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I. INTRODUCTION

Because merger cases get litigated to judgment only every so often, when such a case comes along, it is useful to take stock. We reflect on issues of interest to us as economists that are raised by the recent ruling in the United States Department of Justice's challenge of the Bazaarvoice acquisition of PowerReviews.[2]

II. MARKET DEFINITION VERSUS DIRECT EVIDENCE OF COMPETITIVE EFFECTS

Many economists see little utility in market definition, particularly when direct evidence regarding competitive effects is available.[3] Yet, historically, courts have routinely required that a market be defined in an antitrust case, and we have found that many lawyers support this position.

In our view, *Bazaarvoice* illustrates the problems with making market definition a requirement. The court devoted considerable effort to describing the relevant market and the importance of the relevant market definition to its conclusion that the merger was likely to lessen competition. Indeed, dozens of pages of the court's opinion explicitly covered topics related to market definition. Yet, given the direct evidence of competitive effects presented and relied upon by the court elsewhere in the decision, there seems to have been little need to undertake the extensive effort involved in the market definition exercise.

While the court likely reached the correct ultimate decision from the market definition analysis, it was only because the direct evidence of competitive effects lined up with the finding of high levels of concentration. In fact, it appears that the court's conclusion regarding the appropriate market definition was heavily influenced by its observation regarding the importance of the pre-merger competitive constraint the merging parties placed on each other. But, when the merging parties have been determined to impose significant pre-merger competitive constraints on each other, the need to define a market is largely obviated. In that event, market definition is not needed to serve as an initial screen, and instead becomes merely a box to be checked, adding little to the process.

Bazaarvoice seems to have presented an opportunity to support a conclusion about competitive effects based on direct evidence alone, without first undertaking an extended market definition exercise. The court noted that Bazaarvoice had been forced to lower its bids to

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[2] *See* Memorandum Opinion - Public Redacted Version ("Bazaarvoice Opinion"), *United States of America v. Bazaarvoice, Inc.,* United States District Court Northern District of California, 13-cv-00133-WHO, *available at* http://www.justice.gov/atr/cases/f302900/302948.pdf.

[3] *See* Louis Kaplow, *Why (Ever) Define Markets?*, 124 HARVARD L. REV. 437 (2010) for a recent example. There are, however, dissenters among economists who see value in market definition. See *Gregory J. Werden*, *Why (Ever) Define Markets? An Answer to Professor Kaplow*, 78 ANTITRUST L.J. 729 (2013).

customers in response to competition from PowerReviews. Consistent with this, the court quoted from numerous Bazaarvoice documents that: (i) identified PowerReviews as its primary competitive threat, (ii) stated that the removal of PowerReviews would solidify Bazaarvoice's market position and prevent further price erosion, and (iii) noted that a primary motivation for the acquisition was to remove that competitive threat. Moreover, empirical analysis measuring the frequency of competitor mentions in Bazaarvoice's "Win/Loss" opportunities and "How the Deal was Done" documents indicated that PowerReviews was involved in 80 percent or more of the competitive bids Bazaarvoice faced while no other independent seller was as high as 5 percent.[4]

While this direct evidence of competitive effects appears to be strong, it is largely based on documents. We are disappointed that neither the DOJ's economist nor Bazaarvoice's economist appears to have attempted a more sophisticated economic analysis of competitive effects. For example, neither economist appears to have analyzed the relationship between Bazaarvoice's price to a customer and the presence of PowerReviews in the bidding process for that customer. To the extent that the absence of a more sophisticated economic analysis was due to the litigants focusing their efforts on meeting the hurdle of defining markets, it illustrates a danger of "requiring" market definition—to ensure that the market definition box is checked within the limited time frame provided in litigation, the litigants may forego what would actually be a more probative analysis.

The "requirement" to engage analytically on market definition also appears to have prompted the litigants to search for evidence that, at best, added little incremental value and, at worst, confused matters. Bazaarvoice, for example, argued that the market was wide, encompassing other product options such as a social media, and attempted to show the differences in the level of market concentration if the market were defined to include customers outside of the IR 500.

However, such efforts are not needed and, indeed, are irrelevant when price discrimination markets are appropriate (discussed further below) and direct competitive effects can be identified for a substantial set of customers as appears to have been the case here. If it was already established that PowerReviews served to constrain Bazaarvoice's pricing for some customers within the IR 500, an effort to show lower measures of market concentration under broader definitions of the relevant market would have little or no additional value.[5] The effort to define the market therefore only acted to divert the litigants from the more important question of the extent to which the two merging parties disciplined each other's pricing with respect to those customers for whom they competed.

[4] Bazaarvoice Opinion, ¶¶270-273. In-house or Internal builds, where the company builds their own infrastructure, was mentioned in 12-15 percent of the bidding situations as a competitive threat to Bazaarvoice's position. That the company was able to so closely identify the frequency of the in-house threat is an indication that absent sufficient competitive constraints from other third-party sellers, there would exist the ability to raise prices on a targeted basis to those customers that did not have viable internal options.

[5] It is possible that analyzing the set of providers beyond the IR 500 might identify sets of potential suppliers to the IR 500. This could be useful information, especially if there are instances of an actual supplier repositioning in response to changing market conditions.

Similarly, market definition and the calculation of concentration measures have long been recognized to be seriously flawed as a methodology for analyzing competitive effects of a merger in a differentiated products industry.[6] Here, the products that Bazaarvoice argued should be added to the relevant market definition were substantially differentiated from the products of the merging parties. In this situation, a more reliable assessment of the merger's competitive effects would result from directly analyzing those effects rather than devoting effort to arguing about the boundaries of the relevant market.

In addition to diverting the litigants and the court away from more useful questions, the primary focus on market definition could also have led to the wrong conclusion, although that does not appear to have been the case here. Bazaarvoice took essentially what amounted to two different positions on the relevant market, suggesting that the market should be broader, but simultaneously arguing that PowerReviews was not a viable competitor for Bazaarvoice's core customer base of larger internet retailers. From a market definition perspective this would imply that there are different markets—one consisting of large retailers and another of midsize or small retailers, each with different levels of concentration. If such a position were adopted it could lead to the conclusion that the two firms were not important competitors to one another, as the change in HHIs from the combination would be modest. But such a conclusion would seem to be erroneous given the strong direct evidence regarding competitive effects.

We do not advocate abandoning market definition entirely, nor do we argue that the market definition process never has any value. The market definition process can help identify important characteristics of the competitive environment faced by merging parties. The initial steps involved in performing a hypothetical monopolist test, for example, entail gathering the set of products that could potentially be viable substitutes for the products of the merging parties. Such analysis is valuable because it can explain why, in a post-merger world, the merged firm might be unable to increase prices even if prior evidence showed that the merging parties frequently competed directly against one another.

But, where possible, any conclusion regarding the competitive constraints provided by other products should be informed by an analysis of whether these other products actually disciplined prices in the pre-merger world, for example, in situations where Bazaarvoice and PowerReviews did not compete directly.[7] If this were found to be the case, it potentially would alleviate concerns of a post-combination exercise of market power by the merging parties because the existence of substitute products prevented such an exercise in the pre-merger environment.

In sum, while *Bazaarvoice* presented a golden opportunity for the litigants and the court to downplay market definition and make competitive effects the centerpiece of the antitrust

[6] *See*, e.g., Jerry A. Hausman, Gregory K. Leonard & J. Douglas Zona, *A Proposed Method For Analyzing Competition Among Differentiated Products*, 60 ANTITRUST L.J. 889 (1992).

[7] Of course, a further element of the analysis would involve analyzing entry, either from new suppliers or customers pursuing in-house options, in response to a relative price premium charged by Bazaarvoice where PowerReviews had no visible presence. This type of exercise is more fruitful than simply trying to estimate market share of a potential supplier and drawing some inference from its shares, without knowing whether the presence of that firm has any material effect.

analysis, that opportunity was missed. Indeed, the decision gives no reason to believe that the requirement of market definition, seemingly so embedded in the antitrust case law, will be dropped anytime soon. However, hope springs eternal, even among practitioners of the Dismal Science, and we look forward to future cases giving more weight to direct evidence of competitive effects and less to market definition.

III. PRICE DISCRIMINATION MARKETS

A price discrimination market consists of a subset of customers that could be identified and targeted for a price increase by a hypothetical monopolist. The 2010 Merger Guidelines, as did the previous 1992 Merger Guidelines, discuss conditions under which price discrimination markets may be defined. Thus, the concept of price discrimination markets has been embraced by the U.S. antitrust agencies for an extended period of time. However, previous attempts by the agencies to define price discrimination markets in litigated merger cases have often run aground. An example is the Oracle-PeopleSoft merger.

Bazaarvoice seems to have presented the DOJ an opportunity to give price discrimination markets another try. The court found that pricing was individually negotiated between a customer and a supplier and that suppliers had information about customers that they used to determine the prices they offered to those customers. As a result, pricing varied across customers.

In particular, as discussed above, the court found situations where Bazaarvoice offered discounts to customers for whom it faced direct competition from PowerReviews. When firms set a single price to all buyers, that price is disciplined by the competitive pressure provided by options considered by the marginal customer. With individually negotiated pricing and its knowledge of customers' preferences and options, Bazaarvoice was able to set different prices to different buyers based to some degree on the options available to each buyer. Similarly, a hypothetical monopolist controlling both Bazaarvoice and PowerReviews may have been able to target certain customers (e.g., those who viewed PowerReviews as the only close substitute for Bazaarvoice) for a price increase. This suggests that such customers may form one or more separate price discrimination markets.

The DOJ does not appear to have pursued a price discrimination market argument in *Bazaarvoice*, perhaps being mindful of the difficulties encountered in previous cases. However, as with the excessive focus on market definition, the failure to embrace price discrimination markets may have actually served to reduce the level of clarity. For example, as discussed above, Bazaarvoice argued that the relevant market should be expanded to include customers outside the IR 500. In a situation where a single price was charged to all customers, and the marginal customer was outside the IR 500, that would make sense. However, in the context of price discrimination markets and the associated evidence cited in the court's decision, Bazaarvoice's argument to include customers outside the IR 500 does not make economic sense. If the customers outside the IR 500 had different preferences or options than those inside the IR 500, and this was recognized and acted upon by suppliers, those customers may be in separate price discrimination markets from the customers inside the IR 500.

IV. ENTRY

It is often said that, in an antitrust case, entry is a trump card: if you have it to play, you win. It appears that Bazaarvoice tried mightily to convince the court that potential entrants abound. However, the court was not persuaded, seemingly for three reasons:

1. The court found that any new entry was unlikely to have any significant competitive effect within a two-year time window and thus would not be timely.
2. The court found that, while companies such as Google and Amazon might possess the general capabilities required to enter, they had shown no inclination to do so either before or after the transaction. Thus, identifying potential entrants was not enough. To make a persuasive entry argument, Bazaarvoice had to show that the potential entrants actually would be induced to enter if Bazaarvoice were to attempt a price increase.
3. Most interestingly, the court concluded that, if anything, the merger likely would deter, rather than induce, new entry. The court found that network effects are present and constitute a barrier to entry. Because Bazaarvoice has greater scale after acquiring PowerReviews, its network effects are larger post-merger and thus the barriers to entry faced by a new entrant will be more significant.

A point on entry that does not appear to have been addressed by the litigants relates to the fact that the court found that Bazaarvoice had never made a profit. It is difficult to tell whether the court meant that Bazaarvoice had not yet made a cumulative profit (i.e., recovered all of its previous investments) or it had not yet even achieved an operating profit in any period. Either way, it would not paint an attractive picture to any firm considering entry. Suppose that, due to competition between them, prices were well below the level that would allow Bazaarvoice and PowerReviews to recover their previously sunk costs. In that event, prices could increase substantially post-merger without attracting entry because a potential entrant would fear not being able to recover its sunk costs. Thus, the economic conditions in the industry may make an entry argument even less persuasive.[8]

V. DOES ANTITRUST APPLY TO DYNAMIC INDUSTRIES?

Finally, we note with interest that the court touched upon the question of whether antitrust law should apply to "dynamic industries." The court concluded that it need not address this question in general since there was strong support in the facts of the case that the antitrust laws should apply here.

Our own conclusion is that there is no reason to exempt "dynamic industries" from antitrust analysis. Indeed, as the facts of this case demonstrate, "dynamic industries" may be particularly subject to certain forms of antitrust conduct. For example, as mentioned above, the court found that the existence of network effects meant that the merger was likely to increase the barriers to entry. Network effects are common in high-tech industries.

[8] The U.S. agencies typically use the current pre-merger price level (with adjustments for any expected future changes in economic conditions) as the benchmark for evaluating post-merger prices. However, when current prices are "sustainable" in the sense of allowing the recovery of ongoing costs, but are too low to allow the recovery of previously sunk costs, arguably they are below the "competitive level."

Similarly, the court found that one motivation for the merger was that Bazaarvoice wanted to consolidate its position in its existing product market to "protect its flank" while it attempted to extend into "adjacent" product markets. This strategy bears a resemblance to the strategy identified by Carlton & Waldman in which a firm protects its market power in one market by forestalling entry into a second, adjacent market from which the entrant could leapfrog into the first market.[9] Again, because this type of anticompetitive strategy has application in "dynamic industries," there is no reason to exempt such industries from antitrust scrutiny.

[9] Dennis Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 215 (2002).