NetChoice Response to FTC Request for Public Comment Regarding Contract Terms that May Harm Fair Competition

NetChoice[1] is a trade association of leading internet businesses that promotes the value, convenience, and choice internet business models provide American consumers. Our mission is to make the internet safe for free enterprise and for free expression. We also work to promote the integrity and availability of the internet on a global stage, and are engaged on issues in the states, in Washington, D.C., and in international internet governance organizations.

Introduction

We welcome the opportunity to provide the Federal Trade Commission with feedback about contractual terms related to "fair competition" that the Open Markets Institute petitioned the Commission to investigate. In considering this issue, we ask that the FTC keep in mind:

- The government should refrain from interfering in voluntary contracts between private parties to the greatest extent possible;
- These types of contractual terms often facilitate innovation and benefit consumers in both the short and long run;
- The FTC already has the powers and authority necessary to address these types of contractual terms in specific instances when they are actually anticompetitive;
- Enacting bright-line rules and regulations to enforce a blanket prohibition on these terms will do far more harm than good;
- The focus on FTC enforcement should always be the protection of consumers, not competitors or other parties; and
- If the FTC does want to encourage competition and facilitate entry by smaller competitors, there are a variety of more efficient and less costly ways to do so.

We appreciate the Commission's consideration of our views and welcome the opportunity to provide any additional information or answer any questions you may have.

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[1] NetChoice is a trade association of e-Commerce and online businesses, at www.netchoice.org. The views expressed here do not necessarily represent the views of every NetChoice member.

The Government Should Not Be In The Business Of Interfering In Contracts Between Private Parties

The Commission is considering whether it is appropriate to adopt rules or regulations to prohibit, or severely limit, the use of certain types of contracts between private parties, specifically focusing on exclusivity agreements and non-compete clauses. Any such effort would not only be counterproductive to the FTC's goal of protecting consumers, it would be completely antithetical to the core principles on which this country was founded.

The United States' founding was unique and unprecedented. For the first time in history, the creation of a nation was not based on the seizing of power for the benefit of a select group of people, but instead on a desire to liberate every citizen from the whims of arbitrary authority. As such, the founders took painstaking efforts to ensure our country was built around certain fundamental principles aimed at *curtailing* the power of government actors while empowering individuals to make decisions for themselves. They created a constitutional republic composed of limited government powers and bound by a requirement not to infringe on certain enumerated and unenumerated rights. At the very heart of this system are the concepts of limited government, individual liberty, and private property. Our founders believed that economic and personal decisions should be left in the hands of private parties, not made by government bureaucrats imposing their will on the general populace.

Unfortunately, that is exactly what the FTC would be doing if it enacted paternalistic regulations prohibiting the use of exclusivity contracts and non-compete clauses. Contrary to the intentions of our founders, the FTC would be substituting its own judgment for that of private parties entering into voluntary contracts. Instead of allowing individuals and businesses to decide these matters between themselves, it would be unnecessarily intervening to inhibit what are social-welfare enhancing transactions. This would be a direct infringement on individual liberty, a substantial undermining of our system of private property, and a major expansion of government power. In short, it would be everything our founders fought and stood against.

No one is forced to sign an exclusivity agreement or accept a job with a non-compete clause built into their employment contract. They do so because they believe they will be made better off as a result of the transaction. They weigh the benefits of the agreement with the costs and only proceed if they ultimately find

that there are more benefits. Both sides are in a better position than they would be absent the agreement.

This is exactly how our market-driven economy is supposed to function. Individuals make decisions for themselves based on what they think will be in their best interest. All that goes out the window when regulators substitute their own judgment for that of the parties that will actually be bound by the contract. Rather than a bottom-up economy driven by voluntary transactions between individuals and businesses, you get a top-down economy driven by government decree. What results is an economic and political system diametrically opposed to that which our founders envisioned. The government becomes the arbiter of private enterprise and the United States loses the very essence of what has made it so successful over the past several centuries. In the end, the only people to benefit from such a system are not consumers, but other competing businesses that are able to kneecap their rivals through the use of government power.

Exclusivity Agreements Often Facilitate Innovation And Benefit Consumers

In enacting any rules or regulations governing such terms, the FTC should consider the numerous benefits created by exclusivity agreements and the many ways in which these agreements promote the welfare of consumers. While exclusivity agreements can be used to harm rivals in a way that is anticompetitive, they are often procompetitive, creating socially beneficial results for both customers and businesses that can be underappreciated in current discussions.

For one, exclusivity agreements often help facilitate innovation by allowing businesses to invest in risky, long-term endeavors that may not be feasible absent some way of guaranteeing profitability at the end of the road. Every business decision involves some level of risk, but certain business decisions are riskier than others. Innovative ventures are often riskier for the exact same reason they are innovative, they have never been done before. As such, it is typically very difficult, and often impossible, for a business to determine *ex ante* how such decisions will turn out and whether or not they will ultimately turn a profit. For this reason, businesses typically look for ways to hedge against this risk by identifying mechanisms to ensure long-term profitability before investing in such ventures. One way of doing so is by entering into exclusivity agreements.

Exclusivity agreements provide businesses with greater security regarding these riskier, more innovative investments. As the Nobel prize-winning economist Ronald Coase helped establish, the transaction costs associated with a given decision are

some of the most important factors impacting whether that decision will ultimately be made.[2] These agreements help greatly reduce transaction costs associated with riskier investments by establishing some level of assurance that the business will have a buyer or interested party to work with upon completion of the project. This allows the business to put resources into this venture with some surety that it will pay off. Without such agreements, there is nothing preventing an expected partner from gaining value from the fixed cost of undertaking the innovative investment and then switching to a new, lower cost alternative that can free ride off that investment.

In a similar vein, exclusivity agreements allow a business to invest in third-party partners while also preventing gamesmanship. Some ventures, particularly those with higher initial costs, require a business to invest in third-parties. This can be through the installation of hardware or software, the training of employees, the establishment of communication channels, or a variety of other undertakings necessary to begin the relationship. Businesses may be reluctant to expend resources on these investments if they cannot guarantee they will pay off over time. If a third-party can reap the benefits of these investments, or simply change their mind after they are made, the business may find the risk of such investments outweigh the benefits. And even if they do find that the investment will still be profitable in the long-run, the costs of that risk will almost certainly be baked into the contract price. A third-party that has no intention of reneging on the relationship will end up paying more for something simply because they could not agree to an exclusivity provision that did not materially alter what they already planned to do. They end up paying a higher price for no additional benefit, all because a regulator thought they knew better than those actually bound by the contract.

Likewise, exclusivity agreements prevent opportunistic third-parties from gaming such contracts. Businesses that do enter into these riskier, high-initial-cost agreements with third-parties often become somewhat dependent on that party. In many situations, that dependence can give the third-party considerable leverage over the business. Once a business has invested considerable resources in you as a trade partner, the threat of withdrawal can allow you to extract additional concessions from that business. Without an exclusivity provision, there is little preventing a third-party from using the threat of withdrawal to obtain better contractual terms from a business. Not only is this unfair, it erodes trust in the market and decreases the likelihood that businesses will enter into these agreements going forward.

Finally, exclusivity agreements can help ensure a steady supply of inputs for long-term contracts. Market conditions often fluctuate and exclusivity agreements can be

[2] Ronald H. Coase, *The Problem of Social Cost*, 3 Journal of Law and Economics 1 (1960).

a way for a business to guarantee they will have the resources and materials they need to meet the demand of their customers without undue burden. This facilitates stability in the market and reduces the likelihood of drastic price increases when there is a supply shortage.

Contrary to being a tool for anticompetitive behavior, exclusivity agreements largely benefit consumers through increased innovation, lower prices, and higher quality goods and services.

The FTC Already Has The Ability To Address Anticompetitive Uses Of Exclusivity Agreements

As described above, exclusivity agreements are often procompetitive, benefiting consumers and businesses alike. However, there are situations where they can be used as an anticompetitive mechanism for excluding rivals and increasing costs for consumers. Thankfully, the FTC already has the authority and tools necessary to address situations where businesses are using exclusivity agreements in an anticompetitive way.

Since antitrust law was first established, the United States' primary approach to competition policy has been built around enforcement actions brought against particularized allegations of consumer harm. This approach has a number of advantages. For one, it allows enforcers and plaintiffs to effectively address cases of anticompetitive conduct as they emerge without stifling the market dynamism that spurs innovation and benefits consumers. If the FTC, DOJ, state attorneys general, or private plaintiffs feel as though an antitrust violation has occurred, they have the ability to initiate a suit against the defendant alleged to be harming consumers through anticompetitive conduct. The courts or, in the case of the FTC, an administrative adjudicatory system will then hear the case, allow both the plaintiff and defendant to present evidence, and decide whether an antitrust violation has ultimately occurred. Under the rule of reason, the court will take into account all of the relevant evidence and consider whether the conduct at hand ultimately harms or benefits consumers taking into account the effect of the conduct on quality, price, and innovation.[3] If the anticompetitive effects of the conduct outweigh the procompetitive effects, the adjudicator will typically find that an antitrust violation has occurred and take the appropriate action necessary to remedy the violation.[4]

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[3] *Exclusive Dealing or Requirements Contracts*, Federal Trade Commission, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/dealings-supply-chain/exclusive-dealing-or ("These arrangements are judged under a rule of reason standard, which balances any procompetitive and anticompetitive effects.").
[4] *Id.*

If the FTC feels as though businesses are using exclusivity agreements in an anticompetitive fashion to the detriment of consumers, there is nothing stopping them from initiating an enforcement action under current law. In fact, they often do so.[5] Far from being powerless to address this type of anticompetitive conduct, the FTC has a robust and powerful mechanism for challenging such behavior.

Enacting Bright-Line Rules And Regulations That Limit The Use Of Exclusivity Agreements Will Do Far More Harm Than Good

Considering the numerous procompetitive justifications for exclusivity agreements, the FTC should refrain from enacting bright-line rules and regulations that limit the use of these agreements without regard to their actual impact on consumers in a specific situation.

As discussed above, exclusivity agreements can have both pro and anticompetitive effects. However, the FTC is considering adopting regulations that would prohibit, or greatly limit, the use of these types of agreements across the board. Rather than looking at the unique context of each situation and using the tools they already have to bring enforcement actions in cases where businesses actually are using exclusivity agreements anticompetitively, these measures would deter the use of these agreements even when they would ultimately benefit consumers. This is directly contrary to the mission of the FTC and the purpose of antitrust law in the United States. It treats all exclusivity agreements as equal while replacing in depth analysis with ideological edict. It places the actual welfare of consumers to the side in favor of the policies preferences of unelected bureaucrats. It ignores the ever-evolving nature of the market and the many ways in which these agreements can lead social-welfare enhancing outcomes. It does all of this without doing much of anything to meaningfully combat cases where harm does exist since, as mentioned previously, the FTC already has the tools it needs to address the anticompetitive use of these agreements. The end result will be a regulation that does a substantial amount of harm while producing very little benefit.

Moreover, the authority of the FTC to issue such a rule is questionable at best.[6] During the 1960s and 70s, the FTC's competition rulemaking activity became the subject of considerable controversy and debate. Many felt the Commission had

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[5] *Exclusive Dealing or Requirements Contracts*, Federal Trade Commission, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/dealings-supply-chain/exclusive-dealing-or; *Exclusive Supply or Purchase Agreements*, Federal Trade Commission, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/exclusive-supply-or.

[6] Maureen K. Ohlhausen & James Rill, *Pushing the Limits? A Primer on FTC Competition Rulemaking*, U.S. Chamber of Commerce (Aug. 12, 2021).

become overzealous in its promulgation of rules. Consider the (in)famous example of the "Kid Vid" rule that would have basically prohibited any television advertising aimed at children.[7] This decision and the circumstances surrounding it resulted in the *Washington Post* dubbing the FTC the United States' "National Nanny."[8] As subsequent commentators have explained, "the FTC adopted the reformers' cause uncritically, seeing itself self-appointed champion of American children" such that "even its supporters acknowledge that the FTC made a serious political miscalculation."[9]

In response, Congress passed the Magnuson-Moss Warranty of 1975 and the FTC Improvements Act of 1980 to curb the FTC's excessive rulemaking activity. Congress did not hide its justification for limiting the Commission's powers. In a series of hearings held in the late 1970s, "Congress publicly lambasted the Commission for its activist programs branding these as 'regulatory abuse' by a 'runaway, controllable bureaucracy.'"[10] Together, these Acts greatly limited the Commission's ability to promulgate rules at will.

However, the FTC has recently voted to "streamline" many of these procedures, going directly against the express will of Congress. This will be the first rule promulgated since that vote. As such, it is not clear whether the courts will uphold such a rule, even if it is adopted.

FTC Action Should Always Be Focused On The Welfare Of Consumers

The FTC's indiscriminate desire to ban both pro and anticompetitive uses of exclusivity agreements highlights how it is not focusing its enforcement decisions on the welfare of consumers, but on other values the Commission deems admirable. This is buttressed by the fact that the FTC's call for comments asks for analysis of how these agreements might "disadvantage small businesses, workers, and/or consumers." Not only is the FTC factoring in considerations beyond how these agreements affect consumers, it focuses on consumers last and is willing to consider analysis that does not even take consumers into account. This may not be all that surprising given the Commission's recent decision to overturn a bipartisan policy statement that explicitly tied FTC enforcement to how such decisions will impact

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[7] Robert H. Mnookin & Susan Bartlett Foote, *The "kid vid" Crusade*, 61 The Public Interest 90 (1980).

[8] *The FTC as National Nanny*, Wash. Post (Mar. 1, 1978), https://www.washingtonpost.com/archive/politics/1978/03/01/the-ftc-as-national-nanny/69f778f5-8407-4df0-b0e9-7f1f8e826b3b/.

[9] Robert H. Mnookin & Susan Bartlett Foote, *The "kid vid" Crusade*, 61 The Public Interest 90, 91-105 (1980).

[10] Mark J. Moran & Barry R. Weingast, *Congress as the source of regulatory decisions: The case of the Federal Trade Commission*, 72 American Economic Review 109 (1982).

consumers, but it is certainly concerning[11]. It signals an abrupt departure from a well-considered, longstanding approach to competition enforcement that limited administrative activism and toward an ideologically motivated approach that could harm American consumers, businesses, and the United States' competitiveness for decades to come.

The FTC Can Still Promote Competition and Innovation

While the FTC's potential rulemaking on "fair" contractual terms is misplaced, the agency can still make it easier for new businesses to enter the market and compete against the larger players. Because we are a tech-focused trade association, we will limit our discussion to digital markets.

First, the FTC must recognize the importance of mergers and acquisitions in spurring competition and innovation. In the not-so-distant past, the FTC analyzed mergers based on their likely effects on consumers. Under that regime, most mergers passed muster precisely because most mergers have procompetitive effects. In digital markets, this empirical, evidence-based approach to merger review encouraged venture capitalists to invest heavily in new tech startups. For many VCs, the draw is simple: the startup may become the next Microsoft or at least get acquired by Microsoft. Either way, the startup's founders and financial backers earn healthy profits, which rewards their risk-taking.

Relatedly, mergers provide a safe "off-ramp" for many entrepreneurs. While some startups maintain the same leadership for decades, others see their founders leave to start new projects. The freedom to leave one's business—and to profit—encourages bright minds and capital to keep chasing the next big idea. This in turn keeps innovation alive and thriving. But when merger review is ad hoc and based solely on the commissioners' personal views, as is the new policy, then competition and innovation are both hurt.

The FTC also recently reimposed burdensome prior approval requirements in a number of additional merger cases.[12] In a recent Commission meeting, the FTC voted to overturn a policy statement that struck a necessary balance between identifying and deterring anticompetitive mergers and ensuring that American businesses are not unduly burdened by overly cumbersome restrictions that stifle innovation, harm small businesses, detract from consumer welfare, or cripple America's competitiveness in the global economy. The statement was nothing more

[11] *Open Commission Meeting – July 1, 2021*, Federal Trade Commission (Jul 1, 2021).
[12] *Open Commission Meeting – July 21, 2021*, Federal Trade Commission (Jul. 21, 2021).

than a modest attempt to weigh the benefits of prior approval requirements with the costs they impose. The FTC should consider reversing course and readopting this policy statement to further encourage procompetitive mergers that benefit consumers.

Second, Chair Khan and other commissioners should rethink their hostility to Section 230. Contrary to the Chair's misguided characterization of the law as a "special" gift to tech giants, it's actually responsible for the internet's openness and for spurring competition and innovation in digital markets.[13] Because the law provides clear legal rules about who's liable for whose content, it encourages entrepreneurs to take risks: Rather than worry about potentially being liable for untold sums of money, entrepreneurs can instead invest their time and money in improving and growing their new business. Likewise, Section 230 entices venture capital. Because tech startups are high risk, VCs take solace in knowing that at least Section 230 protects platforms from uncapped, potentially ruinous liability.

To promote competition and innovation, the Commission should return to its old standard for reviewing mergers and rethink the intersection of Section 230 and competition policy. The truth is, without Section 230, competition in digital markets will suffer.

Conclusion

As always, we stand ready to work with the Commission to achieve beneficial outcomes that promote the interests of the United States and benefit American consumers and innovation. We appreciate your consideration of our views.

Sincerely,

Carl Szabo, Vice President & General Counsel
Chris Marchese, Counsel
Trace Mitchell, Policy Counsel
NetChoice

[13] *See* Jennifer Huddleston, *Is Content Moderation an Antitrust Issue? Section 230 and the Current Tech Antitrust Debates*, Competition Pol'y Internat'l (May 25, 2021), https://www.competitionpolicyinternational.com/is-content-moderation-an-antitrust-issue-section-230-and-the-current-tech-antitrust-debates/.