Reflections on the Amex decision and the Bayer/Monsanto merger

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Korean Fair Trade Commission, 1 November 2018

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The Amex decision: The basics

- USDOJ and states sued Visa, MasterCard, and American Express for “anti-steering” provisions in their merchant contracts
- Anti-steering provisions – non-discrimination clauses – prohibited merchants from giving discounts for using different credit cards
  - Target was Discover card, trying to gain share via low merchant fees
- Visa and MasterCard settled, agreed to remove provisions
- Amex refused to settle, so DOJ and states litigated
- DOJ and states won in District Court
- Amex appealed and won in Appeals Court
- States appealed to Supreme Court, but Court affirmed Appeals Court ruling

Amex: The economic background

- Credit cards are a “2-sided market” (2SM)
- Precise definition of 2SM not agreed upon, but generally $D_1 = f(P_1, Q_2)$ and $D_2 = g(P_2, Q_1)$
- Thus “indirect network effects”: Change in number of participants on one side affects willingness to pay on the other side
- Thus “chicken and egg” problem
- Thus complex pricing issues: one side may face zero or even negative price
- Classic example newspapers: readers and advertisers
- More current examples: credit cards, video games, Uber, Airbnb

Amex: The legal background

- Vertical restraints generally analyzed in US antitrust law under "rule of reason"
- Usual methodology in rule-of-reason cases:
  - Step 1: Plaintiff must demonstrate an anticompetitive effect in a relevant market
  - Step 2: Defendant must demonstrate that the challenged behavior serves a pro-competitive purpose
  - Step 3: Plaintiff must demonstrate that the procompetitive purpose could be achieved by a less restrictive means
  - If Plaintiff cannot demonstrate this, then Court balances pro- and anticompetitive effects
- In Amex, District Court ruled that the anticompetitive effects of the restraint on merchants outweighed any procompetitive effects in that market

Amex: The successful appeal

- Second Circuit and Supreme Court: Methodology changes in *some* 2-sided markets
  - This is the first antitrust decision of the Supreme Court referring to 2-sided markets
- With "two-sided transactions platforms" – where "indirect network effects" are strong – the required Step 1 changes
- In those markets, plaintiff must show an *overall* anticompetitive effect – taking account of both "sides" of the market" – in Step 1
- In this case, plaintiffs failed to meet this initial burden

Takeaways from the Amex decision (1)

- With “two-sided transactions platforms”, the plaintiff’s burden in a rule-of-reason case increases
  - Second Circuit: DOJ failed to meet its Step 1 burden showing that the restrictions “made all Amex consumers on both sides of the platform – i.e., both merchants and cardholders – worse off overall”.
  - Supreme Court: “The plaintiffs have not carried their burden to prove anticompetitive effects in the relevant market. The plaintiffs stake their entire case on proving that Amex’s agreements increase merchant fees. We find this argument unpersuasive…. In sum, the plaintiffs have not satisfied the first step of the rule of reason. They have not carried their burden of proving that Amex’s antisteering provisions have anti-competitive effects.”

Takeaways from the Amex decision (2)

- But what, exactly, are “two-sided transactions platforms”?
- Supreme Court: Platforms with “more pronounced” indirect network effects and interconnected pricing…
  - For example, not newspapers, because readers are “largely indifferent” to advertisements
  - Note that this is contrary to traditionally accepted facts and analysis of newspapers
- … That facilitate a *single, simultaneous* transaction between the sides
- Commentators have been discussing what markets qualify as “two-sided transaction platforms”. AAG Delrahim:
  - Uber, Lyft, and Airbnb may qualify
  - Google and Facebook may not, because they are supported by advertising
  - Some activities of Amazon may

Takeaways from the Amex decision (3)

- With “transactions platforms”, how do we define markets?
- Decision: The market is “the transaction”.
- Quoting Second Circuit: “In two-sided transaction markets, only one market should be defined”.
- Dissent:
  - Of course the two-sided nature of the market is important.
  - But the majority decision puts complements into the same market. This is “novel”, and not supported by previous decisions.
- And by the way, *Times-Picayune*: Court held that in newspapers, advertising and readers are separate markets.

Bayer/Monsanto. But first, a word on merger remedies

- Overall philosophy: Where possible, achieve efficiency gains from merger, but prevent or reduce harm to competition
- Guiding principal: Where possible, maintain competition in markets
- Important distinction: Structural vs. behavioral
  - Structural maintains, employs profit-maximization incentives of firms in post-merger market
  - Behavioral seeks to constrain firm behavior, *contrary to* profit-maximization incentives
  - Behavioral generally requires *ex post* monitoring, something agencies and courts may be ill-equipped to do
  - Companies may consider agency limitations in monitoring when they agree on remedies
  - Example: Agreements not to discriminate. Difficult to enforce. Does internal transfer price mean anything?
  - Example: Transition agreements regarding financing or supply ("tolling"). New competitor remains dependent on old.
- Behavioral more common in vertical deals

So structural preferred. But still challenges.

- Main problems:
  - Companies have incentive to create weak competitor
  - Agencies lack expertise, have other demands and duties, may be too eager to declare victory
  - Transition agreements that may be lengthy
  - Weaknesses/failures highlighted in ex post studies by FTC and EC:
    - Spin-off of less than entire business unit, such as individual stores
    - Spin-off to weak buyer – for example, financially weak or without industry experience
    - Sabotage during transition period
    - Examples: grocery stores, car rental agencies, newspapers

Sometimes creative structural remedies

- Focus on: What is the *binding constraint* on competition going forward?
- Example: NYC hop-on, hop-off tour buses (*U.S. v. Twin America*)
  - Merger had been consummated, so investigation was *ex post*
  - Entry looked straightforward *except for* permission to stop near most popular tourist destinations
  - So remedy was spin-off of bus stops, not acquired firm
- Example: USAir/American Air merger
  - Separate from merger, 7 of most important US airports were “slot constrained” or “gate constrained”
  - Settlement required divestiture of slots at LaGuardia and Washington National, divestiture of gates and related ground assets at O’Hare, LAX, Logan, Dallas Love Field, and Miami
- Both examples of focus on protecting competition itself

Bayer/Monsanto deal

- Merger of two of the world's largest agricultural supply companies
  - World leaders in seed and crop protection technologies
- Critics: Merger "too big to fix"
- DOJ accepted largest negotiated merger divestiture in history
  - Basic concerns horizontal
  - Some vertical concerns
  - Some concerns regarding R&D
- Critics continue to cite "execution risk"

Negotiated divestitures

- Horizontal concerns
  - Bayer's cotton, canola, soybean, and vegetable seed businesses
  - Bayer's Liberty herbicide business (competitor to Monsanto's Roundup)
  - Each company's seed/herbicide businesses were connected "systems"
- Vertical concerns
  - Bayer's seed treatment business (concern is competitors to Monsanto's seed business, especially corn)
- R&D concerns: IP and research capabilities, patent licenses, very long term "pipeline" projects
  - GM seeds and traits
  - Wheat
  - Digital agriculture
- All divestitures to BASF, another large agricultural supply company

Notable aspects of required divestitures

- Bayer must include many “complementary assets” that are not directly part of competition issues raised by the merger
  - Reason: Assets raising issues were not “stand-alone businesses”
  - Also: Diverse research portfolios of scientists
- Multiple requirements for Bayer to supply or distribute products for BASF for up to 2 years
  - Supply: Row crop seed treatments, active ingredients used in seed treatments, Liberty herbicide
  - Distribute: Glufosinate products
  - Note that some of these were regulatory requirements of particular countries
- Monitoring trustee
- In 1st year after divestiture, BASF may petition Division to force additional divestitures

Other authorities went further

- China
  - “To allow, within 5 years after the commercialized digitalized agricultural products of Bayer, Monsanto and the entity after the concentration enter into Chinese markets, and on the basis of [FRAND] clauses, all Chinese agricultural software and application developers to connect their digital agriculture software and application programs to the digital agriculture platform of Bayer, Monsanto and the entity ….”
- Russia
  - “Non-discriminatory access of Russian software vendors, providers of telematics services and resources (seeds, plant protection agents, fertilizers, etc.) to digital platforms for precision farming,” and “Non-discriminatory access of Russian companies to the data array collected in Russia, based on which forecasting models are built up under the frame of digital platforms for precision farming.” (FAS website)

Other authorities (continued)

- India
  - “Provide FRAND access to its … digital agriculture products, platforms and Indian agro-climatic data. If the Parties sell agricultural products through their digital agriculture platforms, they are required to allow competitors to connect to such platforms…. The Parties are required to provide free access to Indian agro-climatic data to Government of India institutions for 7 years.” (Shardul Amarchand Mangaldas, “Competition Matters”
- Critics: Are all these conditions competition-related, or just taking advantage of the companies’ need for agency approval?