TESTIMONY OF

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GEOFFREY A. MANNE is the founder and Executive Director of the International Center for Law and Economics (ICLE) in Portland, Oregon. He is also a Lecturer in Law at Lewis & Clark Law School in Portland and a Contributor to the Hoover Institution's Project on Commercializing Innovation. Prior to founding ICLE, Professor Manne was Director of Global Public Policy at LECG and directed Microsoft's legal and economics academic outreach program. Earlier, Professor Manne was a law professor specializing in antitrust law and economics, intellectual property law, corporate governance, and international economic regulation, all topics on which he has written. His publications have appeared in journals including the *Journal of Competition Law and Economics,* the *Harvard Journal of Law and Public Policy,* the *Wisconsin Law Review* , the *Alabama Law Review,* and the *Arizona Law Review*. He is an expert in the economic analysis of law, drawing on degrees from the University of Chicago as well as work for Judge Richard Posner, private practice, and brief service at the FTC. Professor Manne has practiced antitrust law at Latham & Watkins, has served as a Bigelow Fellow at the University of Chicago Law School and an Olin Fellow at the University of Virginia School of Law, and has clerked for Judge Morris S. Arnold on the 8th Circuit Court of Appeals. Professor Manne is a co-founder of the Microsoft / George Mason Annual Conference on the Law and Economics of Innovation (with Joshua Wright). Also with Joshua Wright he is the editor of a forthcoming volume from Cambridge University Press entitled *Competition Policy and Intellectual Property Law Under Uncertainty: Regulating Innovation*. He blogs at Truth on the Market (www.truthonthemarket.com).

I would like to thank Chairman Conyers, Ranking Member Smith, Chairman Johnson and Ranking Member Coble for inviting me to testify. Members of the Committee: My name is Geoffrey A. Manne. I am the founder and executive director of the International Center for Law and Economics (or "ICLE")—a global think tank devoted to bringing academic rigor to policy debates in the areas of antitrust, intellectual property, and financial regulation. I also teach Law and Economics at Lewis and Clark Law School in Portland, Oregon, where I am a Lecturer. I've written widely on competition policy and innovation. I'm the co-editor of a forthcoming volume on the topic from Cambridge University Press, *Competition Policy and Intellectual Property Law Under Uncertainty: Regulating Innovation* (with Joshua D. Wright) and the co-author (also with Joshua Wright) of two articles on the limits of antitrust in the digital economy: *Innovation and the Limits of Antitrust* (published in the Journal of Competition Law and Economics) and *The Case Against the Case Against Google* (forthcoming in the Harvard Journal of Law and Public Policy). In the interest of transparency, Google, among several other companies, has in the past supported ICLE's work.

Economists have been studying antitrust since the very beginnings of the study of economics itself—Adam Smith even has a discussion on the subject in *The Wealth of Nations*. But economics—and by extension legal scholarship—has only come into its own and developed rigorous, sound and evidence-based analysis of the topic since about the 1970s. There is an enormous amount about the economic implications of business conduct that we still don't understand (and some that we do seem to have a handle on), but our antitrust laws nevertheless obligate us to soldier on, developing sound expectations about the anti- or pro-competitive implications of various forms of business conduct nonetheless.

And while antitrust is not unique in operating under conditions of fundamental uncertainty, antitrust may be unique in foisting the burden of this uncertainty onto essentially economic conclusions: The touchstone of antitrust enforcement is the speculative economic implications of scrutinized conduct rather than its adherence to specific rules or legal tenets. As a result, we are forced to assess possible antitrust interventions within a sometimes-unsatisfying "decision-theoretic" framework—weighing the likelihood and the costs of erroneous enforcement against the likelihood and costs of erroneous non-enforcement.

For reasons I will discuss briefly below, this essential analysis tends to counsel against, rather than for, enforcement in many circumstances, and this is particularly true in nascent, evolving and technologically-innovative markets where ignorance about market structure, competition, technology and consumer demand is legion. Following my general remarks, I will spend some time discussing the implications of this reality for assessing the competitive implications of the pending Google/ITA merger. At the end of my prepared remarks I have a brief discussion of the role of privacy concerns in antitrust analysis.

The antitrust landscape has changed dramatically in the last decade. Within the last two years alone, the United States Department of Justice has held hearings on the appropriate scope of Section 2, issued a comprehensive Report, and then repudiated it; and the European Commission has risen as an aggressive leader in single firm conduct enforcement by bringing abuse of dominance actions and assessing heavy fines against firms including Qualcomm, Intel, and Microsoft. In the United States, two of the most significant characteristics of the "new" antitrust approach have been a more intense focus on innovative companies in high-tech industries and a weakening of longstanding concerns that erroneous antitrust interventions will hinder economic growth. But this focus is dangerous, and these concerns should not be dismissed so lightly.

Today's high-tech bête noir is Google. Close scrutiny of the complex economics of Google's technology, market and business practices reveals a range of real but subtle, pro-competitive explanations for features that have been held out instead as anticompetitive. Application of the relevant case law then reveals a set of concerns where economic complexity and ambiguity, coupled with an insufficiently-deferential approach to innovative technology and pricing practiced in the most relevant precedent (the D.C. Circuit's decision in *Microsoft*), portend a potentially erroneous—and costly—result. A better analysis, by contrast, would embrace the cautious and evidence-based approach to uncertainty, complexity and dynamic innovation contained within the well-established "error cost framework." And while there is an abundance of error-cost concern in the relevant Supreme Court precedent, there is a real risk that the current, aggressive approach to antitrust error, coupled with the uncertain economics of Google's innovative conduct, will nevertheless yield costly interventions. The point is not that we *know* that Google—or any other high-tech company's—conduct is *pro-competitive*, but rather that the very uncertainty surrounding it counsels caution, not aggression.

The error-cost framework in antitrust originates with Judge Frank Easterbrook's analysis in his seminal paper, *The Limits of Antitrust*, itself built on twin premises: first, that false positives are more costly than false negatives because self-correction mechanisms mitigate the latter but not the former, and second, that errors of both types are inevitable because distinguishing pro-competitive conduct from anti-competitive conduct is an inherently difficult task, especially in a single-firm context.

While economists have applied this framework fruitfully to several business practices that have attracted antitrust scrutiny, its application to antitrust intervention in markets where innovation is a critical part of the competitive landscape is less-well-developed. While much has been said about the relationship between innovation and antitrust, often in the way of broad pronouncements that innovation either renders antitrust essential to economic growth or entirely unnecessary, the error-cost framework allows for greater precision in policy prescriptions and a more nuanced approach. Some of the implications are well understood in the current body of literature and others have been frequently ignored or remain entirely unrecognized.

In brief, given the link between innovation and economic growth, the stakes of "getting it right" are high. Caution and humility are warranted in light of both the historical hostility towards innovative business practices by competition policy as well as the large gaps of empirically-validated theory in the economic literature on competition and innovation. The traditional problem of identifying and distinguishing pro-competitive from anticompetitive conduct faced by enforcers and courts in all antitrust cases is a difficult one. But those difficulties are exacerbated in innovative industries.

Both product and business innovations involve novel practices, and such practices generally result in monopoly explanations from the economics profession followed by hostility from the courts (though sometimes in reverse order) and then a subsequent, more nuanced economic understanding of the business practice usually recognizing its pro-competitive virtues. This sequence and outcome is exactly what one might expect in a world where economists' career incentives skew in favor of generating models that demonstrate inefficiencies and debunk the economics status quo, while defendants engaged in business practices that have evolved over time through trial and error have a difficult time articulating a justification that fits one of a court's checklist of acceptable answers. In the words of Nobel economist Ronald Coase,

> [i]f an economist finds something—a business practice of one sort or another—that he does not understand, he looks for a monopoly explanation. And as in this field we are rather ignorant, the number of un-understandable practices tends to be rather large, and the reliance on monopoly explanations frequent."[1]

From an error-cost perspective, the critical point is that antitrust scrutiny of innovation and innovative business practices is likely to be biased in the direction of assigning higher likelihood that a given practice is anticompetitive

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[1] Ronald Coase, *Industrial Organization: A Proposal for Research*, in 3 POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 59, 67 (Victor Fuchs ed. 1972).

than the subsequent literature and evidence will ultimately suggest is reasonable or accurate.

Thus while many business practices are criticized by competitors and others as anticompetitive—and sometimes they are, of course—I believe it would be prudent to consider and give greater weight to the pro-competitive explanations as well as the anti-competitive ones. The fundamental truth of antitrust analysis is that the very same conduct (aggressive competition) that could be anticompetitive could also be pro-competitive; there is no easy way to suss out the difference on the basis of simple (or even complex) legislative or judicial language. The cost of hasty intervention is the loss to consumers of the benefits of that aggressive competition, both directly and, perhaps more importantly, by deterring future actions that may likewise attract costly interventions and penalties. Intervention tends to be final, stopping (and deterring) potentially-valuable conduct in its tracks. On the other hand, non-intervention under uncertainty permits the possible pro-competitive bounty to materialize and allows both the competitive marketplace as well as future enforcers to mitigate anticompetitive outcomes that may arise.

Google's acquisition of ITA

Several concerns have been raised about Google's proposed acquisition of ITA. In the interests of time I will not describe the details of the acquisition here but will instead note a few thoughts about the implications of the deal.

The primary concern that has been expressed is that the acquisition would "leverage" Google's dominance into another market—the online travel search market—and permit Google to foreclose access to ITA's important analysis of flights and fares by its competitors.

I would hasten to point out that ITA does not provide nor own the underlying data (this comes from the airlines themselves) but only its proprietary analysis and processing of the raw data. Thus, it would be impossible for Google to foreclose access to the underlying data (even if it wanted to) and its merger could only affect access to ITA's proprietary processing of that data—processing that other companies can and do undertake.

I believe that Google has made it clear—and its own comparative advantage and its entire history supports—that it has no interest in selling airline tickets or making airline reservations. Instead, its interest is in providing access to airline flight and pricing data through its various properties, and permitting online travel agencies to bid on the sale of tickets to Google users looking to buy (much as Microsoft already does with its Bing search engine). If ITA's data analysis and processing service competes with other products offered by Google, then it represents a small fraction of a much larger market and this transaction is competitively insignificant. If it is a different market, on the other hand, then critics need to make clear how Google's dominance in the "PC-based search advertising market" actually affects the prospects for competition in this one. Merely using the words "leverage" and "dominance" to describe the transaction is hardly sufficient. To the extent that this is just a breathless way of saying that Google wants to build its business in a growing market that offers economies of scope with its existing business, it is identifying a feature and not a bug. If instead it is meant to refer to some sort of anticompetitive tying or market foreclosure the claim is speculative and unsupported, as best I can tell.

One big problem here is that the claims of anticompetitive foreclosure do not turn on Google's owning ITA—rather, if it would be profitable for Google to incur the costs of both buying ITA as well as engaging in foreclosure in order to dominate the online travel search market, it would likely have been profitable for ITA to do it itself (or else negotiate away Google's expected gain in the sale price). Otherwise we're left with an argument that Google can do it more efficiently (in which case the claim cuts *against* challenging the merger), or else a claim that Google could be a more effective monopolist than ITA in online travel search—but this is just hand-waving and we still haven't heard why it would be true.

Critics of the deal wave off claims that the DOJ should be reluctant to regulate such a dynamic and innovative industry. But waiving off this concern is, while common these days, inappropriate and dangerous. It is precisely in this sort of dynamic, innovative and not-yet-understood market where the risk and cost of deterring beneficial business models and strategies (to say nothing of technological progress) are highest. To claim that the industry's newness and dynamism are not a reason to forebear from intervention is ill-considered, unsupportable, and backward. Rather, as the technology, usage and market structure, cost, and software for online search generally and travel search in particular change, so do the strategy and profitability of the various business models that build up around them. Whatever Google tries to do at this early stage of market evolution, it will face challenges from competing business models not yet conceived of, changes in underlying software, and demographic/usage/consumer preference changes that will make any market power it might enjoy both fleeting and important in catalyzing the very competitive evolution that will undermine it. Far from being irrelevant to the propriety of a merger challenge, the newness and dynamism of the market is essential to this determination.

Perhaps nowhere is this more evident than in the neck-breaking evolution of the mobile phone advertising market. As is well known, the FTC threatened to challenge Google's acquisition of mobile advertising provider AdMob until

Apple announced its own mobile advertising platform in direct competition with AdMob. No doubt this was viewed by Google as an enormous competitive challenge to its plans in this area—one that was unanticipated both by Google and the regulators at the FTC scrutinizing the merger. As if to underscore the point, shortly after it announced its foray into the mobile advertising space, Apple also implemented rules that precluded Google's AdMob from operating on the iPhone. These rules were recently rescinded, but the fact of vigorous, unanticipated competition between these two technology behemoths remains and has unfolded at a furious pace—like Schumpeterian competition on steroids. Had Apple's announcement come, say, one month later than it did, the FTC may well have blundered into itself foreclosing this competition and paving the way for a far less-consumer-friendly mobile advertising market.

Google's acquisition of ITA is a straightforward vertical merger, where one company has decided to purchase an input into its business outright rather than simply contract with it. The economic literature is overflowing with explanations for this sort of conduct (and at least two Nobel Prizes—those to Ronald Coase and Oliver Williamson—have been awarded for research in the field). Few areas of economic research are as well-supported empirically and as unanimous in their conclusions—in this case, that there are sound and well-supported institutional justifications for vertical integration rooted in the avoidance of the costs of contracting *between* companies rather than within the same entity.

In this case a number of those possible explanations are present. Most notably Google gets to exercise direct control over ITA's talented engineers if it owns ITA—influence that it may otherwise be able to wield only tangentially, if at all, through contracts with ITA. If Google thinks either that it can better manage ITA's human (and possibly also intellectual) capital better than ITA's current management, and/or if it has the foresight, financial wherewithal, intellectual and human capital, or innovative spark to better make use of ITA's resources, then integration is both sensible for the companies and valuable for consumers. I have no doubt that Google has novel ideas about how to process airline data that diverge from ITA's current processes and intends to develop new ways to work with the data within its search environment. Absent integration (or else extremely costly and maybe prohibitively-costly contracts), Google is stuck with the forms of data processing that ITA develops on its own and Google, its shareholders, its many users and its customers (to say nothing of ITA and its investors) would be harmed—as would technological progress and economic growth.

Privacy

A final, quick word about privacy.

No one has put forth an antitrust-relevant theory to support claims that, in cases like the Google/ITA deal and, more relevantly, cases like the Google/AdMob deal, the agencies should pay closer attention to the privacy interests implicated by scrutinized conduct. The data in question in these cases currently exists. The claim is that the same amount of data in the hands of one firm instead of two presents a problem, and that any such combination must be accompanied by "safeguards to protect consumers' privacy." There is no indication why privacy is more in danger when the two databases are combined. These claims contain no clear definition of "privacy," for that matter. Is the fear that my data is more likely to be unintentionally released into the public domain? I don't see why this is any more likely if Google controls two databases than if they are controlled separately by two separate firms. Is the fear that my data is more likely to be used in Google's decision-making when combined than when separate? First, I see no reason why this would be so, and second, this offers huge potential benefits, if true. How does it help me to "safeguard" my privacy by making the products I use otherwise less valuable to me? Privacy's optimum is certainly not the maximum, and the optimum differs for every person. How is this to be incorporated into an antitrust analysis?

Related to this, the implication of this kind of approach is that any efficiency that might be realized from a single firm having access to a larger or more robust database of information is not cognizable, but is, in fact, a bug and not a feature. This would threaten to condemn some efficiency-enhancing conduct by disregarding a potentially-important source of efficiency by labeling it a "privacy degradation" instead of an efficiency. Finally, where concentration of data entails the pooling of many people's data, why is this of any concern to me or any other individual? Is my privacy any more at risk if Google has access to another 10 million people's data? If anything the opposite would seem to be true.

Until proponents of incorporating privacy analysis into antitrust review–especially merger review–put forward anything resembling an antitrust-relevant theory of how mergers (or other conduct) could harm privacy instead of just parroting what amounts to an unsupported conduct-structure-performance assertion, the FTC should *not* "pay close attention to the privacy interests implicated by these transactions."

The basic argument in favor of incorporating privacy into antitrust analysis under *appropriate* circumstances is not too controversial:

- Antitrust exists to protect against the exercise of market power that reduces consumer welfare
- Reductions in non-price competition can reduce consumer welfare
- Privacy can be a form of non-price competition in some markets

- Ergo, antitrust analysis ought to be concerned with privacy concerns

The first three bullet points are easy to understand. I agree that to the extent that privacy amenities can be an important dimension of non-price competition, antitrust analysis must be flexible enough to incorporate those concerns.

What seems to me to be missing in this discussion is a theory of how a particular merger will change the incentives of the firm to provide privacy amenities as a form of non-price competition. Modern merger analysis focuses on the question of how the pricing incentives of the post-merger firm change after the merger. There is a substantial economics literature that has increased our understanding of how mergers might impact pricing incentives. It is generally no longer sufficient in merger cases to point to an increase in concentration by itself as support for the assertion that consumer welfare will be harmed (this is the old, discredited conduct-structure-performance framework I mention above). An agency challenging a merger must present a compelling competitive effects story. Here, the competitive effects are going to be privacy-related. It seems to me that to move forward from "privacy should count in antitrust analysis because it is a form of non-price competition" to "this merger will reduce privacy and harm consumers" one must have a theory that explains: (1) why the specific merger *changes the firms incentives* to provide (or degrade) privacy amenities above and beyond a showing that the merger increases concentration, and (2) if the merger creates market power, why the firm will exercise that power in the form of reducing privacy rather than increasing the price. To my knowledge we do not yet have a theory that accomplishes this aim.