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Second Circuit Rules on AMEX

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Henry B. McFarland frequently consults concerning antitrust issues in financial services and other industries. He previously was an economist in the Antitrust Division of the U.S. Department of Justice.

The Second Circuit recently ruled for defendant American Express (AMEX) in a case brought by the Department of Justice (DOJ) and several states. DOJ argued, and the district court agreed, that AMEX's non-discrimination provisions (NDPs) were anti-competitive. NDPs restricted merchants who accepted AMEX cards from expressing preferences for other payment products. The Second Circuit found that DOJ had not established an antitrust violation and reversed the district court.

The Second Circuit stressed that AMEX's credit card was a two-sided platform, one that had to attract two distinct groups of customers where each group's demand was affected by the demand of the other group. AMEX had to appeal both to merchants and to cardholders. The more merchants who accepted the card, the more attractive the card would be to cardholders. Conversely, the more people who carried the card, the more attractive the card would be to merchants. The Second Circuit found that the district court erred by concentrating on merchants and not paying sufficient attention to cardholders.

For example, the district court defined the market as the sale of network services to merchants. The Second Circuit found that market definition to be a "fatal" error because it ignored cardholders. The court could not define the market by looking only at the price charged merchants because any price increase that reduced the number of merchants accepting the card would necessarily affect cardholder demand which in turn would have a feedback effect on merchant demand and thus on merchant price. Defining the market in terms of only one side might be legitimate when judging a horizontal restraint, where the question would be a possible loss of competition among platforms. In this case, however, the restraint was vertical—AMEX imposed restrictions on merchants accepting its cards. Under those circumstances, defining a market in terms of only one side risked condemning procompetitive behavior.

Similarly, the district court found evidence that AMEX had market power because when it raised price to merchants, few merchants dropped the card. The Second Circuit rejected this analysis because the higher prices to merchants paid for greater rewards to cardholders, and the resulting increased use of the card increased its value to merchants. Moreover, while the district court found that higher prices to merchants were evidence of anticompetitive effects, the Second Circuit rejected that analysis because it did not involve a "two-sided net price" that would account for effects on both merchants and cardholders.

DOJ has petitioned for reconsideration. If the decision stands, however, it may have important implications for how courts treat antitrust questions involving two-sided platforms.

Also In This Issue

The FCC's Eight Voices Rule

Kevin W. Caves and Hal J. Singer discuss the Eight Voices Rule, which prohibits mergers between television stations in the same Designated Market Area (DMA) unless at least eight independent broadcast television stations would remain in the DMA post-merger. Because most DMAs have fewer than eight stations, the Rule prevents television station mergers in most DMAs. The rule ignores competition from non-broadcast competitors. Moreover, the Eight Voices Rule is contrary to the procedures followed by U.S. antitrust agencies. The Rule could block mergers that result in concentration below the thresholds that the antitrust agencies state would create a rebuttable presumption of market power. Furthermore, the Rule ignores evidence concerning entry and merger-related efficiencies that the antitrust agencies would consider in their merger analysis. Econometric analysis confirms that the Rule fails to promote competition.

Need for Proactive Pay Equity Analyses Increases

Changes in federal and state regulations have increased the need for proactive pay equity analyses. Robert B. Speakman describes how such analyses should be conducted. A pay audit must start with a clear picture of the comparisons to be made. Once they have been delineated, a statistical model can be developed to make those comparisons. Building that model begins by considering what employees do to allow the grouping of "similarly situated" employees. Then some measure of job performance, such as experience, should be included in the model. Often, other variables should also be included. These variables differ from company to company and are identified through discussions with human resources personnel and counsel. The results from estimating the model will enable a firm to specifically identify any potential problems and take appropriate action.

The FCC's Eight Voices Rule

Kevin W. Caves and Hal J. Singer

Kevin W. Caves and Hal J. Singer have worked on antitrust issues in a number of industries, including telecommunications. This article is based on a paper they filed with the FCC on behalf of the National Association of Broadcasters.

The Federal Communications Commission's (FCC's) Eight Voices Rule prohibits mergers between television stations in the same Designated Market Area (DMA) unless at least eight independently owned and operating broadcast television stations would remain in the DMA following the transaction. (To count for purposes of the Rule, those stations may be either commercial or non-commercial but must be full-powered.) Because most DMAs have fewer than eight stations, the Rule prevents television station mergers in most DMAs. Although intended to promote competition, the Rule departs from basic principles of economics and antitrust.

The antitrust analysis of a merger often starts with the definition of a relevant market, but the Eight Voices Rule ignores that exercise and simply assumes that local broadcast television is the relevant product market. Thus, competition from non-broadcast competitors is ignored, even though the FCC recently recognized that local advertisers have a number of non-broadcast options, including regional cable networks and geographically targeted Internet-based advertising platforms.

The refusal to consider non-broadcast competitors ignores dramatic changes to the broadcast industry's competitive environment. Broadcast television has been losing viewers and market share to non-broadcast competitors. Video programming markets have become increasingly fragmented, and competition for viewers and local advertising dollars has intensified. Hundreds of non-broadcast channels are now available through cable and direct-broadcast satellite. New entrants, such as Amazon, Hulu, and Netflix, now offer programming over the Internet. There is also substantial evidence of robust and rapidly expanding competition from Internet-based and mobile advertising. The FCC itself found in its most recent Video Competition Report that local advertising revenues are greater for Internet providers than for local broadcast television.

> "The Eight Voices Rule is arbitrary and ignores evidence that is important to the proper antitrust analysis of a merger."

The Eight Voices Rule is contrary to the procedures followed by the U.S. antitrust agencies. The Rule sets up an unrebuttable presumption that a merger is anticompetitive based only on a count of the number of competitors, a crude measure of concentration. The Department of Justice (DOJ) and Federal Trade Commission (FTC) use a different measure of market concentration, the Herfindahl-Hirschman Index (HHI), as a screen to determine if a merger needs further investigation. They then consider a variety of other types of evidence to determine if the merger is anticompetitive.

In contrast, if there are fewer than eight independent stations in the DMA after the proposed merger, the FCC blocks the transaction with no further investigation. Mergers must be blocked even if they would result in concentration below the thresholds that the antitrust agencies' *Horizontal Merger Guidelines* state would create a rebuttable presumption of market power. Even accepting the limitation of the market to include only broadcast stations, a merger that results in a market with fewer than eight stations post-merger might also result in an HHI that the Guidelines would describe as unconcentrated. Moreover, partially accounting for non-broadcast competition would imply that the typical local programming market is unconcentrated under conventional antitrust standards.

Furthermore, the evidence that the antitrust authorities would consider in their merger analysis, and the FCC ignores, includes information that often would indicate a merger of broadcast stations is not anticompetitive. For example, the DOJ and FTC would consider whether the threat of new entry and the expansion of smaller competitors would prevent anticompetitive behavior post-merger. Once non-broadcast competitors are considered, many DMAs have experienced a significant amount of recent entry and expansion.

The standard antitrust analysis of a merger also considers the possibility that the merger will result in efficiencies.

continued on page 4

Need for Proactive Pay Equity Analyses Increases

Robert B. Speakman

Rob Speakman is a labor economist who has served as an expert and as a consultant in numerous employment discrimination and wage and hour claims. He regularly works with companies wanting to evaluate pay equity within their workforce.

Changes in federal and state regulations have increased the need for proactive pay equity analyses. The Equal Employment Opportunity Commission (EEOC) plans to begin collecting employers' pay data in March of 2018, and several states have passed more aggressive equal pay or fair pay statutes. Thus, many employers are considering evaluating (or re-evaluating) their workforce to determine whether there are unexplained gender- or race-based pay disparities and to assess potential liability should a compensation claim be filed.

There are several benefits to conducting an internal pay audit prior to an Office of Federal Contract Compliance Programs (OFCCP) or EEOC investigation or to the filing of a lawsuit. First, the audit allows assessment of potential liability under the protection of the attorney/client work product privilege. Second, an audit reduces the cost of later responding to government investigators, opposing counsel, the courts, or an opposing expert, should such responses be necessary. Third, if a firm does a proactive analysis, it will have sufficient time to develop meaningful statistical models and to research peculiar-looking pay values. Thus, it can refine the data or the model or make any pay adjustments that the analytical results and subsequent research suggest are warranted.

A pay audit must start with a clear picture of the comparisons to be made. Will the analysis examine base pay only or variable compensation too? Is it only interested in examining gender pay differences or race/ethnicity base pay differences? At what level should the analysis be conducted? What data are readily available to conduct the analysis? What other data might be necessary to make the pay comparisons? Once the necessary comparisons have been delineated, it will be possible to develop a statistical model to make those comparisons using regression, a common statistical technique.

"A pay audit must start with a clear picture of the comparisons to be made."

The first step in building a statistical model for use in the audit is to group "similarly situated" employees by considering what employees do. Under federal statutes, job title is often used to form these groupings. Job titles, however, may provide categories that are either too narrow or too broad. Recently passed state fair/equal pay regulations use different terminology for the grouping of like workers – "substantially similarly situated," "equal work," "comparable work," etc. That terminology suggests that a broader "job family" (possibly combining job titles) might be relevant, although that will not be clear until the state courts begin to interpret this new regulatory language. If broader job families are used, then data on education and licenses or certifications might become more important methods of measuring differences in employees that legitimately lead to differences in pay. Unfortunately, most companies do not track education and training nor do they update changes after hire. Even those firms that capture education data often do not capture anything more than the highest degree received.

The second consideration in the model is how well employees do their job. Performance is often difficult to quantify, but it may be measured by proxies, such as time-in-job or time-in-grade, company tenure, and age-at-hire. Age-at-hire is a poor proxy for prior experience. Actual years of relevant prior experience is a better measure, but very few companies gather this information, even though it is often considered when setting starting pay. Data from performance evaluations may also be used to measure performance. At a minimum, any analysis should examine the model's results both with and without performance measures.

A number of additional variables may be worth investigating for possible inclusion in the model. For example, an identifier for the employee's organization within the company, such as the division or department, may capture the decision-making structure as well as differences in payroll budget. Similarly the employee's location may capture geographic differences in pay. Other variables of interest may include whether an employee joined via acquisition (and when the acquisition occurred), and whether the employee possesses special skills that necessitate a premium. (sometimes called "hot skills").Variables may also be included to show that special circumstances have caused an employee to be "red-circled" (paid above grade maximum) or "green-circled" (paid below grade minimum). The variables that should be included vary from company to company. Labor economists rely on discussions with counsel and human resources personnel to further refine the factors to be included in the statistical model to match the company's pay practices as much as possible.

continued on page 4

The FCC's Eight Voices Rule

There is substantial evidence that common ownership of television stations in local markets can lead to substantial efficiencies owing to economies of scope and scale—efficiencies that have been found to result in production of greater amounts of local news programming. Nonetheless, the Eight Voices Rule ignores efficiencies.

Econometric analysis supports the view that the Eight Voices Rule does not promote competition. Panel regressions can be used to estimate the relationship between the number of independent stations in a DMA and local advertising rates. Regression can control for other factors that could affect those rates, such as a DMA's income, population, and demographics. Results from regressions like these showed that DMAs with fewer than eight stations do not have higher local advertising rates than DMAs with eight or more stations. In fact, a reduction in the number of independently owned stations serving a DMA is statistically associated with a decrease in local advertising prices. These findings are consistent with the view that mergers of broadcast stations may often lead to significant cost savings. They are inconsistent with the assumptions underlying the Eight Voices Rule.

The Eight Voices Rule is arbitrary and ignores evidence that is important to the proper antitrust analysis of a merger. Thus, it fails to advance the FCC's objective of promoting competition. Moreover, the Rule proscribes transactions that would likely result in significant cost savings with little increase in market concentration. Such mergers would likely be deemed procompetitive under conventional competition analysis.

The FCC is periodically required to examine its media ownership rules, and to eliminate any that have become obsolete. Unfortunately, the Commission declined to modify the Eight Voices Rule when it completed its most recent Quadrennial Review in August of 2016. In a dissenting statement, Commissioner Pai cited the regression study extensively, and concluded that "the eight-voices test lacks any foundation in economics or the realities of today's television marketplace. Indeed, repealing that test would promote competition and localism in the video marketplace."

Need for Proactive Pay Analyses

A key concern in constructing the model is the data. In many instances, the data to be used are determined by availability, and many companies do not maintain the data necessary to run a proper pay analysis. The data must be carefully reviewed for completeness and accuracy. Analysts need to ensure that values make sense. For example, one dataset indicated that almost all employees earned $60,000 to $120,000, but a few earned over $1 million. In fact, those seemingly very high salaries were measured in yen, not dollars.

After the data have been prepared, it will be possible to estimate the model to determine whether there are any potential problems, specifically statistically significant average pay differences between men and women or between members of different race/ethnicity groups. If any potential problems are found, the model will help identify employees in the analysis who are driving the pay difference.

By way of illustration, suppose that the pay difference between men and women is statistically significant and adverse to women among 500 employees in engineering roles. It is possible to isolate the subgroups within engineers having the biggest influence on the overall female/male pay difference. It may be that a large percentage (e.g. 25%) of the overall engineer pay difference is attributable to a small group of 15 petroleum engineers. Research could then focus on the 15 petroleum engineers rather than all 500 engineers.

The model may be used to identify employees having the biggest impact on the gender pay difference and those with the largest gap between expected pay (from the model) and actual pay. Such refined comparisons will enable the company to focus on a subset of employees, which will reduce the time cost of researching the pay differences. (It will be less costly to review 15 employee records rather than 500.) With a narrower focus, the company will be able to take appropriate action, either by refining the data or the statistical model to show the reasons for the pay differences or by adjusting the pay of selected employees where adjustments should be made.

EI News and Notes

Cellular Phone Customer Class Certified

The Court of Common Pleas of Cuyahoga County, Ohio recently certified a consumer class in an antitrust case alleging that cellular phone service buyers paid higher prices due to Ameritech's price discrimination among wholesale purchasers of cellular service. EI economist John M. Gale's testimony for the class included discussions of the elements of a simulation model to estimate non-discriminatory retail market prices. Dr. Gale's report was quoted and relied upon in the Court's decision on the predominance criteria. Plaintiffs were represented by Gary, Naegele and Theado, LLC; Randy J. Hart, LLC; Law Offices of Mark Griffin; and Hahn Loeser Parks LLP.

Report on Copyright Industries

A report titled "Copyright Industries in the U.S. Economy" was written by Stephen E. Siwek of EI for the International Intellectual Property Alliance. The report describes the economic contribution of the copyright sector, including books, music, videogames, computer software, motion pictures, TV and radio broadcasting, newspapers, periodicals, and journals. Core copyright industries' value added in 2015 was approximately $1.2 trillion, 7% of U.S. Gross Domestic Product. In that year, they employed over 5.5 million workers, about 4% of the U.S. labor force.

Monopolization Case Against Sports League

EI economists John Gale and Michael Baumann assisted Nspire Sports League, LLC, in its monopolization case against National Physique Committee of the USA Inc., the major amateur bodybuilding league in the United States, and against the International Federation of Bodybuilding and Fitness (IFBB) Professional League and IFBB International. Following the filing of Dr. Gale's report, the parties reached a settlement and agreed to dismiss the suit. Nspire was represented by Haynes and Boone.

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