FORDHAM UNIVERSITY SCHOOL OF LAW
FORDHAM COMPETITION LAW INSTITUTE

45th ANNUAL CONFERENCE ON INTERNATIONAL ANTITRUST LAW AND POLICY

Fordham University School of Law
Skadden Conference Center, Costantino Room
150 West 62nd Street, New York, New York
Wednesday, September 5, 2018 — 1:45 p.m.

Antitrust Economics Workshop
Afternoon Session Sponsored by The Brattle Group

Panel 3: The *AMEX* Decision: What's Next?

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Panelists:
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MR. CRAGG: My name is Michael Cragg. I'm a Principal at The Brattle Group. Thank you for coming and joining us this afternoon for a discussion of the *AMEX* decision, which came out several months ago.

On the panel there are two economists, myself and David Evans. David has been very involved in the economic literature as well as the litigation around what has now become the issue of two-sided markets. I think you've written on the order of eight books and several handfuls worth of articles, many of them on this topic. So we look forward to his commentary in particular since it was so highly cited in the actual Supreme Court decision.

MR. EVANS: I got to sell books.

MR. CRAGG: I guess the other point I learned as I did a Google search on you is that Fordham was where you originally started your career.

MR. EVANS: It is. I taught at Fordham Law School for a good ten years back in the old building.

MR. CRAGG: Immediately on my right is Barry Nigro, who is joining us here today currently from the Department of Justice as a Deputy Assistant Attorney General. He was at Fried Frank, for —

MR. NIGRO: Off and on since 1999.

MR. CRAGG: You were the head of the firm's antitrust department for a little while. When he says "off and on," you were at the Federal Trade Commission as well.

MR. NIGRO: Yes.

MR. CRAGG: Presumably you're not speaking on behalf of the government but rather representing your own views today.

MR. NIGRO: Actually, I think even if I said that, I am speaking on behalf of the government, I'm told. That's an FTC thing.

MR. CRAGG: Okay. We'll make sure we don't ask you any questions then.

On my far right is Chul Pak, who is — I probably just bastardized your last name, so if I did —

MR. PAK: No, that's fine, Pak, yes.

MR. CRAGG: I'm doing better than usual.

Also, Chul is currently at Wilson, Sansini. I learned — we were kibitzing just beforehand — he and

Barry have known each other for years. I won’t say how, but part of it was from your time heading up the Mergers IV group at the FTC. Since then, you’ve been very active I’ve learned in a variety of different types of litigations across a variety of both legal issues as well as industry. You previously litigated a number of different cases on behalf of the government.

One of the topics that we’ll certainly be interested in today will be what the impact of this decision will be on litigation going forward.

MR. PAK: I can wear a lot of different hats, and we’ll figure out which hat I’m going to wear today as questions come along.

MR. CRAGG: Excellent. So the format today, it’ll be a Q&A. I’ll be posing questions to the panel, generally speaking. Please feel free to break in with your own perspectives.

Just to get things started, I’m curious: How many people have perused the decision that we’re going

to be talking about today?

[Show of hands]

So about half.

How many people have actually carefully read it?

[Show of hands]

MR. NIGRO: Notice nobody up here raised their hand.

MR. CRAGG: We didn't have a lot of close reads, and so as you guys are providing your commentary I think it'll be important to provide a lot of background, thinking from an educational perspective, as to what some of the terminology is that we'll be looking at.

Barry, if we can just kick things off with you, this question in the *AMEX* decision, the piece that is I think particularly important to economists and lawyers, is the introduction from a legal perspective of a two-sided market. That was really the key legal introduction.

Could you give us a little perspective on what that actually means?

MR. NIGRO: One of the things I worry about in this area, just like I do with the term "big data," is people use it as though it has implications that it is something that needs to be regulated. I worry that people when they say "two-sided market," all of a sudden they mean that it's something that needs to be treated differently. That may or may not be the case, so I think we need to be precise in what we're talking about when we talk about platforms and two-sided markets and things of that nature.

You can have a traditional vertical relationship, which is just a relationship between products or services at different levels of distribution that are not substitutes. They can be one-sided markets; they can be two-sided markets. I think the dissent in *American Express* said they're all two-sided markets, but they could be one- or two-sided, and the two-sided markets can have strong

indirect network effects or not, and the indirect network effects can flow in one direction or both directions.

All of that is to say when we talk about two-sided markets what we're really trying to do is understand the competitive dynamics and the proper way to evaluate those dynamics, taking into account the commercial realities of the market.

When I think about a platform, I think about a space. It can be a physical space, like a shopping mall, that brings consumers or users from two different groups together; it could be a virtual space, such as an app. It's just something that facilitates the interaction among different user groups.

I think whenever we're talking about two-sided markets it's important to be more specific if the purpose of the conversation is really to try to get to the heart of the competitive dynamics of the market. What we're charged with doing at the

Department of Justice is trying to figure out the implications of conduct, the implications of mergers.

MR. CRAGG: Thanks, Barry. One of the phrases you used, which I think is a very important phrase in the decision and one that everyone should take note of, is that the distinguishing feature for a two-sided market is that it exhibit "indirect network effects." That's at least my reading.

Do the three of you guys agree with that interpretation, that that's the distinguishing feature?

MR. NIGRO: I would say it's necessary but not sufficient. But the expert is sitting next to me.

MR. EVANS: In the interest of clarifying things and getting the terminology right, I think the one thing I would discourage people from using too quickly — and then I'll get to the question of indirect network effects — is the term "two-sided markets" because it quickly leads to confusion.

The economic literature is about two-sided

platforms, whether a business is a two-sided platform — and, Barry, I think you accurately described the characteristics of a basic two-sided platform.

Then the question for those two-sided platforms, whether it's a shopping mall or whether it's something like open cable connecting restaurants and users, the question for those platforms is then, who do you compete with? That then leads to the market definition question.

It could be the case that all of the businesses that are relevant competitors are two-sided platforms, and if you want to then use the term, that's then in a "two-sided market," then that's a perfectly fine thing to do.

But it's not necessary, when you start with an antitrust matter or a merger involving a two-sided platform, at least as a matter of economics, that the market only include other two-sided platforms. For example, in the case of a shopping mall, yes, it could be all shopping malls. It could also be retail

stores. In that case, that's a market. If that turns out to be where you define the market boundaries, that could be a market that has two-sided platforms — shopping malls — and also traditional retail stores. My preference is to refer to two-sided platforms, and then that leads to whatever market definition you have.

I would say, getting to the question on indirect network effects, that it is almost always the case — I could probably say it's always the case — that things we characterize as two-sided platforms have indirect network effects that flow at least from one side. So the defining characteristic is there is some interdependency between the demand for the two types of users.

The other defining characteristic that is mentioned in the *AMEX* decision which I think we should also note is that it is often the case for a two-sided platform that the pricing structure — how you balance the prices for the two sides — turns out to be an

important aspect of the business reality. If you think about indirect network effects, the importance of the price structure, and connectedness between the two sides, I think that pretty much covers the gamut.

MR. CRAGG: I was wondering if you guys could provide a couple of examples where you have an interaction between consumers where there are indirect network effects. I think that would be one example which would be helpful to the audience. Then contrast it with a similar type of setup but where there isn't a network effect.

MR. NIGRO: I'll take a stab at it. I'm not sure how good an example this is, but one where there are network effects, the Court used the example of newspapers and advertising to make the point that there the network effects flowed in only one direction. The newspaper was more valuable to the advertisers and increased in value as the number of readers increased.

On the other hand, the value of the

newspaper to the readers does not necessarily increase in value if it becomes nothing but a collection of advertisements. There the Court said that functions more like a one-sided market because the indirect network effects flow in one direction.

I guess something without network effects would be just a traditional retail model where a retailer buys a product from a manufacturer, takes title to it, and resells it.

MR. PAK: I think it's going to really vary — and I think we're going to deal with this a lot more in later discussions, and the economists will be incredibly beneficial — but a lot of it will be on the impact of the data and the pricing effects to the extent you can measure.

But I think what AMEX was trying to get at in distinguishing between the newspapers, for example, because it did give that example of the newspapers, but in the modern day you've got also a number of technology-type platforms, not necessarily payment

platforms, where you do have the network effects, where the fact that the consumer engages more in that platform then creates greater demand from the supply side for more providers into that platform, whether they're app developers or advertisers or something like that, and it does have that symbiotic component.

Whether there is going to be a tight correlation on price and effect, again that comes back to the data, and that will tell you. But I think, directionally speaking, that kind of symbiotic relationship is the network effect that does happen a lot in technology platforms today.

MR. EVANS: The example I love to give on indirect network effects is my favorite example, which is open cable. Open cable is a business where restaurants value the platform to the extent that there are more consumers that are potentially interested in the restaurant, and consumers are interested in platforms that have more restaurants that are potentially aligned with their choice of a

restaurant when they want to go out to dinner and so forth. That's an example where there are clear indirect network effects flowing between both sides.

If you take the restaurant itself, you don't really see those kinds of indirect network effects. One is a single-sided business — the restaurant — and the intermediary that is operating between the restaurant and the consumers is an example of a two-sided platform.

MR. CRAGG: Thank you.

In terms of proving whether there are indirect network effects or not, what kind of evidence does the case instruct us as being relevant? What kind of evidence can you imagine being put on in future cases?

MR. PAK: Again, I think the economists are incredibly important here. It seems to me this is the kind of thing where a question has been created, and the economists will dig into this immensely, and their data analysis will be incredibly helpful.

Certainly in the *AMEX* decision they were able to do a lot more of this robust pricing analysis because on the one side, on the supply side, they had merchant fees as a data point; and then, on the consumer side, AMEX could look to the value of its rewards and see if there was this balance that you talked about.

But I could imagine there are a number of other platform types — for example, search — where that's going to be a very difficult thing to measure because you'll have fees and whatnot that you'll charge to advertisers. But how do you quantify and measure with consumers, who aren't paying anything for that search? In other kinds of platforms you have similar — even open cable, where consumers come in and utilize it without paying anything, but there will be fees and whatnot to restaurants.

MR. NIGRO: I just have a couple of comments.

I agree with Chul that the economists are

going to be very important, and that is highlighted in the decision that came out two days ago in the *NCAA* case, the grant-in-aid cap case with Ken Elzinga. One of the reasons the court gave for not allowing him to introduce evidence of a multisided market is that he does not examine any economic data at all to quantify, test, evaluate, or confirm any of the economic relationships upon which his proposed multisided relevant market is predicated. This is maybe the first decision since *AMEX* came out at a trial court level. Economics will be important.

I think the other thing that is going to be important are the "commercial realities," to use the term that the Court used in *AMEX*. It talked about typically you look at products in a relevant market, you look at substitutes, but then it went on to say the Court should combine different products and services into a single market when that combination reflects commercial realities.

When you really focus on the *AMEX* decision

and you look at the brief that the Department of Justice put in, I think where this all comes to a head is on market definition. The Department was happy for the Court to take account of the efficiencies or network effects — the interdependence on the other side of the market, so to speak. We thought that should not be ignored.

Where we disagreed is that we thought that was the job of the defendants in the second step of the three-part analysis. We thought we established our prima facie case, and the defendants can come in and they can explain why in this two-sided market that the conduct that is being challenged is, on balance, procompetitive, or at least competitively neutral.

What the Supreme Court did is they said that in order to figure whether something is procompetitive or anticompetitive we have to look at it and measure something, so then we have to figure out, well, what do we measure? Then they said, "You have to define the market, even if you have direct evidence of

anticompetitive effect." They said we have to define the market, so we're going to define the market to be transactions.

As soon as you define the market to be a transactions platform, then you've effectively collapsed step one and step two in the DOJ test that was proffered. In a sense, the Court ended up taking account of some of the same thing that the Department thought should be taken account of.

But we had a different approach. I think a critical question in these cases is, what is it that you're measuring and how do you define the market, because that's going to govern the prima facie case as to what, the merchant side or transaction platform? Depending on the answer to that question, you head down two different paths, and the analysis looks a little different. You might get to the same outcome, but the way you get there is clearly different.

MR. EVANS: I don't think we want to relitigate the *AMEX* case.

MR. NIGRO: Especially since I didn't litigate it. [Laughter]

MR. EVANS: And we can anticipate — anyway, I won't say that.

I was going to say, Mike, one point that I was going to ask you about. You would agree that any decision that raises the demand for economists is obviously a good decision, correct?

MR. CRAGG: I'm the progeny of an economist, so I don't know if my children will be economists, but yes, I think in general from a self-interest perspective, more demand for economists is good.

MR. EVANS: It seems social welfare maximizing to me.

To pick up on Barry's point, I think the issue going forward given the *AMEX* decision is how you go about defining markets, and that's going to be the usual fact-intensive inquiry, which is going to be some combination of business documents and econometric exercises.

I don’t know what Ken put in in *NCAA*, but I would expect that typically in these cases you’re going to find that there is an awful lot of interesting detail in how businesses operate, in terms of how they take the demand from each side into account in running their businesses and setting prices and so forth, that is going to be instructive on the extent to which it’s a two-sided platform.

In some cases there are going to be opportunities for sophisticated econometric studies on indirect network effects, basically studies on demand and the relationship between the two sides, and we’ll have economists doing those kinds of studies.

I see this area as, like every other area that antitrust economists get involved in., it’s going to be data-intensive. It’s going to require some economic analysis, but it’s not inherently any more complicated than lots of other stuff that we do all the time.

MR. PAK: It does, though — speaking of full

employment not totally tongue-in-cheek — make litigation much more complex and difficult. As soon as someone says as a defense, "I've got a two-sided market," you've got to litigate that now. That's not a motion to dismiss. That then requires discovery, you're going to go through summary judgment, etc. I'm not even sure a jury can take in all that kind of complex economic information.

MR. EVANS: I really disagree with that. First of all, it's not obvious to me why it's not a motion to dismiss. But, second of all, there's this flavor — and it came in some of the amicus briefs in the *AMEX* case — that this is somehow really complicated, a lot of disagreement, and lots of things can be two-sided markets, and so forth.

But in the economic literature there's not a lot of disagreement. You look at the literature from 2001 to the present, there is a lot of agreement on what are two-sided platforms; there is a lot of agreement on what are not two-sided platforms. There

may be marginal cases, and there may be debates about that, but I think if someone walked in and said: "I'm a restaurant; I'm a two-sided market" or "I'm a retail store; I'm a two-sided market," why is that not a motion to dismiss because there is no evidence to support that?

MR. PAK: I think as a plaintiff you would say, you look at the *AMEX* decision, I've made the factual allegations that this is a two-sided market, and I'll make allegations about small but significant nontransitory increase in prices (SSNIP), etc. You can't dismiss me because the Supreme Court says you need all this kind of data and the analysis, and I need to know what's going to happen on the supply side, on the consumer side, etc.

MR. EVANS: The *AMEX* decision is firmly grounded at the beginning of the decision in the economic literature on two-sided platforms, which more or less follows the definition that Barry gave: It's connecting two distinct types of consumers; there's

indirect network effects; pricing is important.

Sure, if someone can show that those features are important for the business, then I guess I agree with you. But it seems to me that there is a whole class of businesses where those features are not obvious at all and you'd have trouble getting respectable economists at least to come in and argue that it's a two-sided platform. I mean, I suppose you could always find someone to do it. As I said, there's not a ton of disagreement.

MR. PAK: I agree with that. You can always find someone on the economic side to say —

MR. NIGRO: What David is saying is there are a lot of cases where there's not going to be much for him to do.

MR. EVANS: I think that's right.

MR. NIGRO: I tend to agree with Chul, though, that the question has built into it that it's going to depend on the facts, and as long as facts are relevant — and I don't see how else, when we talk

about the commercial realities, that's a fact question — I think it will tend to be the type of thing that will be hard to get rid of on a motion to dismiss. But in the *NCAA* case it was a motion for summary judgment where the judge tossed it.

MR. CRAGG: If I can provide a couple of comments as well.

In terms of whether a jury can comprehend this or not, I spent the better part of two months in the *Sabre* trial working for US Airways. One of the unique features of that trial was that at the end of every witness the judge gave the opportunity for the jurors to write down questions and then she selected from those questions which ones to have the witness address.

What was interesting was that as the trial went on — and I would say right from the very beginning — the jury I thought exhibited a high degree of sophistication in the types of questions that they were asking. The lawyers certainly had the

perspective that it was going to be challenging for a jury, but I think on the whole most people who were there were surprised at the degree of sophistication that the jury was able to bring to the questions that they asked. I think that speaks well as to whether or not these are comprehensible issues or not.

The other observation I would make is that this term, "indirect network effects," the question is — this is a question for lawyers — is that now a legal term in that it then allows the lawyers to present facts which relate to what they'll label as indirect network effects; or do you need an economist to actually be able to look at the documents, look at the factual evidence, and be able to say, "Oh, that's a network effect and that's not a network effect"? How would the proof go, do you think, as we move forward from these cases?

MR. PAK: It's interesting when you read Justice Breyer's dissent. He said, "I looked around for the terminology 'indirect network effects' in

legal cases and I couldn't find it." I think he might have even included two-sided markets, but I can't recall that one. But I do remember him saying, "Jeez, I don't know what indirect network effects look like."

It seems to me, now that the decision has come out and that is an element of the proof, if you have a two-sided platform and you want to fit your case into that, you're going to have to now litigate this, and it is going to be defined by the courts, and it is going to be data-driven, it's going to be price-driven, and you're going to have to put together a lot of economic evidence as well as anecdotal, customer-type evidence to show that what happens to me as the platform on the supply side or the merchant side, for example in the *AMEX* case, is going to depend in part upon what happens to me on the consumer-facing side and vice versa, and there is not going to be that symbiotic type relationship.

It can be in the form of, like in the *AMEX* case it'll be data; it'll be anecdotes about what

happens in competition and how do I hold on to my consumers, etc.

MR. CRAGG: Is it possible to try a case like this without an economist?

MR. PAK: Getting back to that notion, to me what the risk is — I appreciate very much the fact that there are very sophisticated jurors and quite often they can be very enthusiastic. But if you're representing a company and that company's business model is based upon a platform and you're now going to throw the legitimacy of that platform in front of a jury, that to me seems like a huge risk, and many general counsels and executives wouldn't stomach that and would say, "I'm going to settle."

That's my point about the litigation risk associated with these kinds of issues. It's a new layer of risk. You may never get to the trial level.

MR. CRAGG: One of the amicus briefs that were provided to the Court which was signed on by a variety of high-profile economists expressed a great

worry about what the impact of *AMEX* could potentially be in the future if it was decided broadly, namely that is was essentially a "Get Out of Jail Free" card for defendants. Namely, any defendant could argue that their business is a two-sided business, and therefore it raises the burden of proof on the plaintiffs if they haven't dismissed the idea from the outset that it's not a two-sided market.

I was wondering if you could comment on that, and whether you see this being a broad decision or a narrow decision, and how it might play out in the future.

MR. EVANS: I can take a crack at that.

First of all, I'm currently working on complainant cases involving two-sided platforms, so I sure hope that it doesn't kill that side. I don't think it will.

There's no basis in economics, I don't think, for the belief that somehow by recognizing the realities of two-sided platforms that somehow that's

going to lead to a bias on the plaintiff’s or the defendant’s side.

One of the arguments that Dick Schmalensee and I made in the amicus brief that we presented to the Supreme Court is that if you do a single-sided analysis you run the risk of both false negatives and false positives. It’s easy to see why that’s the case, because an important feature of two-sided platforms is benefits and costs, which are interdependent, that arise on both sides. Depending upon where you do the accounting, if you focused on one side, you could end up doing a calculation that showed net harm; or you could do a calculation that showed net benefits and come up with an opposite calculation if you do it at the platform level.

The easiest way to see this is to think about predatory pricing cases. Predatory pricing cases, if you take a one-sided approach, given that we know that a lot of these platforms price below marginal cost as profit-maximizing competitive

behavior, you clearly run into a false positive if you treated it on a one-sided basis.

A good example of that is in France. There is a case involving Google Maps, where a lower court found predatory pricing because Google Maps was free, and the Paris Appeals Court, doing a full-blown overall analysis, rejected that conclusion.

But think about it on the other side. One way in a predatory pricing matter that you could engage in predation is — let's suppose that we all agree that all competitors charge a price that is subsidized, free, or below marginal costs on one side. So I, dominant firm, in order to prey, reduce the above-marginal-cost price on the other side so that it's still above marginal cost but lower, and the effect of that is to basically make it unprofitable for my competitors to compete. If you don't do the full analysis, you're not going to discover that.

I think it's generally true that the errors can go in both directions in these cases, and I just

don’t see as a matter of economics why there is this belief that somehow this is a defense decision. You take business realities into account, and by doing that you hopefully come up with the right answer.

MR. PAK: As to whether or not you read it narrowly or broadly, it’s going to vary, I think, with each court. One reason you might read it narrowly is simply because of the way they define the market as a transaction market. But I would argue that the underlying rationale of the case has broad implications for multiple types of technologies and platforms.

The beauty of the case, or what I would call the benefit of the case, is the very fact that it recognizes cross-platform inefficiencies that arise out of these types of platforms on the consumer side as well as on the supply side. The very fact that it recognizes network effects and the benefits of indirect network effects is a huge leap forward in the thought process that should have broad implications.

MR. NIGRO: At the Department we're still studying the decision. I agree with Chul that the principles on which it's based are not necessarily limited to credit card transaction platforms or transaction platforms per se.

On the other hand, I don't think any time you have a so-called "two-sided" platform that you automatically as a defendant win the case. The Court made clear that if the interdependence is weak or minor, that is not necessarily enough.

I think in the end you're really trying to understand the competitive dynamics, and is the interdependence such that one side of the platform is going to constrain the price on the other side. The Court says that in Footnote 1. It makes that point.

Again, we're still thinking about how to interpret the decision and apply it. But I would think if the answer to that question is no, the hill could be steep for arguing that because it's a two-sided platform and defense wins.

On the other hand, if the answer is yes, then it seems that that's something that should be taken into account at some level and shouldn't be excluded because otherwise you're only looking at half the picture. Our job as enforcers is to really try our best to get it right to the extent that we can and looking at the competitive dynamics and the commercial realities as best we can.

If the economics and contemporaneous business documents and testimony all point in the direction that, yes, the business is really focused on the pricing balance between the two sides and that's what's driving its behavior, then maybe it is a transaction platform or has the same characteristics and should be looked at as a whole.

On the other hand, if that's not what the evidence shows — I don't think that every platform automatically is a so-called "two-sided market" that benefits from *AMEX* — I think it's a fact question and needs to be carefully considered in each and every

case.

MR. EVANS: I agree with that. I think the *AMEX* decision is also a good example of not falling into the trap that once you define it as a two-sided market the defendant automatically wins.

In *AMEX* there's nothing in principle that says that given those allegations the result of the anti-steering provisions was in fact to increase the transaction price and to reduce the output below the competitive level. There could be a set of facts that would support that, and in fact I believe DOJ would argue that it presented that set of facts to the district court and should have won on a two-sided market analysis. In principle, there's no reason in that kind of case that just because it's a transaction platform why it wouldn't be possible to show anticompetitive effects.

MR. CRAGG: I think it's very helpful that you guys are emphasizing that the case is about a transaction platform; the product was defined as a

transaction. The Court it seemed actually tried to distinguish American Express from Visa and Mastercard by recognizing that not only do they provide transactions but they also provide consumer credit, so that's potentially a different dimension of the product.

What seems to be missing from the decision is guidance on how do you deal with product definition when you don't have a transaction platform. I'm curious if you could provide some insight into how that might be resolved in the future given the lack of guidance, at least in my reading of the decision. You might correct me in my reading.

Barry, do you want to take a stab at that?

MR. NIGRO: I think that's a hard question. I'm not sure that I know the answer. That was, as I said earlier, one of the critical differences between how the Department approached the question in this case and how the Supreme Court approached it.

The Department started by focusing on the

merchant fees and said there was direct evidence of anticompetitive effects, no need to define a market or look at market power.

The Supreme Court said, "Well, in order to figure out whether there's direct evidence of an anticompetitive effect, we need to ask 'In what?'" and so we do have to define a market, not for purposes of defining market power but to figure out whether there was an effect in that market.

That to me is the critical question because if it's the platform, you may have one set of competitors, and if it's one side of the market at least to start, you would have another set of competitors. I don't know that there's a simple answer to that question.

MR. CRAGG: Chul or David, do you want to provide us some perspective on what do you do if we're not talking about the product definition being a transaction?

MR. EVANS: I heard two things really, Mike,

in your question.

Just starting with transaction platforms and credit cards, I thought before you moved off from transaction platforms you were raising the question that even within the context of transaction platforms it's complicated because there are different products and services that are in a narrow sense being provided to different customers, in the case of some credit and different things being provided to customers, and how do we deal with that?

I don't think that's a unique problem with two-sided platforms because a lot of times we deal in cases where there's bundling and consumers are getting different variants of products and so forth, and they need to be sorted out and we need to come up with price indices and aggregate them in some way. But it does raise complexities even in that case.

Then I think the next question is, when we say "nontransaction" platforms, well, what is that? What are these nontransaction platforms? If you read

the decision, the term “transaction platform” comes from a paper by Filistrucci, Geradin, Van Damme, and Affeldt, and they basically make a distinction between transaction platforms and what Chul was talking about, ad-supported platforms. That’s really the distinction that’s being made, transaction platforms on one side and then ad-supported platforms on the other side.

Then you have other complexities that need to be dealt with, including how you sort that out from the statement in the decision on *Times-Picayune* and so forth. That’s a whole other set of issues.

MR. PAK: This entire market definition issue, as Barry says — and I agree with David — is incredibly complex, and I don’t think I know the answer either.

I find one, a bit of a tangent. One issue that came up in the case that I found fascinating because you don’t see it laid out in the Supreme Court quite often is raised by the dissent, which is this very question of whether this is a two-sided market or

whatever the relevant market is, we shouldn't even be asking that question because we've got evidence that the district court found of direct anticompetitive effects on multiple fronts.

The Supreme Court, because it was the minority decision, didn't come out and say, "We don't need definitions of relevant markets," but that typically — and as Barry knows from the DOJ litigation — there were both substantive as well as strategic reasons as to why you don't want to get bolloxed down into what is the relevant market.

I think the case here and the question addressed here raises that very fundamental issue: If you believe you've got evidence of direct anticompetitive effects, but the case law always says, "Well, I need to know what's the relevant market?" and then you start tackling that issue, you sometimes can lose the big picture of "Don't we see harm?" But now we have to come up with a market and how we're going to define that market. You can get tripped up on that

issue and not see the ultimate harm effect.

I suspect part of the DOJ's strategy is to avoid that analysis.

MR. NIGRO: So the case argued direct effects and also indirect through market power. Eventually, on appeal the indirect argument was dropped, and the case by the time it got to the Supreme Court was left based on the direct effects.

MR. CRAGG: I guess the issue seems to be whether you agree whether there are direct effects or not, right? Ultimately, that's the chief issue that was tackled by the Court, to say that unless you take account of both sides of this market you can't determine whether high prices on one side is sufficient evidence to determine that there are direct effects.

MR. EVANS: That's the fundamental policy issue for this area, which is, when you have two-sided platforms and you have two groups of customers that are interdependent, does it make sense from a policy

standpoint to treat them separately and allow the possibility that harm to one group of customers is counterbalanced by benefits to the other group of customers?

That's the fundamental policy issue, and the Supreme Court came down on the side of, "Well, if they're interrelated and you have this kind of funny pricing structure going on where harm here may mean benefits here, you need to take them both into account." To me that seems like a sensible thing to do, but that's a policy judgment. It seems to make sense.

MR. PAK: When you look at the decision itself, I thought the dissent and the majority sometimes talked past each other on the facts. I didn't deal with the underlying facts well enough to know what was true and not true, but to David's point of trying to balance basically the majority was saying that on the merchant fee side, yes, the merchant fees were going up, but those higher fees were being

reinvested in higher rewards for consumers, and those consumers then stayed loyal to American Express, brought more high-margin business to retailers, and that net was a balance. Consumer welfare I think was equal, whereas the dissent said, No, there wasn't a net-net-zero. In fact, the higher merchant fees didn't translate into dollar-for-dollar greater rewards and whatnot.

I couldn't tell from the decision as to whether or not it was —

MR. EVANS: So there's a debate over this. Let's suppose that we agree that the facts showed that merchants were harmed and consumers benefited. There are arguments in *AMEX* as to why that wasn't the case, but let's assume we have a platform case where the exclusionary behavior is on the merchant side allegedly, and the effect of that exclusionary behavior is not only to benefit the consumers — people — but benefit them more than financially the merchants are harmed.

It is hard to imagine for me any policy reason why in that kind of situation you wouldn't want to take the benefits to consumers, to people, into account. I can see from a policy standpoint that one could argue the reverse because merchants are people, but I don't understand how one could argue that when consumers are harmed on net why one as a policy matter wouldn't want to take that into account.

MR. PAK: I agree with you entirely. I was talking about the factual distinction in the case that made me think I'm not quite sure exactly which way it was ultimately coming out. But clearly if the merchant fees or the higher cost on that side is being redirected to the benefit of the consumer side, net-net on balance equal, I agree with you.

Quite often technology platforms are created in that fashion. I don't know necessarily the cost, but the network effect component is how products get created in technology platforms in the first place, and without that you're just not going to have the

innovation and the new kinds of products that are out there, the new kinds of platforms, without giving credit to the fact that what is happening is beneficial to consumers as well as the suppliers.

MR. NIGRO: I think we have to be careful because I hear people talking about anticompetitive conduct on one side or price increases on one side benefitting another side. I think it's important that those sides are related, maybe even closely related and interdependent.

Surely you couldn't justify an anticompetitive price increase in order to provide an unrelated good, let's say heart surgery to poor people. Otherwise, you could justify all kinds of price fixing and everything.

They have to be related in some way, and the Court talked about the simultaneous nature of the transactions, so that's probably the most closely related interdependent market you can get. That seems relatively easy from the Court's perspective. Then it

distinguished that from the newspaper advertising example where the interdependence was weak because the indirect network effects flowed in one direction.

Then there is this whole gap between those two extremes, and the question is where you draw the line. I think that's the hard question.

MR. CRAGG: I think that's another dimension of the decision which is important to recognize, is the notion of simultaneity and that in many instances you'll have a platform where the activities aren't happening simultaneously.

You take a gaming system, for instance, where you'll have game developers on one hand producing for the platform, and then the game may or may not take off and grow, and consumers on the other side of the platform to utilize the game. It doesn't seem like the decision gives us much guidance on how to think about that.

Another dimension that the platform decision doesn't also seem to take account of is that as,

Barry, you were noting, and that, Chul, you were noting, a lot of the pricing behavior that economists are interested in is around pricing that allows you to grow the platform. There is an assumption in the literature that growing the platform and balancing the prices on both sides of the platform in order to grow it most rapidly to the largest size possible is what's driving the behavior.

Ultimately, as the platform grows, one of the ultimate issues is that the network effects become a barrier to entry. I'm curious how you guys think or whether there will be cases that differentiate between relatively new platforms versus older, established platforms, and how you might think about that.

MR. EVANS: I disagree with the premise. The economic literature doesn't have a theory that says this is all about growing platforms. The main body of economic theory is an equilibrium theory where in long-run equilibrium these pricing structures emerge as the profit-maximizing pricing structure.

It’s not simply an artifact of starting a platform and growing a platform.

The way to see this practically is if you just look at a lot of platforms that are very old — shopping malls are half a century old, shoppers get in for free, stores pay; ad-supported media, typically the reader’s side gets subsidized., newspapers are generally not really sold at above marginal cost, and advertisers pay; credit cards have had rewards for a long time. The pricing structure, this kind of balancing where one side gets a deal and the other side pays a premium, both in theory and in fact that is a long-run attribute of platform businesses. That’s the premise that I don’t agree with.

MR. CRAGG: In theory the guiding principle is what happens at the margin. In thinking about what the network effects are then for a platform that is being newly formed versus one that is well-established, presumably the network effects that determine pricing will be different at the margin for

those contrasting platforms.

MR. EVANS: Yes, but if we're going to characterize businesses based on business realities, we have businesses that obviously have significant indirect network effects, even if those network effects happen to diminish with quantity. So we have a set of businesses that are characterized by significant indirect network effects, from telecoms to big online platforms to shopping malls and so forth, but they still have indirect network effects, and they are still platforms, and they're characterized as the business model and they're characterized as the pricing relationship.

I can't see what the economic theory would be that says that we — maybe the analysis of pricing effects and so forth will vary depending upon the degree of indirect network effects and the stage and so forth, but in terms of whether something should be characterized as a two-sided platform I don't think there is a I'm-a-two-sided-platform-when-I'm-a-

teenager-but-I-get-over-it-when-I'm-an-adult kind of thing going on.

MR. PAK: My son hasn't gotten over it. He's still a teenager, it seems to me.

MR. EVANS: But by the time he's fifty —

MR. PAK: Right.

MR. NIGRO: He takes your money and spends it. So it's a one-sided platform.

MR. CRAGG: I think what I'm trying to get at is that the nature of the competitive outcome for what prices will look like as a theoretical proposition will change as the size of the platform population changes.

MR. EVANS: But they don't. Maybe in some cases they do, but if you look by and large at two-sided platform businesses over their trajectory — and maybe there's path dependence here — it's not like platforms start with one pricing structure and then they evolve into another pricing structure.

Credit cards have been essentially

subsidized to the user since they were born in 1950; open cable has had the same model of charging restaurants a buck a seat and making it free to the user since it was started in 1998; shopping malls have always been free to the shopper and charged to the retailer. You can go down the list.

MR. CRAGG: I don't think that's —

MR. EVANS: You're making a different point or —

MR. CRAGG: No, no. That open cable, for instance, has changed its pricing policies to both sides of the platform over time.

MR. EVANS: Not much.

MR. CRAGG: No, no. The point is that it is changing it.

MR. EVANS: How is it changing it?

MR. CRAGG: The charge to the restaurant has changed over time.

MR. EVANS: No, it hasn't.

MR. CRAGG: Yes, yes. And the benefit to

the consumer for multiple bookings has changed.

MR. EVANS: But basically open cable is free to the user. There has been some introduction of rewards over time, and there are fees for —

MR. CRAGG: No, but I think you're missing the point entirely, which is the structure may stay the same.

MR. EVANS: I often do.

MR. CRAGG: The structure may stay the same where you have a benefit conferred to one side and a cost to another, but the relative mix of those benefits and costs do change over time.

MR. NIGRO: Think of it this way. If there are network effects, you're saying the network becomes more valuable as more users plug in, right?

MR. EVANS: Yes.

MR. NIGRO: So how is that value captured? I guess you're asking can maybe this relationship, the interdependence exists, but the way you capture that value might change as the value increases.

MR. CRAGG: The question for the platform owner is —

MR. NIGRO: Is that what you're asking if I understand the question?

MR. CRAGG: The question for the platform owner is, at the margin what do I need to pay either side of the platform to attract additional consumers? That's the balancing that matters.

MR. EVANS: I'm still not sure I understand the point. Maybe the details of pricing change a bit, but the inherent pricing structure sometimes changes. Magazines in the United States used to be completely subscription-supported and then they became ad-supported, so there are flips like that that happen. But by and large empirically I'm hard-pressed to see very many examples of platforms that have had fundamental changes in pricing structures. I suppose it could happen. I just don't know many examples.

MR. CRAGG: The issue wouldn't be fundamental changes; the issue is around relative

price changes, and that I think speaks to whether there's market power that would be of interest to either a regulator or someone who is affected by that. That's the only point.

MR. PAK: But doesn't it depend upon the nature of the competition? In other words, size alone doesn't give you market power. I've heard people say that it's not so much the quantity of data that you have but how well do you utilize that data, and then able to translate that into something that a buyer might be able to utilize that generates money for you.

It seems to me that in this day and age looking at it the people who are able to utilize that data and transform it into something that they can sell is getting much more sophisticated and better and better. Therefore, it seems to me the nature of the competitors changes, and doesn't that bring down the price ultimately as opposed to your internal change in business model, whether incremental or whatnot?

MR. CRAGG: Certainly the nature of the

product that you're considering is going to matter here. You're emphasizing the quantity of data, for instance, on an ad-based system or a retailing-type system. Do you make better use of it as opposed to just the pure quantity of it?

MR. PAK: Exactly.

MR. CRAGG: For sure.

We've identified so far some of the critical aspects of the decision as it regards what is two-sidedness and product definition.

One of the questions now is: Assume that for the moment there is market power, that in some way the defendant has been shown to have an ability to exercise market power in its decisions about how to price its product. What kinds of practices in a platform are things that either regulators or those who are being exposed to the platform in some way need to be worried about?

MR. PAK: The *AMEX* one is a good example of this. Whenever you're found to have market power,

courts and regulators have often focused on business practices that tell the entities that that business is dealing with, “You can’t do something with another rival.” That seems to always be the linchpin; that’s a no-no.

Whereas if you focus more on what you and your suppliers or customers can do without referencing rivals, it’s a nuance, but that seems to me — looking at regulators and how they think about things — that’s more permissible than when you say, “You can’t do something with my rival.”

MR. EVANS: Let’s suppose that in the early 1960s American Express, which was then the dominant credit card platform, had a policy where it told merchants that they could only exclusively accept American Express cards, or they had some kind of extreme most-favored nation (MFN) provision that made it difficult for other credit card companies to come in and recruit merchants? That kind of practice would have denied Visa or Mastercard, for example, access to

merchants and would have made it very difficult for them to get the critical mass of merchants necessary to attract consumers.

Generally, practices on the part of platforms may very well have procompetitive effects, but the thing to worry about is practices that prevent rivals from either acquiring or keeping the critical mass that's necessary for these indirect network effects that we've talked about. I would worry about those.

MR. CRAGG: Yes. Is it then less of an issue when there are rivals that are well-established, or does that not matter?

There are two circumstances you can imagine: One is an entrant trying to come in and establish itself, and the other would be that you have, as in the credit card case, several different platforms that are competing with each other.

MR. NIGRO: I would tend to go back to Chul's example. I always think about positive

restrictions and negative restrictions. This is an oversimplification, but if you think about exclusive dealing arrangements, a positive restriction that encourages investment is easier to justify and defend than a negative restriction that says don't do something. That's not to say that you can't have negative restrictions that are procompetitive or positive restrictions that are anticompetitive.

I think the question is whether the restriction that you're talking about forecloses entry or makes entry more difficult. Obviously, if there are more competitors in the market and the market share of the firm that's engaging in that conduct, that's all going to be relevant to the competitive dynamics, but if it's a restrictive practice that is making entry more difficult and there isn't any offsetting procompetitive justification, it's hard to see how that would be lawful.

MR. CRAGG: Just to wrap things up, speaking to the political economy of this topic, do you imagine

that if given the bipartisan group of attorneys general who fought the *American Express* case, do you see states that are potentially going to seek changes in their state antitrust statutes which will limit the impact of the *AMEX* decision?

MR. PAK: It certainly wouldn't surprise me if that did happen because what the *AMEX* decision is talking about is the impact upon merchants, and merchants are typically local business.

We saw in the *Leegin* case and resale price maintenance legislation and actions taken by the state AGs following *Leegin* there is I think a nascent or maybe established political economic desire to protect merchants at the local level, so it would not surprise me if state AGs and legislators look for ways to undercut the *AMEX* decision because it does I think make it more difficult to bring a case against large platforms.

MR. NIGRO: I think it's hard to predict what'll happen. There is some value to having a

uniform set of rules that businesses can adhere to. If there is divergence, I think it would be unfortunate. It would create opportunities for forum shopping and create confusion for the business community. But who knows? It has happened before.

MR. EVANS: I think the worst thing that happened to the area of two-sided platforms when it comes to antitrust is that so many of the cases have involved credit cards because it has turned into basically a referendum on what you think about cards. I think the reaction to *AMEX* is from this almost bipartisan distaste for cards.

MR. CRAGG: The other aspect of the decision is that the United States as a result of this decision is adopting a new concept, namely that having the potential for the economics of a two-sided market being important for the analysis of competition policy. That's a relatively unique position in the world now. How do you imagine this getting reconciled with authorities elsewhere? The alternative would be

that I mischaracterized where we are and that in fact other parts of the world have implicitly adopted the two-sided economic view, now legal view, just with a different language.

MR. EVANS: There are different approaches that have been taken. The United States has taken the approach of really diving into the market definition question. In Europe, the European Court of Justice in *Cartes Bancaires*, which is an Article 101 case, took a different approach than the Justice Department recommended. It's still two separate markets, but then in terms of evaluating competitive effects they combine the two markets together in order to net out the competitive effect. So that's two separate markets but combined for the purposes of establishing competitive effects.

China, not quite as developed, but really looking at the two-sided things after doing separate market definition but then taking into account in the market power and competitive effects stage.

The general two-sided framework is resonating around the world. I think the divergence is really the extent to which you define a single-sided market versus a two-sided one as opposed to whether you need to take both into account.

MR. CRAGG: Let me give you each one last assignment, and then we'll open things up to questions, if there are any.

Could you give your primary takeaway as to what the audience members here should focus on as they think about learning from this precedent?

MR. NIGRO: As I said earlier, I think the critical part of the opinion has to do with the strength of the interdependence and whether the "commercial realities," to use the Court's term, are such that the firm is taking into account both sides of the market when it sets price in the broad sense. The Court indicated that in Footnote 1.

Obviously, the big question is, what market do you look at when you're making those judgments?

Even where you have direct evidence of anticompetitive effects — at last under *AMEX* as I read it — you need to ask in what market. I think the whole case comes down to Pages 10, 11, and 12, and Footnote 7. If that's all you read, that's the meat of it.

It talks about the relevant market definition, the interdependence, and where the exceptions are. I think a lot of us will be spending the next few years trying to figure out where to draw the line between the newspaper advertising market example and the transactional platform where you have simultaneous activity on both sides between different user groups and the interdependence is most pronounced.

MR. EVANS: The weather is beautiful out there. We're going to have some more warm weather. I recommend that you all go to the beach, get a copy of my book, *Matchmakers: The New Economics of Multisided Platforms*, and lie there, perhaps with the *AMEX* decision if you want to be bored as well, and just

read that.

MR. PAK: I second that.

To answer that specific question, though, when you look at the market-definition component of these two-sided platforms, that's to me very technical, and whether you can squeeze your case into that or get your case out of that, that's very fact-specific to me and data-driven.

I think what's more lasting about the case is the fact of the recognition of the benefits of two-sided platforms. In particular, I disagree with Barry. I'd say the last page of the majority decision is basically the most important because to me the *AMEX* decision is another way of looking at vertical relationships and interdependence and interbrand competition.

It's basically saying if you are in a two-sided platform kind of business, there are benefits that arise out of that business, and what you're trying to do is distinguish yourself and innovate, and

that’s the kind of interbrand competition that we want, particularly in the technology sector.

MR. CRAGG: As the moderator I can choose to have the last word, which I’ll take that option.

In terms of the most important advice that I would have for you, I thought David was very astute in telling the audience, “Don’t use the term ‘two-sided’ as a way of instructing yourself on what is going on here,” that the number-one thing to be thinking about is: Are there feedbacks that create a need for differentiating the product and market at issue from traditional vertical relationships?

MR. NIGRO: I can’t believe we made it this long without using the word “feedback.”

MR. CRAGG: That to me is the piece that if you keep your eye on that ball then you won’t be led astray.

Our time is up, right?

MR. KEYTE: Yes, but you can have a question or two.

QUESTION [Pinar Bagci, The Brattle Group]: A couple of comments and a question. In one of the comments, Mike, you mentioned about platforms reaching a sort of tipping point, and David, you said you didn't think that it was entirely relevant.

In the European context at least, regulators have been receptive to ideas about platforms reaching a minimum scale, and they've been receptive to ideas about a pricing structure for a limited period of time until a platform reaches a critical mass. Do you have a view on that?

MR. CRAGG: I think you actually characterized — the difference between the two of us is a little different, but I think it's a good question nonetheless.

QUESTIONER [Ms. Bagci]: Maybe I'll just continue for a bit. For example, like the SEPA direct debit schemes in Europe which have been approved for an interchange for a limited period of time until the platform reached a critical mass. Perhaps it's more

of a comment than a question.

The other thing is about the pricing structure once platforms reach a critical mass. I can think of two. Facebook never had ads, and now Facebook has ads, which changes the consumer experience. From a consumer benefit perspective, my benefit has gone down. Perhaps I'm not paying anymore, but I have to look at ads.

I was thinking YouTube is the same thing. Now there's a subscription service, which means that the quality of the service that I got before has been changed. Both of these changes seemed to occur from a consumer perspective when the platforms reached a certain size.

MR. EVANS: I disagree with you in the case of Facebook just factually. Facebook had ads I think starting within the first year, not to a large degree, but they had ads on Facebook very early on. I think if you go to the early histories of Facebook, Chris Hughes was in charge of the early ad sales. I think

this is as of early 2005.

I think ads on Facebook have been there from the beginning. Ads on YouTube were introduced I think after the acquisition by Google, but that's two years into the history.

But I'm not sure what the point is. Yes, consumers may not like ads. I'll stipulate.

QUESTIONER [Ms. Bagci]: The point was when platforms reach a critical size is there a change in the pricing structure? I was trying to find evidence of that. Because you were saying you didn't think so, that you say the pricing structure doesn't really —

MR. EVANS: I think YouTube is a good example of that, and Facebook is in the sense that the volume of ads on Facebook has increased over time, and YouTube adopted a no-ad policy as have some of these other platforms for some period of time until the platform got off the ground and had critical mass. There's a change in the pricing structure in that way if you're thinking of ads as part of the pricing

structure.

I’m not sure whether you were making a consumer welfare point as well.

QUESTIONER [Ms. Bagci]: Diminished quality—

MR. EVANS: But wait a sec. The thing about ad platforms —

MR. NIGRO: Isn’t this a commonsense thing, though? When someone comes out with a new product, they are trying to get a bunch of eyeballs, so they just push it out there and make it as attractive as possible, and once they get all those eyeballs, then they’re like, “Okay, now I want to monetize this.” I thought that’s how all these businesses worked.

MR. EVANS: A lot of them do. For that kind of content business, consumers may not like ads, but they like content, and they get content because people are willing to pay for ads. So there is a feedback effect between the advertiser side and the user side that’s intermediated to the content, but for those kind of platforms if you impose a restriction, for

example, that they can't have as many ads and reduce the revenue stream, that has to have an impact on the content, which has to have an impact on the consumer value.

MR. CRAGG: James.

QUESTION [James Keyte, Fordham]: A broader question. What does the decision say about nonprice vertical restraints where you define a market, two-sided platform, so you have a market definition that gives the output is this transaction. And then, essentially, you have what appears to be harm to rivals, maybe raising rivals' costs, kind of per Chicago theory. But the Court had a footnote that kind of suggests, "Hey, at the end of the day it's a nonprice vertical restraint and the interbrand form of the rivals may not really matter if output is increasing those other transactions. I just want to see if there was a reaction to that dicta in the case in terms of where the Court is headed on nonprice or settling on nonprice vertical restraint?

MR. PAK: That’s what I was referencing. At the end of the majority’s decision I thought it was very interesting, but it did frame it as interbrand competition in a vertical relationship, and I was thinking to myself, *Well, I think the basic message is AMEX needs to do certain things to protect itself and compete vigorously against Visa and Mastercard*. To me, that did not seem terribly new or different in that regard.

QUESTIONER [Mr. Keyte]: I guess, of course, did the raising rivals’ costs theories kind of take a hit because when they’re saying, “Look, output is the focus. So, if they’re harming each other while output is growing and they’re not a dominant player, there’s an implication that consumer welfare is not at risk.

MR. PAK: That was part of the analysis, that output seemed to have been growing throughout the entire time.

QUESTIONER [Mr. Keyte]: Right.

MR. CRAGG: I thought the fact that was

really important to the Court there was the degree to which AMEX holders are multi-homing by holding Visa cards and Mastercards versus the other way around, where Visa and Mastercard holders aren't all multi-homing by holding AMEX. They noted that there is a distinct difference in the degree of competition between those who are dealing with AMEX cards versus those who are dealing with the other credit cards.

QUESTIONER [Mr. Keyte]: One more question.

MR. CRAGG: Dina had one.

QUESTION [Dina Kallay, Ericsson]: I think mine is a little similar to yours, but I'll ask it anyway. I'm not an expert in two-sided markets or anything. I just read this story as an antitrust story. You know that our comment is usually excluding our competitor, and they come complaining.

To me that story is not here at all. I assume the complainants are the merchants, and they think they're paying too much for a contract that they signed. The anti-steering committee wouldn't have

want — they don't have to sign it. I actually know that overseas most businesses do not accept Mastercard. The merchants tell you to your face, we don't accept them. Give me another card.

I worry that this is not an exclusion case but an exploitative abuses appearing and widening position case I don't want, we read about in Asia and we don't like. What am I missing?

MR. CRAGG: That is a similar defense that was used in the *Sabre* case as well, that the airlines voluntarily signed a contract which included a similar set of restrictions. The argument there from the plaintiffs, from the airlines, was that because the global distribution system had market power, they from a survival perspective had to sign the contract, and so whether they entered into it voluntarily or not was one of the core issues.

MR. KEYTE: All right.

MR. CRAGG: Thank you very much to the panelists, especially those who volunteered at the

last minute to replace their colleagues.

MR. KEYTE: Let’s take ten minutes.

[Break: 3:14 p.m.]