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Does it Matter if Competition is Fair or on the Merits? An Application to Platform Self-Preferencing

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DOES IT MATTER IF COMPETITION IS FAIR OR ON THE MERITS? AN APPLICATION TO PLATFORM SELF-PREFERENCING

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ABSTRACT

Platform self-preferencing is often attacked as being "unfair." Proponents of the consumer welfare standard of antitrust complain that a fairness standard is too vague and too untethered from competitive effects to be useful. However, the consumer welfare standard relies on assessment of whether competition is on the "merits," and the criteria for merits substantially overlap with those for fairness. I show that: (a) depending on the circumstances, self-preferencing can strengthen or weaken the intensity of competition among incumbents, and can make entry easier or more difficult; and (b) the common criteria for fairness and merit do not reliably identify the direction of these competitive effects. Instead, a case-by-case, fact-intensive analysis of actual competitive effects is needed.

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> "When I use a word," Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."[1]

I. INTRODUCTION

Many people are concerned that major online platforms serve as important means by which third-party sellers reach their customers while the platform owners also compete with these third-party sellers in various product markets. For example, Amazon provides an ecommerce platform on which third-parties sell products, sometimes in competition with Amazon's own products. The specific concern is that such a platform owner has a "conflict of interest" and will engage in "self-preferencing" by operating its platform in ways that favor its own products in competition with those of third-party platform users. One study, for example, found that Amazon favors its own products, Amazon Basics, in its product-search results.[2] Similarly, Apple and Google have been accused of preferencing their own products on Apple's App Store and on Google's internet search platform, respectively.

In his 2023 State of the Union address, President Biden called on Congress to "Pass bipartisan legislation to strengthen antitrust enforcement and prevent big online platforms from giving their own products an unfair advantage."[3] One example of this type of legislation, the proposed American Innovation and Choice Online Act, would make it unlawful for a covered platform to:[4]

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1 Lewis Carroll (1899, p. 110).

2 See, e.g., Farronato et al. (2023).

3 Biden (2023).

4 118th Congress, 1st Session, S.2033, Sections 3(a)(1) and 3(a)(2), *available at* https://www.congress.gov/bill/118th-congress/senate-bill/2033/text?s=1&r=54, site accessed January 21, 2024.

> (1) preference the products, services, or lines of business of the covered platform operator over those of another business user on the covered platform in a manner that would materially harm competition;
>
> (2) limit the ability of the products, services, or lines of business of another business user to compete on the covered platform relative to the products, services, or lines of business of the covered platform operator in a manner that would materially harm competition; … .

These provisions outlaw self-preferencing practices that "materially harm competition."[5] Notably, however, the bill defines neither competition nor what it means to materially harm it.[6] Moreover, these proposals to restrict self-preferencing are being made at a time when American antitrust policymakers, enforcers, and academic commenters are engaged in a broad debate regarding what constitutes competition and how one can measure whether competition is stronger or weaker as the result of some change in market structure or market-participant conduct.[7]

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[5] In addition, Section 3(a)(4) of the Act would make certain forms of self-preferencing effectively per se illegal (save a cybersecurity justification). Specifically, it would be unlawful for a covered platform to

> materially restrict, impede, or unreasonably delay the capacity of a business user to access or interoperate with the same platform, operating system, or hardware or software features that are available to the products, services, or lines of business of the covered platform operator that compete or would compete with products or services offered by business users on the covered platform, except where such access would lead to a significant cybersecurity risk[.]

[6] The bill is not unique in this regard. Section 7 of the Clayton Act prohibits transactions that "lessen competition," while Sections 1 and 2 of the Sherman Act prohibit "restraint of trade" and "monopolization," without defining what those terms mean.

[7] In this paper, I focus on the debate between the consumer welfare and fairness schools of competition. There is also a third school of thought, which focuses on concentration as the overriding measure of competition.

Commencing in the late 1970s and for half a century afterwards, a broad, if somewhat murky, consensus emerged around the *consumer welfare standard*. Speaking very loosely for a moment, under the consumer welfare standard, conduct harms competition if the conduct reduces consumer surplus.[8] In recent years, this standard has come under attack on several fronts, one being the claim that fairness is fundamental to the notion of competition as used in the antitrust statutes but that the consumer welfare standard instead focuses solely on "efficiency."[9] In the quotation above, for example, President Biden focused on "unfair" competitive advantage, and Section 3(a)(9) of the American Innovation and Choice Online Act would make it unlawful for a covered platform to,[10]

> in connection with any covered platform user interface, including search or ranking functionality offered by the covered platform, treat the products, services, or lines of business of the covered platform operator more favorably relative to those of another business user and in a manner that is inconsistent with the neutral, *fair*, and non-discriminatory treatment of all business users[.]

Proponents of a fairness standard judge whether conduct harms competition not by whether it reduces consumer surplus but instead by whether the conduct is unfair.

Many supporters of the consumer welfare standard find the appeal to fairness deeply problematic because proponents of a fairness standard have not put forth a coherent or comprehensive basis for assessing whether market conduct is fair. Proponents of the

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8 Although the consumer welfare standard is often associated with Robert Bork, this is not the standard that he advocated. Bork (2021, p. 110).

9 See, e.g., Bedoya (2022) and Hanley (2022).

10 118th Congress, 1st Session, S.2033, Sections 3(a)(1) and 3(a)(2), *available at* https://www.congress.gov/bill/118th-congress/senate-bill/2033/text?s=1&r=54, site accessed January 21, 2024, (emphasis added).

consumer welfare standard argue that its use of consumer welfare as a yardstick provides a coherent and (at least conceptually) well-defined means of determining whether conduct harms competition.

This argument misses an important fact: although consumer welfare plays a central role in the eponymous standard, the standard as applied by U.S. courts is not one based solely on the measure of consumer welfare. Instead, there is a separate requirement that the conduct in question "harms the competitive process" or is "not competition on the merits." Consequently, the fairness and consumer welfare standards have more in common than their respective champions acknowledge. Leading conceptions of fairness seek to identify when conduct constitutes "fair" competition, while the consumer welfare standard seeks to identify when conduct constitutes competition on the "merits." As I discuss in Sections II and III below, criteria by which to determine what is fair have a high degree of overlap with criteria by which to determine what is on the merits. Although this overlap might appear to be good news that suggests the possibility of finding common ground, it is bad news in that what the approaches have in common is vagueness and ambiguity. What the OECD said about competition on the merits can also be said of fairness: "it has served too often as a shortcut that glosses over the difficult work of defining clear principles and standards that embody sound competition policy."[11] I illustrate the common shortcomings of the two approaches by applying them to the

[11] Organisation for Economic Co-Operation and Development (2006), p. 1.

assessment of preferencing by a platform owner that is not also a platform user (in Section IV) and self-preferencing (in Section V).

II. WHEN IS COMPETITION "UNFAIR"?

If one is going to use fairness to define competition or harm to it, then one needs either: (a) a set of principles by which to determine whether specific conduct is fair, or (b) a comprehensive list enumerating what conduct is fair and what is not. The U.S. Congress rejected approach (b) on the grounds that business practices are too numerous and too subject to change for it to be possible to construct a comprehensive and enduring list;[12] instead, it falls on the Federal Trade Commission (FTC) and the courts to determine what practices constitute unfair methods of competition.[13] Unfortunately, neither Congress, the FTC, the courts, nor various proponents of a fairness standard for antitrust enforcement have provided a clear statement of principles. For example, Section 5 of the FTC Act and the FTC's recent statement on unfair competition refer to "unfair competition" but do little to define fairness with any specificity.[14]

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[12] See, e.g., FTC v. Sperry & Hutchinson Co., 405 U.S. 233 (1972), pp. 239-240, and references cited therein.

[13] See, e.g., F.T.C. v. R..F. Keppel & Bro., Inc. 291 U.S. 304 (1934), pp. 310-312, discussing the Federal Trade Commission Act.

[14] Federal Trade Commission Act (15 U.S.C. 41 et seq.); Federal Trade Commission (2022), p. 9 (Conduct may constitute unfair competition if it is "coercive, exploitative, collusive, abusive, deceptive, predatory, or involve[s] the use of economic power of a similar nature… [or is] otherwise restrictive or exclusionary, depending on the circumstances… [and also] the conduct must tend to negatively affect competitive conditions." Notes omitted.).

One important distinction among principles of fairness is whether the assessment of an outcome is made by reference to the characteristics of the outcome itself (e.g., whether there is income inequality among households or whether small businesses are profitable) or by examining whether the outcome is the result of a fair process or procedure (e.g., asking whether there was equality of opportunity regardless of the actual outcome).[15]

There are several problems associated with defining harm to competition by appealing to intuitive principles of what constitutes a fair outcome. One is that policies intended to promote outcomes satisfying some of these principles can be in direct conflict with any reasonable notions of competition and rivalry. For example, policies that seek to promote the welfare of smaller suppliers can create incentives for more-successful suppliers to curtail their efforts to attract buyers so as not to be accused of leading to an unfair outcome. But most people would recognize increased efforts to attract buyers as the essence of competition.

Another problem is that these principles may conflict with one another, which (at a minimum) raises the question of how they should be weighed against one another.[16] Trading the realization of one measure of fairness off against another is made difficult by the fact that these principles generally do not offer precise metrics. In fact, even the application of a single principle can raise questions of tradeoffs without providing precise

15 See, e.g., Nozick (1973) and Varian (1975).

16 Kirkwood and Lande (2008, p. 211) conclude that the Sherman Act's goal is to protect consumers while the Robinson Patman Act seeks to protect small businesses from "unfair competition" (in the form of larger rivals able to secure lower input prices) even when that protection comes at the expense of consumer welfare.

answers. For example, in evaluating an outcome, how much weight should be given to the welfare of market participants in the poorest decile versus those in the second-poorest decile? Faced with a set of ill-defined and possibly conflicting principles of fairness, business decision makers may be unable to determine what they can and cannot do, which can be expected both to reduce the effectiveness of antitrust policy and to lead to adverse unintended consequences.[17]

A policy that defines harm to competition through the application of outcome-based notions of fairness can also be very hard to administer. Under a policy that defines competition as fair only if it promotes the welfare of low-income households, for example, antitrust enforcers would have to determine what constitutes a fair societal distribution of wealth and then measure the wealth of the employees, business owners, and customers to evaluate the effects of any given enforcement decision. The evaluation could also turn on factors that had little or nothing to do with the industry in question (e.g., local real-estate prices could affect employees' real incomes) and would raise issues concerning the interaction and division of labor among different government policies (e.g., income taxation).

In the remainder of this paper, I will focus on the second approach, which focuses on characteristics of market conduct rather than the outcomes to which that conduct gives

[17] As discussed in Section III below, Melamed (2005) makes a similar point with respect to a pure consumer welfare standard.

rise (i.e., an outcome that is the result of a fair process is itself fair).[18] A then-Acting Assistant Attorney General of the U.S. Antitrust Division stated that "[a]nimating the beliefs of ordinary Americans who demand vigorous antitrust enforcement are the value of fairness and the belief that properly functioning competitive markets are themselves fair."[19]

Of course, stating that an outcome is fair if it is generated by a properly functioning competitive market does not provide a workable definition of fair competition, and raises at least as many questions as it answers. One is how much rivalry is enough for a market to be "competitive"? Economists have developed the notion of workably or effectively competitive markets, which provides at least a partial answer.[20] Here, I will focus on a second question: do some forms of rivalry constitute "unfair competition" and thus fail to generate fair outcomes regardless of the apparent degree of rivalrous conduct?

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[18] In assessing the fairness of the process, I will focus somewhat narrowly on the competitive process and will not consider the process by which market participants are endowed with skills and resources. Consider a labor market. Regardless of the nature of competition in that market, one might question what is fair about some people having more valuable skills than others, whether due to nature or nurture. A competitive process may not be fair if it involves competition that had an unfair starting point.

I will also ignore the issue raised by Ducci and Trebilcock (2019) of whether the antitrust enforcement and adjudication process is itself fair.

[19] Hesse (2016, p. 3). See also, id., p. 2 ("[antitrust] professionals and the public are moving more toward a consensus vision of antitrust focused on protecting competition and the fairness inherent in it.").

[20] Clark (1940) is an early example.

Many people have concluded that the answer is "yes," and several principles regarding what constitutes a fair process have been suggested.[21] One way of consolidating several of them is the following:[22]

- *A party should not gain competitive advantage through deception.* This is the oldest and possibly least contentious criterion for fairness. The concept of unfair competition in English common law arose from the idea that infringing a rival's trade-mark by passing off one's own goods as being those of the rival was unfair.[23] The idea of unfair competition was then expanded to include competing based on deception more broadly.[24] More recently, Hughes (1994, p. 299) has argued that one "component of fairness entails the protection of legitimate expectations" which is "consistent with the precept that rules should not be changed in the middle of the game." This notion of fairness could be conceived as applying the deception criterion to the dynamic treatment of business partners

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[21] In addition, many people appear to be comfortable using the concept without attempting to offer a coherent or principled definition. See, e.g., Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary of the U.S. House of Representatives (2022).

[22] There are other principles and organizing frameworks. See, e.g., Hughes (1994).

[23] Based on his examination of the legal systems of several countries, Haines (1919-1920, p. 26) concluded that:

> Three steps are readily discernible in the growth of the law of unfair competition: first, statutes and judicial decisions relate to trade-marks and trade names; second, special laws are enacted covering false advertisements, bogus sales, corruption of employees and betrayal of business secrets; third, unfair competition is extended to include combinations and agreements that interfere with competition such as exclusive dealing and tying contracts.

[24] Haines (1919-1920).

and rival suppliers, as well as consumers.[25] It provides one basis for criticizing what has been referred to as an "open early, closed late" strategy, whereby a firm unilaterally restricts the interoperability of its platform with rival platforms after it has attracted complementary suppliers that had been expecting interoperability.[26]

- *It is unfair to compete by taking actions that lower rivals' quality or raise their costs.* An early application of this criterion was to competition to attract waterfowl to be hunted. In a mid-nineteenth-century case in England, "[t]he court said that it was lawful for the plaintiff to attract his feathered customers away from the Duke (of Rutland) with birdseed, but not for the defendant to attract them back again with rockets and combustibles."[27]

- *A party should not be able to take too much advantage of its past investments and resulting success*.[28] Proponents of a fairness standard do not characterize their concerns in this way but it encapsulates what they do say. There are both within- and cross-market versions of this criterion, and the sources of advantage derived from past success can include money, a customer base, or a large range of

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25 Hughes (1994, pp. 299-300) cites *Aspen Skiing* as an example because the defendant terminated an established course of dealing.

26 Shapiro (2005).

27 Chafee (1940, p. 1290) citing Ibottson v. Peat, 3 H. & C. 644 (Ex. Ch. 1865).

28 Proponents of a fairness approach to antitrust also argue that a party is entitled to the fruits of its labors. For example, the U.S. Supreme Court condemned misappropriation as a form of unfair competition (International News Service v. Associated Press, 248 U.S. 215 (1918), pp. 241-242), and Hughes (1994, p. 299) offers the view that "[a]ll firms are entitled to rewards commensurate with their level of success in the market." This raises the largely unanswered question of how much reward is fair or "commensurate"?

complementary products (e.g., apps for a smartphone). Within-market examples include the claim that it is unfair for a large firm to bargain for quantity discounts that allow it profitably to charge lower prices than its smaller rivals.[29] Turning to cross-market concerns, some people would deem it unfair for a large firm to engage in vertical integration when doing so creates a competitive advantage. And there is a long history of considering tied-sales to be unfair.[30] The ability to finance predatory pricing might also be condemned by this principle, whether within market or cross market.

- *Competition is unfair if a supplier relies on practices that are immoral, unethical, or contrary to public policy (even if not illegal).*[31] For example, a candy company was found to have engaged in unfair competition when it sold candy with prices and prizes revealed only after purchase, thus encouraging "gambling among children."[32] Presumably, some people consider the use of sexual images to sell products to be immoral and thus an unfair method of competition.

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[29] This principle is embodied in the Robinson-Patman Act, for example.

[30] Haines (1919), pp. 17, 23-24, and 26; Federal Trade Commission (2022, p. 14).

Hughes (1994, p. 299) posits a right that encompasses this criterion and might even be considered as a definition of competition on the merits: "All firms are entitled to have their offerings considered objectively and to receive the unbiased verdict of the marketplace." Hughes considers tied sales to violate this norm because they foreclose potential customers from "freely considering the competitive merits of the products offered by other firms seeking to compete in the market." (Id.)

[31] See, e.g., Federal Trade Commission (1980), summarizing the criteria applied by the Commission and the courts at that time.

[32] F.T.C. v. R..F. Keppel & Bro., Inc. 291 U.S. 304 (1934). Mercifully, Cracker Jack was spared condemnation during my childhood.

- *Market outcomes should not entail the imposition of coercive or oppressive terms on trading partners*. The legislative history of the Federal Trade Commission Act contains several expressions of concern with "oppressive competition," while offering little clarity as to what makes conduct oppressive.[33, 34]
- *Competition is unfair unless it constitutes "competition on the merits."*[35] The definition of competition on the merits will be discussed below.

III. THE CONSUMER WELFARE STANDARD AND COMPETITION ON THE "MERITS"

Under a pure consumer-welfare standard, a court assesses the overall effects of the challenged conduct on consumer welfare (as measured by consumer surplus) and deems the conduct to be illegal if it lowered consumer welfare.[36]

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33 See the legislative history and early court cases cited in Federal Trade Commission (2022). One statement is a list of examples of unfair competition, including "engaging in or practicing unfair or oppressive competition in relation to the acceptance or procurement of rates or terms of service from common carriers not granted to other shippers under like conditions" and "the making of oppressive exclusive contracts for the sale of articles of which the seller has a substantial monopoly." (51 Congressional Record—House 51 (1914) (statement of Rep. Hinebaugh), p. 8861.)

34 This is a point at which the distinction between fair outcomes and fair processes can become blurred. The oppressive terms could be part of the outcome or the process.

35 Bedoya (2022).

36 Salop (2009, p. 338) argues that this is the standard legislated by Congress in the Sherman Act and adopted by the courts. Salop refers to a consumer-surplus standard as the "true consumer welfare standard" to distinguish it from Bork's confusingly named "consumer welfare standard." (Id., p. 336).

The modern version of the "consumer" welfare standard focuses on changes in trading-partner welfare. I will use the term consumer welfare as a shorthand.

There are several problems with the use of a pure consumer-welfare standard. Perhaps the most significant one is that such a standard would impose extremely strong requirements on firm behavior. For example, the standard would make it illegal for firms to earn expected economic profits—consumers would be better off if the firm earned the minimum amount necessary to remain in business while pursuing consumers' preferred innovation investment strategy. The standard would also ban sellers from investing to improve their bargaining positions, such as engaging in forward integration to offset the market power of a monopsony buyer, where the buyer is considered to be a "consumer."

Another objection to using changes in consumer welfare to define harm to competition is that changes in consumer welfare need not correspond to any intuitively reasonable notion of a change in competition. First, changes in consumer welfare can arise under monopoly. For example, innovation by a monopolist may raise or lower consumer welfare due to changes in the extraction of consumer surplus.[37] There is no coherent sense in which the degree of competition is changing as consumer welfare changes in a monopolized market. And a drastic innovation might lead to a firm's monopolizing a previously rivalrous market as rivals are driven to exit. Even if consumers were better off due to the innovation, it seems paradoxical to say that competition had increased.

Yet another example is provided by a seller holding an auction that first engages in advertising to attract additional bidders. If the resulting increase in rivalry among bidders raised the winning bid without changing the identity of the winning bidder, the consumer-

[37] In theory, it could even lower total surplus for the same reason.

welfare standard would condemn the seller's conduct as harming competition. To say that such advertising harms competition because it increases rivalry and leads to a higher winning bid is to give "competition" a meaning the opposite of common usage.[38]

Moreover, such advertising sometimes would lead to greater buyer welfare by promoting a better match. The firm holding the auction thus might be hard-pressed to make a credible prediction of the expected effects of its advertising on consumer welfare. More generally, a pure consumer-welfare standard would often be very hard to apply. For example, the ban on expected economic profits would be tantamount to an extreme form of regulation, and antitrust enforcers would face many of the information asymmetries that can make effective regulation difficult, especially in innovative industries. The difficulty of applying the standard can also undermine the ability of policy to deter anticompetitive behavior. Commenting on the use of this approach to assess allegations of exclusionary conduct, Melamed (2005, p. 1254) argues that prospective defendants generally do not have sufficient information to predict the net effects of their conduct on consumer welfare and that, consequently, this test for anticompetitive conduct "would likely either be ignored, impose excessive transaction costs (a kind of tax on entrepreneurship), or result in excessive caution."[39]

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[38] Similarly, as discussed below, a platform that brings together buyers and sellers can have incentives to encourage entry by additional sellers, which can lower the welfare of existing sellers. If sellers are considered to be consumers of the platform's services, then this conduct would be said to harm competition under a pure consumer welfare standard.

[39] One way to try to solve this issue would be for enforcers to identify specific practices that are presumed to harm consumer welfare. But to do so, it would be necessary to identify

Whatever the merits of a pure consumer-surplus approach, the consumer-welfare standard as applied by U.S. courts is not such an approach. For example, under the consumer-welfare standard as applied by U.S. courts, charging monopoly prices is not illegal if a firm has lawfully obtained monopoly power.[40] This is true even though—at least in the short run—consumer welfare would be higher if such a firm charged lower-but-still-profitable prices. Instead of a pure consumer welfare standard, U.S. courts apply a standard under which there is also a separate determination of whether there is harm to the competitive process: to be illegal, conduct that harms consumer welfare must be conduct that does not constitute *competition on the merits*.[41] Even advocates of "the consumer welfare standard" often have in mind some notion of effects on the competitive process in addition to changes in welfare levels.[42] For example, advocates of the

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the average effects of each of many different practices—where the average is taken over situations in which firms will find it profitable to undertake the conduct in question—because almost any conduct can have ambiguous effects in certain, possibly very narrow, circumstances. This would be a very difficult, if not impossible, undertaking given the number of potential business strategies and their likely evolution over time.

[40] Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398 (2004), p. 407.

[41] Based on judicial opinions and the legislative histories of U.S. antitrust statutes, Kirkwood and Lande (2008, p. 191) conclude that the "ultimate goal of antitrust… [is] to protect consumers from behavior that deprives them of the benefits of competition."

Based on his review of Supreme Court decisions, Werden (2013, p. 713) argues that "that the rule of reason focuses solely on how a challenged restraint affects the competitive process." In other words, whether the conduct constitutes competition on the merits is the legal test without regard to effects on consumer surplus.

[42] For instance, Salop (2006, p. 336, emphasis added) states that "Antitrust law focuses on consumer welfare (in particular, preventing economic harm to purchasers from *anticompetitive* conduct), … ." See also, id., p 330 ("[I]f the fact-based analysis indicates that the exclusionary conduct likely increases or maintains barriers to competition or entry and likely leads to higher prices, then the exclusionary conduct would be condemned unless the evidence of likely and substantial procompetitive benefits is so strong that consumers are unlikely to be harmed.").

consumer welfare standard for merger policy treat the merger as harming the competitive process unless proven otherwise.

Whether in conjunction with a consumer-surplus test or as a standalone concept, one must define what constitutes rivalrous conduct that is not competition on the merits. Examples of proposed criteria include:

- *A party should not gain competitive advantage through deception.* The abuse of government process (e.g., obtaining a patent through deception) has been identified as conduct that is not competition on the merits.[43] And as Carrier and Tushnet have stated, "by definition, false advertising is not competition 'on the merits' because it is deceptive about the merits."[44, 45]

- *A party should not take actions that raise rivals' costs or diminish rivals' quality*. Stated affirmatively, conduct is competition on the merits if it makes a party a

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[43] Organisation for Economic Co-Operation and Development (2005, p. 217).

[44] Carrier and Tushnet (2021, pp. 1852-1853), emphasis is original.

Surprisingly some courts have found that false advertising is competition on the merits because it is competition regarding the merits of the advertised products and rival products. See, e.g., Retractable Technologies, Inc. v. Becton Dickinson & Co., 842 F. 3d (5th Circuit, 2016), discussed by Carrier and Tushnet (2021).

[45] The concern with deception is another illustration of the fact that the consumer welfare standard is not a pure consumer-surplus standard: at least in the short run, consumers might benefit from deception by a firm with a lower-quality product when doing so increases the competitive pressures faced by an industry leader (e.g., in a Bertrand duopoly model in which the surplus that consumers believe the weaker firm offers them is what drives the equilibrium surplus offered by the stronger firm). It is also a simple matter to construct models in which a seller harms consumers by truthfully pointing out flaws in rivals' products, which allows that seller to raise its prices.

more attractive trading partner relative to some absolute standard without making rival parties less attractive trading partners relative to some absolute standard.[46]

- *A party should not be able to take too much advantage of its past investments and resulting success*. For example, the U.S. Supreme Court has long held that a product should stand on its own and that tying prevents a product from being chosen on its merits (i.e., the price and quality of the product) rather than because its sale was tied to that of another product.[47, 48] Predatory pricing can also be condemned under this principle, where past success allows a seller to fund the period of predatory losses incurred from pricing below cost.[49]

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46 See, e.g., United States v Microsoft Corp, 253 F3d 34 (DC Cir 2001), p. 59 ("If the monopolist asserts … that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal—then … .").

It has long been recognized that conduct that promotes competition can simultaneously raise rivals' costs and promote competition. Output tests are one way of implicitly balancing these effects. See, e.g., Melamed (2016) ("… 'competition on the merits' means conduct that on balance increases output. Conduct can increase output by reducing costs or (quality-adjusted) prices or by increasing product quality or diversity and thereby shifting the demand curve to the right."). However, as Katz (2019, Section 6) and Krattenmaker and Salop (1986, Section VIII.A) discuss, output tests have conceptual and practical shortcomings as measures of competition and welfare.

47 See, e.g., Times-Picayune v. United States (1953); Northern Pacific R. Co. v. United States, 356 U.S. 1 (1958); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

48 Indeed, according to Werden (2006, note 25) the Supreme Court first used the term "competition on the merits" in a tying case (Northern Pacific R. Co. v. United States, 356 U.S. 1 (1958), p. 6).

49 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., *509* U.S. 209 (1993), p. 223 ("As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or ….").

IV. APPLICATION TO PREFERENTIAL TREATMENT

The concepts of both fair competition and competition on the merits share several criteria, specifically condemnation of: deception, raising rivals' costs, and taking inappropriate advantage of past successes. These concepts also share several shortcomings as enforcement guidelines, as I will now illustrate in the context of platform self-preferencing.

By definition, a platform facilitates the interactions of users on its different sides. Often, users on one side are sellers and users on the other are buyers, and it useful to adopt the buyer-seller terminology when discussing preferencing.[50] Platforms generally offer buyers some means of discovering sellers. For instance, Amazon.com, the Apple App Store, and Google Play Store offer search functions. Typically, a platform can choose to treat a seller better or worse in the discovery process. A product might appear higher or lower in an ordered list of search results in settings where consumers are known to favor products with higher placement, for example. Or a platform might draw attention to certain sellers by featuring them in highlighted sections of its results page, such as the Amazon "Buy Box." The discovery process can be broader than traditional search. For example, Apple and Samsung smartphones currently are shipped with Google as the default search provider at key access points, which makes it easier for smartphone users to "discover" Google Search.

[50] Buyers and sellers should be interpreted broadly. For instance, a seller could be an entity purchasing highlighting or amplification of its messages on a social network.

Preferencing can also entail differential access to platform features and functions. For example, a mobile operating system might expose certain application programming interfaces (APIs) to some applications developers but not others. An important difference between preferred treatment in a discovery process and preferred access to features and functions is that typically the former is necessarily rival in that the lead search position, say, can be awarded to only one seller. By contrast, access to a feature or function may be non-rival in that it is feasible to grant multiple sellers access to it.

Is a platform's favoring its own products over those of third parties fair and/or competition on the merits, and does the answer to this question inform enforcers about competitive effects? Before examining these issues, I consider preferencing by a platform owner that is *not* also a seller on its platform. I do this both: (a) because prominent parties have condemned preferential treatment of third parties as well as self-preferencing,[51] and (b) to provide context for assessing the effects of self-preferencing. As I will now discuss, although the effects of preferencing strike some people as self-evident, they are anything but.

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[51] For example, in addition to prohibiting various forms of self-preferencing narrowly defined, Section 3(a)(3) of the proposed American Innovation and Choice Online Act would make it unlawful to "discriminate in the application or enforcement of the terms of service of the covered platform among similarly situated business users in a manner that would materially harm competition[.]" This provision can be thought of as an expanded version of the Robinson-Patman Act's prohibition of price discrimination that adversely affects competition.

Hanley (2021, p. 2) defines *self*-preferencing broadly (and confusingly) to include preferencing third parties: "Self-preferencing occurs when a firm unfairly modifies its operations to privilege its own, another firm's, or a set of firms' products or services."

At the outset, it should be noted that, unless the arguments are limited to certain market conditions, attacking the fairness or merit of purchasing preferential treatment runs the risk of being arbitrary and inconsistent. For instance, placement in a platform's discovery process is just one of many inputs that sellers utilize to compete. If paid placement is unfair or not competition on the merits, then why isn't it also unfair or unmeritorious for other media to sell advertising and for product sellers to purchase it? For that matter, why isn't it anticompetitive for a firm to purchase any inputs that make its output more attractive to buyers? As far as I am aware, no proponents of a fairness approach nor those of the consumer welfare standard have called for it to be illegal for restaurant chains to advertise or to use higher-quality ingredients, although such practices might make it more difficult for smaller, rival restaurants to compete.

One approach is to limit concerns regarding preferencing to situations in which: (a) the platform has substantial market power in the supply of the input at issue; and (b) preferred access to the input provides substantial competitive benefits for the recipient. In the remainder of this paper, I will assume that the platform is a very important form of distribution for the sellers, and that preferential treatment significantly boosts demand for the recipient's product. In other words, I will restrict attention to situations in which preferencing has substantial effects on competition and ask whether various fairness and merits criteria help one determine whether the effects are positive or negative.

A. COMPETITIVE EFFECTS

As I will now discuss, when conditions (a) and (b) are satisfied, preferencing can harm competition but also can lead to greater competition by any reasonable interpretation of

competition as rivalry. Specifically, under some conditions, blocking preferencing makes entry by new sellers more difficult and softens price competition among incumbent sellers on a platform.[52]

The potential effects of preferencing on competition can be seen most starkly in the case of entry. Suppose there is a physical product sold through a monopoly platform that provides buyers a ranked list of sellers of the product. Assume that there is a single incumbent seller and a single potential entrant, where the latter offers a differentiated product. The platform owner does not own either the incumbent seller or the potential entrant.

One of the reasons the effects of preferencing are complex is that preferencing can affect consumer behavior in several ways, such as by reducing consumers' search costs or raising their expectations of the quality of the product receiving preferential treatment. In the present example, assume that past sales and preferred placement are substitute forms of consumer exposure and that increased exposure has diminishing marginal returns with

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[52] Restricting preferential treatment can also adversely affect buyers utilizing the platform through mechanisms that might not be labeled as harm to competition. For example, if it cannot sell preferred placement to sellers, the platform may have incentives to raise the quality-adjusted prices that it charges buyers because the additional sellers that incremental buyers attract are no longer as valuable to the platform—what is known in the literature as a "waterbed effect." (Genakos and Valletti (2011).)

In addition, under some interpretations of neutrality, a platform may be prevented from usefully matching buyers with high-quality sellers. For example, an Apple executive testified that the firm picked Google as the default search provider on Safari because Google offered a higher-quality search experience for iPhone users than did other search engines. (Feiner (2023b).) In their theoretical model of preferential placement in search results, Armstrong et al. (2009) found that, when sellers have heterogeneous product qualities, buyers are best off when the seller with the highest-quality product receives preferential placement.

respect to current sales. Specifically, suppose that, if the entrant does not receive preferred placement, then a consumer will ignore the existence of its product, and the entrant will make no sales. By contrast, if the entrant's product does receive preferred placement, then a consumer will consider both firms' products: the entrant's because of preferred placement, and the incumbents' because of exposures through past sales.

Under these assumptions, if the incumbent receives preferred placement, then the entrant will make no sales and the incumbent will price at the monopoly level. By contrast, if the entrant receives preferred placement, then the two firms will compete, resulting in differentiated-Bertrand prices.[53] To analyze the competitive effects of allowing platforms to engage in preferencing, it is necessary both to: (a) solve for equilibrium when preferential treatment is permitted, and (b) identify the but-for world in which preferential treatment is not allowed.

To characterize the equilibrium when preferencing is allowed, suppose that the platform owner is not also a seller on its platform. The owner chooses its preferencing policy to maximize the platform's profits, which generally depend on how preferencing affects both buyers and sellers because buyer and seller welfare affects the fees that the platform can charge those parties. For simplicity, ignore the effects on other platform fees and

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53 Although intuition suggests that the duopoly prices will be lower than the monopoly price, it is well established that the incumbent's duopoly price could be greater than its monopoly price if, when faced with competition, the seller focuses on those consumers with the strongest preferences for its product. For instance, Frank and Salkever (1992) present a model in which entry by a generic drug can lead to an increase in the branded incumbent's prices by reducing the own-price elasticity of reduced-form brand-name demand. Empirical studies, e.g., Regan (2008), have found that generic entry was associated with an increase in the branded price.

suppose the platform runs a second-price auction for placement in the lead position in its search results.

As is well known from bidding models of patent races, there is a bias toward the incumbent producer's outbidding the prospective entrant because of the benefits of exclusion.[54] Indeed, in the present example, the only benefits to the incumbent from purchasing preferred placement is that it prevents the entrant from gaining exposure. There are, however, scenarios in which the direct benefits to an entrant can be sufficient to overcome any exclusionary benefits an incumbent might realize from outbidding the entrant. For example, the entrant may gain more than the incumbent would lose because the former offers a differentiated or lower-cost product that expands the market.[55] In general, either the incumbent or the entrant might win the bidding.

Critics of preferencing focus on cases in which the incumbent wins and blocks entry. Suppose that, because of this concern, preferencing is forbidden and the platform is required to rank results in a "neutral" or "unbiased" order. One interpretation of such a requirement would be that the ranking algorithm must display first the product that a consumer is most likely to purchase if it is placed first. In this case, a neutral algorithm might well place an incumbent's product first. Knowing this, the potential entrant would

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[54] See, e.g., Gilbert and Newbery (1982).

[55] In other settings, when there are multiple incumbents, a free-riding problem may prevent them from excluding the entrant even when doing so would be profitable for the incumbents collectively. Intuitively, the entrant may take only a little business from each of several different incumbents. The example given in Section IV.B.1 below has this characteristic. A similar effect arises in Vickers (1985) analysis of entry deterrence through preemptive patenting when there are multiple incumbents.

anticipate making no sales and would not enter. Even equally randomized placement might not be enough to make entry financially attractive. In other words, there are situations in which, when preferencing is allowed, the entrant will purchase it and successfully compete in the product market but, when preferencing is prohibited, the market will be monopolized by the incumbent.

Next, consider the effects of paid placement on competition among incumbents. Critics of preferencing focus on situations in which preferred placement strengthens the position of a dominant seller, which can lead to higher prices in the short run and have adverse long-run effects because the weaker seller is denied scale or cumulative sales that would otherwise improve its product.[56] However, there are also conditions under which "neutrality" can serve to soften competition by creating a set of "captive" customers for each firm, thus giving all firms a reason to set relatively high prices.

The following highly stylized example illustrates the general mechanism.[57] Suppose that there are two incumbent sellers, denoted by $i = 1,2$, each having constant marginal costs of c per unit. Suppose further that, if seller i's product is in the preferred position, then a

[56] Chen and Schwartz (2023, p. 28) examine whether letting consumers choose their defaults when they first join a platform would remedy the long-run problem and find that it would not because, in their model, all consumers would choose the stronger product as the default if initially presented with choice screens. A distortion arises because an individual consumer ignores the effects of his or her choice of default on the future quality levels of the competing firms.

[57] Chen and Schwartz (2023) present a more sophisticated model in which similar effects arise. They show that, in comparison to the leading firm's winning the default for all consumers, a public policy that assigns the default position to the weaker firm for a share of consumers softens competition and raises equilibrium prices. There is also additional harm to those consumers assigned to the lower-quality firm.

consumer chooses product i if and only if $b - p_i \geq \max\{b - t - p_{-i},0\}$ and product $-i$ if and only if $b - t - p_{-i} > \max\{b - p_i,0\}$, where b is the benefit of the product, t is the (possibly psychic) transaction cost of considering the non-preferenced product, and p_i is the price of product i. If seller i receives preferred placement for all consumers, then the equilibrium prices are $p_i = c + t$ and $p_{-i} = c$, and all consumers purchase product i. Now, suppose that the platform is forced to have neutral placement, which consists of giving each seller preferred placement half of the time, and that a seller cannot set its price contingent on its search-results position. Then, as long as $t \geq \frac{1}{2}(b - c)$, the equilibrium prices are $p_1 = b = p_2$.

Comparison of the formulas for equilibrium prices reveals that, when $b > c + t > b - t$, the equal-treatment regime leads to higher equilibrium prices than does the preferencing regime. Intuitively, when each seller has a set of consumers for which that seller is the default, each seller finds it more profitable to charge a high price to take advantage of those consumers' greater willingness to pay for its product than to charge a low price to compete for all customers. By contrast, under preferencing, the disadvantaged firm has no such group of consumers, and the firm attempts to overcome its disadvantage by lowering its price to marginal cost.

Observe that, in this example, the platform may find equal treatment more profitable than preferencing: when the platform uses equal treatment to soften downstream competition,

the platform may be able to appropriate the resulting downstream profits through fees levied on the sellers.[58]

In general, whether a platform will adopt a preferencing policy that promotes or weakens seller competition depends on the many factors that can affect the platform's ability to extract surplus from buyers and sellers. For example, a platform might want to promote perfect competition among sellers when it is able to fully extract the resulting buyer surplus though platform fees charged to consumers. In other situations, such as the example above, where the platform can better extract surplus from sellers, it might want to promote monopolistic seller behavior.[59]

B. Application of the Common Criteria

I next examine whether the three principal criteria for fair competition and competition on the merits are useful in identifying whether preferencing harms entry and/or softens competition. Of course, under the consumer welfare standard, whether conduct constitutes competition on the merits is not the sole basis for determining whether it is illegal—the conduct must also harm consumers.[60] And even under the fairness approach,

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[58] I note in passing that Federal Trade Commission (2022, p. 13) identifies practices that facilitate tacit coordination as unfair methods of competition. By this definition, choosing *not* to engage in preferencing can be an unfair method of competition.

[59] The U.S. Department of Justice has alleged that Apple granted Google search preferential access on iOS devices to allow Google to earn monopoly profits in the search market that it shares with Apple. (United States of America v. Google, LLC, District Court for The District of Columbia, Case No. 1:20-cv-03010, Amended Complaint, January 15, 2021, § V.A.1.)

[60] In practice, there are other conditions as well. For example, courts typically require a showing that the defendant has substantial market power. And the Supreme Court has held "that petitioners may not be liable for attempted monopolization under § 2 of the

there can be a separate condition that includes harm to consumers.[61] But reliance on changes in consumer welfare has the problems identified in the discussion of the pure consumer-surplus standard in Section III above. The analysis below examines whether these criteria can serve to avoid or limit these problems.

1. Deception

As discussed above, the notions of both fairness and competition on the merits indicate that it is problematic when consumers make incorrect inferences from a platform's decision to grant a product preferential treatment and those inferences lead to material changes in the market outcome. However, at least as measured by equilibrium margins and entry, such deception can lead to more intense rivalry.

Consider a platform that sells preferred placement in its search results. If the platform does not disclose its preferencing policy, a consumer may believe that a product receiving preferred placement is, in the platform's view, the best match from the consumer's perspective and may believe that this is an informative signal. As the following example demonstrates, this deception can benefit both consumers and weaker sellers.

Consider a product sold by five Cournot oligopolists. A representative consumer derives gross dollar benefits $B = \sum_{j=1}^{5} \alpha_j x_j - \frac{1}{2}\left(\sum_{j=1}^{5} x_j\right)^2$, where x_i is seller i's output level,

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Sherman Act absent proof of a dangerous probability that they would monopolize a particular market and specific intent to monopolize." (Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447 (1993), p. 459.)

[61] Federal Trade Commission (2022, p. 9) ("Second, the conduct must tend to negatively affect competitive conditions. This may include, for example, conduct that tends to foreclose or impair the opportunities of market participants, reduce competition between rivals, limit choice, or otherwise harm consumers." Internal note omitted.).

$\alpha_i = \alpha_0$ for $i = 1,2 \ldots,4$, and $\alpha_5 = \frac{6}{7}\alpha_0$. Each seller incurs a fixed cost of $F = \left(\frac{\alpha}{21}\right)^2$ if it produces output. The common, constant marginal cost of output is subsumed in α_i.

In this example, if seller 5 does not appear in the first search position, then consumers correctly perceive the values of α_i and the resulting inverse demand curves are $p_i = \alpha_i - \sum_{j=1}^{5} x_j$. By contrast, if seller 5 does appear in the first search position, then buyers make consumption decisions as if $\alpha_i = \alpha_0$ for all five sellers, but realized consumption benefits are as given by the formula for B above. In other words, placing seller 5 in the first position deceives buyers into believing that seller 5's product generates greater consumption benefits than it actually does.

Standard calculations show that, absent deception, only sellers 1 through 4 are active in equilibrium; given consumers' lower willingness to pay for its product, seller 5 would be unable to cover its fixed costs and chooses not to produce output.[62] By contrast, the equilibrium under deception is symmetric, and all five sellers are active.[63]

Comparing the sellers' profits under the two equilibria, seller 5 is willing to pay more to purchase the preferred position than is any of sellers 1 through 4.[64] As long as the platform is unable to charge seller 5 its full willingness to pay for the preferred position,

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62 Sellers 1 through 4 each sells $\frac{\alpha}{5}$ units and earns profits $\left(\frac{\alpha}{5}\right)^2 - \left(\frac{\alpha}{21}\right)^2$.

63 Under deception, each of the five firms sells $\frac{\alpha}{6}$ units and earns profits $\left(\frac{\alpha}{6}\right)^2 - \left(\frac{\alpha}{21}\right)^2$.

64 Seller 5 is willing to pay up to $\left(\frac{\alpha}{6}\right)^2 - \left(\frac{\alpha}{21}\right)^2$ for the preferred position, while any of sellers 1 through 4 is willing to pay up to $\left(\frac{\alpha}{5}\right)^2 - \left(\frac{\alpha}{6}\right)^2$.

seller 5 gains from deception. Notably, even though they are the ones who are deceived, consumers also collectively gain from deception.[65]

In general, there are two broad types of consumer-welfare effects arising from deception: (a) changes in the intensity of competition, and (b) matching effects. As the example above demonstrates, deception that favors a firm with a less-attractive product can intensify price competition while harming matching.[66] Thus, preferred placement can deceive buyers in a way that "levels the playing field" for a smaller or weaker seller, which can benefit that seller and, depending on parameter values, lead to higher or lower consumer welfare.[67] In summary, the deception criterion by itself does little or nothing to identify the effects of preferencing on entry, rivalry, small-seller welfare, or consumer welfare. Instead, one must determine these effects by examining the specific facts.[68]

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[65] Consumer surplus is $\frac{1}{2}\left(\frac{4\alpha}{5}\right)^2$ when seller 5 does not appear in the first position, and $\frac{1}{2}\left(\frac{5\alpha}{6}\right)^2 - \left(\frac{\alpha}{6}\right)\left(\frac{\alpha}{7}\right) > \frac{1}{2}\left(\frac{4\alpha}{5}\right)^2$ when it does. The term $\left(\frac{\alpha}{6}\right)\left(\frac{\alpha}{7}\right)$ captures the fact that consumers' true benefit function differs from the one they perceive when making purchase decisions.

[66] In the example above, seller 5 is a bad match because its product has the same production costs but generates lower dollar consumption benefits than rival products.

[67] The matching effects and net change in surplus may vary across consumers. Suppose, for example, that there are multiple buyers, each with a utility function of the form given in the text. While deceived, a buyer is indifferent between any two consumption bundles that involve the same total amount of output. Consumers who purchase only from sellers 1 through 4 clearly gain from the price decrease triggered by deception, but a consumer who purchases solely from seller 5 can be worse off.

[68] Note that, when deception benefits consumers, the consumer welfare standard would not indicate that this conduct harms competition. Similarly, some proponents of a fairness standard might approve of the deception when it enables entry.

2. Raising Rivals' Costs

Both approaches to assessing competition might condemn preferencing on the grounds that it raises the costs incurred by rivals of a seller receiving preferential treatment. Indeed, the Department of Justice argued that Google's purchase of default positions on iPhones substantially raised rivals' costs of obtaining data and search traffic, which led these rivals to offer lower-quality search results than they otherwise would have.[69]

A major weakness of this criterion is that, in the presence of various benefits of scale, *any* action that a supplier takes to make its product more attractive will tend to divert sales from rivals' products, which will make those products less attractive (in the presence of network or data effects) or more costly (in the presence of declining marginal costs of production). Hence, on its own, the raising-rivals'-costs criterion does little to help determine whether conduct softens competition or harms entry.

A policy under which the courts concluded that any attempt by a firm to increase its sales is unfair or unmeritorious under these conditions, which are common in many industries, could stifle competition rather than promote it. In the short run, current market leaders may be incentivized to compete less vigorously to avoid triggering liability. And in the long run, firms may be less willing to invest in becoming market leaders in the first place.

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[69] United States of America v. Google, LLC, District Court for The District of Columbia, Case No. 1:20-cv-03010, Amended Complaint, January 15, 2021, ¶¶ 8, 57, 95, and 113.

The concept of predatory overbidding for inputs in a non-platform context was addressed in Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., *549* U.S. 312 (2007).

There is a need for a principle limiting and refining the use of this criterion to condemn preferencing (or other conduct).[70]

One approach is to apply the logic of the "no economic sense test" to the firm purchasing preferred placement. Under this test, conduct is not exclusionary unless it makes no business or economic sense but for the likelihood of harming competition.[71] However, it will often be the case that conduct will both strengthen a seller's competitive position and weakens those of its rivals, making the necessary calculations difficult.[72] There is also a more troubling issue. Suppose that a firm undertakes an innovation that lowers its production costs or improves its product quality and finds that—having made the innovation—it is profitable to make such attractive offers to consumers that at least some other sellers are driven to exit the market. In addition, suppose that making these attractive offers maximizes the firm's profits even after these rivals exit, but that investing in the innovation would not be profitable if, instead of exiting the market, the rival firms continued to sell output at prices greater than their marginal costs but less than their average costs. To apply the no economic sense test, one would need a means of determining whether the induced exit represented harm to competition or was the result of vigorous competition. In this sense, the sense test begs the fundamental question.

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[70] In the other direction, an expert witness retained by Google argued that the rivalry to purchase preferred placement is itself a form of competition. (Bartz (2023).) Here, too, a limiting principle is needed, or else no contract would be exclusionary as long as rivals were offered the chance to bid against it.

[71] See, e.g., Werden (2006).

[72] See the discussion in Section IV.B.2 above.

Another approach is to condition liability on whether the firm receiving preferred placement is currently a market leader. However, this approach could stifle competition, as I will discuss next.

3. A Firm Should Not Benefit Too Much from Past Success

Preferential treatment has been attacked on the grounds that firms that have been successful in the past may have greater abilities to purchase preferential treatment and thus entrench their positions. As shown above, preferential treatment has ambiguous effects on the intensity of competition among incumbents and the ease of entry. Preferential treatment can harm competition in some circumstances, but it can promote entry when the entrant is the one receiving preferential treatment and can intensify competition if it allows a weaker incumbent at least partially to offset advantages enjoyed by rival sellers. These facts suggest that the past-success criterion might be a useful means of distinguishing between the pro- and anticompetitive cases. Upon reflection, however, it is far from evident that an enforcement policy under which preferential treatment is objectionable only when granted to already successful incumbents would promote competition.

One problem is that granting preferential treatment to a weaker incumbent can soften price competition for reasons discussed in Section IV.A above—the formerly weak firm might have incentives to abandon its low-price strategy to exploit a set of captive or preferred customers created by the preferential treatment.

Another problem arises when the platform's treatment of a seller influences consumer decision making and generates matching benefits—the dominant firm might be the one

that generates better matches, so that granting preferential treatment to the weaker product might be a form of deception, while having no preferential treatment of any firm (in those cases where it is feasible) could deny consumers potentially useful information.

Limiting the availability of preferential treatment to weaker sellers is also problematical because it undermines investment incentives. For example, it might be more profitable to be classified as a weak incumbent—and thus be eligible for preferential treatment—than to invest in obtaining competitive advantages that then render the seller ineligible for preferential treatment. In short, the policy of favoring weaker sellers can be seen as rewarding sellers for offering unattractive products.

There is also more-limited application of the past-advantage criterion, one that can be viewed as a cross-product application of the criterion. Specifically, testifying as a witness for the U.S. Department of Justice, the CEO of DuckDuckGo alleged that, had Google not demanded to be the exclusive default search engine for *all* users of the Safari web browser on iPhones, his company's search engine might have been able successfully to compete to be the default search engine on the iPhone Safari web browser for the segment of consumers who are particularly concerned with privacy.[73] Under either a fairness or merits approach, one might object to such exclusivity on the grounds that it prevents a product from standing alone for a given customer segment and being fully considered on its own merits. This practice is similar to a tie-in sale, although here it is a

[73] Feiner (2023a).

tie-in purchase. In this regard, it is notable that, in general, the competitive effects of ties are complicated and can be positive or negative.[74]

In short, the past-advantage criterion does little to distinguish cases in which preferential treatment harms competition from those in which it promotes competition.

V. SELF-PREFERENCING

It is frequently alleged that a platform owner has an inherent conflict of interest when it also offers products that compete with those of third-party platform users, so that self-preferencing (here, using the term to refer to a platform that treats its own first-party seller more favorably than some or all third-party sellers) is greeted with even more skepticism than is platform preferencing generally.[75] In this section, I address three questions: (1) what effects does integration have on a platform owner's incentives to preferentially treat certain sellers, including its own, first-party seller; (2) does self-preferencing strengthen or weaken competition; and (3) to what extent do the concepts of fairness and merit allow one to distinguish procompetitive from anticompetitive instances of self-preferencing?

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74 See, e.g., Burstein (1960), Whinston (1990), Carlton and Waldman (2002), Nalebuff (2004), and Evans and Salinger (2005).

To be clear, I am offering no opinion on the merits of the United States' case against Google.

75 See, e.g., Khan (2019). This is a reversal of the usual antitrust treatment of independent firms and vertically integrated firms—typically the latter have greater latitude to structure the relationship between the different vertical stages than do the former.

A. THE EFFECTS OF INTEGRATION ON PREFERENCING INCENTIVES

In comparing the preferencing incentives of integrated and non-integrated platform owners, an important initial observation is that a platform bears an opportunity cost of favoring itself. Suppose that a platform grants its own, first-party seller preferential treatment. When preferential treatment can be granted to only a limited number of sellers (e.g., only one product can be first in a set of search results), the platform will be able to sell preferential treatment to fewer third-party sellers than otherwise. Even when an unlimited number of sellers can receive preferential treatment, third parties may be less willing to pay for preferential treatment when the first-party seller receives it too.[76]

That said, there are at least two important differences between an integrated firm's preferencing incentives and those of an independent platform and downstream providers:

- *The integrated firm may more fully internalize the effects of preferencing on the first-party seller than on third-party sellers.* In theory at least, an integrated platform completely internalizes the effects of its preferencing decisions on its first-party seller. By contrast, the platform may or may not be able to extract all the benefits that a third-party seller enjoys from preferential treatment. For example, if there are multiple third-party sellers that value preferential treatment equally to one another, then the platform could run an auction and fully extract the value. In other cases, however, it would be infeasible to extract all of a third-

[76] For example, when the platform provides access to some feature for its first-party seller, the value of that feature to a third-party seller may be lower either because the feature can no longer serve as a source of product differentiation or because the third-party seller would realize the cost savings associated with the feature over fewer unit sales.

party's surplus associated with preferential treatment, and there could be various forms of the traditional monopoly distortion in the sale of that treatment—while trying to extract surplus from third parties, the platform might restrict the sale of preferential treatment to them, which means that, all else equal, the platform would have a tendency to favor its own product.[77] For example, suppose that the third parties have heterogenous values of preferred placement and the platform runs a second-price auction. Although third parties would have incentives to bid their true values of preferred placement, the first-party seller could have an incentive to shade its bid upward to extract more surplus from the other firms when it was the second-highest bidder. Or, if the platform set a posted price for preferred placement, it would have an incentive to set the price higher than its own value of preferred placement, trading off the possibility of losing a sale to a third party against the gains from obtaining a higher price when such a sale did occur. Either practice would create a bias toward the platform's downstream division's winning preferred placement.

- *The first-party seller internalizes its effects on the platform and, thus, will, to some degree, indirectly internalize the effects of its conduct on third-party sellers and buyers.* Internalizing the effects on third-party sellers could lead the first-party seller to behave more or less competitively than third-party sellers, depending on the circumstances. The first-party seller will behave more

[77] For reasons discussed in the next bullet point, a platform may also have incentives to preference its first-party seller to increase the competition faced by third-party sellers.

competitively than would a similar third-party seller if doing so helps the platform extract rents from third-party providers, as happens when competition from the first-party seller drives down third-party sellers' profits while strongly increasing buyers' willingness to pay for the platform's services. However, the first-party seller will behave less competitively than a similar third-party seller if behaving competitively would reduce third-party seller's willingness to pay the platform for its services by more than it would increase buyers' willingness to pay for platform services. Consideration of deadweight loss suggests that more intense seller competition should increase the sum of buyer and seller benefits potentially available for the platform to extract, but the platform may have different abilities to extract incremental surplus from the two sides depending on its fee structure, for example. Hence, the comparison of first- and third-party sellers is ambiguous.

As a result of these two effects, an integrated platform owner can have incentives to favor its first-party seller in granting preferential treatment.

B. COMPETITIVE EFFECTS OF SELF-PREFERENCING

The implications of these incentives to self-preference are complex for at least two reasons. First, as discussed in Section IV.A above, preferential treatment of a third-party seller can have positive or negative effects on competition. Second, although internalization has been called a conflict of interest, it can have beneficial effects too; as just discussed, a first-party seller may behave more competitively than would a third-party seller. Hence, it should come as no surprise that self-preferencing can strengthen or weaken competition in comparison with a neutrality regime.

Zou and Zhou (2023) show that, in the short run, search neutrality can soften price competition between third-party sellers and an integrated firm's first-party seller. Zou and Zhou (2023, pp. 25-26) also identify conditions under which search neutrality can lead the platform to preempt the entry of third-party sellers because additional sellers can be less valuable to the platform under search neutrality than paid placement. This effect arises in their model because, under search neutrality, price competition is softened, which has the effect that consumers do not consider options other than the one receiving prominent placement. By contrast, when the platform favors itself, the entrant will charge a lower price, leading some consumers to search for the non-prominent product, which can lead to better matching of seller and buyers, thus increasing the volume of commerce on which the platform collects a commission. In short, as with an unintegrated platform, there are conditions under which a prohibition of preferencing can soften price competition and make entry more difficult.

As discussed in Section IV.A above, an independent platform may not choose the optimal pattern of preferencing from the perspective of promoting competition. The difference between the incentives of an integrated platform and an independent one can make this distortion better or worse. An integrated firm may be more likely to monopolize the downstream market because the firm fully appropriates the downstream profits resulting from the market power that preferencing generates for its first-party seller but an independent platform may be unable to do so when preferencing a third-party seller. In the other direction, because an integrated platform/seller may be able to internalize certain benefits of increased downstream competition to a degree that independent firms

cannot, downstream competition may be more attractive to the former. For example, an integrated platform owner may self-preference to increase competition by facilitating the entry of a first-party seller that creates more competitive pressure on rival sellers than would a third-party entrant.

A final difficulty in assessing competitive effects is that they may vary over time. For example, some people would argue that Amazon Basics are examples of procompetitive entry, while others would argue that the long-run effects will be to induce rivals to exit.

C. Application of the Common Principles

Self-preferencing, like preferencing generally, can strengthen or weaken competition. Do the criteria regarding raising rivals' costs and inappropriate benefits from past success help one determine the sign of the competitive effects?

With respect to the raising-rivals'-costs criterion, it is useful to consider the rivalrous-preference and non-rivalrous-preference cases separately. The non-rivalrous case is a form of refusal to deal, and a prohibition of preferencing in these cases raises the issue of investment incentives that is central to U.S. courts' reluctance to impose a duty to deal: forcing a platform to share with rival sellers the fruits of its costly investments will weaken the platform's investment incentives.[78] This criterion raises particularly difficult

[78] Shelanski (2009), p. 371; Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004), pp. 407-408 ("Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.").

The reluctance to impose a duty to deal has been expressed specifically in the platform-preferencing context. (United States District Court for the Northern District of

issues with respect to intellectual property, which may have near-zero costs of dissemination. Does the low cost of dissemination mean that *any* refusal to license intellectual property to a competitor is a form of raising rivals' costs that would fail the no economic sense test? The adverse investment incentive effects of such a policy would be profound and could change races to innovate into waiting games, with each firm hoping to free- or cheap-ride on its innovating rivals.[79] Alternatively, courts would have to determine appropriate licensing fees and essentially regulate prices, which is a difficult task for a specialized regulatory body, let alone for a generalist court.[80]

In the exclusive case, the issue of investment incentives can be especially strong—not only would the platform have to offer something of value to third-party sellers, the platform would not be allowed to offer that value to its first-party seller.

Next, consider the criterion that a firm should not benefit too much from past successes. Self-preferencing can be characterized as a form of tying.[81] Like other forms of tying, self-preferencing can be condemned as being unfair and/or not on the merits because the

California, In re Google Digital Advertising Antitrust Litigation, No. 5:20-cv-003556-BLF, ECF No. 143 (N.D. Cal. May 13, 2021), Order Granting Motion to Dismiss with Leave to Amend (expressing concern that allegations that Google's ad server functioned better with Google's own buying tools than with those of third parties relied on a duty-to-deal theory of harm).)

79 See, e.g., Katz and Shapiro (1987).

80 The Supreme Court has reached a similar conclusion. (Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398 (2004), p. 408 ("Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill suited.").)

81 Hovenkamp (forthcoming). Indeed, as noted in Section IV.A above, preferencing of a third-party seller can also be considered as a form of tying.

firm uses success in one market to obtain advantage in another. But self-preferencing can have positive and negative effects on competition.[82] Moreover, self-preferencing can also be viewed as a means of allowing a platform to monetize past investments. That is, the platform owner generally will have attained its current market position by having invested in the platform. Antitrust policy generally favors allowing a firm to earn a return on its past investments. If it is fair or competition on the merits for a firm to take advantage of past successes *within* a market (at least to some degree), why isn't it also fair to do so *across* markets? An enforcement policy that limits the ability to benefit from success in other markets risks becoming an attack on systems-level competition and vertical integration.[83] Surely a firm is allowed to enjoy some benefit from vertical integration. But how much is too much? Here too, there is a need for a (currently missing) limiting principle.

VI. CONCLUSION

The analysis above demonstrates that there is not a sound basis for declaring that self-preferencing should be either per se legal or per se illegal. Instead, the competitive effects of self-preferencing vary with the circumstances, which suggests that—given our current state of knowledge—a case-by-case, fact-intensive evaluation is appropriate.

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[82] The same is true of tying generally. See, e.g., the sources cited in note 74 above.

[83] To insist that a platform should treat a first-party seller exactly as it treats third parties is effectively to deny that benefits of integration exist: by definition, the benefits of integration cannot be realized by independent firms transacting with one another at arm's length.

What principles should be applied in evaluating any given case? Determining whether competition is "fair" or on the "merits" is central to the fairness and consumer welfare approaches to antitrust, respectively. Alone, however, neither an appeal to "fairness" nor to "merit" is sufficient to evaluate whether conduct harms competition. Rather than rely on vaguely defined words, additional work—in the forms of both academic research and fact-intensive court cases—should be undertaken to identify the linkages between market conditions and the equilibrium effects of self-preferencing.

> "When I make a word do a lot of work like that," said Humpty Dumpty, "I always pay it extra."[84]

[84] Lewis Carroll (1899, p. 111).

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