



THE FREE STATE FOUNDATION

A Free Market Think Tank for Maryland.....Because Ideas Matter

Perspectives from FSF Scholars
July 8, 2019
Vol. 14, No. 16

The DOJ Needs to Reconsider Market Definition for Advertising Markets

by

Theodore R. Bolema *

I. Introduction and Summary

Antitrust analysis of mergers, monopolization, and other types of commercial practices starts with defining the relevant market. For antitrust purposes, the Department of Justice (DOJ) has long subdivided advertising markets into segmented radio, broadcast TV, cable, and online advertising markets. This no longer makes sense, and DOJ needs to alter its past practice to account for the realities of competition and convergence in today's marketplace.

At the Antitrust Division's recent Public Workshop on Competition in Television and Digital Advertising, Makan Delrahim, the Assistant Attorney General in charge of the Antitrust Division, stated that DOJ is willing to take a closer look at changing market realities and perhaps reconsider its current overly strict advertising markets definitions.

This is a welcome development. According to the 2010 Horizontal Merger Guidelines relied on by the DOJ, the key market definitional question for antitrust analysis is whether digital or online media advertising is a close enough substitute for at least some advertisers so that enough of them would switch from one to the other if the price of the first went up. Substantial evidence now shows that these online and more traditional advertising markets have converged and

The Free State Foundation
P.O. Box 60680, Potomac, MD 20859
info@freestatefoundation.org
www.freestatefoundation.org

compete to a sufficient extent for the DOJ to consider those different media channels part of the same product market.

DOJ's rather outdated approach to defining and subdividing advertising markets was an issue in several recent high-profile investigations by the DOJ. Recent examples, which were discussed by AAG Delrahim in his speech, include the Nexstar acquisition of Media General and its broadcast television stations, Sinclair Broadcast Group's proposed acquisition of Tribune Media (which was abandoned by the parties after an investigation dragged on), and the DOJ's challenge to the AT&T/Time Warner merger. Although AAG Delrahim stood by the market definitions that the DOJ applied in those instances, he explained: "[W]e recognize that industries change. In order to ensure that we continue to update our analysis of media markets, we need to take into account the latest industry trends, the latest technological evidence and the latest economics." As AAG Delrahim pointed out, revisiting market definition is a normal part of antitrust enforcement as conducted by both Republican and Democratic administrations.

At the Public Workshop on Competition in Television and Digital Advertising, the AAG and DOJ staff heard from a series of industry witnesses that radio, broadcast television, cable, and online advertising markets are converging with extensive substitution occurring among them. For example, Christopher S. Ripley, CEO of the Sinclair Broadcasting Group, provided data on the 40-year trend of broadcast television losing audience share to cable or other alternatives. Meanwhile, most popular content on cable, including HBO, Showtime, Starz, and ESPN, are now available on Internet streaming services, while other popular content offerings, including the Time Warner channels, Disney, and Discovery channels, will be available by next year.

Most significantly, Mr. Ripley showed that digital advertising revenue has more than quadrupled since 2007 and now exceeds the combined revenues for broadcasting and cable channels. This reversal is especially pronounced for local ad revenue, where digital dominates, while cable and broadcasting are more competitive for national advertising. And according to an eMarketer report, digital ad spending is the fastest growing form of advertising: "Digital made up 36.7% of total media ad spending in 2016 and will account for around half by 2021." At the DOJ's workshop, other industry witnesses representing TV and radio broadcasting, cable, and social media services also described how their respective services were in competition with each other's platforms for advertising audiences and revenues.

Additional evidence regarding convergence and competition in radio, broadcast television, cable, and online advertising markets is contained in the Federal Communications Commission's *Communications Marketplace Report* (2018). The FCC's report recognized that "[b]roadcast stations compete with one another, as well as with cable networks and OVDs, for viewing audiences primarily on the basis of program popularity." It cited data from 2016 and 2017 indicating that local and national advertising revenues for Internet or online video services are growing while advertising revenues for broadcasting remain flat and have declined for cable and other multichannel video programming distributors (MVPDs). For instance, the Internet/online generated \$33.9 billion or 41.7% of local advertising gross revenues in 2017, up from \$28.3 or 35.4% in 2016. By contrast, broadcast TV and radio sectors grossed \$12.2 billion or 15% and \$10.4 billion 12.7%, respectively, in 2017. The cable sector's numbers were even lower, and 2017 gross revenues for all traditional advertising sectors declined from 2016 levels.

Additionally, the FCC's report points to ways in which radio and TV broadcasters as well as cable providers have responded to competition from rivals, including by adopting Internet website social media strategies for earning advertising revenues, by enhancing original content offerings to counterbalance advertising revenue declines, and by offering their own content via Internet streaming.

How to define the modern media advertising market is not some technical debate that is of interest only to antitrust scholars and economists. Rather, it has important implications for how DOJ carries out its mission of promoting competition and protecting consumers. When DOJ views the communications marketplace as more segmented into discrete product markets than is justified, those segments appear more susceptible to domination by one or a few market providers. In turn, this may trigger DOJ enforcement actions based on false positives when competitive market conditions actually exist. And employing narrow market definitions may distort the ability of antitrust agencies to assess accurately the pro-competitive benefits of mergers like the AT&T/Time Warner merger. In that case, DOJ challenged the merger, but the trial judge found no compelling evidence of anticompetitive harm and actual evidence of efficiency benefits.

Radio, broadcast television, and cable advertising clearly are competing with digital advertising, and, for the most part, online advertising is now winning. But overly narrow market definition makes mergers unnecessarily difficult in non-online industries in which advertising revenues have been falling, and may protect online advertising outlets from competition from non-online channels for advertising revenues. Given the substantial evidence of convergence and competition between radio, broadcast television, cable, and online advertising markets, DOJ should finally recognize that those competing platforms now operate in the same market.

II. The Antitrust Division and Market Definition for Advertising Markets

Antitrust analysis of mergers, monopolization, and other types of commercial practices starts with defining the relevant market. DOJ has traditionally distinguished between online and offline advertising, considering them to be separate product markets. It has also deemed different offline media advertising, including radio, broadcast television, and cable, to be separate advertising markets.

However, Assistant Attorney General Makan Delrahim indicated in a May 2, 2019, speech at the Antitrust Division's Public Workshop on Competition in Television and Digital Advertising that DOJ is willing to reconsider this overly strict approach to market definition for ad markets:

Different media channels may serve different roles in the eyes of advertisers, from brand awareness to sale. This is not to say the different channels do not compete. They certainly do on some level. The question for us is, how do they compete?

While we are confident in how we have defined markets in our past cases, we recognize that industries change. In order to ensure that we continue to update our analysis of media markets, we need to take into account the latest industry trends, the latest technological evidence and the latest economics—reason enough to hold this workshop today and tomorrow.

Moreover, as we consider the changing marketplace, it is important to keep in mind former Assistant Attorney General of Antitrust[] Anne Bingaman's comments in a speech on *Competition and Innovation: The Bedrock of The American Economy*, where she noted that – and I quote – "we're not the first generation to be confronted with increasingly rapid change. It's probably true that every generation since the beginning of the Industrial Revolution has worried about the impact of the changes that they were experiencing."¹

When the DOJ views the communications marketplace as more segmented into discrete product markets than is justified, that segmentation can undermine its mission of promoting competition and protecting consumers. Overly narrow advertising market definition makes mergers unnecessarily difficult in non-online industries in which advertising revenues have been falling, and may protect online advertising outlets from competition for advertising revenues. And employing narrow market definitions may distort the antitrust agencies' ability to see the pro-competitive benefits of mergers like the AT&T/Time Warner merger, in which the trial court found no compelling evidence of anticompetitive harm and actual evidence of efficiency benefits.

The way AAG Delrahim is framing this discussion is a positive development. It is encouraging to see the head of the Antitrust Division calling for DOJ to take a fresh look at this issue. The AAG also correctly points out that revisiting of market definition is a normal part of antitrust enforcement as conducted by both Republican and Democratic administrations as markets change.

In another part of the same speech, however, AAG Delrahim appears to exhibit some reluctance to move away from the way DOJ has been narrowly defining advertising markets:

Our experience with advertising markets has taught us that there are varying levels of substitution for ad placement across media. For example, through our investigations, we have found that even if it means absorbing a price increase, some of the evidence we have seen suggests that advertisers are unlikely to look beyond broadcast spots within a given DMA. Price is not the only factor: we have heard advertisers express concerns about brand safety and ad fraud on digital platforms. In addition, our investigations involving Google have shown that search advertising is used by advertisers very differently than other forms of online or offline advertising.

Digital advertising offers an opportunity to target customers in a way that was unimaginable in traditional media advertising. Understanding the extent to which that distinction is significant from an advertiser's perspective is important to our analysis of these markets, as is the increasing ability of other media to target consumers. Although they may have embraced digital advertising, we must understand if advertisers view advertising on digital media as a substitute to television advertising or as a useful complement.²

AAG Delrahim is correct that there are differences between digital advertising and television advertising. For example, digital advertising can be targeted to customers and made interactive in ways that advertising in offline media usually cannot be. But claiming that it may be unclear

whether digital media is a substitute to television advertising or a useful complement is far from a sufficient reason to consider digital media advertising to be in a different product market from television advertising. Indeed the DOJ's own Horizontal Merger Guidelines (2010) make it clear that this alone is not enough.

Rather, the key question for antitrust analysis is whether digital media advertising is a close enough substitute for at least some advertisers so that enough of them would switch from one to the other if the price of the first went up. This is reflected in the 2010 Guidelines. If digital media and television advertising are close enough substitutes for switching advertisers to make such a price increase unprofitable, then the two should be considered to be in the same market for antitrust purposes.

As will be discussed below, substantial evidence can be found that the two markets have converged and that different channels for advertising compete to a sufficient extent for the DOJ to find, using its own Horizontal Merger Guidelines, that they generally should be considered part of the same product market.

III. The "Hypothetical Monopolist Test" from the DOJ Horizontal Merger Guidelines

AAG Delrahim noted in his speech how defining appropriate advertising markets has been an issue in several recent DOJ investigations:

We recently looked at several broadcast mergers. In late 2016, the Antitrust Division required Nexstar to divest seven broadcast television stations in order to complete its proposed acquisition of Media General. More recently, we reviewed Sinclair Broadcast Group's proposed acquisition of Tribune Media, which the parties abandoned last summer after lengthy investigations by both the Antitrust Division and the FCC. Based on the parties' documents and the other evidence available at the time we alleged that the relevant market was limited to broadcast spot advertising within a given Designated Market Area (DMA).

Advertising was also an important issue in the recent AT&T/Time Warner merger investigation. . . .

In addition to our merger work, our investigations into anticompetitive conduct have provided a wealth of information about media advertising markets. Since last November, we have reached settlements with seven broadcast television companies, who we alleged had colluded with their competitors to reduce competition in the market for broadcast advertising.³

The DOJ provides the analytical framework it uses for evaluating the competitive implications of these and other proposed mergers in its 2010 Horizontal Merger Guidelines.⁴ The current Guidelines rely on the "hypothetical monopolist test" to identify and define the relevant market.

This test starts with a narrowly-defined product market and asks whether a hypothetical monopolist can profitably impose small but significant and non-transitory increase in price ("SSNIP"). If a hypothetical monopolist could raise the price by this amount and find the price increase to be profitable (*i.e.*, not lose so much business to alternative suppliers outside of the

hypothesized market to make the price increase unprofitable), then the market is properly defined for antitrust purposes, according to the 2010 Guidelines. If not, the market is expanded and the test is repeated, until a broad enough market is defined for a hypothetical monopolist to be able to raise prices profitably.⁵

The 2010 Guidelines further explain:

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value.⁶

The 2010 Guidelines then identify a series of factors the antitrust agencies should consider when applying the hypothetical monopolist test, many of which were raised at the Workshop where AAG Delrahim gave his speech.⁷ The most relevant of these factors will be discussed in the next section.

As Carl Shapiro, the former chief economist for the Antitrust Division, points out, the hypothetical monopolist test is intended to be broadly applicable, even in situations where there is no clear break in the chain of substitutes and where customers (or advertisers, for the purposes of this analysis) differ greatly in their willingness to substitute more distant products or channels in response to a price increase.⁸ Thus, the 2010 Guidelines approach can be applied to assess whether television and digital media advertising are in the same product market, and substantial evidence now indicates that they are.

IV. Substitutes, Complements, and When They Converge

AAG Delrahim in his speech framed the issue as: "Although they may have embraced digital advertising, we must understand if advertisers view advertising on digital media as a substitute to television advertising or as a useful complement." While he has a point that there are ways that digital media advertising can complement television advertising, the way he is framing the issue suggests an either/or relationship – that they are either substitutes or complements. But this is a false dichotomy – digital media advertising and television advertising can be both at the same time, for different advertisers.

Some products are close substitutes, like Ford cars and similar GM cars, and clearly are in the same product market. Even though some consumers may perceive significant differences between the Ford and GM cars, the vast majority of customers will buy one or the other. Nonetheless, it is possible that a very small number of customers might be found who buy both the Ford car and the GM car because they perceive the two to have such sufficiently different benefits that the customer wants to have both of them.

At the other end of the spectrum, some products are "perfect complements" with little potential for substitution. Toothbrushes and toothpaste are an example. Toothbrushes and toothpaste tend to be purchased together in relatively fixed proportions. If the price of one goes up, it doesn't help most consumers to buy less of the product with the price increase and more of the other product. If the price of toothbrushes goes up, consumers don't purchase more toothpaste and fewer toothbrushes, because the vast majority of customers will not see any advantage to using more toothpaste to substitute for having fewer toothbrushes.

Whether two products are, on balance, substitutes or complements is measured by the cross elasticity of demand. A positive cross elasticity of demand indicates the two products are substitutes, so that if the price of one goes up, sales of the other product will increase, reflecting how a majority of customers (by volume of sales) consider the two products to be substitutes. But that only tells us that most customers bought more of the second product after the price of the first increased, and some may actually have bought less, perhaps because they considered the goods to be complements.⁹

Online and television advertising, to the extent they are complementary, are not perfect complements in the same sense that toothbrushes and toothpaste are perfect complements. Online advertising offers interactivity and other benefits to advertisers that television advertising does not, and television advertising reaches audiences that are not reached by online advertising. So there is a complementary relationship between the two, as AAG Delrahim correctly noted, but at the same time there is some degree of substitutability. A significant portion of the benefits from each can be achieved with more advertising in the other channel. If the price of television advertising were to increase, some (even if not all) advertisers on television can switch some of their advertising online and still reach an equivalent audience.

How much such switching across advertising channels occurs is largely an empirical question. Several of the factors identified in the 2010 Horizontal Merger Guidelines appear to be particularly relevant for assessing the degree to which radio, broadcast TV, cable TV, and online advertising platforms compete against each other, including:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions. . . .
- the conduct of industry participants, notably:
 - o sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
 - o industry participants' behavior in tracking and responding to price changes by some or all rivals; [and]
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market. . . .¹⁰

V. Evidence From the DOJ Workshop and the FCC Indicates Advertisers Will Move Across Platforms

At the Antitrust Division's Public Workshop on Competition in Television and Digital Advertising where AAG Delrahim delivered his speech, he and the DOJ staff were presented with substantial evidence that radio, broadcast television, cable, and online advertising markets are converging with substantial substitution among them. All of the following comments and presentations fit squarely within the factors cited above from Section 4.1.3 of DOJ's 2010 Horizontal Merger Guidelines.

Ty Ahmad-Taylor, Facebook's Vice President for Business Product Marketing, got right to the point when he said: "We view that we are a likely substitute or a swap for television, for print, for cable advertising and for other types of media that might compete for your attention."¹¹ On the same panel, Comcast Cable Advertising President Marcien Jenckes stated that Comcast now considers that local cable ads and broadcast ads to be substitutes for each other.¹² He added that "Any platform that can be used to reach a particular audience is potentially a substitute for another platform."¹³

Rick Kaplan, General Counsel for the National Association of Broadcasters, pointed out another issue with DOJ's approach to market definition for advertising, which is that DOJ had been overstating the impact of broadcast television ads while dismissing much of the impact of online advertising. Kaplan said that DOJ has been conflating reach with viewers. A broadcaster's reach describes how many people can theoretically watch broadcast television but not how many viewers actually do so. According to Kaplan, "Without missing a beat, DOJ has already repeatedly rejected requests to include digital in the broadcast TV marketplace, explaining that online ads 'can be skipped, minimized, or blocked.'" Kaplan pointed out that broadcast advertisements can also be skipped by leaving the room or hitting fast forward on a DVR. Thus, he concluded, "In most cases, it is harder to do an end-around a digital ad, because often you can't even get to the highly-desired content without playing one or more advertisements."¹⁴

In the last panel of the Workshop, Christopher S. Ripley, CEO of the Sinclair Broadcasting Group, Inc., provided data on how these formerly-segmented markets for advertising have converged. His data showed the 40-year trend of broadcast television losing most of its audience to cable or other alternatives, and also how much of the most popular content on cable, including HBO, Showtime, Starz, CBS, and ESPN, is now available on streaming services, while other popular offerings, including the Time Warner channels, Disney, and Discovery channels, will be available by next year.¹⁵

Most significantly, Ripley showed that digital advertising revenue has more than quadrupled since 2007 and now exceeds the combined revenues for broadcasting and cable channels. This reversal is especially pronounced for local ad revenue, where digital dominates, while cable and broadcasting are more competitive for national advertising.¹⁶ Ripley cited an eMarketer report showing digital ad spending is the fastest growing form of advertising. According to the eMarketer report, "Digital made up 36.7% of total media ad spending in 2016 and will account for around half by 2021."¹⁷

The Federal Communications Commission's *Communications Marketplace Report* (2018) provides additional evidence regarding convergence and competition in radio, broadcast

television, cable, and online advertising markets. The FCC's report recognized that "[b]roadcast stations compete with one another, as well as with cable networks and OVDs, for viewing audiences primarily on the basis of program popularity." The report cited data from 2016 and 2017 indicating that local and national advertising revenues for Internet or online video services are growing while advertising revenues for broadcasting remain flat and have declined for cable and other multichannel video programming distributors (MVPDs).

For instance, the Internet/online segment generated \$33.9 billion or 41.7% of local advertising gross revenues in 2017, up from \$28.3 or 35.4% in 2016. By contrast, broadcast TV and radio sectors grossed \$12.2 billion or 15% and \$10.4 billion or 12.7%, respectively, in 2017. The cable sector's numbers were even lower, and 2017 gross revenues for all traditional advertising sectors declined from 2016 levels.

Additionally, as an indication of the scope of the market, the FCC's report points to various ways in which radio and TV broadcasters as well as cable providers have attempted to respond to competition from rivals, including by adopting Internet website social media strategies for earning advertising revenues, by enhancing original content offerings to counterbalance advertising revenue declines, and by offering their own content via Internet streaming.

VI. Conclusion

Competition across media channels, and particularly between online and offline channels, is not new. One only has to look at newspaper classified ad sections to see how this once-important revenue source for newspapers was taken over years ago by Craigslist, Facebook Marketplace, and other online sites that make the same information readily available and nearly costless to search. The evidence provided at the DOJ Workshop shows the same thing is occurring, although so far not as dramatically, for other advertising channels. Radio, broadcast television, and cable advertising clearly are competing with digital advertising, and, for the most part, at present online advertising is winning.

The DOJ's approach of subdividing advertising markets into radio advertising, broadcast advertising, cable advertising, and online advertising is outdated and distorting how DOJ should be looking at the market for online and off-line advertising. Overly narrow advertising market definition makes mergers unnecessarily difficult in traditional media channels in which advertising revenues have been falling. This approach by DOJ is likely protecting online advertising channels from competition for advertising revenues and may be distorting DOJ's ability to consider the pro-competitive benefits of mergers like the AT&T/Time Warner merger.

AAG Delrahim's call for DOJ to reconsider how it defines these markets is a positive development. There is now an abundance of evidence, from FCC reports and from DOJ's own Public Workshop on Competition in Television and Digital Advertising, for DOJ to conclude, following the methodology in its current Horizontal Merger Guidelines, that segmenting markets for advertising fails to recognize current market realities and likely is undermining the mission of the DOJ to protect the interests of consumers.

* Theodore R. Bolema is a member of the Free State Foundation's Board of Academic Advisors and Executive Director of the Institute for the Study of Economic Growth at Wichita State University.

¹ Makan Delrahim, "Assistant Attorney General Makan Delrahim Delivers Remarks at the Antitrust Division's Public Workshop on Competition in Television and Digital Advertising," (hereinafter "Remarks") (speech, Washington, DC, May 2, 2019), available at: <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-antitrust-divisions-public> (citing Anne K. Bingaman, "Competition and Innovation: The Bedrock of The American Economy," (speech, Lawrence, KS, September 23, 1996), available at: <https://www.justice.gov/atr/speech/competition-and-innovation-bedrock-american-economy>).

² Delrahim, Remarks.

³ Delrahim, Remarks.

⁴ U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines" (2010) [hereinafter "2010 Guidelines"], available at: <http://www.ftc.gov/opa/2010/08/hmg.shtm>.

⁵ According to the 2010 Guidelines: "The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ('hypothetical monopolist') likely would impose at least a small but significant and non-transitory increase in price ('SSNIP') on at least one product in the market, including at least one product sold by one of the merging firms." 2010 Guidelines, ¶4.1.1.

⁶ 2010 Guidelines, ¶4.1.2.

⁷ 2010 Guidelines, ¶4.1.3.

⁸ Shapiro, Carl, "The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years," (September 10, 2010), p. 36, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1675210.

⁹ Similarly, a negative positive cross elasticity of demand indicates the two products are complements, so that if the price of one goes up, sales of the other product will go down, indicating that more customers (by volume of sales) consider the two products to be complements. But that only tells us how a majority of customers perceive the relationship between the two products, and some customers may still consider the goods to be substitutes.

¹⁰ 2010 Guidelines, ¶4.1.3 (internal citations omitted).

¹¹ "DOJ Pushed to View Digital Ads Just the Same as Broadcast/Cable Promos," *Cablefax* (May 6, 2019), available at: <http://www.cablefax.com/regulation/doj-pushed-to-view-digital-ads-just-the-same-as-broadcast-cable-promos>.

¹² Alexandra S. Levine, "FTC-Facebook Watch," *Politico* (May 6, 2019), available at: <https://www.politico.com/newsletters/morning-tech/2019/05/06/ftc-facebook-watch-432464>.

¹³ "DOJ Pushed to View Digital Ads Just the Same as Broadcast/Cable Promos," *Cablefax*.

¹⁴ *Id.* Dave Lougee, President and CEO of TENGA, Inc., agreed with Kaplan when he said: "Just because my channel reaches a household doesn't mean they ever watch it."

¹⁵ Christopher S. Ripley, "The Future of Advertising Adapting for an Uncertain Future," (May 3, 2019), available at: <https://www.justice.gov/atr/page/file/1160701/download#Chris%20Ripley>.

¹⁶ Ripley, "The Future of Advertising Adapting for an Uncertain Future."

¹⁷ "US Ad Spending: The eMarketer Forecast for 2017," *eMarketer* (March 15, 2017), available at: <https://www.emarketer.com/Report/US-Ad-Spending-eMarketer-Forecast-2017/2001998>.