally, the arguments made by both the FTC and merging parties indicate that case-specific facts on purchasing characteristics of customers (and whether they are identifiable and observable), switching ability of customers, and pricing behavior by the merging firms continue to be key elements in defining an alleged price discrimination market.

EI News and Notes

Su Sun Testifies in a Chinese Court

On April 25-26, 2018, EI Vice President Su Sun testified at the Guangdong High People's Court. Dr. Sun testified on behalf of YY Inc. in its high-profile appellate case against NetEase Inc. related to the live streaming of video games.

First Meeting of the Utility of the Future Rates Group Held

The first Utility of the Future Rates Group ("UFRG") meeting was successfully held in San Francisco on April 26-27, 2018. Over 20 utility directors and managers from private and publicly-owned utilities across the United States and Canada gathered to discuss critical issues and approaches related to innovation in electricity rates and programs that will facilitate the transition to a system with increasing Distributed Energy Resources. EI's Senior Vice President Amparo Nieto and Principal John Morris presented at the meeting. The next UFRG meeting will be held in the Fall. For more information about the group please visit https://ei.com/utility-future-rates-group/.

Su Sun speaks on an ABA panel updating standard essential patent litigation in China

China has become a hot litigation battlefield for SEP owners and prospective licensees. In an ABA webinar on February 9, 2018, Dr. Su Sun was among several lawyers and economists discussing their first-hand experiences litigating SEP cases in China.

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