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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
HORIZONTAL MERGER GUIDELINES REVIEW PROJECT

Thursday, December 10, 2009
9:00 a.m. to 5:00 p.m.

Northwestern University School of Law
Conference Center
340 East Superior Street
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APPEARANCES

WELCOME

Mr. Henry Butler
Ms. Molly Boast
Mr. Richard Feinstein

PANEL 1: ENTRY

Mr. Dennis K. Carlton Mr. Robert Pratt
Mr. Spencer Weber Waller Mr. Robert Gertner

PANEL 2: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

Ms. Deborah Platt Majoras Ms. Monica Noether
Mr. Michael D. Whinston Mr. James Langenfeld

PANEL 3: UNILATERAL EFFECTS

Mr. Kevin M. Murphy Ms. Roxane Busey
Ms. Mary T. Coleman Mr. Paul T. Denis

PANEL 4: EFFICIENCIES

Mr. Michael Baye Mr. John W. Treece
Mr. Stephen Calkins Mr. Samuel Thompson, Jr.

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P R O C E E D I N G S

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INTRODUCTION AND WELCOMING REMARKS

MR. BUTLER: Good morning. It's, like, too cold to talk. My name is Henry Butler. I'm the executive director of The Searle Center on Law, Regulation and Economic Growth, which is a unit at the law school.

We fund faculty research. We engage in some large-scale empirical studies, the State Consumer Protection Study that we just released. We run judicial education programs, education programs for state attorneys generals and their staff. We've been in business since the summer of 2007.

We have worked with the FTC on a number of programs, which has been very enjoyable for us. We had Bill Kovacic was doing some hearings on the FTC at 100. That was about a year ago we had a hearing here at the law school.

We also have established an annual conference with the economists at the FTC. The second one was just last month. It's the FTC/Northwestern Economics, Microeconomics

1 Conference. We worked on that with the Center
2 for Study of Industrial Organization out in
3 Evanston as well. And so we look forward to
4 continuing that relationship.

5 So when we were approached about
6 hosting this workshop, we were very happy to do
7 that and glad to have all of you here. So welcome
8 to the law school.

9 We're actually in a Kellogg
10 building. We use this building for a lot of
11 our programs because it's primarily here for
12 classes that are taught in the evening. So
13 there's always a lot of space availability here,
14 and it works well for us.

15 There are refreshments down the
16 hallway. Lunch will be at the law school
17 across the way. That's during exams, so we'll
18 ask you to be quiet as we walk over during
19 that. But it's great to have you here and look
20 forward to a productive day.

21 MS. BOAST: Thank you, Henry. I can't
22 keep my nametag on. I'm Molly Boast from the
23 Department of Justice, and I want to thank you
24 for hosting this.

25 We decided we couldn't leave the

1 Midwest out of our worldwide tour of Merger
2 Guidelines Workshop, but in particular we
3 couldn't leave out Chicago in all their
4 variations.

5 I'd like to welcome all of you on
6 behalf of both the Department of Justice and
7 the Federal Trade Commission.

8 Rich Feinstein, the bureau
9 director, Bureau of Competition, will be
10 hosting. He and I will host alternate panels
11 today. And special thanks to Liz Callison,
12 who's sitting here in the front row, from the
13 FTC's Bureau of Economics, who has been truly
14 the one person without whom none of this would
15 have been possible. She's steadfastly
16 helped us organized each of these.

17 These workshops, as you know, grew
18 out of an initiative by the two agencies to
19 take a look at the existing Horizontal Merger
20 Guidelines, which have been place in large
21 measure since 1992, but not substantially
22 revised with the exception of the Efficiencies
23 Division since then.

24 We came into this project without
25 any pre-designs; and in contrast to past

1 efforts when the guidelines had been revised,
2 we decided we would do well to see whether
3 there was a consensus around making any
4 changes, and if so, what those changes ought to
5 be and then what parts of the guidelines.

6 I think our public statements have
7 suggested that we're not committed to making
8 revisions. We are also not at this point
9 contemplating a major overhaul.

10 That said, at least based on the
11 first couple of workshops we've conducted thus
12 far, there have been a number of different
13 points raised that would suggest that there
14 ought to be some changes made.

15 And so again, we're continuing to
16 try to work for areas where there's consensus
17 so that we bring together the best legal and
18 economic scholarship in this effort.

19 No one workshop covers all of the
20 topics. Some of you may know that the agency
21 has published a list of questions to help frame
22 the discussion, although they're by no means
23 meant to be limiting. We have different
24 topics at different workshops just because
25 there's no time in one day to do justice to all

1 of them.

2 Our first panel, which I will
3 moderate this morning, is on entry issues,
4 which seems like a small part of the
5 guidelines; but when I get back to my notes,
6 I'll tell you why I think it matters.

7 I asked someone to go back and
8 look at the reported merger cases. There's, of
9 course, discussion of entry in other kinds of
10 antitrust litigation.

11 And it seems that the Baker Hughes
12 decision in 1990 was part of what prompted the
13 merger guidelines revisions in 1992.

14 Since then, we did not find any
15 case where a prima facie case had been
16 established by the government and then was
17 rebutted by the likelihood of entry.

18 There are a couple of decisions
19 that give very extensive discussion to entry
20 issues. Most recently and probably most
21 notably, because of their thoroughness, both
22 FTC cases, more power to them. One was the
23 Chicago Bridge and Iron case in 2008, and
24 most recently the CCC Holdings case in 2009.
25 Both those courts talk about entry a great deal.

1 The Chicago Bridge and Iron case,
2 you may remember, was a case where one of the
3 principal issues that the Commission was
4 litigating was whether in a consummated
5 transaction it was fair to assume that the
6 parties had sort of gamed the system and
7 the entry analysis might not look like what
8 it might in a different situation.

9 In CCC Holdings it was a much more
10 straightforward, very detailed rundown of all
11 the various kinds of evidence that could
12 be responsive to an entry inquiry.

13 Let me tell you a little about how
14 we're going to proceed. I'll introduce our
15 eminent panelists. Each of them have been
16 asked to speak on the topic of entry but
17 without any pre-designs on what they say about
18 it for five to seven minutes.

19 They're invited to comment on each
20 other's presentations; and I will say we have a
21 reporter here, so we want to be clear, but
22 we're happy to take questions from the audience
23 as well.

24 After their presentations and any
25 commentary that they have on them, we'll go

1 through a series of questions that we've put
2 together that hopefully will help elicit some
3 of the things we want to have discussed in the
4 course of this session.

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PANEL 1: ENTRY

MS. BOAST: So let me introduce in no particular order our panelists. Sitting immediately to my right is Dennis Carlton, Katherine Dusak Miller Professor of Economics at that other school down on the South Side, specifically the U of C School of Business.

Sitting to my left is Bob Pratt, who joins us from the Illinois Attorney General's office. Thank you very much. It's wonderful to have State participation.

Continuing over, playing the tennis game, we'll go to Spencer Weber Waller, who comes from the Loyola University School of Law and is also the Director of the Institute for Consumer Antitrust Studies, as probably many of you get his mailings, which are wonderful.

And last, but certainly not least, Rob Gertner, who is the Joel Gemunder Professor of Strategy and Finance, also at that other school in Hyde Park, the Chicago Booth School of Business, and also principal with Chicago Partners.

Rob has been interested in this

1 project pretty much from the day it was
2 announced, so I'm especially pleased that he's
3 here.

4 And we'll start with comments by
5 Spencer Weber Waller.

6 MR. WEBER WALLER: Molly, you'd like us
7 to speak from the table?

8 MS. BOAST: Whatever you wish, are
9 comfortable with.

10 MR. WEBER WALLER: This is fine.

11 Hi. Thank you so much for
12 including me in the hearings, and I appreciate
13 a chance to come over here. I happened to have
14 gone to law school at Northwestern; and while I
15 didn't have a lot of classes in this building,
16 at the time our career center was here and I
17 had almost all my job interviews. So this is a
18 nice change, although it's maybe similar, where
19 I'm going to be grilled to the same level as
20 when I was seeking jobs in the market.

21 My comments this morning, and I
22 want stay very brief and do more in the Q and
23 A, my comments are part of a larger project
24 that I'm involved in on the role of brands in
25 intellectual property and antitrust.

1 And obviously my specific comments
2 are going to be limited to mergers and as much
3 as possible entry in that connection. But in
4 that larger project, and my coauthor is here
5 today, his name is Deven Desai, I'm arguing
6 that brand, brand management, brand strategy is
7 one of the most important aspects of modern
8 business management. Equally delighted to be
9 able to say those things at the Kellogg School.

10 Through all the different and
11 varied techniques of brand management,
12 businesses strive to differentiate their
13 products and services, create and enhance
14 customer loyalty, facilitate price
15 discrimination, reduce price elasticity, and
16 create price premiums.

17 Now, here today and in the larger
18 project, I'm not arguing that any of these
19 things are necessarily bad or that a successful
20 brand is an antitrust violation.

21 However, we are arguing that
22 neither intellectual property law nor antitrust
23 law has truly accounted very well for the true
24 nature and importance of brands, and as a result
25 has formulated a variety of seemingly disparate

1 rules, many in the merging area, a little bit
2 in a vacuum, which doesn't take into account
3 the nature and importance of brands and
4 brand management.

5 When you think about these
6 doctrines in the law, whether they are market
7 definition, market power, entry, which we're
8 here to talk about today, and many, many other
9 issues, in particular antitrust as it relates
10 to vertical distribution of products and
11 services, when you use a brand lens, a lot of
12 issues that don't seem to be related suddenly
13 come into focus and make a little bit more
14 sense.

15 And I want to suggest that only if
16 you understand and appreciate the role of
17 brands and apply them to antitrust analysis can
18 you have a meaningful discussion of whether the
19 trends in the law are appropriate.

20 And so first and foremost, I want
21 to suggest that this requires government
22 agencies, legal scholars, practitioners,
23 policymakers, judges, others to be as
24 conversant in the law of marketing and brand
25 management as they are industrial economic

1 analysis, indeed untraditional market analysis.

2 So I'm going to get into the
3 specifics I think more when we get into the
4 questions and answers that Molly has for us;
5 but I want to suggest that oftentimes you get
6 some surprising results, things cut both ways.

7 Thinking about brand issues, just
8 bringing them more to the forefront doesn't
9 automatically suggest that you have more
10 enforcement or less enforcement or that
11 individual parties would have a harder time
12 getting a merger cleared or an easier time.

13 But I do think it sheds a lot of
14 light, and for example, my point of entry with
15 respect to the issues of entry, when I was
16 thinking about brands, some of these comments
17 are in the written submissions that are up on
18 the Web site, some are in the paper as it's
19 continuing to evolve.

20 One of the merger guidelines and
21 commentary talks about brand repositioning as
22 either sort of a form of entry or as an
23 alternative of entry that the agencies will
24 reconsider.

25 I'll be discussing in greater

1 detail as we get into that kind of specifics
2 why when you look at the marketing literature
3 that marketing people for a variety of reasons
4 believe that, in their words, it's virtually
5 impossible.

6 So when you bring those kinds of
7 insight to bear, it just sort of suggests at
8 both microlevels and at larger levels ways of
9 bumping up to the forefront, theories,
10 research, people, literature that's in the
11 business community.

12 We just don't tend to talk about
13 it as much in law and economics. So that's
14 why I'm here and why I'm grateful to be able to
15 add those perspectives.

16 MS. BOAST: Thank you, Spencer.

17 Let me just plant a question with
18 you now that you don't have to answer now since
19 I promised no surprises. And that is just because
20 I read these cases recently preparing for this, in
21 the Chicago Bridge decision, the court made a
22 distinction between a general reputation, perhaps
23 not quite the same as brand but close enough for
24 this discussion I think, which the court did not
25 think was of entry variant and a reputation for

1 industry-specific trades.

2 And I want to think a little bit
3 about how reputation and brand actually should
4 play into the entry analysis, so maybe we can
5 come back to that.

6 Rob Gertner, I think you were
7 going to be our next commenter.

8 MR. GERTNER: Great. Thank you to the
9 FTC and DOJ for organizing these workshops and
10 including me. It's a pleasure and honor to
11 participate.

12 If you will indulge me in a brief
13 introductory remark, I will get to entry in
14 under a minute.

15 The current guidelines have been
16 successful in many ways, but they no longer are
17 an accurate portrayal of agency practice, nor
18 do they fully reflect the richer understanding
19 and frameworks that have developed in the years
20 since they were adopted.

21 So I welcome a revision, but I do
22 want to note one caveat. Possibly to the
23 chagrin of the agencies, the guidelines are
24 sometimes used and sometimes misused by judges
25 in litigation.

1 A revision will likely increase
2 their use because the status of the guidelines
3 will be enhanced by a revision whose
4 introduction states that it reflects actual
5 practices and best practices as of 2010.

6 The mere fact of revising the
7 guidelines raises the stakes; and unless the
8 revision is a substantial improvement, the net
9 result may be worse policy.

10 I'll now move to discussion of
11 entry; and I will work hard not to turn it into
12 a discussion of market definition, which all
13 roads seem to lead to, maybe for good reason.

14 Entry basically shows up in two
15 places in the current guidelines, and I
16 would argue that neither is the right place.
17 It is correctly missing from market
18 definition -- whoops, there I go.

19 It appears with the idea of
20 including uncommitted entrants as market
21 participants as part of HHI calculations in the
22 structural analysis, and as a separate step of
23 the analysis to see if entry considerations
24 should trump a competitive effects analysis,
25 which concluded that there would be a

1 short-run incentive to raise price or a
2 prediction that the merger would raise price.

3 Instead, I will argue that if
4 entry considerations are important, it should
5 be integrated into a competitive analysis.

6 In order to discuss this, I would
7 like to use an example based on a generic version
8 of the facts of the Thomson Reuters merger
9 where I served as a consultant to the antitrust
10 division of the DOJ.

11 The role of the example is just to
12 make my comments tangible. Nothing I say is
13 based on any significant details or direction
14 of the investigation, public or confidential.

15 Thompson and Reuters each provided
16 software platforms, terminals and data for
17 financial information and analysis. Both
18 customized their products for clients who could
19 choose different software and data elements and
20 would pay accordingly.

21 Bloomberg also provides these
22 services; and for the purpose of this
23 discussion, I will assume that Bloomberg was
24 vertically differentiated with higher quality
25 and higher prices.

1 Bloomberg, in contrast to Thomson
2 and Reuters, did not customize its offerings
3 but gives all data and all software to all
4 buyers, approximately.

5 Bloomberg could easily compete
6 more directly with Thomson and Reuters
7 individually or collectively after merger by
8 taking some of the functionality out of its
9 product and lowering price. But prior to the
10 merger, it chose not to do so.

11 The question is how do we
12 incorporate Bloomberg in merger review. One
13 note, given my desire to avoid discussing
14 market definition, I will treat
15 repositioning within a broad market and
16 entry into a narrow market as equivalent
17 for the purposes of my remarks.

18 A key point to note is that the
19 analysis should not depend on whether or not
20 Bloomberg is part of a broad market in which it
21 may reposition itself or a potential entrant in
22 a narrower market.

23 I know Kevin Murphy will talk more
24 about this issue in another context this
25 afternoon.

1 So let's begin with a discussion
2 of uncommitted entry, first generally and then
3 in the context of this example. So uncommitted
4 entry is really very similar -- in fact, I
5 think it's almost equivalent -- to the notion
6 of contestability.

7 And I was an undergrad at
8 Princeton at the time Bobby Willig, who was my
9 adviser, and Bill Baumol, who were working on
10 contestability. So these issues are in my
11 blood.

12 In fact, I had to futilely
13 struggle to replicate in my notes Bill Baumol's
14 exquisite -- he's an amazing artist -- three-
15 dimensional, multicolored chalk drawing of
16 transray convexity.

17 I found myself giving up and just
18 listening, so in some ways I think I'm scarred
19 for life by contestability theory.

20 But from this work we learned a
21 great deal about many things. But contestability
22 is not really an applied concept. It's really
23 theoretical benchmark, much like perfect
24 competition or complete Arrow-Debreu markets.
25 It's not, it's not a market reality.

1 Like these other paradigmatic
2 models, it focuses our attention on what's
3 missing in the real world, why the assumptions
4 don't hold, and what the implications are. And
5 that way it enhances our understanding.

6 But just like complete
7 Arrow-Debreu markets, anything approaching
8 contestability or uncommitted entry rarely
9 exists.

10 The dichotomy of uncommitted entry
11 and committed entry is about as useful as
12 thinking about dividing the world into those
13 economies where there are complete Arrow-Debreu
14 markets and those without, and perfectly
15 competitive industries and those which are not.

16 So take the Thomson Reuters
17 example. It seems like it ought to be very
18 close to the ideal. Bloomberg entry into that
19 segment seems like it ought to be very close to
20 our concept of uncommitted entry.

21 It costs us virtually nothing to
22 eliminate functionality from its platform.
23 However, even in this case, entry is not
24 without costs. Many of them sunk.

25 Bloomberg would need to develop

1 and implement a fairly significant marketing
2 strategy for a different type of customer, have
3 to train salespeople, et cetera.

4 Furthermore, and perhaps in some
5 ways more importantly, the opportunity cost of
6 lost sales on the more expensive platform, the
7 potential depreciation of its brand, all would
8 have to be considered.

9 So the uncommitted entry analysis
10 in the guidelines asks us in this case to
11 determined not only whether or not Bloomberg
12 would enter if a merger of Thomson and Reuters
13 were to yield a small but significant price
14 increase. Note, I do not add non-transitory
15 even though the guidelines do because I don't
16 think Bloomberg would know when it had to make
17 its decision whether or not the price increase
18 was transitory or non-transitory. Small glitch
19 in the guidelines. But also what its resulting
20 share would be.

21 Then we're supposed to incorporate
22 these revised shares in our HHI calculations to
23 determine anticompetitive presumptions.

24 I hope this seems like an absurd
25 exercise. It is complex and it mimics the

1 entry analysis we need to do if it is treated
2 as committed entry as part of a competitive
3 effects analysis rather than a structural case,
4 which in this instance would really be an entry
5 analysis with direct evidence really mimicking
6 the structural case.

7 For these two reasons, the kind of
8 theoretical problem and the practical problem
9 -- I think the distinction of uncommitted
10 entry and committed entry is unnecessary and
11 placement of entry considerations into HHI
12 calculations is misplaced.

13 Next I want to address sort of a
14 more important issue with respect to entry,
15 which is entry being used as a step after the
16 competitive effects analysis rather than being
17 integrated into the competitive effects
18 analysis.

19 I will continue using the Thomson
20 Reuters Bloomberg example, although I think
21 it's less perfect for these points.

22 Here is how an investigation might
23 proceed according to the guidelines, and I
24 think consistent with agency practice.

25 The agency, maybe outsiders and

1 the parties, will develop and estimate an
2 econometric model that estimates short-run
3 demand elasticities under an assumption of
4 static differentiated product competition.

5 Assume for now that this analysis
6 implies the new equilibrium would involve
7 significantly higher prices. Then we will ask
8 whether entry or repositioning by Bloomberg
9 would occur to make the price increase
10 unprofitable. If so, the agencies would not
11 seek to block the merger.

12 Here is the problem. If entry is
13 an important constraint on competition
14 post-merger, it is likely an important
15 constraint pre-merger as well. If this is the
16 case, the maintained assumption of the
17 econometric model that prices are determined by
18 short-run demand elasticities is incorrect.
19 The model is misspecified and the analysis
20 suspect.

21 If we accept the premise that
22 entry may constrain prices post-merger, it
23 seems clear that we should at least consider
24 that it may also constrain prices pre-merger.
25 And then it is essential that entry be part of

1 the competitive effects analysis.

2 I believe that in many industries
3 potential entry and other long-run demand
4 elasticity considerations play a significant
5 and large role in constraining prices.

6 So the right analysis should
7 incorporate this in the analysis of how a
8 merger affects pricing incentive.

9 Now, I think it's hard to look at
10 Microsoft and the detailed analysis of
11 Microsoft pricing that occurred in the
12 antitrust litigation and not think that part
13 of an important force in Microsoft's pricing
14 of Windows was thinking about long-term
15 demand elasticities and entry, long-run entry
16 possibilities.

17 I think we see it as commonly part
18 of managers' discussions with respect to
19 pricing and is present in internal pricing
20 documents that we see.

21 The conclusion that entry should
22 be integrated into a competitive effects
23 analysis is an example of two broader points
24 Kevin Murphy and I tried to make in our written
25 comments.

1 First, that a multistep approach
2 to competitive effects analysis is often less
3 effective than an integrated approach that
4 incorporates both entry and efficiencies.

5 And second, that an important goal
6 of merger review is to develop an understanding
7 of how competition works in the industry pre-
8 merger.

9 The analysis should be consistent
10 with and explain the key merger facts and then
11 demonstrate how the merger changes competition
12 and pricing incentives.

13 I think that's all I want to say
14 for now, and I'm sure I'll have much to say in
15 the Q and A.

16 MS. BOAST: All right. Well, thank
17 you, Rob. That was extremely interesting.
18 Your warning at the very beginning is something
19 that both Rich Feinstein and I take quite
20 seriously since we're both litigators and we
21 worry a lot about guidelines, both as a set of
22 guidance for the parties we see before us but
23 also how courts perceive them. And your
24 comments on entry are quite timely.

25 One thing for you to think about,

1 perhaps to comment on later, is whether the
2 juxtaposition of the competitive effects
3 analysis and then entry immediately following
4 in the current guidelines isn't really a way of
5 saying it's all part of the same discussion but
6 the burden shifts.

7 Our next commentator will be
8 Mr. Pratt from the Illinois Attorney General's
9 office.

10 MR. PRATT: Thank you, Molly. And I
11 join with the other panelists in thanking DOJ
12 and the FTC for putting on these workshops and
13 for inviting me to be here. It's an honor.

14 I'll begin with a disclaimer. The
15 views that I will express are my own, not
16 necessarily those of the Attorney General of
17 Illinois, not those of NAAG, and certainly not
18 those of any other attorney general.

19 I'd like to address two,
20 two points. First, I'll address the only
21 question regarding entry, which is included in
22 the twenty questions for public comment, that
23 is whether there should continue to be a
24 distinction in the guidelines between
25 uncommitted and committed entry.

1 Dropping the distinction is one
2 change which most commentators seem to support.
3 I haven't read them all but it seems to be a
4 majority view in that direction, and I agree.

5 There are two basic reasons for my
6 view on this. First is that a separate
7 analysis of uncommitted entrants is not
8 something I've ever seen done. And that's an
9 observation which has also been made by others
10 with broader experience than myself in the
11 merger area.

12 So the current formulation fails
13 the very basic test of whether it reflects
14 actual practice and, thus, provides meaningful
15 guidance to business and to enforcers.

16 The second reason for eliminating
17 the distinction is that, as the ABA said in its
18 comments, the distinction is largely artificial
19 and potentially confusing.

20 Even for antitrust lawyers, some
21 definitional gymnastics are required to nail
22 down the concept that committed is inferior to
23 uncommitted in this context. And I think that
24 confusion is worsened by the guidelines' own
25 conflicting usage of the term committed, which

1 you can find in footnote 27 where it is stated
2 that firms which have committed to entry prior
3 to the merger will be included within the
4 market, much like uncommitted entrants are
5 included within the market, but that only
6 committed or post-merger entry will be
7 considered as possibly counteracting the
8 merger's anticompetitive effects.

9 So if you are committed as in the
10 first usage, in other words, committed prior to
11 the merger to enter, you are like an
12 uncommitted entrant. Only if you are committed
13 as in the second usage are you committed for
14 purposes of entry analysis. And if you think
15 about it long enough, you will have to be
16 committed.

17 So to conclude on this point, an
18 uncommitted entrant is just like any other
19 potential entrant except that its entry may be
20 somewhat more likely than others because no
21 sunk cost will be incurred and its entry is
22 more apt to be timely.

23 The timely, likely and sufficient
24 entry formulation, I think, is a robust one
25 which does not require additional and

1 confusing, perhaps contradictory distinctions.

2 The second point I'd like to
3 address goes to the nature and extent of
4 evidence which is required for merging parties
5 to prevail on an assertion that entry will
6 eliminate the anticompetitive effects of an
7 acquisition.

8 In the first workshop last week,
9 Rich Parker commented on how important it is
10 that the guidelines be accessible and
11 understandable to business persons and that
12 they reflect the actual practice of the
13 agencies.

14 The entry provisions of the
15 guidelines fall short in an important way.
16 Reading the current entry section, a business
17 person at least, if not an antitrust lawyer, a
18 business person would come away with the
19 impression that analysis of the prospects for
20 entry is a mechanical exercise.

21 First, entry alternatives are
22 measured and weighed, what has to be done to
23 enter. Then it is asked whether those
24 alternatives could, hypothetically, be achieved
25 in a timely, likely and sufficient way.

1 There is scant reference to the
2 importance of actual experience, yet in
3 practice it's the rare merger which the
4 agencies or the states have permitted to
5 proceed on the basis of entry without quite
6 substantial, empirical evidence of a history of
7 entry, vertical integration into the market, or
8 at least credible expressions of intent to
9 enter by particular identified firms.

10 In the guidelines, references to
11 the role of this type of evidence are few. In
12 Section 3.1 it is stated that recent examples
13 of entry may provide a useful starting point
14 for identifying the necessary actions, time
15 requirements and characteristics of possible
16 entry alternatives.

17 But that, that understates the
18 role of entry experience and the existence of
19 actual identifiable entrants likely to enter.
20 It suggests, at least to the layperson, that an
21 entry case based on economic analysis and
22 hypothesized entry may succeed, even in the
23 face of history and in the absence of credible
24 and identifiable entrants.

25 Enforcers and experienced

1 antitrust counsel, though, know that an entry
2 story almost never carries the day in the
3 absence of such evidence.

4 Molly mentioned the two litigated
5 cases. I didn't look at those, but I did go
6 back and look to the cases that are described
7 in the 2006 commentary.

8 In the commentary, in the entry
9 analysis section, there are case examples, and
10 by my count there are six examples of cases in
11 which it was decided not to challenge the
12 merger based on an entry analysis.

13 In five of those six cases, the
14 summaries indicates that there was substantial
15 evidence of entry history or intent as follows:

16 First, there was evidence of
17 actual prior entry in three of the cases,
18 Omnicare-NeighborCare, ADS-Hancor, and
19 Wrigley-Kraft. There was evidence of prior
20 entry based on outsourcing of the basic
21 function at the issue in Playbill-Stagebill.

22 And there was evidence of the
23 customer's stated intent and ability to sponsor
24 entry and specifically identified entrants in
25 the National Oilwell Varco transaction.

1 The sixth matter came close. It
2 was the Cinram-Time Warner matter, which
3 involved DVD/CD replication technology, and
4 that technology was found to be readily
5 available for license from patent pools.

6 In addition to the examples in the
7 commentary, which I think illustrate the
8 importance of concrete evidence of entry, the
9 commentary text also does a better job than the
10 guidelines, I think, of stating that entry
11 experience is important to evaluating the entry
12 starting.

13 And it does so effectively while
14 emphasizing that past entry is by no means
15 conclusive as to the likelihood of effective
16 post-merger entry.

17 The point is not that there is
18 anything economically or analytically wrong
19 with the guidelines' approach. It's just that
20 the guidelines fail to acknowledge that in most
21 cases empirical evidence of entry history or
22 intent will be necessary if there's any
23 prospect of successfully defending an otherwise
24 anti- competitive acquisition on entry grounds.

25 I would be remiss if I didn't note

1 that the NAAG 1992 Horizontal Merger Guidelines
2 mirror the DOJ/FTC guide on the issue of entry
3 with one exception.

4 The NAAG guidelines add at the end
5 of the entry section references to evaluating
6 empirical evidence and they emphasize the
7 importance of historical entry.

8 That is an important and a
9 valuable addition. I think it would be much
10 better to integrate the references with the
11 rest of the entry section rather than to simply
12 append it to the end, as was done in the NAAG
13 guidelines.

14 But it's a change that I think
15 should be made to the federal guidelines and
16 perhaps some fine-tuning of the NAAG guidelines
17 as well.

18 That concludes my comments.

19 MS. BOAST: Bob, thank you for all the
20 homework you did. That was incredibly
21 illuminating just to hear the cases and
22 commentary pulled together and analyzed that
23 way.

24 And I think you put your finger on
25 something that is, again, one of the challenges

1 for the working group and all of us in this
2 exercise, and that is how prescriptive do we
3 make these guidelines.

4 I mean, you rightly point out what
5 I see in the reported decisions that there's a
6 kind of hierarchy of evidence that courts tend
7 to rely on.

8 Entry is enough of a microcosm
9 that we can see that pretty clearly; and by the
10 same token, for the reasons Rob alluded to in
11 his opening salvo, not so sure some of us are
12 prepared to lay all that out in the guidelines.
13 So more to come on that.

14 Last but not least, Dr. Carlton.
15 Your turn.

16 MR. CARLTON: Thank you. It's a
17 pleasure to be here to give my views on the
18 merger guidelines.

19 My views on entry as well as other
20 topics related to the merger guidelines are
21 described more fully in the paper I submitted
22 to the DOJ/FTC in their request for comments
23 and also in a forthcoming interview that is
24 going to be published by the ABA's Antitrust
25 Magazine.

1 Let me here highlight my main
2 recommendations on the entry section. And then
3 I take no more than one minute for a few other
4 comments on non-entry.

5 In general, the entry section, as
6 other parts of the guidelines, I think are
7 pretty good and they've served a very valuable
8 purpose, though, of course, they, they could be
9 improved somewhat.

10 My main recommendation on the
11 entry section is to get rid of the distinction
12 between committed and uncommitted entry.

13 Committed entry, a committed
14 entrant incurs some cost to enter, while an
15 uncommitted entrance does not. Almost all
16 entry requires some sunk cost; so although this
17 is a theoretical distinction that one can make,
18 I've not seen it to be practically useful.

19 I've been in private practice as a
20 consultant for Lexicon, worked on many mergers
21 that have been taken before the division over
22 the last twenty, thirty years; and I don't
23 think I've ever had an occasion to use this
24 distinction.

25 When I was the deputy at the

1 Department of Justice, I don't recall any cases
2 before me that used this distinction. Maybe
3 there are some, but I just don't think it's
4 been practically useful.

5 That would be the main change in
6 the entry section. I have three other
7 comments, though, on entry that I'd make.

8 First, entry is not so easy -- based
9 either on the theoretical literature, the
10 recent theoretical literature in economics or
11 empirical literature.

12 Let me talk about the theoretical
13 literature for a moment. In the presence of
14 sunk cost and uncertainty, Dixit and Pindyck
15 show that entry may not provide the tight
16 constraint on price that we think it would
17 based on our very simple models of free entry
18 and exit.

19 I've discussed this more
20 thoroughly in a paper on entry barriers in the
21 American Economic Review in 2004 and also in
22 the recent ABA handbook that Dale Collins
23 edited on antitrust.

24 I like the title of my AER
25 article. It's something like Barriers to

1 Entry, Are They Barriers to Understanding. And
2 I think they have been. And if you do use the
3 word barriers to entry, I think you should be
4 very careful what you mean.

5 So the theoretical literature
6 has recently shown that this tight constraint
7 that entry can provide may not be so tight.

8 What does the empirical literature
9 show? Well, the empirical literature shows
10 that entry often fails and that the type of
11 firm that enters has an enormous effect on its
12 success as well as its effect.

13 So for example, firms that are
14 completely new to the industry grow much less
15 rapidly after entry than firms that enter from
16 related sectors.

17 So what's the implication of this
18 first comment I'm making about entry? I think
19 that if you're going to rely on entry providing
20 a constraint to what might look otherwise as an
21 anticompetitive merger, the agency should
22 require evidence, strong evidence that entry
23 could occur.

24 And one way to do that is to rely
25 on a past history of successful entry. Second

1 observation that follows is that both theory on
2 sunk costs as well as the empirical literature
3 will stress the importance of having a
4 sponsored entrant.

5 If you have a few big buyers who
6 either could vertically integrate themselves or
7 collectively could sponsor a new entrant,
8 that's something that matters a lot when there
9 is sunk cost and can provide, and I think has
10 provided in many instances, tight constraints
11 on pricing.

12 My second comment on entry. To
13 echo something Rob said, if an entry constraint
14 exists post-merger to constrain prices, it
15 likely exists pre-merger.

16 So what does that mean? That
17 means the techniques you're using to analyze
18 what's going on pre-merger should take count of
19 that constraint.

20 As Rob said, if you did a merger
21 simulation based on short-run elasticity in
22 Bertrand competition, you probably are not
23 reflecting that.

24 So what emerges from that? It
25 means that the -- I won't say old style, but if

1 I was speaking to a new, young, industrial
2 organization, academic, I would say old style.

3 MS. BOAST: Thanks a lot, Dennis,.

4 MR. CARLTON: The old style of price
5 versus concentration is capturing exactly what
6 you want, both pre-merger and post-merger, if
7 you can do an empirical analysis that controls
8 some of the econometric problems of endogeneity
9 that we know exists.

10 Another way of saying this is
11 reduced form analysis, which is a bit out of
12 style amongst younger industrial organization
13 economists, is precisely the right type of
14 analysis for a merger case in comparison to the
15 more detailed structural analysis.

16 And in fact, my experience has
17 been both in the private sector and also when I
18 was at Justice that the agencies, the FTC and
19 DOJ, are cognizant of this point.

20 My third observation on entry,
21 somebody beware of speculative theories that are
22 related to entry.

23 What do I mean by speculative
24 theories? There are two I'll mention in
25 particular, theories that relate to something

1 that I'll call innovation markets.

2 Those firms who in the future I
3 can predict are going to be innovating in
4 products that don't yet exist, okay, or
5 theories relying on elimination of
6 potential competitors.

7 Who are potential competitors?
8 Competitors who would otherwise enter the
9 industry. Both of those require the analysts
10 to predict who are those new firms that are
11 going to be coming into the future.

12 And I would be very cautious and
13 underscore the difficulty of being able to
14 predict those in reliable way and, therefore,
15 be very skeptical of pursuing such theories.

16 All right. Let me just end by
17 just listing, and I don't have time to go
18 through, although the papers I mentioned do,
19 some of my other comments in one minute.

20 In addition to my recommendation
21 about getting rid of the committed versus
22 uncommitted distinction, I would make the
23 following general observations about the
24 guidelines.

25 Keep market definition in the

1 guidelines. Although it's a crude concept,
2 it provides a useful constraint, especially
3 on what courts and what judges can do.

4 Second, don't make the guidelines
5 a textbook of techniques to use. The analysis
6 done by the agencies is much more sophisticated
7 than what you would hypothesize based on the
8 step-by-step approach in the guidelines and
9 the reliance on market definition.

10 It's much more a competitive
11 effects analysis, a much more integrated
12 approach. I think that's fine. I think to
13 deal with that in commentary is the right way. I
14 don't think you should try and articulate that
15 in the guidelines.

16 Third, I like HHI cut-offs. I
17 like market share cut-offs even though I
18 understand that they are crude. The reason I
19 like them is they provide safe harbors, which I
20 think is very desirable.

21 To the extent you do keep such
22 cut-offs in the guidelines, it would be useful
23 when you give numbers to say what basis you're
24 using, empirical basis for some of the numbers.

25 My main comment, if I had to give

1 a fourth comment, I'd put a star on this one.
2 The distinction between coordinated and
3 unilateral behavior in the guidelines to me
4 is not well-founded. They both rely on
5 non-cooperative game theory, and I explain
6 this in my paper. Unfortunately, I can't be
7 at the session -- I know there's a
8 specific session on that this afternoon.

9 But if I had to give one comment
10 on the guidelines, it would be that one, that
11 that needs improvement.

12 Two other comments. One, I'd
13 alter the definition of geographic markets.
14 The notion of drawing circles around locations
15 rather than circles around buyers is confusing.

16 I understand theoretically how
17 they can be integrated, but I think it leads to
18 difficulties in particular agencies sometimes
19 formulating market definition.

20 And my final comment has to do
21 with efficiencies. I think the efficiency
22 section should be tweaked a little bit in
23 accordance with the recommendations of the
24 Antitrust Modernization Commission in that you
25 should give more attention to fixed-cost

1 efficiencies, especially in industries that are
2 dynamically changing. Because over the medium
3 run a fixed cost is, in a sense, a variable
4 cost. And you'd take a long enough view.

5 I'll stop there.

6 MS. BOAST: Thanks, Dennis. That was,
7 again, very useful and we welcome the
8 checklist. It sort of goes back to my opening
9 comments about having now been more or less
10 midway through the workshop process, I'm
11 beginning to wonder how modest we can keep our
12 goals in thinking about guideline provisions.

13 Does any of you want to comment on
14 the specific points made here before we go into
15 Q and A, which will probably elicit all of that
16 comment anyway? Rob?

17 MR. GERTNER: I'd like to say one thing
18 about Spencer's comments. I think the point he
19 makes is an important one. I think it's
20 actually broader.

21 I've been teaching strategy in the
22 business school now for almost twenty years, so
23 I've been thinking about competition issues
24 from the business perspective a lot.

25 And you know, the antitrust

1 community tends to divide practices and
2 implications into either kind of efficiency
3 enhancing or anticompetitive.

4 And what's missing from all that
5 is the search for and the attempt to maximize
6 scarcity rents. And that's kind of what brands
7 are about. In brands you are trying to create
8 a scarce asset and try to extract as much
9 profit as you can from that scarce asset that
10 you're creating.

11 And that's an awful lot about what
12 business is trying to do left and right. And I
13 think, to a large extent, the way we think about
14 antitrust, both economists and lawyers often kind
15 of misses that. And I think that perspective is
16 enormously useful.

17 It's probably even more useful
18 in antitrust outside of merger analysis than
19 it is in merger analysis, but I think it's
20 really fundamental. I think that perspective
21 should be added into the mix.

22 MS. BOAST: It reminds me of a program
23 I spoke at several years ago when I worked at
24 the FTC, and it was a pharmaceutical program
25 where an investment banker stood up and talked

1 about lifecycle management of the drug.

2 And I said, you know, what you
3 call lifecycle management is what we call
4 monopoly extension. So we do take it into
5 account, from a different perspective.

6 MR. WEBER WALLER: I just had a brief
7 comment on Dennis, particularly looking at the
8 literature about entry and the type of entry
9 being critical. I think that's obviously in
10 the guidelines.

11 But I just want to emphasize
12 something. It may well have been something you
13 cited in the paper. I don't have it in front
14 of me.

15 But there is a really interesting
16 article in the Michigan Law Review by
17 Avishalom Torr of the Haifa Law School Faculty,
18 and it's both a combination of theoretical
19 and empirical evidence, mostly from behavioral
20 economics, which sort of bridges both sides of
21 what you talked about.

22 It gets into the kinds of firms
23 and the incentives as to why firms enter and
24 why they often fail; and it makes the point, as
25 you did, that oftentimes entry happens more

1 often than we would think but by precisely the
2 wrong firms for what we care about.

3 MS. BOAST: Which would also make it
4 inherently ridiculously difficult to try to
5 predict.

6 MR. LANGENFELD: Jim Langenfeld. Paul
7 Denis is here, and he and I were fortunate
8 enough to be on the revision process -- lucky
9 enough to be involved with Bobby and John
10 Peterman in the revision process back in 1992.

11 I certainly compliment you on the
12 openness of this treaty. This looks like a
13 star chamber since we did the revision; so this
14 is a huge improvement, in my opinion.

15 But just focus specifically on
16 entry. My recollection was the reason that
17 committed and uncommitted, which seems to be a
18 target of a lot of the commenters here, was put
19 in the guidelines because there was a
20 perception that any time -- well, partly was
21 the economics literature at the time.

22 And the other part of it was there
23 was a concern that the -- not necessarily the
24 economic staff, but the legal staff, if they
25 found any -- pretty much any, any barrier, any

1 sunk cost associated with entry, they would
2 pretty much say entry couldn't discipline
3 anything.

4 This is before the more recent
5 literature that Dennis points out. And there
6 was a concern to try to get them to focus on
7 the two separate issues.

8 And I agree with Rob that it's a
9 bit of an artificial distinction to try to
10 create market shares for an uncommitted entrant
11 because they have very small entry costs.

12 But it does actually happen
13 sometimes in my experience both at the FTC when
14 I was there and now. If you have in very rare
15 instances, for example, in gasoline and oil,
16 pipeline and production mergers, the homogenous
17 product is shipped around the country to a
18 variety of different locations.

19 You're analyzing what's going to
20 happen to a merger in a specific geographic
21 reason. You can look at the net-backs, the
22 profits you make from shipping oil from one
23 place to another, it's not quite a national
24 market, but almost, and you can actually
25 identify when product will be profitable to

1 ship from where it's currently going, say, in
2 St. Louis, to Denver, if prices were to go up
3 in Denver due to a result of a merger,
4 hypothetically due to a merger.

5 You can then look at the pipeline
6 capacity, and you can actually see what the
7 most could be that could be shipped into that
8 area in response to a merger.

9 So you could actually go through
10 and do a market share analysis and see whether
11 that would expand substantially or whether it
12 would be a trivial, very trivial extension.

13 The concept of uncommitted entry,
14 in my experience at least, never perhaps
15 overstates the case because in some sense
16 they're not shipping there but they could.

17 And I guess I'd want to find out
18 from the panel in general whether it's true
19 that Rob's experience -- and Dennis', I guess,
20 that's true, that you never ran into a
21 situation like that when doing a merger
22 analysis. Or would you characterize that as
23 something else other than uncommitted entry?

24 MS. BOAST: Let me supplement Jim's
25 observation with another comment and then let

1 those who wish to respond. And that is to echo
2 a point that Bob Pratt made, and that is even
3 taking the kind of analysis Mr. Langenfeld is
4 suggesting, is it not adequately covered by
5 other guidelines language.

6 MR. CARLTON: I would respond that
7 when I was at the department, I actually asked
8 if anyone had ever come across this; and I don't
9 think the answer is never, as you point out.
10 There may be cases where people have used it.
11 My sense is it's rare.

12 But more importantly, to just
13 reiterate what Molly said, I think that the
14 distinction I found it, though I find many
15 people find it confusing, and I think if you
16 got rid of the distinction, the guidelines are
17 sufficiently flexible that any competitive
18 constraints that are on the price post-merger
19 should properly and would properly be
20 considered by, you know, either agency.

21 So I think the possibilities that
22 you raised in your example would certainly
23 be considered and as a constraint on price.

24 And that just goes, I think, more
25 to the point that the analysis the agencies do

1 is much more integrated than this kind of step
2 by step. And the whole idea of are you a
3 market participant or not a market participant,
4 the only reason you need that in part is to
5 figure out how do I calculate market share.

6 But then that raises the question,
7 well, how do I calculate market shares? Is it
8 based on sales, is it based on capacities if
9 you're uncommitted entrant?

10 So then you're getting into fuzzy
11 stuff, and we all know that market definition
12 is very crude. So that's why you make this
13 distinction so you can figure out how to
14 calculate market shares.

15 You know, my sense is the agencies
16 if they didn't have this distinction would
17 understand the competitive constraints and take
18 them into account.

19 They do things in a more
20 sophisticated way than the guidelines. So
21 that's why I don't disagree with what you're
22 saying. As a theoretical matter, it could be a
23 distinction and occasionally may come into
24 play; but I think it could would be covered by
25 the other language in the guidelines.

1 MR. GERTNER: I agree completely with
2 Dennis, and I won't try to reiterate in my own
3 words because I won't do it as well.

4 I think Dennis sort of pointed to
5 it showing up maybe in the standard entry;
6 but I think that in the example you gave,
7 it seems hard to imagine that a careful
8 competitive effects analysis wouldn't
9 incorporate the exact issues that you were
10 considering.

11 So I think, again, if you were
12 constricted to just do kind of an HHI analysis,
13 perhaps you'd run into problems. But if you
14 actually try to think about how a price is
15 determined in this market, both pre- and post-
16 entry, I think that you know that the
17 ability to people to reroute through their
18 existing network would have to be a part
19 of analysis of how prices and competition works.

20 MR. DENNIS: An observation here from
21 a historical perspective. I think we had at the
22 time we were drafting the guidelines our own
23 little endogenated problems, and that related
24 to presumptions and the role of presumptions.

25 If you look at it from today's

1 perspective where the structural presumption
2 doesn't really matter that much anymore,
3 certainly way less than '92, the debate
4 over where you want to put uncommitted
5 entrants seems a little bit silly, and
6 the panel has sort of picked on that
7 very effectively.

8 But if you roll the clock back and
9 think about the importance of presumptions and
10 the way the agencies used presumptions, the
11 distinction actually meant a great deal more in
12 practice and meant a great deal more in terms
13 of shaping how the agencies thought about the
14 problem.

15 And that's why I think the
16 distinction made a much greater difference back
17 then than it does today.

18 MS. BOAST: Another audience or comment
19 question.

20 MR. MURPHY: There's a little bit of
21 tension, it seems to me, to keep the
22 presumption -- it falls on what you're saying.
23 The presumption is based on share and then
24 wanting to do kind of the right analysis from
25 the point of view of competitive effects, which

1 is what we ultimately want to do.

2 It seems to me that you -- why you
3 say you want to keep them, that's precisely
4 what makes this question of are they in or are
5 they out kind of a discrete question as opposed
6 to what it ought to be is they get incorporated
7 to the extent they're important for
8 competition.

9 So when you say I want to keep the
10 presumptions based on HHI's and the like, I
11 think there's a bit of tension between that and
12 wanting to have a correct competitive effects
13 analysis done.

14 I don't know quite how that's
15 going to fit together very well. Often what I
16 see is you want to do the market definition, as
17 we always do in economics, well, what is the
18 most illuminating from thinking about
19 competition in the marketplace.

20 But that might not fit very well
21 at all with, you know, the HHI-type guidelines
22 that are in there. You might want to define a
23 very narrow market or a very broad market
24 realizing that it is what it is, either very
25 narrow or very broad. And then I think you

1 need to take that into account.

2 So I'm not quite sure how you can
3 say let's keep the presumptions in there based
4 on HHI and then at the same time allow to us
5 deal with entry in this kind of fluid way of,
6 well, we don't have to decide whether committed
7 or uncommitted whether they go in the HHI's or
8 not.

9 MR. CARLTON: Yeah, let me clarify. I
10 didn't mean to suggest that I would keep
11 necessarily the structural presumptions in
12 which you, you know, block a merger if the HHI
13 is high, or would always block it if it were
14 high. I would say it kind of a little
15 differently.

16 I like safe harbors. I would let
17 a merger go through if, under reasonable market
18 definitions, the HHI is real low.

19 That does not mean I would always
20 attack a merger if the HHI as high. I think
21 what an analysis of, say, price on HHI tells
22 you if you could do such an analysis, if you
23 have no effect it would tell you the market may
24 well be broader than what you're defining it
25 as.

1 And therefore, in those cases in
2 which it's hard to define a market but a
3 competitive effects analysis shows you don't
4 see any effect, I would say that undercuts
5 whatever market definition you're using
6 -- the market definition is just a very
7 crude way of trying to infer the forces
8 of a constraint on price.

9 So you know, if you've got a
10 narrow market and high HHI's and no effect on
11 price, I would say you haven't defined the
12 market right; and therefore, I would use the
13 competitive effects analysis as a way to
14 broaden the market definition.

15 I think the reason why I would not
16 abandon market definition and just go to
17 competitive effects is I think that gives too
18 much discretion. I'm not so much worried about
19 agencies.

20 But when you get into the courts,
21 if you say to someone, you don't have to define
22 a market. You know, just use the competitive
23 effects analysis. And you know, whatever you
24 think is reasonable, go ahead and do that.

25 That scares me. So I think market

1 definition, though it's very crude for a lot of
2 the reasons you're suggesting, it is a useful
3 constraint, especially in the courts. So
4 that's why I wouldn't abandon it.

5 But I do think if there's a high
6 HHI, I think that's what you mean by a
7 structural presumption, you know, that's easily
8 trumped by a competitive effects analysis.

9 MR. MURPHY: That's what I'm trying to
10 say. I'm not trying to advocate for getting
11 rid of market definition either, but I just
12 think you have to realize that not all markets
13 that are defined fit in the same box and can't
14 always apply.

15 MR. CARLTON: I agree. If you had a
16 high HHI and that was the structural
17 presumption, you had no competitive effects, I
18 think your conclusion shouldn't be it's a
19 concentrated market, I'll sue. I think it
20 should be, gee, maybe what I'm measuring as the
21 HHI, which I think should give me an indication
22 the price should go up is not the right thing
23 to measure.

24 MS. BOAST: It's totally clear to me
25 that committed versus uncommitted entry is

1 the tail wagging the dog here. I think we
2 ought to go back to entry, if we could, in a
3 narrower sense, although this is useful.

4 I think if we have time at the
5 end, I certainly see the connection; but there
6 are some specific things that the working group
7 wanted to try to get some focus on.

8 So let me trump the remaining
9 comments and questions for the moment and
10 return to some of the questions we've put
11 together to try to bring a little bit of focus.

12 First question is we talk about
13 entry in various manifestations in the
14 guidelines. We've got expansion by incumbents.
15 We have de novo entry. We have repositioning
16 in different parts. We have it in who's in the
17 market. We have it in unilateral effects
18 analysis. And then we have the standalone,
19 quote/unquote, entry section.

20 Should we be consolidating all of
21 these entry considerations, where would we do
22 that, and should the same standards, or time,
23 likely and sufficiency of entry, apply in these
24 various places in the guidelines where the
25 entry currently exists.

1 I'll let anybody who wishes go
2 first.

3 MR. WEBER WALLER: We've already
4 pointed out in several instances why it's a bit
5 of a seamless web. And the same issues keep
6 coming up whether you call them market
7 definition, competitive effects or specific
8 entry.

9 I think the framework, and I think
10 this is a point Bob Pratt made already, that
11 the overall framework of timeliness, likelihood
12 and sufficiency of entry is clear, realistic
13 and useful. And I think it satisfies the
14 overall goals of the guidelines.

15 Whether that should be the only
16 place they appear sort of at the end after
17 you've done market definition, competitive
18 effects, I think the problem is it suggests the
19 cookbook or the textbook that we all know the
20 guidelines aren't.

21 I'm worried about something in the
22 shadows of what Dennis is talking about, which
23 is what happens when you get into courts. I
24 think while all of us realize that this is just
25 the beginning of the analysis that the parties

1 and the agencies do, it's not clear to me
2 courts actually do -- you know, there's
3 not a lot of litigated merger cases obviously.

4 But it's not clear to me that they
5 look at it the same way, and I think they tend
6 to look at it as a cookbook. And there's
7 certainly a couple cases where the agencies
8 have lost where the court says market
9 definition, you have to do market definition.
10 And where the agencies have said we have or
11 it's encompassed in our competitive effects,
12 the court has said no, no, I need market
13 definition because it says so.

14 And I would be concerned that the
15 reverse. I understand that the agencies
16 haven't lost cases where they've shown all the
17 preceding steps and then had the parties rebut
18 on the basis of entry. That doesn't happen
19 very often and it won't no matter what you do.

20 But I'd be concerned about the
21 court that looks at this as a cookbook. I
22 think it's adequately -- I'll just state it
23 this way. I think it's adequately handled in
24 agency and party practice.

25 I'd be concerned that -- my main

1 concern is keeping entry as the separate
2 section gives the court yet another opportunity
3 to say agencies have to do A, B, C and D, and
4 you didn't do D.

5 MS. BOAST: Let me see if I can push
6 back a little, and just for purposes of this
7 debate, if we just relied on timely and likely
8 and sufficiency as the rubric for all forms of
9 entry and we didn't specify anything further,
10 how would we give guidance to courts or
11 practitioners about the difference between an
12 incumbent expansion, as one example, and de
13 novo entry where intuitively one would think
14 the standards, pick one, timeliness, might not
15 be the same.

16 MR. GERTNER: I think the issue really
17 goes to the point that I was trying to make
18 earlier about integrating entry into thinking
19 about the way in which competition works in the
20 industry.

21 And because I think that you need to
22 think about, what it is that's constraining firms
23 in their pricing.

24 I think if there was something that was
25 sort of holistic to describe all these different

1 manifestations of entry, it would be to think
2 about how do these non-pricing, expansion,
3 entry, repositioning, activities of other
4 firms, either incumbents or potential entrants,
5 constrain pricing both pre- and post-merger.

6 In general, I like the words timely,
7 likely and sufficient; and I think it would
8 be near the bottom of my list of things to
9 pick on, but since you bring it up.

10 One of the things I think about, I
11 think about a firm, let's say it's a software
12 firm, that could very well in its pricing
13 decisions feel constrained by a potential
14 entrant even though in order for somebody,
15 any potential entrant out there to develop
16 a competing product would take three years.

17 I'm sitting there as the incumbent
18 firm and I may well price today in a way that
19 would make that entry unattractive. All right.

20 In that way, you know, entry
21 plays a really important role here; and thinking
22 about it using especially sort of a two-year
23 horizon on a timely, likely and sufficient
24 really wouldn't be capturing everything that
25 was relevant.

1 So in that hypothetical, entry
2 plays a really important role even though maybe
3 it wouldn't meet the standard, that particular
4 entry wouldn't meet the timely, likely and
5 sufficient standard.

6 That said, you know, you can't
7 leave this all up in the air. You need some
8 standards. You need some guidance. And I
9 think those words are good words to have as a
10 key element.

11 And I think if you incorporate
12 this idea of thinking about the way in which
13 entry and other manifestations like entry
14 affect competition pre- and post-merger, I
15 think those two things go a long way.

16 One final thing. There are all
17 these elements, and people talk about to
18 what extent is it a five-step process. All
19 right.

20 The guidelines don't actually say
21 you proceed in this order. They're just
22 written that way. I think it's sort of become
23 the practice and the way people think about
24 it, especially with kind of burden shifting
25 is also not in the guidelines.

1 I think it would be useful
2 actually to move away from the perception of
3 it as being kind of a sequential process as
4 opposed to a more integrated process, however
5 it's done, and actually be a little more
6 explicit in saying that it's not first we
7 decide what the short-run implications
8 are and then we think about efficiencies and
9 entry, but it's all part of a broader
10 effects analysis and these are the elements.

11 MR. CARLTON: Yeah, would I agree
12 with these comments that the focus is the
13 competitive constraints on price both
14 pre-merger and post-merger. And you know,
15 attributing how much of a constraint each of a
16 myriad of factors are can be difficult.

17 There's no question that each of
18 these -- expansions by the incumbents, de novo
19 entry, repositioning, all can be a constraint.
20 To have to go down the list or in the guidelines
21 and talk about each one separately strikes me as
22 difficult and probably undesirable.

23 I think that you should simply
24 say -- I agree with Rob, you should just say at
25 the outset, and I think this does reflect

1 agency practice, they look at all the
2 competitive constraints on price when they're
3 analyzing a merger.

4 Now, it is true that you can look
5 in the data and sometimes do econometrically
6 the exact hypothetical that sometimes the
7 guidelines want, that if price goes up and
8 there is an inability for existing firms to
9 expand, does anyone come from outside the
10 area, does a new firm come in. So you can
11 actually see whether there's evidence on
12 each one of these factors, and I think the
13 agencies do that.

14 But I'm not sure I think it would
15 be wise to sort of delineate a separate type of
16 analysis for each one. I do think as you get
17 more speculative as to what might occur, you
18 could say the burden shifts because it becomes
19 harder to prove that a new entrant would come
20 in if a new entrant has never come in.

21 Now, let me just give a concrete
22 example. I was involved in a case involving
23 the toy industry. And if you can go around the
24 country, there are certain parts of the country
25 where if you look at the major toy sellers

1 they're concentrated if you don't consider
2 smaller toy stores, and there are other parts
3 of the country where that's not true.

4 You now have a pretty good
5 experiment. Are the prices in one place the same
6 as the prices in another place? And if they
7 are, then the constraint of having entry of
8 small toy stores, which come in and out of
9 existence pretty easily, you could say is
10 likely to be constraining price.

11 So sometimes you can do these
12 experiments quantitatively, econometrically;
13 and it's exactly reflecting sort of the earlier
14 comments that Rob and I made that the
15 constraints pre-entry can tell you a lot about
16 the constraints post-entry.

17 An integrated approach is clearly
18 the right way to do it, and that's what
19 I think the agencies do. But I don't
20 necessarily think the guidelines have to be
21 specific and delineate all the many techniques
22 you could use.

23 MS. BOAST: Bob, do you want to comment
24 on this? We've taken your useful point, and
25 everybody is now free-riding on it. So I think

1 we ought to give you some air time on this.

2 MR. PRATT: Right. Just to get back to
3 your question, what guidance should we give to
4 the courts on this, you know, on various types
5 of entry.

6 Can we do it in a meaningful way,
7 which doesn't somehow come back to undercut
8 our own analysis or position in the court.
9 And, you know I think that's, that's a
10 tough question. I don't know what else
11 to say.

12 I think there's some value,
13 as Dennis points out. You know, the
14 sponsored entry is often a more certain,
15 more valuable type of entry, whereas in a
16 de novo entrant often, you know, you got
17 the wrong entrant of someone who
18 fails.

19 Take the air transportation
20 industry is replete with examples of failed
21 entry. It's an attractive place to put capital
22 for some people for some reason. But you know,
23 it's a tough, it's a tough question. I suppose
24 you could put something in the guidelines
25 ranking various types of entry and providing

1 some general comment as to why it should be
2 valued more greatly than others. But that
3 would be a difficult task.

4 MR. WEBER WALLER: Molly, if I may.

5 MS. BOAST: Sure.

6 MR. WEBER WALLER: Bob, the danger is
7 the guidelines are -- you know, we have this
8 lovely pamphlet, and the point is to have
9 something that is pitched at a level of detail
10 that is an accurate and sophisticated
11 description of what the agencies do, but
12 is reasonably understandable to the,
13 high-end business community that has to live
14 under them and can be applied and understood
15 by counselors and courts, and other agencies
16 can use it as well.

17 When you get into this kind of
18 entry work under these circumstances, this kind
19 of entry, you're describing the merger
20 commentary, which is great, but it's a phone
21 book.

22 MR. PRATT: Right. I don't disagree
23 with at all.

24 MR. WEBER WALLER: I don't disagree
25 with him there, you know. I agree with

1 everything that everybody said. I'm just as
2 torn as probably Molly and the other people
3 who have to do this, is how do you encompass
4 that in the kind of right pitch and level of
5 detail in the guidelines.

6 I mean, I have lots of comments
7 about why brand repositioning normally isn't
8 going to happen, and therefore, isn't an
9 effective alternative or form of entry. But I
10 can't, frankly, think of how you work that into
11 what should be in the guidelines rather than a
12 more detailed analysis or commentary.

13 MS. BOAST: Let's turn to that for a
14 moment because you said you wanted to get into
15 it, and I'm happy to spend a couple minutes on
16 it.

17 When you talk about brand
18 repositioning, what I tend to think of is --
19 well, I guess maybe we ought to -- let me ask a
20 different question.

21 Are there certain industries where
22 your observation has more prominence, and
23 if so, what are the characteristics of the
24 industry?

25 MR. WEBER WALLER: It's more a matter

1 of language and vocabulary than industries.
2 But the marketing literature that I've been
3 reading in connection with this project tends
4 to talk about product categories more than
5 relevant markets than we do in antitrust; and
6 in general, a lot of industries are
7 characterized by kind of premium brands and
8 value brands.

9 And so if you were to have a
10 merger -- and by the way, it leads us back to
11 market definition, we always seem to end up
12 back there.

13 It just suggests that functional
14 substitutability may not be really as important
15 as scarcity and product differentiation if
16 successful consumers view only certain things
17 as reasonably effective substitutes even though
18 in one case it's baking flour. You know, you
19 can make cookies out of anything.

20 If the branding is successful,
21 it's only the branded flour that consumers
22 might view as interchangeable.

23 So if you had a merger that
24 affected two of the only or the important
25 premium brands, the question is, could

1 manufacturers of value brands trade up.

2 The brand literature says that's
3 virtually impossible because of the successful
4 associations of quality and other things that
5 the premium brands have been able to create.
6 That's one example.

7 If you go the other way and you
8 had a merger between two value brands, is there
9 any reasonable likelihood that a premium brand
10 would trade down? The answer is no, because
11 the whole point was to create the scarcity and
12 the rent or quasi-rent that Rob talked about.

13 They just wouldn't want to, and it
14 would defeat the whole purpose of a successful
15 branding campaign in the first point.

16 That's the kind of perspective I'm
17 talking about. But again, I don't mean adding
18 in literally in the text of a guideline.

19 MS. BOAST: Let me turn to another
20 question, much smaller question. It sort of
21 flows out of this distinction about what we
22 say in the guidelines.

23 The guidelines, for all intents
24 and purposes, I think, can be read to say that
25 two years is the outside limit for entry

1 analysis in whatever form you're looking at it,
2 sometimes shorter.

3 And I guess my question is, is two
4 years really too long to ask consumers to bear
5 a transient effect; or looking at it from the
6 other end of the telescope, is two years too
7 short under certain conditions and certain
8 industries?

9 Should we specify a time or should
10 we just collapse this, as we've been talking
11 all morning, into a discussion about
12 constraints, prices and now how you assess the
13 evidentiary value of the entry that's positive,
14 whichever side?

15 MR. CARLTON: I have two responses.

16 MS. BOAST: Kevin has a response, too.

17 MR. CARLTON: One, should the
18 overcharge last two years or less is sort of
19 one way to phrase your question.

20 What's funny about phrasing the
21 question that way, and this is a general
22 problem with the guidelines, it's clear why
23 they do it this way, is an economist doesn't
24 just care about the price, he cares about the
25 price times the quantity.

1 I mean, in a sense what you're
2 trying to avoid here is dead weight loss caused
3 by creation of market power. And we know that
4 it's a triangle. It's a price element and
5 it's a quality element.

6 So it's kind of funny, really for
7 prosecutorial discretion, what the departments
8 and the agencies should be looking at, it seems
9 to me, is the dead weight loss you're imposing.
10 Is that large or small.

11 And then presumably the reason why
12 you allow any price increase to be imposed in the
13 short run is because there's some off-setting
14 benefit in the long run.

15 It's really a cost-benefit
16 analysis. I don't think there's going to be a
17 hard-and-fast rule two years is right or wrong.

18 But the second thing I want to
19 comment on, the way you phrased the question
20 makes it seem like two years is all that
21 matters for entry. Paul and Jim made an allusion
22 to the fact there was this -- that the guidelines
23 were revised in '92 before.

24 And I was for a time a secret
25 consultant to the Department of Justice, then

1 revealed, but we didn't have open hearings.
2 And I made many comments, and the only comment
3 that I think is observable in the guidelines is
4 on Page 28 based on paper that Rob and I wrote.

5 And it said, in a durable good
6 industry, if you have entry after year two, and
7 it's known, there can be enormous constraints
8 on the price in years one and two. The
9 guidelines explicitly recognize that. That
10 simply underscores that it's the competitors'
11 constraints that matter, period.

12 MS. BOAST: Bob?

13 MR. PRATT: I've got a short answer,
14 and that is that, you know, these are
15 guidelines. The two-year rule is useful
16 because of its clarity. It sets forth an order
17 of magnitude of duration that we're looking at,
18 and it should be understood by everyone that
19 there will be fluctuation in either direction.
20 But it's important to have a guide, a
21 benchmark.

22 MR. CARLTON: I agree with that.

23 MR. GERTNER: I agree with the bottom
24 line, Bob's bottom line. But I almost think that
25 -- I don't know, I went through the guidelines

1 thinking would the guidelines be better and more
2 accurate if every number was taken out. And I
3 actually think the answer may well be yes.

4 I think the notion -- given the
5 caveat that we've already talked about a number
6 of times, so I won't repeat, I think some
7 notion of timeliness is important.

8 Does adding the word, the number
9 two years beyond the word timely actually
10 reduce or increase confusion and quality of
11 analysis? And I'm not so sure.

12 If two is interpreted to mean kind
13 of sort of what we mean by timely is something
14 around two years, then maybe that's about the
15 level of precision we want.

16 But I think, you know, kind of
17 throughout, I think the false precision -- I
18 mean, Dennis said about HHI presumptions, you
19 know, if we're going to keep them, we need an
20 empirical basis for them.

21 Well, I think that means we don't have
22 numerical presumptions anymore because I don't
23 think anyone is going to find an empirical basis
24 for those other than the practice, inferring what
25 they are from the practice. Maybe you can

1 identify them -- you can't identify them for
2 what's going to be anticompetitive. Maybe you can
3 identify what the agencies do.

4 MR. CARLTON: Safe harbors.

5 MR. GERTNER: Yeah, safe harbors are
6 good -- I agree that we should have safe harbors.
7 I don't agree that you could find what the
8 threshold should be based upon anything other than
9 what do the agencies do.

10 MR. CARLTON: You think you couldn't
11 come up with an HHI safe harbor of a thousand
12 and not worry for a first pass?

13 MR. GERTNER: If you're a UPP kind of
14 guy, you'd get price increases at that level.

15 MR. CARLTON: I mean, I think the real
16 question is given the type one and type two
17 errors you make whenever you're making a
18 decision, don't you want to give some
19 guidelines to say, listen, if this is a small
20 merger, you guys have tiny market shares.
21 I'm not going to analyze it even though it may
22 be a one-in-a-million chance.

23 MR. GERTNER: I actually agree that the
24 best place for numbers are safe harbor
25 presumptions with narrow market definition. I

1 agree.

2 MS. BOAST: I must say that Rob's view
3 is very much what we've heard from the staff as
4 we've been meeting with them section by section to
5 make sure that we don't trip up their work, of
6 course, in this process.

7 And almost to a person the first
8 thing they've said is get rid of the step-wise
9 approach and all this structure because that's
10 not what we do.

11 We go out and collect the facts
12 and then we back into it because we think
13 that's what the front office wants.

14 MR. WEBER WALLER: Very briefly on the
15 timeliness, it says generally two years. In
16 light of Bob's comments and in light of yours,
17 Rob, can I conceive of a situation where entry
18 farther out has some present or future effect?
19 Sure, of course.

20 But I think the reality is it's a
21 benchmark and it's a de facto presumption. And
22 I think that's right. You know, the agencies
23 sometimes struggle to predict competitive
24 effects.

25 I think the burden should squarely

1 be on the parties. If they're really saying
2 distant and unlikely entry somehow actually
3 matters in this case, fine. If they've got the
4 facts and it's quite concrete, then I'm
5 confident the agencies will think about it
6 under the current framework. So I kind of like
7 that.

8 MS. BOAST: We've got about two-and-a-
9 half minutes left. I'd like to have thirty
10 seconds each on this question should there be a
11 burden on the parties on entry, who should bear
12 responsibility for the principal facts around
13 entry. And then we'll just let each person
14 give their number one item for merger change.

15 Anybody have a view on burden?
16 Rob?

17 MR. GERTNER: Well, I think the
18 questions are different. I think the
19 guidelines work well without specifying burdens.
20 I think that's probably the way it should be.

21 I think, again, that would raise
22 it to the level of trying to tell courts what
23 burdens should be; and I think that would,
24 again, push it towards as if it's a litigation
25 guide rather than what it's intended to be.

1 That said, I think on the question
2 of who brings the facts, I think to some extent
3 the entry facts and the entry -- the evidentiary
4 process for trying to figure out these very
5 difficult entry questions seem to me to be hard.

6 I think that the parties will have
7 to bear the burden of providing the information
8 because I think a lot of the standard types of
9 documents and requests and things that agencies
10 get easily might be more problematic with respect
11 to entry issues.

12 MS. BOAST: Bob, do you have a view as
13 an enforcer?

14 MR. PRATT: Yes, yes, the burden should
15 be on the party. You know, that's not entirely
16 joking. I do think they have the burden of
17 bringing to our attention, at least, identifying
18 the sources of entry.

19 And you know, of course we're not
20 going to base our actions upon what
21 information they provide; but you know, we'll
22 certainly look into it. But I think the
23 initial burden is on them to make an entry case.

24 MS. BOAST: Dennis?

25 MR. CARLTON: Well, I think figuring

1 out on whom to place the burden is a legal
2 question that really has to do with type one
3 and type two errors of the courts.

4 But putting that aside, from an
5 economic point of view, I would say the burden
6 shifts as the argument you're going to make
7 departs further and further from general
8 evidence in the economic literature.

9 And the way the burden should
10 shift is that your empirical experience in the
11 industry, to the extent that you're claiming it
12 would be different than what a general
13 literature is showing, becomes higher on you
14 when you make that argument.

15 And just to clarify on these
16 presumptions on HHI, I'm not big fan of these
17 specific levels when you trigger things. So
18 your suggestion of what the staff was saying
19 about the levels, I think, is exactly right.

20 But that would not lead me to get
21 rid of safe harbors as part of the definition.
22 That would lead to -- I think to too much of an
23 undisciplined approach.

24 MS. BOAST: Spencer, any views on
25 burden? You don't have to chime in here if you

1 don't want to.

2 MR. WEBER WALLER: Yeah, if entry
3 remains something at the back end of the
4 process, I think it should primarily be the
5 party's burdens to the transactions for all the
6 reasons I've said.

7 Be Careful-what-you-ask-for, if it
8 becomes a more holistic analysis of competitive
9 constraints pre- and post-merger, and more
10 closely tied to market definition and
11 competitive effects. Just be careful because if
12 that happens, I think courts will likely make that
13 more likely part of the government's burden.

14 MS. BOAST: That's why I'm asking the
15 question.

16 Well, Dennis, you told us
17 already what your number one change would be;
18 and that is to loosen the artificial
19 distinction between unilateral and coordinated
20 effects analysis.

21 So I'm going to take your turn
22 away and let the others go. If you could
23 recommend one single change to us, what would
24 it be, Rob?

25 MR. GERTNER: I hate to do this, but I

1 actually agree with Dennis, and so I'll make it
2 very brief.

3 MR. CARLTON: Why do you hate to?

4 MR. GERTNER: I don't get to say
5 something different. That's all. I like to
6 agree with you, Dennis.

7 MS. BOAST: Bob, what about you?

8 MR. PRATT: Well, if I could change the
9 question just a bit to say one thing that I
10 think would be useful, and that is some
11 reference in the guidelines to power buyers,
12 what that means.

13 It's an issue that has come up in the
14 courts over many decades. It goes back to the
15 '60s and '70s, the concept of the importance of
16 a power buyer. And I think in the Baker Hughes
17 case it became even more pronounced.

18 So some discussion of what it means,
19 what the agencies will view as a credible power
20 buyer story, even if it's only sponsored entry by
21 a power buyer. Even if you stop there and say,
22 we'll take that into account, but beyond that,
23 we're skeptical. But some treatment of the power
24 buyer issue.

25 MS. BOAST: Spencer, what about you?

1 MR. WEBER WALLER: From my opening
2 remarks, you might guess, it relates to market
3 definition and the role of brands both in
4 taking the existing test, such as SSNIP, more
5 seriously in connection with branded consumer
6 goods where sometimes it leads to more narrow
7 markets than you might otherwise think is the
8 case.

9 And in general, simply be more
10 aware of the business approach to branding as
11 to the market definitions it creates for
12 analyzing these.

13 MS. BOAST: Thank you all for your
14 thoughtfulness, your time, your contributions
15 and putting up with the cold weather.

16 I've eaten a little bit into the
17 break times, but we will reconvene at 10:45 so
18 everybody can -- nobody needs to go outside I
19 guess today. Thank you all.

20 (Applause.)

21 (Brief recess.)

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24
25

1 PANEL 2: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

2 MR. FEINSTEIN: We're slightly behind
3 schedule. So why don't we get started.

4 For those of you who don't know
5 me, I'm Rich Feinstein. I have the privilege
6 of currently serving as the director of the
7 Bureau of Competition at the FTC and the
8 additional privilege of being part of the gang
9 of six, along with Molly and four others, who
10 have been tasked with managing this process of
11 considering revisions to the Merger Guidelines.

12 It's a real pleasure to be here
13 today and also to have the opportunity to
14 moderate this very distinguished panel.

15 The format is going to be pretty
16 similar to what we just went through. I've
17 asked each of the panel members to have opening
18 remarks of five to ten minutes, and I'm going to
19 try to enforce that in terms of length.

20 After the opening presentations,
21 we're going to talk about some questions.
22 We'll welcome questions from the audience.
23 I've also asked each of the speakers to
24 offer some final thoughts in the last couple of
25 minutes.

1 And, if they have thoughts that go beyond
2 the specific topic of this panel, which is
3 competitive effects, if they have larger
4 suggestions for the guidelines process, I would
5 also encourage them to feel free to offer
6 those as well and we can perhaps do that at the
7 end.

8 With respect to competitive
9 effects, in some sense that's what the whole
10 exercise of analyzing mergers is about is
11 trying to make a well-informed prediction about
12 likely competitive effects.

13 And one of the interesting
14 corollaries of that is what do you do in
15 instances where you have relatively direct
16 evidence.

17 That may be easier to see with respect to
18 consummated mergers, but there are certainly models
19 or examples of direct evidence that have potential
20 applicability of how you analyze prospective
21 mergers.

22 And what this panel really is
23 going to talk about or try to address is the
24 different forms that evidence can take and what
25 sort of significance it should be given and

1 how, if at all, that should be incorporated
2 into revised guidelines.

3 So let me introduce our four
4 speakers, and I'll do it in the order in which
5 they're going to be speaking, I think. That's
6 my goal.

7 Our first speaker is Debbie
8 Majoras, who is immediately to my left, and
9 probably well known to everybody in the room.
10 She was previously a very distinguished Chair
11 of the Federal Trade Commission. Before that
12 served as a Deputy Assistant Attorney General
13 in the antitrust division and is currently a
14 vice president and general counsel of Procter &
15 Gamble.

16 I don't know whether she intends
17 to address the imminent cancellation of As the
18 World Turns that I read about yesterday, what
19 the competitive effects of that might be, but I
20 did think of you when I saw that in the paper.

21 MS. MAJORAS: That's our last soap
22 opera.

23 MR. FEINSTEIN: Last soap opera. We're
24 very pleased to have Debbie with us this
25 morning.

1 Following Debbie will be Michael
2 Whinston, who is the Robert E. and Emily H.
3 King Professor of Business Institutions in the
4 Department of Economics here at Northwestern
5 and a very distinguish industrial organization
6 economist.

7 After Michael, Monica Noether will
8 be speaking. Monica is currently the executive
9 vice president and chief operating officer of
10 the Charles River Associates. She is also a
11 very active consultant and testifying expert on
12 a variety of matters, including, in particular,
13 matters in the health care sector, where our
14 paths have crossed from time to time over the
15 years. We both served at one time as vice-
16 chairs of the Antitrust Practice Group of the
17 American Health Lawyers Association. And prior
18 to going to CRA, Monica was also at the Federal
19 Trade Commission back in the '90s. '80s and
20 '90s?

21 MS. NOETHER: '80s actually.

22 MR. FEINSTEIN: Then our fourth speaker
23 is Jim Langenfeld. Jim is a director at LECG,
24 an adjunct professor at the Loyola University
25 Law School here in Chicago, and has also spent

1 ten years at the Federal Trade Commission, the
2 last six of which he served as director for
3 antitrust in the Bureau of Economics. And Jim
4 also is a very experienced and thoughtful
5 expert on these topics.

6 So with that, let me turn it over
7 to Deb Majoras.

8 MS. MAJORAS: Well, thanks very much,
9 Rich. It's good to be back. I was thinking
10 that I'm not used to being outnumbered by
11 economists anymore. I'm sort of outnumbered by
12 MBA's these days, but good to be with all of
13 you.

14 I doubt you could find any tool
15 that the federal antitrust agencies used that's
16 had a greater impact than the Horizontal Merger
17 Guidelines.

18 If you look well beyond the two
19 agencies, that methodology is used by private
20 parties very extensively to determine whether
21 to even pursue a merger in the first place.

22 Obviously it's used by courts in
23 determining the validity of mergers and it's being
24 used by jurisdictions outside the federal
25 government here and, of course, around the world.

1 The one difficulty with guidelines
2 I always found when I was at the agencies
3 thinking about these things is that, they have to
4 be stable enough for a period of time that they
5 actually are helpful and useful in the transparency
6 that they provide.

7 On the other hand, our discipline
8 is not static. And we are constantly gaining
9 experiences and learning new knowledge that we
10 should be using in reviewing mergers.

11 So that's the trick in knowing when to
12 make revisions. I do applaud the agencies' efforts
13 to review the guidelines at this stage to see
14 whether a revision seems to be a good idea,
15 particularly given that it appears that the
16 agencies are not contemplating, at least at
17 this point, and I realize you're keeping an
18 open mind, Rich, but don't appear to be
19 contemplating a wholesale dumping of the
20 framework that we have that we've all become
21 pretty accustomed to and I think has worked
22 pretty well.

23 That would potentially have a very
24 tumultuous effect in the short term,
25 particularly in a very, very difficult economy

1 that's characterized by enough uncertainty
2 right now, but obviously potentially also for
3 the long term when you have a lot of
4 constituents that rely on these. So it's
5 something to think about.

6 I've been pleased to see that the
7 commentary on the guidelines that the agencies
8 issued in 2006 has been able to provide further
9 guidance and transparency to all of the
10 constituency; but I have no doubt that
11 eventually the time would come to think about
12 whether, okay, is it really time to revise
13 these guidelines.

14 So we're here today to discuss on
15 this panel the direct evidence of competitive
16 effects, which has been described and I'm glad
17 you all described it as evidence that is not
18 based on inferences drawn from increases in
19 market concentration.

20 So it seems like it's kind of the
21 everything else outside of, outside of market
22 concentration. And the reason I say I'm glad
23 you defined it is because when I first saw the
24 name of the panel and hadn't remembered how you
25 had defined it when you put out the notices, I

1 wasn't exactly sure what it was meant to cover.

2 And I'm not sure, to be honest
3 with you going forward, whether we have the
4 right label on all of that evidence. To call
5 this all direct evidence seems to me to be
6 perhaps a little bit broad and perhaps promises
7 a little bit too much, but I'll get to that in
8 a second.

9 The first thing I do want to say
10 is there's been a lot of debate about how much
11 weight to place on concentration inferences,
12 including whether to eliminate them.

13 And there's no question that
14 they're not a perfect indicator, and there's some
15 question whether it's any indicator at all when
16 we're talking about unilateral effects in
17 differentiated products setting.

18 But I would say this. Without
19 them, as imperfect as they may be, or some
20 substitute or some set of safe harbors, the two
21 most important merger review processes in the
22 entire process chain would be rendered way too
23 difficult and way too expensive.

24 And by that I'm talking about
25 first the party's antitrust review that they do

1 with their lawyers in-house and with outside
2 counsel before deciding whether to even proceed
3 with the merger.

4 That's a very important component
5 of deciding whether to spend the time and money
6 and the effort involved in a merger. And second,
7 I'm talking about the agency's review within the
8 first thirty days after the HSR filing is
9 made. Most mergers live or die within those
10 two time periods.

11 So whenever we're thinking about
12 what kind of an analysis we do, we have to keep
13 some of it simple enough that that can actually
14 be done.

15 I think that, frankly, you can't perform
16 a complete competitive effects analysis in thirty
17 days. And given that most mergers pose no
18 competitive issues, you've got to have efficiency
19 in that thirty-day period.

20 That said, I do agree with what we
21 said in the commentary, which is that the
22 concentration levels are a starting point.
23 Obviously the competitive effects analysis when
24 you have a hypothesis that a merger may be a
25 problem is the most important piece. And then what

1 we're calling today direct evidence provides the
2 basis for the closer scrutiny.

3 Now, the questions that were
4 provided by the agencies for thinking about this
5 evidence asks the question whether guidelines
6 should discuss the types of evidence that are
7 pertinent in a horizontal merger review and how
8 they are used.

9 Now, a lot of people think it's a
10 bad idea to put those in the guidelines. I
11 actually think that putting some of that in the
12 guidelines would be useful, or putting it in
13 the guidelines appendix, for example, if it
14 somehow makes the guidelines themselves a
15 little bit too clunky.

16 Provided that, A, that guidance is
17 broad enough and inclusive enough that it won't
18 inhibit the introduction of new types of evidence,
19 evidence not contemplated in the guidelines, but
20 that is nonetheless probative because I don't think
21 it's an unlimited set, but I think it could be
22 beyond our imagination today.

23 B, that it's made clear that the
24 guidance is not just providing a type of
25 checklist. There's always that danger that people

1 start looking at it as a checklist or start
2 thinking that it's all equally probative, because I
3 don't think that's the case.

4 And C, that it's also made clear
5 that the agencies ultimately are going to look
6 at the evidence as a whole in any given matter.
7 So you might have some evidence of one type
8 that's somewhat probative, evidence of another
9 type that's more probative. You have to look
10 at it as a whole piece.

11 The commentary stated that, quote,
12 "The agencies assess the full range of
13 qualitative and quantitative evidence obtained
14 from merging parties, their competitors, their
15 customers in a variety of sources."

16 And I might just build on this in
17 the guidelines by discussing more specifically
18 the types of evidence that the agencies look to
19 as probative, perhaps some indication, based on
20 experience of what might make it more or less
21 probative without settling on, you know, this
22 is the ultimate evidence or that's the ultimate
23 evidence, because I do think that that would be
24 a mistake. Again, making it clear this list is
25 not intended to be exclusive.

1 I think this would be useful not
2 only to parties contemplating a merger, and
3 clearly it would be, but also to courts and
4 other institutions that look to these
5 guidelines for help.

6 That's not the primary purpose of
7 the guidelines obviously, but it is a reality.
8 There were many times during my travels when I
9 was with the FTC or DOJ where after we were
10 explaining the U.S. analytical framework to
11 perhaps officials at a new agency or perhaps in
12 a developing country someone would always ask,
13 and usually it was the person who knew they
14 were going to have to do the work on this at
15 the end, would always ask the question, okay,
16 okay, I see the analysis. How do you actually
17 do it? How do you actually figure it out?

18 That's important, too. Again, if
19 it's too clunky to put in the guidelines, I
20 would think about an appendix. The question's
21 been asked should it include examples, like the
22 commentary does.

23 Perhaps not, given that the
24 commentary is out there and that in itself
25 could be updated. On the other hand, if you

1 look at what the FTC on the consumer side does
2 with its, for example, endorsement guidelines,
3 where basically it sets out the guidelines and
4 then has another document that sets out
5 hypotheticals and examples from real
6 experience. That might be, that might be a way
7 to do it.

8 I'd like to talk a little bit
9 about whether defining markets is necessary,
10 but I think we'll probably talk about that in
11 the Q and A. So I think I'll probably stop
12 there, Rich, and let the others have their
13 turn. Thank you.

14 MR. FEINSTEIN: Michael.

15 MR. WHINSTON: Thanks. It's a pleasure
16 and an honor to be asked to participate in
17 discussing the possible revision of the merger
18 guidelines, an issue that I think is of great
19 importance both for consumers and overall
20 efficiency.

21 So in my opening remarks I want to
22 comment on three topics. Two quite quickly,
23 and then a third at a little more length.

24 The first point, I think, is the
25 guidelines really should not be static. I

1 think Debbie was just mentioning, and I would
2 reiterate it, that the last significant
3 revision was over twenty-five years ago.

4 And you know, I think a
5 fundamental fact is in those twenty-five years
6 knowledge in the field of industrial
7 organization, in economics, knowledge in the
8 area of horizontal mergers is one of the areas
9 that's seen the most progress. So as such, I
10 think the time is really right for an updating of
11 the guidelines.

12 The second thing I wanted to
13 comment on briefly is the issue of what are the
14 aims of the guidelines. So I think if you're
15 thinking about updating the guidelines, it's
16 obviously worthwhile to think about what the
17 purpose is.

18 You can think of a number of different
19 purposes. One is they may provide an outline for
20 internal use of the agencies themselves. Obviously
21 then you want to describe the procedure that you're
22 using.

23 Second thing is they're
24 communicating to firms and the antitrust bar.
25 And there, too, I think it suggests a very

1 transparent approach so that firms aren't
2 spending time investigating and thinking about
3 mergers that ultimately aren't going to happen
4 or aren't dismissing mergers that could happen
5 and would be good.

6 The third issue which has come up,
7 Debbie mentioned and it came up in the previous
8 panel, is teaching and influencing the courts.
9 So I think in that regard, if you're going to
10 do that, it suggests the need to explain why
11 the agencies believe certain kinds of evidence
12 are useful or not useful.

13 And I think, you know, not -- I'm
14 not a district court judge or an appellate
15 court judge, but if I were, I probably wouldn't
16 be looking at the economics literature, maybe
17 not too much at law review articles explaining
18 the economics literature, but I think
19 there may be a real role for the agencies to be
20 explaining, to have short documents that
21 explain the procedures that they're
22 using and when they think they're good and when
23 they think they're not good.

24 Actually, until an hour ago, I
25 personally did not know about the commentaries

1 and I haven't even looked at them. But I think
2 there's a real role for those kind of documents
3 potentially.

4 And the final possibility is maybe
5 they are relevant for bargaining position.
6 Ultimately many problematic mergers are
7 settled; and if you want to get to X, it's
8 not clear necessarily that you should start at
9 X.

10 That I think is perhaps a little more
11 controversial. I think it is interesting to note
12 that there's a big discrepancy right now between
13 the current thresholds and current practices. And
14 at least one argument for that might be this kind
15 of bargaining element.

16 The third thing I want to talk
17 about at greater length is the issue of market
18 definition and concentration-based
19 presumptions.

20 So I think when it comes to
21 mergers that go to second requests, in some
22 sense the agency seems to follow an open-ended
23 and detailed inquiry that reflects really the
24 very best methods currently available.

25 And while the guidelines don't

1 currently mention many of the methods that are
2 used, they're twenty-five years old, and it's
3 not surprising, they don't really seem to get
4 in the way to too large a degree either.

5 To me I think the place where they
6 do currently seem most out of sync in current
7 learning is in their market definition and
8 concentration-based procedures, which seem now
9 in some sense mainly to be used as an initial
10 screening device.

11 I completely agree with Debbie
12 about the importance of having initial
13 screening devices; and I think having some kind of
14 device is critical. The question is what kind of
15 device should it be.

16 Now, while intuitive, I think this
17 market definition procedure and also the
18 associated concentration thresholds are not
19 based directly on any model, nor are they
20 clearly linked to any empirical results of
21 merger effects. Ultimately maybe they will be,
22 but right now I don't think they are.

23 Moreover, the procedure currently
24 has a somewhat odd and roundabout nature
25 because if we have the information to answer

1 the market definition question, we typically
2 also have the information to just directly
3 study the degree to which a merger would
4 increase prices, at least in a unilateral
5 effects sense.

6 So I think it would be nice to
7 improve on this state of affairs. One
8 interesting proposal for doing so, which is
9 focused on differentiated product industry,
10 appears in a recent paper by Joe Farrell and
11 Carl Shapiro. And guess I'd like to say just a
12 few things about it.

13 So the basic idea is fairly
14 straightforward. A merger causes the newly
15 merged firm intuitively to face a new cost of
16 lowering its price, namely, the loss of
17 profitable sales by the new and acquired
18 division.

19 So if we measure the size of this
20 effect, which equals the product of the
21 diversion ratio and the division's price cost
22 margin, we can then go compare it to some
23 typical presumed level of merger- induced
24 efficiency.

25 Maybe we say that 5 percent on

1 average. I'm not saying that's the right
2 number, but whatever number you like. So if
3 it's larger than in Farrell and Shapiro's
4 terminology, there's upward pricing pressure
5 caused by the merger. And then what they
6 propose is using this as a screen to determine
7 whether to investigate further.

8 Now, I think this is an attractive
9 idea compared to current market definition
10 procedure. It has the advantage that it's
11 actually directly linked in a clear way to what
12 we think is a key driver for merger-induced
13 incentives for unilateral price increases.

14 In a sense, it's a poor man's
15 merger simulation exercise; but for screening
16 purposes, the poor man's approach is exactly
17 what we want.

18 Now, it has some drawbacks. Given
19 the time constraints, I guess I won't mention
20 them now. It's not clear how often we're
21 going to really know what price cost margins
22 are or diversion ratios. It doesn't include
23 other effects that, in a sense, the concentration
24 thresholds could, such as typically a merger
25 might encourage collusion, maybe it

1 would encourage entry, maybe there would
2 be capacity adjustments. And you know,
3 their procedure is going to leave all of
4 that out, just like merger simulation does.

5 So there are limitations, but I think
6 it has the potential to be useful. That said,
7 I'm a little surprised Joe and Carl stopped
8 where they did.

9 In particular, they proposed this
10 method for differentiated product industries,
11 emphasizing their difference from homogeneous
12 product industries where they seem to suggest
13 that the concentration approach makes more
14 sense.

15 But I think that in fact exactly
16 the same kind of procedure could be used
17 in homogeneous product industries where you
18 think capacity is an important competitive
19 asset.

20 So indeed the presence of upward
21 pricing pressure in homogenous product
22 industry can be judged directly from
23 merging firms' margins. Unlike in differentiated
24 product industries where you need to know diversion
25 ratios, here you don't even need

1 to know anything about demand.

2 Moreover, it's much more certain
3 to translate into lower levels of consumer
4 welfare than in a differentiated product
5 industry.

6 So with this in mind, when I
7 was thinking about it, I thought it was
8 of some interest to see how this application
9 of the upward pricing pressure approach
10 would compare to existing concentration
11 thresholds in homogenous good industries.

12 So for example, suppose we
13 initially have an industry with equal-sized
14 firms facing a constant elasticity of demand.
15 The demand elasticity is 2, and presume this
16 is for the overall demand in the market, and
17 the presumed efficiency gain is 5 percent.

18 It turns out uniform pricing
19 pressure would exist whenever the post-merger
20 Herfindahl exceeded 1,052. With an efficiency
21 gain of 10 percent, it would exist if the
22 post-merger Herfindahl was above 2,222, which
23 are numbers that are actually remarkably close
24 to the current thresholds.

25 It turns out, however, that the

1 level of concentration at which uniform pricing
2 pressure would be present depends greatly on
3 the industry's demand elasticity.

4 So with a demand elasticity of
5 1.5, it would be present with possible efficiency
6 gains of 5 percent and 10 percent, then it would be
7 present if the HHI exceeded 769 with a 5 percent
8 gain or 1,587 with a 10 percent gain.

9 On the other hand, if the demand
10 elasticity were greater, then it wouldn't be
11 present with a 5 percent efficiency gain until
12 concentration was about 2,100, and with a 10
13 percent gain until it was 5,700.

14 So, I think one of the things this
15 illustrates actually is in a pretty
16 stark way some of the benefit of the pricing
17 pressure approach relative to the current
18 concentration ratios in that the pricing
19 pressure makes the screen sensitive
20 to an economic factor, namely the elasticity
21 of demand, that has clear implications for
22 pricing incentives, okay, while the
23 concentration numbers don't have anything to do
24 with that.

25 In that sense, I think it sort

1 of suggests that if there's a procedure like
2 this that can readily be sensitive to include
3 factors like that, it may be useful.

4 Now, that said, I think it's
5 important before incorporating anything like
6 this to get a good sense for how often it's
7 going to be possible to use and, how it differs
8 from the current screening procedures.

9 So to me, I think one thing the
10 agencies should be doing is, both going forward
11 and looking back, comparing methods like this and
12 see what difference they would make and whether
13 they seem to give good answers or not as screening
14 devices. I'll stop there.

15 MR. FEINSTEIN: Thanks, Michael, very
16 much.

17 As some of you may be aware,
18 Monica was a testifying expert in one of the
19 textbook examples of a merger where there was
20 found to be or there were found to be direct
21 effects, which I think to some degree
22 drove the result; and that's, of course, the
23 Evanston Hospital case.

24 I don't know if you're planning to
25 talk about that specifically or not, Monica;

1 but in any event, certainly I think it's
2 generally relevant to what we're talking about
3 here today.

4 MS. NOETHER: And it's obviously
5 helped me think a lot about the issues
6 with respect to concentrated markets.

7 I want to start off by thanking
8 the DOJ and FTC for inviting me to participate
9 today. I'm honored to be able to take part in
10 what I think is a very important session and
11 very timely.

12 As Rich suggested, within the
13 broad context of thinking about all sorts of
14 nonstructural evidence, I'm going to focus
15 primarily on evidence related to consummated
16 mergers.

17 Obviously analyses of consummated
18 mergers are a minority in the merger
19 evaluations that take place, but I think
20 they're still of interest both because there
21 are situations where the agencies want to go
22 back and look at a merger that has already
23 happened and also because there may be some
24 more general lessons that can be learned from a
25 systematic analysis of consummated mergers.

1 So the question I think that comes
2 up in this context is can a post-merger
3 consummation investigation skip most of the
4 structural analysis, and for that matter, most
5 of the more qualitative evidence of competitive
6 dynamics since there's evidence of actual
7 conduct, particularly what's happened to prices
8 following the completion of the merger.

9 I think all of us agree, and it's
10 certainly been stated by various panelists,
11 that market definition itself is really merely
12 a tool that provides a context for analysis in
13 competitive effects, either prospectively or
14 retrospectively.

15 And certainly when you're talking
16 about a differentiated product industry,
17 precise market definition is always going to be
18 arbitrary. It's really the closest
19 substitution that's the relevant question.

20 But the question I think about
21 skipping, most of the structural analysis in a
22 consummated merger case is really the same
23 question that you could apply to any kind of
24 case where we have observations of actual
25 behavior.

1 And the question is, is the use of
2 anti-competitive market power the most probable
3 explanation for the behavior of the market
4 dynamics that we actually observe after this
5 has happened.

6 And in most conduct cases, I think
7 we end up actually doing the full analysis,
8 which does involve at least some form of market
9 definition, at least to establish the context
10 in the which of the analysis is done.

11 I'd argue that even in the merger
12 cases the same kind of logic holds, or at
13 least, and here's sort of my fundamental theme,
14 we need to check to make sure that the various
15 pieces of the analysis all corroborate each
16 other.

17 Is there a credible unilateral or
18 coordinated effects story which comports with any
19 observed price increases. And the question to
20 ask in sort of checking on that
21 corroboration -- and I'm going to, as Rich
22 suggests, I focus on healthcare, and so I will
23 use hospital mergers generally.

24 Whether you want to a draw an
25 analysis to Evanston or not, I don't think is

1 important to frame my comments on this.

2 So you know, the first question I
3 look at is are the merging firms close
4 substitutes for each others. Certainly
5 hospitals are differentiated in various
6 regards.

7 Did they offer the same range of
8 services, are they geographically proximate,
9 since you've got local markets generally. Did
10 they have overlapping medical staffs.

11 Second, to what extent did the
12 hospitals compete with each other prior to the
13 merger. What evidence is there. What do their
14 own marketing or planning documents say about
15 each other versus other facilities.

16 Then focusing on their customers
17 versus all the managed care organizations. Is
18 there any evidence the managed care
19 organizations played the hospitals off of each
20 other.

21 And I would think certainly
22 documents that one obtains in the normal course
23 of business are probably generally going to be more
24 credible than testimony at the time of trial, for
25 example.

1 If you look at the MCOs network,
2 can you see that one hospital was in some of
3 the networks but not the other, suggesting that
4 they were substitutes for each other.

5 Looking also at patients, the
6 other customers in hospitals, what does patient
7 flow data suggest about whether a significant
8 number of patients chose between the merging
9 facilities as opposed to other hospitals that
10 service the areas. What do the patient survey
11 say.

12 Third, to what extent did the
13 other hospitals appear to compete with one or both
14 of the facilities. Same types of evidence that
15 you'd use to compare to try to determine whether
16 the two hospitals in question were substitutes for
17 each other.

18 And can MCOs live without both
19 hospitals because there are other competitors
20 that they can use to essentially build credible
21 networks for patients.

22 Fourth, were the market dynamics
23 changing, e.g., were there other hospitals that
24 were repositioning by adding new services,
25 building new ambulatory services, for example,

1 or affiliating with new medical groups to bring
2 patients to them.

3 And then finally we get to the
4 econometric evidence of the direct effects,
5 which I think has been sometimes suggested
6 that's all we need to do; but I see that really
7 as just one additional piece of the puzzle that
8 needs to fit in with the others.

9 Essentially the econometric
10 exercise is essentially finding a way to
11 estimate what the but-for price would have been
12 in the absence of the merger, and then
13 comparing it to the prices that we actually
14 observed after the merger occurred.

15 There are two approaches that are
16 generally used. The so-called difference-in-
17 difference approach, which is really looking at
18 price changes. And in that situation, you need
19 to find a control group that's identical in
20 terms of all of the demand and cost pressures
21 in every regard to the merging facilities,
22 except that they didn't merge.

23 And to do the analysis, since you
24 are focusing just on changes, essentially it's
25 assuming that all of your control group

1 facilities, as well as your merged facilities,
2 were in complete equilibrium as sort of the base
3 point from which you start the analysis.

4 And you know, for example, in the
5 hospital context, contracts tend to go on for
6 long periods of time. So to the extent that
7 you've got hospitals at different points of
8 their contractual cycle, the assumption that
9 all are at the same point in equilibrium at
10 the beginning may not always be valid.

11 The second approach is using
12 multiple regression analysis -- controlling for
13 all of the same relevant times, cost and demand
14 features.

15 And I would argue again that in
16 both of these methodologies, while
17 theoretically they're certainly valid
18 methodology, they're generally impossible to
19 apply completely or sufficiently accurate,
20 particularly in differentiated product
21 industry.

22 You've got data limitations,
23 measurement issues. Again, in the hospital
24 context or health context, generally quality is
25 a very important dimension of competition and

1 just a dimension of differentiation, but very
2 hard to measure in any kind of objective or
3 qualitative way.

4 This kind of makes me think about the old
5 saying that economists are the only ones that
6 predict the past with about a 50 percentage
7 accuracy.

8 But returning to the original
9 question regarding the necessity of structural
10 evidence, I just want to comment on one piece,
11 and I know we'll talk about it more later.

12 There's a notion that one can back
13 into market definition. In other words, if you
14 observe prices went up, it must be the case
15 that the merging firms constitute a market to
16 themselves.

17 And that kind of logic, I think,
18 again, is only appropriate if we're absolutely
19 sure that we've ruled out all the alternative
20 explanations of an observed price increase.
21 And my comment would be that that's relatively
22 impossible.

23 So again, just to sum up, I think
24 you need to make sure that all of the different
25 types of evidence, and it includes certainly the

1 analysis of price, price changes that can be a
2 piece of it, but you need to look at the other
3 types of evidence to make sure that all the types
4 of evidence are consistent with each other.

5 And if they're not, and in
6 particular if you do observe price increases,
7 but the other types of evidence suggest that
8 the firms really weren't particularly close
9 competitors, then you need to think about what
10 the price changes are telling you and what it
11 is that you're really measuring.

12 Is the price increase real or is
13 it just a matter of timing. What's the
14 appropriate baseline or benchmark? For
15 example, are there quality issues that you
16 haven't been able to take account of? Are
17 there other data issues in the econometrics
18 that you've done? Are all customers impacted? If
19 they're not, is there a good explanation for
20 why different competitors -- customers have
21 been impacted in different ways? What's happened
22 to output? That's an important question that
23 certainly needs to be considered. If you see
24 prices have gone up but output's gone up, too, what
25 does that tell you. And just finally, are there

1 alternative explanations?

2 And bringing it back to certainly
3 the current question about should the
4 guidelines be changed, if there's going to be a
5 change that essentially suggests there should
6 be more emphasis on direct effects, I think it
7 would be important to stress that we need to
8 consider the context of the evidence you're
9 looking at, essentially look at all the pieces
10 together.

11 MR. FEINSTEIN: Thank you, Monica, very
12 much. Jim.

13 MR. LANGENFELD: Thank you, and once
14 again, thank you and Molly for including me.
15 I'm very honored to be part of the process and
16 to get back on the horse.

17 After thinking about the Merger
18 Guidelines for so long in the early '90s, now I
19 get to think about changing them again a little
20 bit and hopefully a little of what I think now
21 might be of help, I hope.

22 The first thing I want to do,
23 though, is be a little contrary and say I don't
24 agree -- I'm going to focus on the topic at
25 hand, which is the direct evidence of

1 competitive effects.

2 I've submitted, as Dennis and Rob
3 have, more general comments which are available.
4 And I will have an article coming out in Global
5 Competition Policy that summarizes some of my
6 thoughts.

7 But to go specifically to this
8 area, so I'm going to take a narrow focus. The
9 first thing I'm going to do is I'm going to say
10 that I don't think the panel is named
11 correctly.

12 Now, I understand this is a
13 definitional thing, but we need to think about
14 what we're talking about here.

15 As Carl Shapiro has defined it,
16 and Debbie mentioned this, that maybe it's a
17 little too broad a topic in terms of
18 classifying all these things as direct effects
19 evidence.

20 Really, very little of what we're
21 going to talk about today or what question two
22 of the twenty questions that the agencies, I
23 think, have very well crafted, question two
24 talks about so-called direct effects evidence.

25 But the definition is, as Debbie

1 points out, anything other than structure.

2 Well, that doesn't make any sense. Now, wait a
3 minute.

4 What Monica is talking about here
5 from a consummated merger is direct effects
6 evidence. We had an action and you can
7 hopefully, doing it the right way, as Monica has
8 done, you get a result. That is direct evidence.

9 All the other things under this
10 panel we're talking about are really indirect
11 effects evidence. They just don't happen to be
12 structural.

13 So I think we need to keep that in
14 mind as we go through this, and I can focus on
15 one of the specific types of evidence and maybe
16 that will illustrate the point.

17 But I want to read, and before I
18 talk about that a little bit, let's keep in
19 mind also the agencies says their goal is,
20 which is "to determine if updating the
21 guidelines could more accurately and clearly
22 describe current agency practice," all right,
23 "and reflect and incorporate learning and
24 experience gained since 1992."

25 Those are the goals. So I'm going

1 to look at question two in the context of those
2 two. Seems the right thing to do.

3 Question two asks, "Should the
4 guidelines be revised to address more fully how
5 the agencies use evidence about likely
6 competitive effects that is not based on
7 inferences drawn from increases in market
8 concentration?"

9 This is the language that I think
10 would be more appropriate for the panel, you
11 know, what else beyond concentration should we
12 consider.

13 I think the answer to that is
14 unequivocally a yes. The guidelines, even back
15 in '92, we crossed this bridge. If you look at
16 Sections 1.11 and 1.21, they talk about
17 examples of evidence.

18 They talk about buyers having
19 shifted or considered shifting. Now, we're not
20 talking about a tool so much. But it also
21 talks about whether sellers base business
22 decisions on the prospect of buyer substitution
23 in market definition, both geography and product,
24 and the timing and cost of switching products.

25 So we're already past that. Now,

1 maybe more specific guidance is the type of
2 tools and the questions that should be asked is
3 a fair question. How general should they be,
4 and Debbie mentioned that.

5 But I think that putting this type
6 of so-called, this nonstructural evidence in
7 the guidelines, and at least maybe at a general
8 level, is really important.

9 So the answer to that, should they
10 be in there, absolutely yes, for transparency
11 purposes.

12 So let's look at the next question
13 within question two. "If such revisions are
14 undertaken, what types of such direct," once
15 again, I wouldn't use the word direct,
16 "evidence are pertinent? How should the
17 following categories of evidence be used?"

18 Well, let's look at those
19 categories that are listed. Those categories
20 are natural experiments, evidence from
21 consummated mergers, post-merger plans, a la
22 Whole Foods, Kevin will know about this,
23 benefits from parties from head- to-head
24 rivalry, customer views, and the history of
25 industry coordination.

1 While I'm sufficiently old to know
2 that at least the last four of those,
3 post-merger plans, benefits of head-to-head
4 rivalry, customer views, and history of
5 industry coordination, have been used since my
6 first term as a staff person at the FTC, which goes
7 back into the '80s.

8 So those are things that the
9 agency have used, they continue to use, and
10 perhaps they need some explanation. But they
11 should be mentioned, in my opinion. These aren't
12 new. So they sort of address the first part
13 because this is what the agency has been doing for
14 decades.

15 The new ones are what I would call
16 natural experiments because that really has
17 developed since 1992, and particularly with the
18 Staples merger.

19 And evidence of a more sophisticated
20 analysis of consummated mergers than we've had
21 before, and Posner wrote about you should see what
22 happens after a merger if it's not an HSR
23 challenge.

24 But really, the type of work that
25 Monica has been doing, and others, but that

1 post-merger type of analysis has really become much
2 more sophisticated, much more understandable, I
3 believe.

4 So those are the two areas, and
5 Monica has covered the second. So I'm going to
6 talk about the first one, which is natural
7 experiments.

8 And Mary Coleman, who's here, and
9 and I have written the definitive paper on
10 natural experiments, of course, that came in
11 the issues of Competition Law and Economics.

12 You know, we thought a lot about
13 this. We got comments. Our referee was
14 Greg Werden, so you know, we got a few
15 comments back. For those of you who know
16 Greg, you can imagine. It still got in, so I
17 feel pretty strong that we got this about as
18 right as you can.

19 So controlled experiments are the
20 first thing to keep in mind. Because if you
21 know what a natural experiment is, let's figure
22 out what an experiment is, right?

23 So let's look at the ones that
24 really are the better ones, frankly, in a lot
25 of ways, controlled experiments. Frequently

1 used in scientific studies. What are they?

2 You create two groups that are
3 really, really alike, all right. And you have
4 one group that's going to be experimented on
5 and one group that's not. And you subject one
6 group to some exogenous experiment. You give
7 them a pill that's supposed to make them feel
8 better, and another one you give a placebo.

9 And then you compare the changes
10 after they start taking the drug, let's
11 say, and you see what the outcomes are. So you
12 have sort of a benchmark. So what you're
13 really doing is using a control group and an
14 experimental group.

15 Now, sadly enough, in economics we
16 really don't have the option, except sometimes
17 with state laws, to really run these type of
18 experiments. Things go on. The market goes
19 on.

20 We can't say, okay, this group
21 over here, you're only going to buy these
22 products. And this group, you're going to buy
23 other products. Which one of you are happier.
24 We just don't have that, especially in a
25 competition world.

1 So what we have defined as a
2 natural experiment, and there is some
3 disagreement about this because we were the
4 first that really actually tried to define
5 this, as far as Mary and I could tell, "A
6 natural experiment compares the outcome
7 associated with the firm or market of interest
8 with those of other firms or markets that serve
9 as a control group," that is to say unaffected
10 by the behavior of interest. So you're trying
11 to define something.

12 And the key, really, the first
13 time in the merger context that this ever
14 really took place was in the Staples case. And
15 Malcolm Coate has -- we've talked about
16 Malcolm. He's checked me. He thinks we're
17 right on this. So if Malcolm believes it,
18 there is some assurance we're correct on that.

19 But what really has happened is
20 it wasn't a direct evidence because the merger
21 hadn't taken place, but it was a natural experiment
22 in the sense that there were different geographies.

23 There were a different number of
24 office superstores that competed, one, two or
25 three. And there was both econometric and

1 documentary evidence, although the judge seemed
2 to rely more on the documentary evidence, to
3 say that if there were two, the prices were
4 lower than if there was only one, and if there
5 were three, the prices were lower than if there
6 were only one or two.

7 And think about the challenges in
8 market definition here. I mean, office
9 superstores, you could buy pencils anywhere,
10 right. But yet, this type of natural
11 experiment, is what I would call it, actually
12 won the day for the FTC in a litigated case.

13 So what's important to keep in
14 mind in terms of writing something like natural
15 experiments into the guidelines?

16 Well, the first thing, and these
17 are sort of Daubert-type concerns, I mean, I
18 teach as adjunct professor at a competing law
19 school here, but really, the key thing is, in
20 my senses, if we're going to do economic work,
21 and the agencies are going to put forth
22 something as a reliable piece of evidence, we
23 should always think in terms of whether it's
24 Daubert-proof or not.

25 So, first of all, does the

1 experiment fit the facts. In other words, how
2 close are the facts to what you're trying to
3 simulate, to the merger.

4 Do prices go up, for example,
5 after a previous merger. And lastly, does the
6 analysis employ sound economic methodologies.
7 That is to say, are we really measuring
8 outcomes effectively, prices, output or
9 quantity, innovations? Are we measuring those
10 accurately?

11 Are we controlling for other
12 factors, such as what Monica has pointed out?
13 Have we identified the most comparable groups
14 for the experiment? And what are the results?
15 Are they sound? Can we look at them if it's
16 econometrically several different ways? Is it
17 consistent with other market evidence?

18 Because I think all of these
19 pieces that you could consider in terms of
20 putting in and measuring nonstructural analyses
21 all need to be checked against other types of
22 real-world and other types of analyses.

23 I don't think you really want to
24 put all of your eggs in a natural experiment,
25 an econometric, a merger simulation study. I

1 just don't think it's appropriate.

2 This is a real-world phenomenon.
3 You should have evidence from more than one
4 point of view. Thanks.

5 MR. FEINSTEIN: Thank you very much,
6 Jim. What I want to do first is kind of follow
7 up on something that was alluded to in several
8 sets of remarks.

9 I'm happy to adopt nonstructural
10 evidence as opposed to evidence of direct
11 effects if that makes people happier.

12 MR. LANGENFELD: Makes me happier.

13 MS. MAJORAS: You're a good moderator
14 keeping us happy.

15 MR. FEINSTEIN: I think it's a useful
16 observation actually.

17 With that as background, as I
18 think a couple of speakers noted, and as I
19 suggested at the beginning, in some sense
20 figuring out what the likely competitive
21 effects are going to be with an unconsummated
22 merger is the goal of this entire exercise.

23 Making a well-informed prediction
24 that if you're in court is persuasive to a judge
25 or if you're not in court it's persuasive to

1 the enforcement agencies one way or the other.

2 And market definition is not the
3 end. It's just one of the tools along the way.
4 But for the lawyers in the room there are lots
5 of cases, of course, that say you need to
6 define a market and you need to assess the
7 likely competitive effects in the context of
8 that market.

9 And one of the ways traditionally
10 that that's been done, of course, is based on
11 structural evidence. So if we're going to
12 leave the structural evidence off to one side,
13 then the large question is what's the relationship
14 between the use of what we'll call nonstructural
15 evidence and market definition?

16 Is it still necessary to define
17 the market from an economic perspective? Can
18 you back into it in a way that's sufficient to
19 meet one's burdens in court? Are there
20 circumstances in which the existence of this
21 sort of nonstructural or direct evidence makes
22 it unnecessary to define a market at all?

23 I'd love to hear the views of any
24 of the panelists who have views. Debbie, do
25 you want to go first?

1 MS. MAJORAS: Sure. Well, as you know
2 better, I can't speak for the economists,
3 there's three sitting with me, but the way I've
4 always looked at this is it seems to me from an
5 economic standpoint that, yes, you would be
6 able to dispense with defining markets the way
7 we do because the way we define markets is a
8 legal tool that we've come up with.

9 But having said that, we don't
10 have a perfect economic system for
11 reviewing mergers. We can't. We have to do it
12 within the context and within the framework of
13 a legal system and within the framework of a
14 system that's fairly predictable.

15 You know, a lot of lawyers say,
16 look, we understand the analysis, we understand
17 the very close relationship between the
18 evidence that you're using to define the market
19 and the evidence you're using go to predict
20 competitive effects, particularly in unilateral
21 analysis with differentiated products, it's the
22 same, and that's how people say you can back
23 into it.

24 But what lawyers say again and
25 again is that they're very concerned about

1 taking away that discipline of starting with
2 market definition. And there's also the
3 reality that courts do expect to see it.

4 I guess what I would say is I think there
5 is a disciplining effect. I think we can, we can
6 pull apart a little bit, though.

7 First of all, at a minimum, I
8 would say that even the guidelines or at some
9 point, and we've tried to do this in decisions
10 perhaps like Evanston and others, at a minimum,
11 I think courts need to understand better how it
12 is that there's this relationship between
13 market definition and competitive effects so
14 that when you define a market in a
15 unilateral effects case, often you come up with
16 this market definition that sounds very
17 gerrymandered to people, it sounds really
18 stupid, frankly, because it looks like it bears
19 no relation to a market in the real world.

20 So that's a problem that the
21 agencies have had, and I think that's a problem
22 to be addressed. You could say, well, the
23 underlying unilateral effects analysis is
24 wrong, but I don't hear people necessarily
25 saying that.

1 So if the analysis is right,
2 you've got to get the way that it's described
3 to courts and other constituents right because
4 this is a legal exercise.

5 The second thing I would say is I
6 think in a Federated case, the way the FTC said,
7 look, we don't see a need
8 to define a market, because even if we define
9 it in X, Y, Z fashion, there's not going to be
10 a problem.

11 I think that's actually an
12 appropriate use, in other words, you know, when
13 you are excluding the possibility of a problem.

14 I, by the way, was recused on that
15 case, so I'm not tooting my own horn; but I
16 actually think that much like you would in an
17 analysis turn to entry and see that there's just
18 absolutely no entry problems. So you can very
19 quickly turn to that.

20 Finally, I think if people think
21 -- and I've thought about this a bit, and I
22 think if people think there are other
23 situations where they want to push for not
24 having to define a market, I'm not sure we're
25 there yet.

1 And I think what I would rather
2 see is some more discussion and work being done
3 in this area because if we're going to that, if
4 we go to that eventually, it would be very
5 hard, back to the points I made before, which
6 is that companies need to know how to evaluate
7 these things, we need to know how to evaluate
8 them within the first thirty days.

9 Where are the situations that we would
10 think that a market doesn't need to be defined.
11 Other than what I just said, I don't think we're
12 there yet. So I'd be hesitant at this stage to
13 take the discipline of market definition out.

14 MR. FEINSTEIN: Michael, do you want to
15 go next?

16 MR. WHINSTON: Sure. So I think one
17 thing that's worth just noting, I think saying
18 that the concentration numbers are just structural
19 and they're not including any nonstructural
20 evidence or direct evidence, whatever you want
21 to call it, is actually a little inaccurate because
22 the market definition exercises is including
23 information about demand substitution, for example.
24 Right? And incentives for raising price. That's
25 exactly how the question

1 is structured. You know, would a hypothetical
2 group of firms have incentive to raise prices
3 of these products by 5 percent, whatever.

4 So to answer that question, you're
5 using all of that information. The question is
6 really how are you using it? In a sense, market
7 definition and structure is some summary of that
8 information. The question I think is whether
9 it's the right summary.

10 Now, the issue, the separate issue
11 is do we know for sure what the right summary
12 is right now? Probably not. But I think we
13 know some things.

14 And, I think this pricing pressure thing
15 I was talking about is just a different way of
16 using that same information.

17 I guess the other thing I would say
18 is, I agree, getting from where we are to maybe
19 where we're going to end up, first of all,
20 we're not sure exactly where we're going to
21 end up, but improving things in a way that -- I
22 think the education point with the courts is
23 actually an important one.

24 So you know, if you take it as
25 given that the courts use market definition, they

1 will always use market definition, that's never
2 going to change, then what the agencies need to do
3 maybe it's a little bit different than if you don't
4 take that as given.

5 MR. FEINSTEIN: And I don't know that
6 it's necessarily a given for all time; but as
7 we sit here today, it seems to be an element
8 as to which the government or the plaintiff has the
9 burden of proof.

10 And I think this gets to another
11 question, and I want to get back to hear from
12 Monica and Jim as well on the question that's
13 pending, because I think everybody agrees that
14 these guidelines, certainly historically, they have
15 influenced the courts, and I think it's likely to
16 assume that they will continue to influence the
17 courts.

18 And I think that makes it very
19 important that they be written in terms that
20 generalists judges can also comprehend. And
21 that's one of our challenges, speaking for the
22 two lawyers who are on the group, Molly and me.

23 But anyway, let's go back to
24 Monica and then Jim on this question of the
25 relationship between this kind of evidence and

1 market definition.

2 MS. NOETHER: Again, I'll just maybe
3 reiterate a couple of the points I made in my
4 opening remarks that I think obviously market
5 definition is something that provides the
6 context for the rest of the analysis.

7 I agree with Mike, essentially
8 it's an interactive process because you
9 obviously need to look at the competitive
10 dynamics, and in particular what do customers
11 view as potentially good substitute products,
12 to come up with an accurate or more reliable or
13 useful market definition.

14 But it's really an exercise in and
15 by itself, except that I think to bring up a
16 point that was made in the first panel, which
17 is that structural evidence can at least form a
18 basis for some safe harbors, provided, again,
19 that the exercise is done carefully.

20 And I guess I'll now take off on a
21 point that Mike made in his remarks when he
22 went through kind of the algebra of HHI's
23 related to market elasticity and essentially we
24 have a higher HHI threshold if the market
25 elasticity is greater. All we're saying is that

1 there are potentially more other substitutes.

2 Maybe you want to broaden your
3 market definition. I guess what I'm saying
4 it's a circular thing; but I do think, again,
5 going back to my opening remarks, that it's
6 often dangerous to think that you can just go
7 straight to the competitive effects analysis
8 without the context of market definition or
9 back into market definition because you think
10 you've done the competitive effects analysis.

11 Because I just don't think it
12 provides enough sort of organizational
13 structure around the analysis; and you can come
14 up with some erroneous conclusions by
15 essentially looking at evidence, for example,
16 on what's happened to prices if you don't
17 understand the market dynamics that are
18 reflected by customer preferences essentially,
19 which is what the market definition exercise is all
20 about.

21 MR. LANGENFELD: Well, I agree that
22 market definition and looking at shares can be
23 helpful in the context of which Mike has
24 pointed out. There is an analysis for doing
25 market.

1 I think in terms of a consummated
2 merger, if you have clear evidence that,
3 controlling for other things, that prices went
4 up as a result of the merger, I think that
5 spending a lot of time on market definition is
6 a waste of time.

7 I agree with Monica that at least
8 talking about it a bit so people know what
9 you're talking about is fine. But it's not
10 critical or not as important, I
11 would say.

12 When we're looking prospectively, and
13 adopting my own term of all these being indirect
14 market definition analyses that we're talking about
15 here, nonstructural, I think you need to look at
16 each of those to the extent that they're available.

17 You have data. You're not always
18 going to have information available for a
19 natural experiment. You're not -- sometimes
20 you are. Sometimes you aren't -- to do it
21 well.

22 Looking at what customers tell
23 you, sometimes you'll get a clear picture.
24 Sometimes it will be just blah. Or if it's a
25 product that individual customers are buying,

1 you know, downstream -- to food stores merging, for
2 example, you're not going to be able to go
3 out to the customers, unless you have a lot of
4 survey data to find out what they're doing.

5 Market definition, I think, is an
6 important element. It shouldn't be the
7 critical element, and I know Paul Denis has
8 some strong views which I tend to agree with on
9 whether there should be presumptions built in
10 to any of these things.

11 But I would look at market
12 definition as being an important part along
13 with the other types of analyses that we do and
14 not to give it a trump card, but not to say
15 it's irrelevant in most mergers.

16 MR. FEINSTEIN: Let me shift for a
17 second to non-price effects. Jim, in your
18 opening remarks I think you suggested that the
19 only real direct evidence as opposed to the
20 term nonstructural is evidence that tells you
21 something directly about price effects, if I
22 heard you correctly.

23 MR. LANGENFELD: That is correct.

24 MR. FEINSTEIN: As Michael pointed out,
25 the whole hypothetical monopolist effect is

1 focused on the likely ability to increase
2 price.

3 The question I'd be very
4 interested in hearing the group's views on is
5 whether there is non-price-related evidence,
6 direct or otherwise, but particularly direct, I
7 guess, that really should be viewed as
8 probative.

9 You know, for example, if there's
10 evidence of reduced innovation or product or
11 service degradation which doesn't necessarily
12 translate directly into something that could be
13 measured in terms of price, you know, should
14 the guidelines address that type of direct or
15 nonstructural evidence?

16 MS. NOETHER: I think absolutely if you
17 can measure what's happened. I mean, I think we
18 tend to gravitate towards prices because they're
19 numbers and more easily measured and, therefore,
20 one thinks one can analyze them better.

21 But if you can come up with
22 measures, because of what's happened to quality
23 or service or, you know, potentially
24 innovation, that are concrete and not biased,
25 and you can try to analyze that, then that's

1 certainly appropriate. But I just
2 think we're limited by the information that
3 tends to be available.

4 MR. WHINSTON: I would echo that and say
5 if we can do it, we should. Remember, we're
6 trusting -- not in the case of consummated mergers,
7 but in the case of predicting mergers that are not
8 consummated -- we're trying to predict how those
9 things are going to change.

10 So not only do you have the
11 problems of measurement, and the evaluation of how
12 they affect consumers, but you need to have
13 some either natural experiment or model or
14 something that allows you to predict what those
15 changes will be.

16 You know, I think the reason we
17 focused on predicting price is that we happened
18 to have better models and be better at that,
19 not because we think the other things are
20 unimportant.

21 But you can imagine in an airline
22 industry if you had some natural experiment of
23 previous mergers and the merged firms had regularly
24 cut back flight frequency, and you would want to
25 include that in the effect on consumers, not just

1 the effect of price.

2 MR. LANGENFELD: I'll be quick here. I
3 mean, I agree with what's been said; but I
4 think that -- and this is actually, once again,
5 this is an amateur reading the law, right --
6 but I think that the law typically recognizes
7 both price and output effects, at least in
8 Section 2 type of cases and those type of
9 things.

10 One of the things that Monica and
11 I both worked on, I was hired by the
12 Pennsylvania Insurance Department recently. We
13 had not a natural experiment, but an actual
14 experiment, direct effects evidence of what
15 happened when there was entry and competition
16 of certain part of Pennsylvania in healthcare.

17 Now, healthcare is really, really
18 complicated, as Rich knows, and we -- actually,
19 we worked on a healthcare matter together years
20 ago.

21 But the one thing you can measure
22 is to see whether output has gone up or down by
23 the addition of one more competitors in the
24 market.

25 There were some arguments about

1 that wouldn't take place, and I won't go into
2 the details in this particular area. So one of
3 the measures that we've looked at is to see whether
4 there's evidence that output has gone up or down.

5 Because one argument was this firm
6 came in and everyone was made worse off. Well,
7 it was hard to get a good price, and you could
8 look at some quality measures. But the one
9 thing you could actually count would be whether
10 in this case more people had health insurance
11 or less.

12 So there actually are instances
13 where you should not just look at these quality
14 things, but I think you need to keep in mind
15 that you can have these type of analyses where
16 you look at output and that frequently will
17 tell you what the net effect on welfare is.

18 MR. FEINSTEIN: Debbie?

19 MS. MAJORAS: I would say I think we've
20 been a little bit, in the antitrust world, I
21 think we've been a little bit schizophrenic
22 about how we treat non-price effects.

23 I mean, I think -- there's a sense
24 that they exist and we talk about them. And if you
25 look the way some mergers have been decided over,

1 say, the past eighteen months, certainly at the
2 FTC, it's clear that at least some commissioners
3 think that this is something that's very important.
4 And yet, we're much more focused on price.

5 So I guess my point would be that
6 guidelines are meant, I believe, to reflect actual
7 practice. I'm sure that the 1992 guidelines, and
8 those of you who were there could confirm this,
9 also, it seemed, were intended to push the law a
10 little bit forward as well, but mainly looking at
11 what the actual practice is.

12 And if the agencies are looking at
13 non-price effects, it would be very useful to
14 know what the agencies were looking at and how.

15 And it's always been an interesting point
16 to me. Because, as I say, I'll end where I started,
17 I think it's a little bit schizophrenic.

18 MR. FEINSTEIN: I guess that what the
19 agency should be looking and the how the agency
20 should be looking at them for the non-price
21 effect are two of the questions that these
22 workshops are open to answering and to seek input
23 on. That's not something that I think we would
24 attempt to decide for ourselves.

25 MR. WHINSTON: Can I say just one other

1 thing?

2 MR. FEINSTEIN: Please.

3 MR. WHINSTON: I think coming back to
4 something I said about how much our knowledge
5 of mergers has changed in twenty years, I think
6 it's worth remembering if we go another
7 twenty years I'm quite sure, for example, non-price
8 effects, we would be better at predicting them. I
9 don't know how much better, but we will be better.

10 So I think it's important for the
11 guidelines to be open, and other people have
12 said this, to new methods and techniques that
13 come in. In that regard, I've known about
14 these commentaries now for an hour, but it
15 seems to me that --

16 MR. FEINSTEIN: It's up to two hours
17 now.

18 MR. WHINSTON: Sorry. You're right.

19 That a broad document, which is
20 kind of almost more constitutional, here are
21 the principles and general things we can look
22 at that stays for quite a while, but with some
23 related documents that are giving you more
24 detail, more explanation for why you're doing
25 what you're doing but that's revised much more

1 frequently I think might be, you know, a useful
2 approach.

3 MS. MAJORAS: Rich, if I could just go
4 to your last point, which is you probably
5 wouldn't just do it on your own but you want to
6 know what people think about what you should
7 do.

8 I think that's great government
9 and I appreciate it. I was partially making
10 the point that I think the agencies already do
11 consider non-price effects, but we're not sure
12 how that's being done.

13 So to the extent it is being done,
14 just reflecting that alone would be, would be
15 helpful.

16 MR. FEINSTEIN: We'll go a couple more
17 minutes because we started a few minutes late,
18 but I want to turn to give each of you a minute
19 or so to offer any concluding remarks.

20 Somebody at the workshop in
21 Washington last week said that the most
22 important principle that we should be applying
23 here is the Hippocratic oath. I would say
24 we're mindful of that.

25 So I guess I would ask each of

1 you against that background, what would you change,
2 if anything, and why?

3 If you had to, as Molly said, if
4 you had to identify one thing, and it can be
5 obviously on the narrow topic we've been
6 discussing, or more broadly?

7 MS. NOETHER: I think, if anything,
8 maybe make it clear that the analysis that is
9 done by the agencies and that should be done by
10 other folks who use the guidelines is really a
11 holistic kind of analysis rather than a
12 sequential series of narrowly defined steps.

13 There's a variety of different
14 types of evidence that is and certainly should
15 be considered. Depending on the case,
16 different types of evidence are going to be
17 more or less compelling, but essentially
18 looking at all the pieces and making sure that
19 at the end of the day you got a story that fits
20 all the credible pieces of evidence in.

21 MR. FEINSTEIN: Ideally, yes, the
22 pieces corroborate each other.

23 MS. NOETHER: Yes.

24 MS. MAJORAS: I'm going to do two and
25 just do them fast.

1 MR. FEINSTEIN: That's fine. That's
2 the former chairman's prerogative.

3 MS. MAJORAS: This one is not going to
4 be original, but I'm going to add to the
5 chorus. I would maintain some safe harbors or
6 presumptions on structure, but I would revise
7 the HHI's, if that's what you use, so that they
8 actually reflect current practice.

9 People say that all the time.
10 It's interesting when you counsel your client
11 and you go through with them what the law is
12 and then you tell them it says that but that's
13 not really what they mean, that just undermines
14 the whole thing for them.

15 And I actually do think it's
16 important for your business clients to have
17 respect for the process, which we try to give
18 them. So I would do that.

19 The second thing I would do is I
20 would make some changes if you keep sort of the
21 dichotomy of coordinated effects, unilateral
22 effects, and I know that Dennis Carlton would
23 not, he would do that in a different way, but
24 in any event, that discussion in unilateral
25 effect particularly in differentiated products,

1 I would fix that.

2 I think we've learned enough
3 through experience now to understand where the
4 problems are, not only in the guidelines, but
5 in how the agencies have put on cases in
6 unilateral effects where there's been some
7 success but there's some some kind of
8 confusion.

9 I would try to clear up that
10 confusion, including what I said, making sure
11 the relationship between market definition,
12 provided you keep it, and I suspect you will,
13 and how we think about unilateral effects.
14 Link that together so it's more understandable.

15 MR. WHINSTON: I guess people say, say
16 what you're going to say and then say it again.
17 You know, I think there's lots of things that you
18 could improve in the guidelines in
19 terms of when we go to a full analysis
20 describing what is done in a more accurate way,
21 unilateral and coordinated effects being
22 one example. That it isn't sequential, that it's
23 integrated, that pieces have to add up, we're
24 looking for consistency in what those things are
25 saying.

1 But at some level I'm not sure if I look
2 at the way things are being analyzed, I'm not sure
3 that the guidelines are, as I said earlier, that
4 constraining when things really get to a full
5 analysis.

6 I look at what the expert reports are
7 saying. I don't think they're hemmed in by some
8 sense by the guidelines when it gets to that kind
9 of stage.

10 So I think I would spend some time
11 thinking about what these safe harbors are, whether
12 they're the best safe harbors we can use in terms
13 of the presumptions. That's where the market
14 definition and the structural numbers really come
15 in.

16 MR. FEINSTEIN: Jim?

17 MR. LANGENFELD: I guess -- well, I
18 think that the way the twenty questions have
19 been put is very good. I really do. And I
20 think saying and keeping in mind when you're
21 thinking about making any changes, A, is this
22 really what the agencies do; and B, is this
23 reflecting new things that we should do to
24 improve.

25 If it's something that's been done

1 for decades, then it should be reflected in the
2 guidelines somewhere, at least in general, I
3 think, just for transparency purposes.

4 If it's something new, like
5 natural experiments, more detailed analysis of
6 consummated mergers, using a UPP test, any of
7 those things, I think you need to think, okay,
8 those are new things since '92.

9 We need to think about them
10 carefully. Are they going to have legs. Are
11 they going to be here in the future. You need
12 to be careful about how you use those and put
13 them in the right context.

14 So I think anything that you
15 change, especially if it's something new, you
16 need to think about it and be careful about
17 sort of cementing it into the guidelines for
18 the next ten or fifteen years. You really just
19 need to be careful about that.

20 With that regard, I've also
21 argued, my second point, and I wasn't chairman,
22 that you should be revising, and I know you'll
23 do this right after you finish the Horizontal
24 Merger Guidelines, the non-horizontal merger
25 guidelines because if you talk about agency

1 practice, you know, the Horizontal Merger
2 Guidelines are a lot closer to agency practice
3 than the Vertical Merger Guidelines are. I
4 think everyone knows them, to the extent you
5 even know they exist.

6 Secondly, there's been a lot more
7 analysis and thought about vertical issues
8 since 1984, the last time the Vertical Merger
9 Guidelines were revised.

10 I know with this you're going to
11 sweep up in a few months and then we'll give
12 you the next thing to do.

13 MR. FEINSTEIN: That's probably as good
14 a place as any to stop. Please join me in
15 thanking this panel for what I thought was a
16 very lively conversation.

17 (Applause.)

18 (Lunch recess.)

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1 PANEL 3: UNILATERAL EFFECTS

2 MS. BOAST: Welcome back to our
3 afternoon workshop, and let me use this
4 occasion to thank our hosts once again for
5 offering us this space, but more particularly
6 for feeding us so well. If it weren't so cold, I'd
7 feel like I needed to go for a jog after that
8 fabulous lunch.

9 The topic for this first panel
10 this afternoon is the well-known unilateral
11 effects. This is one of the areas where I
12 think it's fair to say we know already and
13 probably knew going into this exercise we were
14 going to have to do some work.

15 So, the suggestion that you might see
16 some changes in this part of the guidelines is
17 probably not a surprise to anyone. That said, this
18 is a complicated topic. There are lots of
19 different ways in agency practice in which
20 unilateral effects come into play.

21 There is a tremendous amount of
22 writing and thinking that's gone on in the
23 area; and as you've even heard throughout the
24 discussion that we've had this morning, a large
25 number of different views.

1 So over the course of the five
2 workshops, this is one of the two or
3 three topics that is receiving repeated
4 multiple treatment because we really want to
5 get as many viewpoints as we can and see where
6 the consensus lies.

7 We are extremely privileged to
8 have the panel that we do have today. Let me
9 start with Kevin Murphy to my left. Kevin is
10 the George Stigler Distinguished Professor of
11 Economics at that other school, the University
12 of Chicago School of Business, and also a
13 principal with Rob Gertner in Chicago Partners.

14 Next to Kevin is Roxane Busey, a
15 very long-time friend of mine, former head of
16 the antitrust section of the ABA, and currently
17 a partner at Baker & McKenzie here in Chicago.

18 Next to Roxane is Mary Coleman,
19 who is now a senior vice president at Compass
20 Lexecon, but served as a senior official in the
21 Bureau of Economics at the FTC during the Whole
22 Foods case, I believe.

23 MS. COLEMAN: No, no, before. I was
24 on the other side of Whole Foods.

25 MS. BOAST: So I knew she had

1 something to do with Whole Foods. In any
2 event, had real hands-on experience with some
3 of the things we're going to be talking about.

4 And last but certainly not least,
5 again, Paul Denis, a partner at Dechert in D.C.
6 Paul was serving as counsel to Jim Rill during
7 the 1992 guidelines revisions. So think of the
8 position sort of as the functional equivalent as a
9 law clerk to a judge. He's doing all the work,
10 probably a lot of the thinking and giving all the
11 credit to his seniors. But he was very deeply
12 involved in it. In addition to working actively in
13 his practice on these matters, he is able to speak
14 to some of the history.

15 I think our order of play today is
16 that we are starting with Mary Coleman.

17 MS. COLEMAN: Thank you, Molly. And
18 thanks for the opportunity to participate on
19 this panel and in this process.

20 For my discussion, I thought as a
21 starting point it might be useful to discuss
22 some of what we mean by unilateral effects.

23 I think a lot of times when people
24 think about unilateral effects they think about
25 differentiated products or consumer-type

1 products that are sold at a single price and using
2 Bertrand-type models to think those through.
3 But there are many other types of models that
4 are relevant to a unilateral effects discussion.
5 There's really not a one-size-fits all approach.
6 And particularly the information, analyses,
7 and evidence that are most relevant can vary
8 to some extent, depending on which model
9 is appropriate in a particular case.

10 The guidelines, to some extent,
11 already recognize this by the distinction
12 between homogeneous and differentiated
13 products. However, I think it might be
14 useful to have some more clarification on
15 these points in the guidelines.

16 The way I think about this is I
17 characterize theories into three general
18 buckets, although there are variations within
19 each of those.

20 The first area in where you have a
21 relatively homogeneous product and the key
22 issue is how much output or capacity exists in
23 the market, and that sort of determines where
24 prices are in the market. For a merger then, the
25 key question is whether the combined firm would

1 have the incentive and ability to restrict
2 output or capacity. And the general types of
3 economic models that are generally most relevant
4 here are dominant-firm-type models or potentially
5 Cournot models, depending upon the structure of
6 the market and how large the firm is and what
7 the other competitors look like. The key types of
8 issues that you tend to look at are, first of all,
9 determining what the relevant market is is clearly
10 important, what the demand elasticity is or the
11 shares for the merged firm and how that changes
12 with the merger. What does this reply response
13 of others look like. What are their incentives
14 to respond to a restriction and output, what
15 are their abilities, and how does that change
16 from the merger.

17 The second general bucket of
18 theories are where you have differentiated
19 products, but you essentially have one price to
20 the purchasers of those products. It might vary
21 geographically or the like, but within a particular
22 channel or geography you have a single price.
23 These would generally be consumer product-type
24 mergers, could also be retail-type mergers. That
25 would fall into this bucket. And generally the

1 types of model that's considered here is a
2 differentiated or Bertrand-type of model. How
3 applicable it is to the particular case, of course,
4 depends on the firms at issue. Retailers, that's
5 probably a little more of a stretch to put it there
6 just because you have multiple products being sold
7 and priced in
8 a fairly complicated way, and Bertrand may
9 not pick up that well. But that's usually
10 the nature of the models that we're looking
11 at. Key issues, we are looking at here are
12 what does consumer behavior look like, who are
13 they considering as close substitutes for each
14 other. If you have information, try and measure
15 demand elasticities and cross-elasticities, and
16 looking at potentially the diversions from that
17 information between the products of the merging
18 parties. One issue that can be important to
19 consider, though, in those types of cases is
20 whether or not the products of both companies
21 are actually going to continue to exist after
22 the merger.

23 In some cases, they'll actually be
24 re-branding so that you really just go to the
25 product of one of the companies. This is

1 particularly the case in retailing mergers
2 where it's not that frequent that the combined
3 company actually keeps both names going forward
4 but actually moves to one or the other. And that
5 can change the competitive dynamic and how you look
6 at the merger because even if pre-merger the two
7 parties had a fair amount of diversion between
8 them, if one of them is now gone, you have
9 to think about, well, if prices go up, what's
10 going to happen to customers who might have
11 gone to the product that disappeared and now
12 would they go somewhere else or would they stay
13 with the merging party.

14 So it's not that the diversions
15 don't have information, but it's sort of a
16 somewhat different question. You're asking
17 them when the two products continue to exist.

18 And the third area, and the one I
19 think is not generally very well covered
20 currently in the guidelines, is the case which
21 is very common, however, in a lot of mergers
22 where you have individualized customer-by-
23 customer negotiations and some differentiated
24 suppliers and where basically your -- the issue
25 is what will be incentives or pricing in those

1 individual customer negotiations post-merger.

2 The types of theories that fit
3 generally best here are auction or bid models,
4 although with a significant caveat that most of
5 the time in the real world it's not really sort
6 of auction setting that these models set up,
7 but there's a lot of negotiation occurring
8 between the customers and the suppliers that is
9 different from what you'd see in the auction
10 setting.

11 The key issue, as I note, is
12 whether or not the combined firm will have the
13 incentive to bid higher prices following the
14 merger than they would to a significant number
15 of customers.

16 There could be a couple reasons why this
17 might occur. One, they're just with fewer bidders,
18 the firms, all firms have the incentive to bid
19 higher. There's some models that would suggest
20 that would be the case. In other cases, it may be
21 that you're taking away the next best option for a
22 significant number of customers and the other
23 options that are out there are
24 substantially farther away.

25 So in the first case with the too

1 few bidders, the question would be, and the
2 types of analyses you'd do, is does the number of
3 bidders matter and do you have evidence to
4 suggest that reducing the number of bidders by
5 one will actually impact outcomes.

6 In the second case you want to
7 look a lot at how close are the two merging
8 parties as substitutes. How much do they
9 compete against each other. What other options
10 exist and customers could credibly turn
11 to. Again, looking at what happened in the
12 past, often you're looking at win/loss
13 information or the like, is very important,
14 but it's also important to take into context
15 that the future will be somewhat different.
16 Again the supply of the combined company is
17 not likely to come out and be bidding
18 two different options to customers. They
19 may, but in many cases they'd probably
20 come out with one bid. And the real
21 question is whether the customer who may
22 have seen the two companies, say, A and B,
23 as their best alternatives could credibly
24 bring in C and come to the same outcome as
25 prior to the merger. So it's important to

1 look at the ability of either customers to
2 change their strategies and who they turn to
3 as well as suppliers potentially to reposition
4 and become a better alternative.

5 In general, I think that it would
6 be useful for the guidelines to provide some
7 more detail without getting too much detail so
8 that they still are guidelines, on the type
9 of theories that exist for unilateral effects
10 as a starting point and then how you do the
11 analysis depending on which theory makes the
12 most sense.

13 MS. BOAST: Thank you, Mary. That
14 was -- I'll call it an overview, although it
15 was obviously more complete than that, but
16 a really helpful way of thinking about the
17 different kinds of cases we see and perhaps
18 why there's confusion out there. But also
19 why the guidelines don't currently come
20 remotely close to adequately covering all
21 those different buckets, as I think you put it.

22 I mean, your comment about the
23 individual customer-by-customer negotiation
24 group is quite potent with me because I think
25 in the six or seven months since I've been at

1 DOJ, that's probably about at least 50 percent
2 of the mergers we've looked at, if not more.

3 Let's move on this ladies-first
4 afternoon to Roxane Busey next.

5 MS. BUSEY: Thank you, Molly, and thank
6 you to both you and Rich for including me in
7 this panel.

8 Obviously, I'm not going to be
9 giving much of an economic perspective. I'm
10 going to be focusing more on the legal aspects.
11 And I thought for this just introductory part, I
12 might give a little bit more of a background or
13 framework for considering modifications to the
14 guidelines.

15 As has been stated by others, the
16 purpose of the guidelines, as stated in the
17 guidelines, is to outline the present
18 enforcement policy and to reduce uncertainty
19 associated with enforcement of the antitrust
20 laws in this area. They also serve a secondary
21 purpose of advising the antitrust bar and their
22 clients with respect to the risks associated
23 with an antitrust analysis of a transaction.

24 But what I wanted to really
25 emphasize was the importance of the guidelines

1 in terms of the court. And I know this has
2 been said before, but I'd like to say it a
3 little differently.

4 Some courts do cite the merger
5 guidelines in merger cases. Some don't. Some
6 courts cite the merger guidelines in non-merger
7 cases, and I think that's where in some way the
8 greatest concern is. And I go even further, I'd
9 say not only do the courts in non-merger cases
10 cite the merger guidelines, but the parties do and
11 the economists do. My experience has been that
12 they don't do it with the same rigor or
13 analysis as they would do in a merger case.
14 I think this is a problem; and I think the
15 guidelines, as sort of a background comment,
16 need to take this into account with respect to the
17 drafting.

18 To the extent that there are
19 topics, such as market definition or definition
20 of monopoly power, or whatever, direct effects,
21 if that's what we want to talk about. These
22 are cropping up in other cases. And so for that
23 reason as well as for what's going on in terms of
24 merger analysis, I would encourage greater
25 transparency and greater guidance.

1 A secondary comment that is
2 related to that is what is the relationship
3 between the guidelines and the commentary.
4 Obviously there needs to be consistency between
5 the two, but one thing I would point out is
6 that these guidelines differ from other
7 guidelines that are promulgated by the
8 agencies. They don't include any
9 hypotheticals. They include very few case
10 cites. They have a very different style about
11 them. That may be because they were one of the
12 first guidelines. I don't know. But the point is
13 that they're very different. I assume at this
14 point no one wants to change that style
15 dramatically.

16 On the other hand, instead of
17 perhaps including hypotheticals, some reference
18 to the commentary or the importance of the
19 commentary one way or the other might be
20 appropriate to consider in this revision.

21 The other thing that I wanted to
22 mention that, again, comes from the point of
23 view of a legal perspective, is the importance
24 of these guidelines and the use of economic
25 tools with respect to the challenges that are

1 posed by the Daubert standard.

2 I think that this was made
3 reference to by Jim in the prior panel. But
4 here I think that there are some lessons to be
5 learned in terms of the introduction of new
6 theories. Whether they may be used by the
7 agencies, that's properly appropriate, but they
8 may or may not hold up in the court. And that
9 should also be taken into account.

10 I think the guidelines are very
11 clear in saying that they are not a litigation
12 tool just as with respect to my first topic,
13 clearly the courts are not bound by the
14 guidelines. Nevertheless, I think it's
15 important to keep in mind that the guidelines
16 do play some role in litigation.

17 The other thing that I would say
18 along those lines, and I think to some extent
19 this may be done in the commentary, I'm not
20 sure about this, but I think that the courts
21 make errors in terms of understanding the
22 guidelines or interpreting economic tools. I think
23 the agencies are clear about this. They feel in
24 some cases that they're not only just in terms of
25 argument, but just in terms of the understanding of

1 the courts.

2 I think that in terms of the
3 commentary, some of the cases that are included
4 are included because the agencies have seen the
5 positive use of a particular analysis. And I
6 believe some cases are excluded because there was
7 some misunderstanding by the court or by the
8 economist or by the lawyers with respect to the
9 analysis. I would suggest that that
10 might be an exercise that, again, doesn't have
11 a lot to do with economic principles
12 necessarily, but does have to do with the
13 purpose and understanding of the guidelines in
14 the context of litigation.

15 Another point that I would like to
16 raise is what is the role of the guidelines
17 with respect to the HHSR process. What role,
18 if any, is there between the initial thirty-day
19 review and the second request. At this point it's
20 fairly clear, I think, that the guidelines have
21 virtually no relationship to the process. There's
22 no indication that if you're going to do further
23 analysis or further analysis is required that
24 it's required within that thirty-day period or
25 that it's required as part of a second request.

1 I'm not necessarily suggesting
2 that the guidelines be changed to accommodate
3 that; but I am suggesting that, as a practical
4 matter, lawyers tend to look to see, well, what
5 can we do within the thirty-day period. How
6 much time do we need to produce the documents
7 or make the analysis, and that that should also
8 be a factor that's taken into account.

9 I think the real question I was to
10 answer is is there any need for amendment to
11 the guidelines with respect to unilateral
12 effects; and I think I'm going to say what a
13 lot of people have already said, which is, yes,
14 the HHIs are outdated, and if they continue to
15 be used they need to be adjusted upwards.

16 Personally, I question the use of
17 the presumptions. The guidelines are very
18 clear in saying that they're not a litigation
19 tool, and yet, they've used for many years the
20 notion that if you satisfy a particular threshold,
21 then there is a presumption -- I'm sorry, I guess
22 it's the other way around. If you don't satisfy a
23 particular threshold, then there is a presumption.
24 I think the use of the term presumption is
25 inappropriate and perhaps that should be viewed as

1 a screen or a signal or a trigger that there should
2 be further analysis required. I question the 35
3 percent rule. I think it's important to have a
4 screen. I think we might want to reconsider
5 whether that's the appropriate measure and the
6 appropriate screen. To the extent that the
7 agencies have had more experience and have
8 relied on other econometric tools with respect
9 to differentiated products, I think that they
10 should be clearly stated, perhaps not in depth,
11 but clearly stated. I also think the agencies have
12 now had more experience with respect to, I
13 guess, indirect evidence, to use Jim
14 Langenfeld's term. And, to the extent that is
15 the case, that should be noted.

16 Finally, with respect to consummated
17 mergers, there's really no suggestion of whether
18 the analysis would be any different. And I think
19 it's clear that the analysis could very well be
20 different because the evidence is there and,
21 therefore, could be considered differently.

22 So with respect to all of my
23 comments, I will stop. I have some other
24 thoughts about the theories of unilateral
25 effects and the use of bids. But for

1 background purposes, I think I've covered what
2 I'd like to say. Thank you.

3 MS. BOAST: Thank you, Roxane. That
4 was helpful and a whirlwind tour of a lot of
5 different points.

6 Your comment about the
7 relationship between the guidelines and the HSR
8 process itself was made in the workshops in
9 Washington as well; and actually, in response
10 to that one thing our task force is doing now
11 is collecting our voluntary request letters
12 that precede second requests and looking at
13 those and second requests themselves to see
14 whether it makes sense, not necessarily in this
15 vehicle but we're certainly open to thinking
16 about it, to articulate sort of what's the
17 threshold body of information that we look at
18 most closely in any transactional review. I think
19 people tend to know that, but it's not really been
20 published in a systematic form. So Kevin Murphy,
21 please proceed.

22 MR. MURPHY: Thank you very much. And
23 again, thanks for having me here today. I
24 guess where I would start is, first of all, I
25 would like to reiterate some of the things that

1 were said this morning, which is kind of this
2 distinction between sort of unilateral and
3 coordinated effects is a little bit odd. Also the
4 sort of distinction between structural analysis and
5 analysis of direct effects, I think, again, is a
6 little bit odd and not necessarily very helpful.

7 Finally, the one I would probably
8 focus on the most is the interrelationship between
9 what you might think of as market definition and a
10 competitive effects analysis.

11 I think the best way to think
12 about all these things is to go back and start
13 with, well, what is a merger analysis about in
14 the first place. Well, it's about how will
15 competition in the marketplace change as a
16 result of the merger. And to analyze that, you
17 have to understand how competition takes place now
18 and how the elements of that competition will
19 be changed if and when the merger goes forward.

20 The evidence you can put
21 forward on that could be based on a structural
22 analysis or it could be based on an analysis of
23 competitive effects or an estimate of
24 competitive effects.

25 One of the things I like to think

1 of is that market definition plays an important
2 role there, as does more direct evidence on
3 competitive effects. And I think the important
4 thing is that they not get in the way of each
5 other. In principle they should be complements.

6 An example was sort of the Whole
7 Foods analysis that I was involved in. In that
8 case you had Whole Foods and Wild Oats who were
9 the potential parties that were going to merge,
10 and then you had a whole host of other
11 supermarkets out there. When we started with
12 market definition, and people kept saying, well,
13 we've got to do market definition, that's the
14 key here. And when you started with that
15 analysis, you're left with two very
16 unattractive market definitions.

17 One was all supermarkets lumped
18 together, in which case this merger was a
19 no-brainer. We should go home and forget about
20 it. There's nothing there from a structural
21 standpoint. And on the other side we were left
22 with, well, you could define the market to
23 be PNOS, in which case -- in most cases this
24 was a merger to monopoly. Obviously neither
25 one of those was a very good description of

1 what that case was about.

2 The way I approached it is, I
3 think, the way economists approached it
4 generally, is, well, we should choose to define
5 our aggregates -- I won't call them markets --
6 define our aggregates and firms in a way that's
7 useful for letting insight into the case.

8 And the useful way to think about
9 that case was that Whole Foods and Wild Oats
10 and maybe a few other people who were distinct
11 from a whole group of other participants in the
12 market, traditional supermarkets.

13 Our whole question was would
14 there be an anticompetitive effect here if
15 there was a merger. That was the right lens to
16 use for the analysis, and we shouldn't decide
17 the case based on market definition. We should
18 look at the competitive effect and then that will
19 tell us at the end what was the right market
20 definition. But the idea that we'd have a stage of
21 market definition then and analyze the effects
22 within the market was not very helpful in that
23 case.

24 And I get back to Rob gave you an
25 example earlier today of Thomson Reuters. It

1 was the same issue. So the right lens for
2 thinking about that was Bloomberg was
3 different, Thomson and Reuters were more
4 similar in what they did, and whether you
5 called it a broad market that included all of
6 them or a narrow market with repositioning or
7 entry by Bloomberg really didn't matter. So
8 you could do the analysis in either way.

9 Well, what's the burden in the
10 current framework? Well, the problem is
11 currently we have these sort of structural
12 presumptions that are built into the guidelines
13 which carry, like it or not, some weight to
14 that second stage of the analysis.

15 You know, you're not free to say
16 I'm going to choose the most effective lens for
17 thinking about competition without getting some
18 burden carried over from the presumption. So I
19 think it's important that we try to reduce the
20 presumptions, the structural presumptions in
21 the guidelines.

22 If you think about it in terms of
23 unilateral effects versus coordinated effects
24 or structural versus direct effects -- if you think
25 about those dichotomies, they're both useful

1 frameworks, but you don't want them getting in the
2 way of each other. You don't want them sort of
3 interfering with doing the best analysis you can.

4 So one answer to that is, well,
5 let's just jump in and do a competitive effects
6 analysis right from the beginning. The problem
7 with that is there's just way too many mergers
8 to do a competitive effects analysis in every
9 merger that comes over the transom. So what you
10 need to do is you still need to have a stage one
11 where we can screen things out and a stage two
12 where we actually do a competitive effects
13 analysis.

14 When it comes to stage two, I'm
15 very much on board with what I think most
16 people said this morning and from what I read
17 people said at other workshops, this
18 distinction that somehow we're going to parcel
19 out entry and put it over here, and we're going
20 to put efficiencies over here, and then we're
21 going to do the analysis if none of those
22 things existed and then we're going to bring
23 those in later. I don't find that very
24 helpful.

25 I think in many cases that I've

1 worked on, competitive effects, for example,
2 and efficiencies are just intimately tied
3 together. They're kind of part and parcel
4 often in the same events. The same thing that
5 generated efficiencies generates potential for
6 competitive effects. I don't see any real
7 reason to separate them out in a particular
8 format.

9 As was said earlier today, same is
10 true with entry. Entry is part of the market
11 equilibrium that exists today. You think about
12 direct evidence. Well, any direct evidence you put
13 forward about pricing effects of market
14 structure or pricing effects of market events.
15 If entry is important, it's already influenced
16 those numbers. You can't say entry's not part of
17 my analysis. The data you have, you might wish
18 you had data that didn't reflect the impact of
19 potential entry, but the data you have does.
20 You can't divorce it out of the data, so it has
21 to be by definition part of your analysis.

22 So how do we do stage one, stage
23 two? I think we should be able to do stage one
24 and stage two where you have to decide which
25 mergers are no problem and which mergers warrant

1 further study.

2 It seems to me a structural market
3 definition/Herfindahl approach isn't the only
4 way to either push things forward or say we
5 don't need any further analysis. So for example,
6 if somebody comes in and says I have good evidence
7 of direct effects or unilateral effects, that's
8 probably enough to push this to stage two even if
9 we can't jump through all the other
10 hurdles.

11 Similarly, if somebody comes in
12 and says, well, there's no overlap in what I
13 sell and what he sells, so however you define the
14 market, the diversion ratio is so low here, it's
15 not going to cause a problem, that should get you
16 through the review. If somebody says we have a
17 well-defined marketplace and our shares are both
18 small, then off to the side unless somebody
19 came back and said either that market's wrong,
20 or number two, I have evidence of direct
21 effects, which, again, would presumably trump
22 your market definition as being appropriate in
23 that case.

24 So I guess the way I see it is the
25 current guidelines are a little too focused on

1 the structural side of things and the
2 structural side of things sort of interferes
3 with what I think is the most effective
4 analysis of unilateral or direct effects.

5 I think both ought to play a role
6 at both stages. I think getting rid of some of
7 the structural presumptions would really help
8 us do a better analysis, particularly at stage
9 one and even at stage two because it would
10 allow us to define the market not in terms of
11 what fits a preordained set of guideline
12 numbers, but what fits with the best analysis
13 at stage two.

14 And this case came up earlier in today
15 in Mike Whinston's discussion where he said,
16 you know, what happens when you have a
17 diversion ratio of a certain amount depends a
18 lot on what the market elasticity is. What the
19 elasticity was at stage one when you defined your
20 market has to be carried forward to stage two. And
21 the problem we have right now is that we have these
22 presumptions that don't really allow sufficiently
23 for that.

24 So I think getting rid of some of
25 the presumptions on the HHI's would be a very

1 good idea. At a minimum, they need to be
2 adjusted to reflect current practice.

3 Finally, I think probably if
4 they're going to be used at all, they should be
5 used more in the safe harbor direction,
6 although that safe harbor should be able to be
7 defeated by evidence of direct or unilateral
8 effects.

9 MS. BOAST: Kevin, if I heard you
10 correctly, you said that the structural
11 presumption could be used to -- if you had a
12 well-defined market and low shares to make a
13 decision that you didn't need to go to phase
14 two.

15 I'm not sure I heard you say the
16 other way around, and maybe you did by
17 implication, that if you have a well-defined
18 market and high market shares, you go to stage
19 two?

20 MR. MURPHY: I think you probably would
21 end up going to stage two unless someone could
22 demonstrate the absence of effects in spite of
23 those shares.

24 You're talking about a merger in
25 Boston and I have market outcomes in forty

1 other cities that have the market structure
2 you're looking at and prices are no higher
3 there than they are elsewhere, I think you're
4 ready to go. You don't need to go to stage
5 two. Maybe that is stage two.

6 MS. BOAST: I understand. I felt like
7 you were using the screen one way, and I just
8 wanted to raise the question about whether
9 reducing reliance on the structural, quote,
10 "presumptions," closed quote, meant -- and that
11 would be a fair position to say you used the
12 structural presumption to screen things out and
13 otherwise you look at effects and start there.

14 I don't have a conceptual problem
15 with that. I might have a practice problem
16 with it. One comment, since I can't seem to
17 resist commenting during the middle of these
18 presentations, about structural presumptions in
19 the guidelines.

20 The way I've always thought about
21 it, and the way it certainly works in practice,
22 is that I think of litigation as a burden-shifting
23 exercise in the sense that burdens shift
24 because courts want the burden on the party
25 most in control of the relevant information at

1 any given point in the process.

2 Internally, and I think Roxane is
3 right, maybe the label is wrong. It's more a
4 question of telling you that if this following
5 set of conditions is satisfied, we will be
6 operating from this premise. That's not to say
7 that we're done and you do the rest of the work.
8 But one of the internal discussions is, we
9 periodically meet with staff to review the various
10 matters. They'll say you've got X, Y and Z,
11 bearing in mind they're mostly starting with what
12 is a version of competitive effects analysis
13 anyway. It's a way of guiding, you
14 know, how far do we want to go and what is the
15 next piece of evidence we should be looking at,
16 and so sometimes setting priorities.

17 But it's also a way of saying you
18 should know that as a general proposition when
19 we reach this set of conditions, we will be
20 thinking that there might be something to
21 pursue further, which is essentially what you
22 were saying.

23 Paul, please pick up with whatever
24 you want to say.

25 MR. DENIS: Thank you, Molly, and thank

1 you, Rich, for the invitation to be here. It's
2 a pleasure and honor to be part of this
3 process.

4 My remarks are my own. They don't
5 necessarily reflect my clients or my partners
6 or my firm. But I would like to acknowledge
7 I've been in a number of seminars on this past
8 couple months on the guidelines revision
9 process. Cornerstone had one, CRA had one,
10 LECG just had one; and I've benefited a lot
11 from being part of that. Most of all I'd
12 be remiss if I didn't acknowledge how much I
13 benefited from the transformative experience
14 of working with Jim Rill, Bobby Willig, Donna Shore
15 over at DOJ, Jim Langenfeld, John Peterman at the
16 FTC and many others during the formation and
17 drafting of the guidelines. It was really
18 a unique professional experience, and one that I've
19 gotten a great deal out of and definitely
20 influences how I come out at this program
21 today.

22 My own views on unilateral effects
23 are driven by what I see is really a central
24 tenet in guidelines drafting, and that's that
25 the guidelines ought to be about asking the

1 right questions.

2 That sounds a little bit trite to
3 say in a setting like this. You can say, well,
4 what are the right questions. Well, the right
5 questions I think revolve around identifying
6 the conditions that are necessary to establish
7 that a merger is likely to have adverse
8 competitive effects. They're categorizable under
9 Section 7. That's what we ought to be focused
10 on. Those are the right questions. And that
11 necessarily implies a fairly high level of
12 generality.

13 Roxane referred to this in her
14 remarks, that merger guidelines are unlike some
15 of the other federal enforcement guidelines,
16 they don't go into a lot of examples, a lot of
17 discussion of evidence. That was by design, and I
18 think it actually was the right way to go. Because
19 by sticking with the right questions approach and
20 staying away from evidence, not entirely away from
21 evidence, but largely we stayed away from evidence,
22 created a document that had a great deal of
23 credibility with people.

24 It's lasted far longer than any of
25 us expected. No one would have predicted that

1 the guidelines would have been around for
2 seventeen years before encountering substantial
3 revision. And I think it's because the
4 guidelines achieved a level of credibility by
5 focusing on the right questions, not getting
6 into the nitty-gritty of the evidence.

7 The commentary is a far better
8 document for that; and I certainly subscribe to
9 the notion that we should have a regular updating
10 of the commentary to go into more of those issues.

11 What's happened with the
12 guidelines because of the approach they've taken,
13 they've gotten widespread adoption. Not just by
14 practitioners within the agencies and outside the
15 agencies, but also by the courts and globally. I
16 mean, it has become the template for merger
17 analysis around the world, and it's because of the
18 approach that we took. It had a fairly high level
19 of generality and, therefore, was able to be
20 applied in a wide variety of complex.

21 So we've got a durable document
22 that I think has been largely successful. I
23 certainly won't say it's perfect. As wedded as
24 I am to what we did, I'd have to agree that it
25 is time to change, and particularly in the area

1 of unilateral effects that we're talking about
2 here.

3 When we introduced the unilateral
4 effects section to the guidelines in '92, it
5 was definitely the single biggest innovation in
6 the document. There had never been a
7 unilateral effects section. There was a leading
8 firm proviso in the '84 guidelines, but people
9 really didn't talk about unilateral effects. So
10 this was a big change at the time.

11 We're now all quite familiar with
12 it; but when we rolled it out, it was pretty
13 unfamiliar. It's turned out to be the most
14 influential change, I think. If you look at
15 government complaints, this is not a rigorous
16 analysis. But having eyeballed a lot of them, they
17 are largely dependent on the unilateral effects
18 theories in this case. There are very few cases
19 that are based entirely on coordinated effects
20 theories, and I would suggest that the coordinated
21 theory is usually subsidiary to the unilateral
22 theory these days.

23 But ironically, despite being the
24 most influence change, unilateral section is
25 probably the least understood. And I think

1 it's on just about everybody's short list of
2 things that need to be revised.

3 So what went wrong? Where did we
4 fall off the rails here and what can we learn
5 from the history as we embark on a process of
6 considering revisions to these guidelines?

7 At a high level, I see two things
8 that went wrong. One, in some respects we
9 adopted too high a level of generality. And in
10 other respects, we got away from the central
11 tenet of asking the right questions.

12 On the point of generality, we had
13 a basic notion of unilateral effects that I
14 think was well-articulated in the guidelines.
15 By unilateral we meant, you know, without
16 concurrence of rivals, without the need for
17 coordination. It's a different mode of
18 competitive analysis. I think it is different
19 than coordinated, and Dennis Carlton and I have
20 had this discussion a few times and I guess
21 we'll have it again.

22 We stress in the guidelines that
23 unilateral effects can arise in a number of
24 different settings. We spent a fair amount of
25 time on a couple of those settings in the

1 document. We spent a lot of time on the
2 setting in which firms are distinguished by
3 differences among their products, and that's
4 the bulk of the unilateral effects section. We
5 spent less amount of time on the setting where
6 firms are distinguished by their capacities.
7 That's what most people call the homogenous
8 products section of the guidelines. It's really
9 not the homogenous product section. It's all about
10 the source of distinction between the firms. And
11 then we buried in the footnote this notion that
12 firms might also be distinguished by their
13 abilities to serve different customers or different
14 groups of customers.

15 We threw in notions of auction
16 markets and bidding markets. That's where we
17 kind of fell off the rails, I think. There was
18 not enough texture to those different settings
19 and we didn't lay out the necessary conditions
20 for establishing a problematic transaction in
21 those settings. In part because I don't think the
22 state of the economic learning was that good at
23 the time, we weren't really in a position to do
24 that with a lot of confidence. We didn't want
25 to get ahead of the economics, and that's

1 certainly something I would urge in this
2 process, is we not get too far ahead of the
3 economics.

4 We probably could have done a
5 better job even with the state of economics at
6 the time. So that's one source of our problem
7 here. And we tried to put too much, I think,
8 on the template of differentiated product site.

9 In terms of the right questions,
10 we did fall off the rails on that one. We
11 threw in a presumption in the middle of the
12 unilateral effects section. The reason we did that
13 was twofold. First, there were significant
14 concerns about unilateral effects leading to a
15 bunch of small effects cases, that resources
16 would be wasted chasing small effects cases. So we
17 started out by trying to put in a safe harbor to
18 avoid that problem. We ended up with a
19 presumption, sort of ended up with a camel, I
20 think, because of the committee process.

21 Others were concerned the
22 government would never be able to prove a
23 unilateral effects case. I think, you know,
24 we've seen the government can certainly prove a
25 unilateral effects case. So the presumption that

1 we ended up with practically defies application.
2 The conditions that have to be met to apply it are
3 so cumbersome as to be almost impossible in
4 differentiated products.

5 So those two things, I think, have
6 created a lot of confusion in unilateral; but
7 they also point in the direction of things that
8 can be done to fix the problem.

9 I think if the drafters can break
10 out these different settings in more detail and
11 set out the necessary conditions for
12 establishing a problematic transaction, that will
13 go a long way to solving the first problem. That's
14 talking in more detail about auction markets,
15 distinguishing between open and closed auctions,
16 talking about the individualized negotiation
17 setting, talking about locational- type spatial
18 models that the government uses quite often.

19 If we can do that, I think people
20 will understand the connection between what's
21 in the guidelines now and the modes of analysis
22 or the modes of competitive interaction that
23 were not well treated there.

24 The other thing you have to do is
25 go back to asking the right questions, and two

1 corollaries to that. One is I would not put
2 tools into the guidelines. I would not put in
3 UPP or GUPP or GUPPI or any of these other
4 tools. These are useful things to do.
5 They inform us in certain settings about the
6 right questions, but they're just tools. I
7 would explore them in the commentary, but I
8 wouldn't put them in the guidelines.

9 I would certainly drop the
10 presumption that's in the unilateral effects
11 section right now. In fact, I would drop all
12 the presumptions. Others have made that point
13 as well. When you think about Baker Hughes
14 and presumptions, as Molly was getting into
15 earlier, it's about burdens shifting in terms
16 of coming forward with evidence.

17 Guidelines ought to be burden-
18 neutral. They actually profess to be burden-
19 neutral, but I think this is one area where
20 they're not. The presumption has to go.

21 In its place the agencies are
22 going to have to deal directly with the issue
23 of substantiality. That's the elephant in the
24 room, I think, and it's the hardest one to deal
25 with. Nobody wants to say that we're

1 willing to tolerate certain adverse effects
2 that hurt certain people. But I think that is
3 the thing that you're going to have to wrestle
4 with the most.

5 I'm just about out of time
6 here. I guess I will leave it at that. If the
7 drafters can pull off that much, I think they
8 may end up with a document that's going to
9 outlive its predecessor.

10 MS. BOAST: Paul, do you mean
11 substantiality throughout the entire merger
12 analysis, or did you mean to be specifically
13 referencing the concern that led to the safe
14 harbor, and that is, you know, tiny effects
15 cases?

16 MR. DENIS: I think it's a broader term
17 than just the tiny, little unilateral effects
18 cases. It was most pronounced there because we
19 were making a change, but it comes up in other
20 contexts as well.

21 If you have a statute that says
22 there has to be a substantial lessening of
23 competition, we never spent much time talking
24 about the substantial part. We talked a lot
25 about the lessening of competition part and how

1 to make that operational. But we routinely
2 duck the substantial one because that's a hard
3 question.

4 MS. BOAST: Because I think it also
5 says in a relevant market; and therefore, we
6 spend all our time trying to figure that out
7 before we figure out whether it's substantial.

8 MR. DENIS: Markets are one way of
9 ensuring that we get substantiality. If you
10 force yourself to define a market, you have a
11 dimension over which to measure this effect.
12 You're more likely to get something that's
13 substantial as opposed to saying I can just
14 identify this effect through whatever technique
15 I happen to have because I've got very good
16 economists.

17 MS. BOAST: Well, that was very
18 helpful, the historical part of it. I'm dying
19 to know, but save it for a private
20 conversation, what the actual enforcement
21 experience with unilateral effects theories was
22 at the time these guidelines changes came into
23 place in 1992.

24 First of all, do any of the
25 panelists want to comment on anything you've

1 heard thus far or expand upon it?

2 MR. MURPHY: I would just reiterate a
3 little bit what you just said, which is if you
4 go straight to the unilateral effects or direct
5 effects kind of analysis, you always do have to
6 circle back in some sense to market definition
7 to get that substantiality component.

8 It's another place where market
9 definition shows up in the guidelines, because
10 we sort of say implicitly within a market if
11 some people gain and some people lose, we look
12 at the net and see who gains, but we don't do
13 that across markets. And market definition,
14 therefore, has yet another place that it shows up
15 in the analysis. I think in some sense if you take
16 a deemphasis on market definition, you then have to
17 have a substitute way of talking about
18 substantiality.

19 MR. DENIS: Molly, if I could, one
20 other point. I think each of the panelists, I
21 think it's fair to say each of the panelists
22 all day have noted the interconnection between
23 the various elements of the guidelines
24 analysis. And Kevin really pushed on this in
25 his remarks about how the various pieces keep

1 feeding back into each other.

2 That's a really important
3 observation, I think, in thinking about the
4 drafting and this issue that's on the table
5 about how did the pieces fit together and how
6 should the guidelines be applied.

7 I'm a strong booster of keeping
8 the framework and making people work through
9 the framework in an orderly way. I mean, I
10 agree that you can skip steps. Those of you, and
11 this room is full of experienced practitioners, you
12 can skip steps, right, because you're making
13 assumptions about the steps you're skipping and you
14 know what you're skipping. And you know how they
15 fit together.

16 That is an important point I think
17 people are forgetting. When they say I don't
18 need this framework, they're ignoring how
19 dependent they've become on the framework.
20 They've completely internalized it. People have
21 gotten very good at applying the framework. But I
22 think to ensure that the next generation of
23 practitioners will do as well, I think we need to
24 keep the framework and keep the emphasis on the
25 working through the framework in a fairly linear

1 way.

2 MS. BOAST: Although we've heard a lot
3 about making sure we recognize these are just
4 tools, they're all leading to the same end, the
5 process should be flexible, I think there's
6 also a theme that some version of a framework
7 is a helpful way of corroborating the results.

8 But this is one of the reasons
9 that the very beginning, before we even began,
10 opened our first panel, I said now that we're
11 about halfway through the workshop process, I'm
12 beginning to wonder whether our modest goals
13 were too modest.

14 I think Steve Calkins has his hand
15 up.

16 MR. CALKINS: All right, Kevin. I had
17 careful notes during your remarks that you
18 specifically were saying you ought to put a lot
19 less weight on market definition. I've got you
20 down as saying don't do market definition very
21 much. Then in the comment just now you
22 emphatically came out and said it's important
23 to do market definition. And if you could
24 reconcile those two, and indeed you might even
25 reference back to your wonderful product example

1 that you were discussing with Dennis Carlton and me
2 during the break before, and think through exactly
3 what would you do with market definition and how
4 would you use it.

5 MR. MURPHY: I guess I would say the two
6 shouldn't get in the way of each other, I guess is
7 what my key emphasis was.

8 Ultimately we have to establish
9 how things change and how competition is
10 affected. And to do that, you can start with
11 kind of a market definition because that kind
12 of identifies the players and helps you
13 understand how competition occurs today and
14 then gives you a lens on how it's going to
15 change when you introduce more people or reduce
16 the number of competitors in that case.

17 The other is to start with
18 competitive effects and say, look, if I can
19 establish competitive effects, then I've
20 learned a lot about how I should be defining
21 the market and then come back to market
22 definition later.

23 And either one can allow you to
24 get to either stage one or stage two, but I
25 don't see how you could jettison entirely the

1 market definition problem for exactly where I
2 ended up, which is you have to in the end
3 establish some sort of substantiality because
4 you can't have a situation where you're going
5 to say some people are going to be hurt and I'm
6 going to define them to be arbitrarily quoting
7 market and, therefore, this merger shouldn't go
8 through.

9 You have to have a way of saying
10 this is at a level which this is an antitrust
11 concern. This is something that has a
12 competitive effect. For example, talk about
13 repositioning. When somebody repositions,
14 almost always somebody's going to be worse off.
15 And it's not just an individual. Lots of
16 individuals could be worse off. But you can't say,
17 well, therefore I'm going to define a market of
18 those people and, therefore, this merger shouldn't
19 go through because that subset of people is worse
20 off. That can't be the right way to go. We're
21 never going to fully escape market definition, even
22 though in many cases it doesn't help.

23 The final place I want to go,
24 though, is to remember that you don't need to
25 define every market definition at the same

1 threshold. You can have a case where the best
2 market definition is a narrow one and do a
3 whole analysis realizing it's very narrow. In
4 another case where it's very broad, and do the
5 whole analysis realizing it's very broad. And
6 those are fine. Do the market definition that
7 suits the problem, that illustrates the issues and
8 allows you to come to the right conclusion I think
9 is the way I think about it. In the Whole Foods
10 case, it seemed like the right way to do it was a
11 narrow market, realize it was a narrow market, and
12 go from there. That's what I would say.

13 MS. BOAST: Mary, Roxane, do you want
14 to comment on this thread of the conversation?

15 MS. COLEMAN: One point I want to make
16 as well on the market definition point is that
17 a lot times, I think it was said earlier in
18 the panel, that it's a disciplining process. A lot
19 of times when you're doing a competitive effects
20 analysis, you're really focused a lot on the
21 competition between the merging parties.

22 And of course, doing it right, you
23 should be looking at competition with all the
24 other players as well. Market definition sort
25 of forces that as well so that you're not only

1 focused on that competition between the merging
2 parties, but it forces you to be make sure
3 you're looking at the other competitors as well.
4 Kevin's point, making sure if there's a
5 potential effect that it's either likely
6 substantial or that you're actually measuring
7 the right competitive effect, you haven't
8 missed that, oh, no, there's actually a lot of
9 other people out there through repositioning or
10 whatever means might actually make it so
11 there's no likelihood of competitive effects.

12 MS. BUSEY: I would only add, I would
13 like to agree with Paul Denis. I hadn't really
14 thought about this, but I think he's right that
15 in the private practice we internalize a lot of
16 the analysis. When we talk to a client, we're
17 asking them about all the questions that the
18 lawyers can ask. We don't just ask about who
19 you compete with. We talk about possible
20 entries and efficiencies, and it all kind of
21 comes out. It's not in any particular order.
22 So I guess I would say that.

23 The other thing that I would say
24 is the question of market definition seems to
25 be muddled a little bit by the HHIs and the

1 presumption. I think if you just put that aside
2 and talk about do you really need to know who
3 competes in this market, can you approximate a
4 market. That's informative. The market
5 analysis, I think, is informative to some
6 extent.

7 MR. MURPHY: I agree. I agree. You've
8 got to understand the players and how
9 competition occurs; but to think that that
10 definition of a market, think of it in terms of
11 the overall elasticity of demand for that
12 market, you're going to have cases where that
13 market is really, really broad and the
14 elasticity of demand might be one and another
15 case where it might be five. And you can't
16 have a fixed set of presumptions to apply to
17 both of those markets because those markets are
18 incredibly difficult.

19 I don't care whether it's Bertrand
20 competition or Cournot competition or anything
21 else. Those markets are really different, and you
22 can't have a fixed set of standards. You want to
23 be able to choose the one that works the best for
24 the case you have, and the presumptions stand in
25 the way of that, the way I see it.

1 MS. BOAST: Jeff?

2 MR. GROSS: This last point that was
3 made about confusing the market definition for
4 purposes of the concentration analysis and
5 market definition that you would handle
6 unilateral effects, competitive effects, I
7 think is an important one.

8 I think what happened is that
9 historically we had the old structure
10 performance paradigm of Philadelphia National
11 Bank and Von's and some of those other cases;
12 and I'd be interested, maybe in a private
13 conversation, from Paul's reflection as to the
14 extent that they were fearful of getting away
15 from that old paradigm.

16 We sometimes let that in the
17 HHI analysis overshadow what is going on in
18 terms of competitive effects because you're
19 really, if you're calculating the elasticities
20 with what's going to happen in terms of market
21 power as a result of a merger in the
22 competitive effects, you are defining a market.
23 You have to have that as a market.

24 But that's really a different,
25 it's really a different approach and we need to

1 push that structure paradigm, which is a nice
2 way to start, particularly for safe harbors. You
3 know, if you can get into the HHI and say, hey,
4 we've got a safe harbor here, and we can move on.
5 But once you get past that safe harbor, then I
6 think you need to set that aside and start focusing
7 on the competitive effects.

8 MS. BUSEY: I'd also like to state what
9 I think is the obvious, which is no one pays
10 any attention to the HHI's really.

11 MR. GROSS: Unless you're in a safe
12 harbor.

13 MS. BUSEY: Well, yeah. Even then it's
14 an embarrassment when you have to explain them.

15 MS. BOAST: Well, of course, the safe
16 harbors from a strict enforcement point of
17 view, a strict legal point of view, there is no
18 safe harbor. So you could have a safe harbor
19 for purposes of an HSR review; but if it turns
20 out in a consummated transaction that there
21 were competitive effects, there's no safe
22 harbor, to make the point clear.

23 MS. BUSEY: To state it a different
24 way, in the healthcare guidelines they
25 don't have exactly safe harbors; but they state

1 that certain things will not be challenged
2 except in extraordinary circumstances. Which,
3 you know, when I first read it, I thought, what
4 is that. But you realize that that's the
5 prosecutorial discretion, that there is a safe
6 harbor of whatever percent. But it isn't for
7 sure. It's just -- it is a guideline. That's
8 really all that it is. And it wouldn't hold up
9 in court, but neither would the healthcare
10 guidelines.

11 So it seems to me there's some
12 advantage to -- on the HHI, I just think that
13 the decision has to be made whether to keep them at
14 all. Personally I wouldn't do that.
15 But if you're going to keep them, adjust them,
16 or at least make the reference to say based on
17 case experience thus far this is where the
18 HHI's come out.

19 I mean, if you want to give some
20 deference to them, that's fine. I think you
21 should also take into account what EU's done.
22 They've used HHI's, but they've got different
23 numbers. Are their numbers better? I guess
24 they're better. Are they good enough? I don't
25 know. That's a whole separate issue.

1 MS. BOAST: Touching on the
2 international issues is, unfortunately, truly a
3 topic for another day.

4 It's one of the things Rich and I
5 and the task force know we have to think about
6 in undertaking this review is the legacy that
7 we've left around the world with the '92
8 guidelines, and how many countries as they've
9 tried to put guidelines in place or to
10 undertake some kind of merger analysis have
11 effectively started with the structural
12 presumption in some kind of market
13 share/concentration ratio/HHI.

14 MR. MURPHY: I would say just in
15 reference to the last comment, Whole Foods was
16 a good example where the structure just didn't
17 really help. You were left with two structures,
18 neither of which really directly addressed the
19 concerns that were on the table. You know, a
20 merger to monopoly or a merger of nobody's. And at
21 that point you should say, well, that's just not a
22 great framework for solving this problem. Let's go
23 on and try to analyze the problem more effectively.

24 You know, that's what was in the
25 way. In other places structure might be

1 helpful, but in that one it wasn't.

2 MS. BOAST: I'm going to exercise the
3 chair's prerogative and try to switch our
4 topics because I want to be make sure we cover
5 this in one of these workshops. And it strikes
6 me that we have a couple of people with views
7 on this, as that is the relationship in the
8 guidelines in the economic literature and in
9 the law between unilateral effects and
10 coordinated effects.

11 The guidelines effectively treat
12 these as two separate threads of analysis.
13 Certainly that's the way they're understood. We've
14 heard from Dennis this
15 morning and Kevin alluded to it, that maybe
16 this is not right. I'm interested in
17 people's thoughts -- about whether there is a point
18 of convergence or if it is indeed a complete
19 overlap, how we ought to articulate that if we were
20 to revise this part of the guidelines, particularly
21 in light of the courts' continued -- less so now,
22 but still continued -- reliance upon a coordinated
23 effects framework.

24 Anybody can start.

25 MS. COLEMAN: I'll start, I guess. I

1 think in some cases there are significant
2 differences between looking at a unilateral
3 effects case and a coordinated effects case,
4 depending upon the nature of what you're
5 looking at and the types of models you're
6 looking at.

7 So in, say, a more homogenous
8 products type of industry or, actually,
9 probably better to Paul's point, capacity-type
10 industry, there may really be a question of a
11 dominant-firm-type model where it really is a
12 true unilateral effects type of analysis, where
13 the merged firm will restrict output and
14 how the other guys may react by expanding output,
15 but they have limits on that. But I think that
16 sort of fits better into that type of analysis.

17 When you're talking about a lot of
18 the ways that people are pricing, say,
19 differentiated products in a Bertrand-type setting,
20 you can call that unilateral, but then you are
21 really trying to take into account, at least to
22 some extent, the reactions of others. Is that
23 unilateral or coordinated? It's a little hard to
24 tell.

25 I particularly always have

1 difficulty figuring out in the number of
2 bidders models where when you reduce the number
3 of bidders by one, you reduce the sum that were
4 bidding and so everyone will raise their bids. Is
5 that coordination or is that unilateral? It's kind
6 of hard to pigeonhole that in one setting. It's
7 sort of doing things in your own interest, so
8 usually call it unilateral, not coordinated. But
9 it's also clearly very much taking into account the
10 reactions of others. While I think there's some
11 reasons to think about the distinction of looking
12 at whether the firm on their own, no matter how the
13 other players react, would find something
14 profitable. In some cases I think the distinctions
15 aren't all that helpful.

16 MR. MURPHY: I guess I would come down
17 in the same area. I think in many cases
18 they're not very helpful because while you can
19 come up with stories. For example, take the
20 homogeneous products. You can say, well, I've got
21 the dominant firm. Well, that's unilateral. Well,
22 then you can just have some simple kind of
23 coordination-type world. And suddenly that same
24 market looks like a very coordinated effects world.

25 I've got Bertrand pricing for some

1 guys that take other prices given. Now, I've got
2 two gas stations across the street from each
3 other. I take into account the fact if I cut
4 my price, he's going to cut his price in
5 response.

6 Is that coordinated? Is that
7 unilateral? I don't know. It's a bit of both. I
8 guess I find most cases have evidence of both. And
9 the models we put on may be unilateral models and
10 coordinated effects models, but I don't think
11 that's as good a description of reality as it is of
12 the description of the models we throw at it.

13 MR. DENIS: Let me try to defend the
14 distinction or draw it in a different way that
15 maybe will make it more clear. I take the point
16 that both Dennis and Kevin have made that all of
17 what we're calling collateral and unilateral
18 derives from noncooperative oligopoly theory. No
19 dispute about that.

20 Where the difference lies is
21 whether the reactions of rivals have any impact
22 on the merged firm or not, whether they have to
23 take that into account. Of course, everybody
24 always thinks about what their rivals are doing.
25 The distinction we tried to draw between

1 coordinated and unilateral was whether the
2 rivals' reactions mattered.

3 So if you want to take the case
4 where firms are differentiated by their
5 capacities. Essentially what the guidelines
6 are saying is that there's a circumstance in
7 which rival firms can't do anything about the
8 merged firm's restriction of output. Why? Because
9 they don't have the capacity to do it. That's the
10 answer. That, we're saying, is unilateral because
11 you can look at it as the rivals' reaction can't do
12 anything or that the merged firm doesn't have to
13 take it into account.

14 It gets a little squishy, I'll
15 admit, on firms that are differentiated by
16 their products when you take repositioning into
17 account. We bifurcated repositioning away from
18 sort of the initial inquiry. The initial inquiry
19 is strictly unilateral. We're saying we're
20 essentially assuming that the world's not changing.
21 And we're saying if we assume the world's not
22 changing, can you raise your price? All right.

23 So by defining away reactions, we've made
24 it unilateral. That may seem like a bit of a
25 trick. Maybe it is. But it was a way of

1 simplifying the problem, and then focusing on
2 repositioning as separate stuff.

3 If you look at coordinated,
4 coordinated is all about mutual accommodation
5 amongst the firms that are part of the market.
6 And the notion of coordinated is this price
7 elevation can't work without that mutual
8 accommodation.

9 So I don't take it as a critique
10 to say that all these things derive from
11 non-cooperative oligopoly theory. They do.
12 But they reflect very different modes of
13 competitive interaction.

14 Firms are competing on output.
15 Firms are competing on price. Firms may be
16 competing on product positioning, and some have
17 more product space. These are different modes of
18 interaction. I think we need to look at them
19 differently. And if the labeling of
20 coordinated versus unilateral is bugging
21 people, we can certainly change the label. But
22 I think the idea that we have to keep in mind
23 is not all markets work the same way.

24 MR. MURPHY: I guess I would say the
25 last thing you said just sounded like whether

1 they are strategic substitutes or strategic
2 complements in some sense, is kind of what you
3 were saying is which way people respond.

4 The other thing I would say on the
5 repositioning point, is you say, okay, I'm
6 going to do market definition without people
7 repositioning. But ultimately market
8 definition has to rely on data. And if the data
9 was generated in a world where the potential to
10 reposition was important, that's all part of what
11 we're going to then use to define a market.

12 It's, like, I don't know how to
13 pull that out of the data and then do the
14 market definition analysis that wasn't there.
15 Nor do I know why because I want to put it back
16 in later anyway. I would just keep it in there
17 and live with it.

18 MR. DENIS: If anybody could pull it
19 out of the data, he could.

20 MS. BOAST: Actually, Paul's
21 explanation is quite interesting to me because
22 if you go back, even the drug wholesalers case
23 where Judge Sporkin kind of got confused
24 between coordination and the unilateral
25 analysis in some points. The case law, the judge's

1 early introduction to merger analysis was
2 simple. If you take one rival in a defined
3 market out, will it make it easier to collude.
4 That's all they were really thinking about.

5 Now Paul is telling us we really
6 never meant that -- not in those terms, in the
7 coordinated effects discussion of the
8 guidelines. So I feel like not only do we have
9 a convergence issue in what that whole
10 discussion was intended to do in the
11 guidelines, but something not responsive to the
12 case law because of the opportunity to collude
13 piece.

14 MR. LANGENFELD: Actually, my
15 recollection is consistent with yours, Molly. This
16 is sort of an incipency, arguably, type of
17 statute. We want to prevent the facilitation of
18 collusion; and even though the original Stigler
19 models, your professor, chair, talked about it, I
20 think it was based on, you know, a game
21 theory, a Cournot-type model, but did talk
22 about the facilitating conspiracy.

23 And that's certainly what the
24 coordinated effects section looks at -- the
25 likelihood of being able to reach an

1 agreement, the aspects of whether you could
2 punish someone if they deviate from the
3 agreement. That's why you count the number of
4 competitors. Right? So that's really where
5 it's focused now, and that was my understanding
6 back why it was in there.

7 But in the accommodation the way
8 Paul puts it is at the center of that, too.
9 And if you look right now at where a lot of the
10 antitrust action is, it's suing every industry
11 that you could possibly imagine for price
12 fixing or customer allocation.

13 Look at the Europeans -- look here.
14 That's where a lot of the non-merger action is
15 right now. So think that there is a concern, a
16 legitimate concern, about conspiracy or
17 coordination that is not just unilateral.

18 I attended a session in part
19 of the D.C. workshop in this, and Professor
20 Marx, interesting name, had a very good insight
21 that I thought that we had missed in '92.

22 MR. DENIS: We missed something?

23 MR. LANGENFELD: And that's the way the
24 guidelines are currently written, it's a set of
25 three negatives basically. You got to get over

1 this hump, you got to get over this hump, you got
2 to get over this hump. Well, if you're bringing a
3 case based on coordinated effects and all you have
4 to do is knock down one of those three humps,
5 well, it gives the defensive side, that gives
6 the merging parties a lot of ammunition.
7 There's no positive there.

8 And Professor Marx made the point,
9 which I think is very valid, that the guidelines
10 need some balance here. She's done a bunch of
11 analysis of coordinated effects and pricing,
12 most of which I have seen. But her key point is,
13 look, there should be something to weigh on the
14 other side. In other words, shouldn't we have an
15 element of the guidelines that says what is the
16 gain to coordination?

17 And if the gain to coordination is
18 really big, and she has some models to do this,
19 I don't think you want to get that complicated,
20 but if the gains of the coordination are very, very
21 big, like, say, in an industry with low
22 marginal costs, high priced fixed costs, then
23 shouldn't that be a positive thing to show, to
24 say, look, they've got all of this to gain and
25 maybe they have these impediments to being able

1 to coordinate. But the gain is awfully big, so
2 we shouldn't be surprised that they are making
3 attempts, at least, at coordination. And that
4 pulling one major competitor out of the market
5 may increase that.

6 MS. BOAST: I want to just focus people
7 on -- first of all, let the panelists talk
8 since they're our guests, but try to focus on
9 how we think about fixing the guidelines to
10 make all of this clear, just to make sure we're
11 all still staying on the exercise of the today.
12 Paul.

13 MR. DENIS: Coordinated, the one thing
14 where we can fix the guidelines is to focus
15 more clearly on the question that Kevin put on
16 table right at the beginning of his remarks,
17 was how does the merger affect competition as
18 it exists today.

19 So the issue shouldn't be whether
20 there are great gains to coordination or
21 whether the market is conducive to
22 coordination. The question is, how is this
23 merger changing the gain. If we believe that
24 there's not coordination going on today, then we
25 must believe that the merger somehow is going to

1 enable coordination to flourish post-transaction.
2 And what is it about taking out the acquired firm
3 that does that. Or if we think that there was
4 coordination pre-merger and we think that this is
5 going to stabilize it in some way, improve it in
6 some way, make it more perfect, what is it about
7 this transaction that's doing that.

8 That's something that I don't
9 think we were as clear on as we could have been
10 in the guidelines, in part because I think
11 people at the time were very concerned about
12 Jim's sort of three negative points of saying,
13 well, if you make it very clear that a merger
14 has to change something, that we're going to be
15 held to that standard in court.

16 I think the agencies are now held
17 to that standard in courts, and maybe people
18 won't be afraid to admit it.

19 MS. BOAST: Rob, if you have a thirty-
20 second comment I'll allow that, and then I'd
21 like to get one more question in.

22 MR. GERTNER: I'll try to do a
23 thirty-second comment. I think one of the
24 problems is that the way in which coordinated
25 effects is handled is as if there's a sort of

1 very specific set of models in mind.

2 And so the only way dynamics show
3 up in the guidelines is really through some
4 notion of punishment dynamics through
5 punishments and cooperation.

6 But there's an enormous amount of
7 dynamics out there in the world, things like
8 investment and capacity, switching costs, you
9 know, a whole variety of other things that
10 create dynamic links, which in concentrated
11 markets make things like accommodation matters,
12 things like thinking about effects on competitors
13 is essential to the way anyone would participate.

14 You don't need punishments; and
15 there's sort of no natural place in the
16 guidelines to think about the way in which the
17 analysis of those kinds of mergers would occur.

18 They don't fit into the definition of
19 unilateral effects. They don't fit the analysis as
20 typically done in unilateral effects. But the
21 coordinated effect language isn't what's going
22 on in those markets necessarily either. And I
23 think that really needs to be addressed.

24 MS. BOAST: This is obviously a topic
25 where we could spend literally an entire

1 workshop or more.

2 Let me ask one other question of
3 the panelists, and we have only a couple of
4 minutes left, so just some quick reactions.

5 One thing we hear routinely from
6 the parties and quite frankly routinely from
7 staff is these firms or these products, rather,
8 are or are not the closest substitute.

9 I think Dr. Shapiro, were he here, would
10 pound the table and say that's not really the test.
11 I suspect every economist in this room would agree
12 that while the closeness of substitution matters,
13 that closest substitute or next best substitute
14 isn't the proper test.

15 We are thinking about how we give
16 guidance in this area without creating a
17 standard in the world.

18 Any ideas?

19 MR. MURPHY: First of all, I will say
20 that closest isn't the right test. That's the most
21 obvious one. Whether you're the number one or
22 number two depends on how close number one and
23 number two are. But not only that, depends on how
24 competition occurs in the marketplace. I think
25 it's going to be difficult to have a firm

1 discussion of that.

2 In a differentiated products
3 world, you can be on the other side and still
4 matter a lot. In a bidding auction market, maybe
5 it doesn't matter that much where you are in terms
6 of on the other side. It depends on where the
7 fourth guy is because you're eliminating the third
8 guy in line. Well, how close is the fourth guy to
9 the second guy. So I don't think it's going to be
10 easy to have a uniform standard there. I think
11 it should be made clear that it's not always
12 closest.

13 MS. BUSEY: I agree with that, although
14 I wouldn't give up the closest. If you happen
15 to have a closest that's merging, that's the
16 problem. So I wouldn't abandon that
17 altogether.

18 MS. BOAST: And that's helpful in
19 explaining to clients especially.

20 MS. BUSEY: Helpful to explaining to
21 clients, but seems to me it's also relevant.

22 MR. MURPHY: Showing you're not the
23 closest isn't sufficient to say there's not a
24 problem. I think that's really what we're
25 trying to say here.

1 MR. DENIS: I think, Molly, if you
2 adopt the approach that I was envisioning of
3 breaking down your different modes of
4 competitive interaction, laying them out in
5 more detail in the competitive effects section,
6 what you will find is that for some of them a
7 standard is closest and for others it's not. And I
8 think that would be informative to people. It's
9 not uniformly the answer that you have to be
10 closest. I agree with that.

11 But I can envision situations,
12 Kevin alluded to bidding models, some bidding
13 models where that is the test, and I would say
14 you have to be the closest. Particularly if
15 you go down the road of these kind of single
16 customer product points.

17 MS. BOAST: Mary, do you want to
18 comment at all?

19 MS. COLEMAN: What I would say, you
20 know, that most economists would agree
21 clarifying that issue would actually be very
22 helpful because you see it a lot, they're not
23 the closest substitutes that we're buying. And
24 you try to explain to people why that's not
25 necessarily the case, depending on the markets

1 and everything. So having some clarification of
2 that would be very helpful to giving guidance
3 to practitioners, to business; and actually,
4 you know, stepping back, we often talk about
5 practitioners.

6 Giving guidance to staff is
7 actually important. You get a lot of new staff
8 in all the time, so actually having some
9 guidance about what they should be looking for
10 and not always be asking their colleagues, but
11 having something they can look at to help them
12 understand how they should be approaching cases is
13 also really very important.

14 MS. BOAST: Well, we are officially out
15 of time. It's been really my privilege to
16 share this session with an incredibly
17 illustrious panel, to whom I hope we will all
18 give our thanks.

19 (Applause.)

20 MS. BOAST: We reconvene at 3:00
21 o'clock for efficiencies.

22 (Brief recess.)

23

24

25

1 PANEL 4: EFFICIENCIES

2 MR. FEINSTEIN: I guess I should
3 disclose, actually, this is sort of an
4 exquisite irony, on a panel that's supposed to
5 address efficiencies, one of our panel members
6 is trapped on an Amtrak train that is stuck
7 somewhere between Detroit and Chicago. That's
8 Dan Crane, who is a professor at the University
9 of Michigan, so he will not be joining us.
10 He's a victim of inefficiency.

11 MR. CALKINS: We're not even standing
12 by to see if he walks in?

13 MR. FEINSTEIN: He sent me a note
14 telling me ten minutes ago that he was still
15 struck on the train. If he walks in, we'll be
16 happy to see him, but I'm not counting on it.

17 So there will be four of us
18 instead of five; and if nothing else, that may
19 allow us some additional time for dialogue
20 amongst the panelists and questions from the
21 audience.

22 Let me introduce the panelists who
23 are here. By the way, Dan Crane did submit,
24 along with Joe Simon, some very thoughtful
25 comments, and I think he will be submitting in

1 writing some of what he was going to be
2 presenting today, so they will still become
3 part of the record.

4 Our first speaker today to my
5 immediate left is Mike Baye, who is the Burt
6 Elwert Professor of Business at the University,
7 Kelley School of Business, and also served as
8 the Director of the Bureau of Economics at the
9 FTC during 2007 and 2008. He is a well-regarded
10 expert on the issues that we'll be addressing today
11 and a very thoughtful commentator.

12 After Mike, we will have John
13 Treece, who is a very experienced trial lawyer
14 at Sidley & Austin here in Chicago with a
15 variety of experience on a lot of cutting-edge
16 antitrust issues, both as a trial lawyer and
17 also as a counselor.

18 Following John we'll hear from
19 Professor Sam Thomson, who is currently at Penn
20 State where he is the Arthur Weiss Distinguished
21 Faculty Scholar and director of Penn State
22 Center for the Study of Mergers and
23 Acquisitions. He's also been a professor of law
24 at UCLA, Director of UCLA Law Center for Study
25 of Mergers and Acquisitions, and at one time

1 was the head of the tax department at Schiff,
2 Hardin & Waite here in Chicago in addition to a
3 number of other positions. We're very pleased
4 to have him with us.

5 And our final speaker is Stephen
6 Calkins, who is currently the Associate Vice
7 President for Academic Personnel and a
8 professor of Law at Wayne State University. His
9 teaching focuses extensively on antitrust and trade
10 regulation. And Steve also served in the
11 mid-'90s as the general counsel of the FTC
12 during the time that Bob Pitofsky was the
13 Chairman. He is a much sought-after speaker on
14 antitrust issues of all stripes.

15 So with that, let's get started
16 and I'll turn it over to Mike Baye.

17 MR. BAYE: Thank you, Rich. It's a
18 real pleasure to be here, and I'm grateful to
19 have an opportunity to help with your discussions.
20 I agree with much of what was said this morning.

21 Certainly economics is a dynamic
22 science. Things have changed since the
23 guidelines and the revisions which dealt
24 explicitly with efficiencies were put in place.
25 I'm happy to contribute to that dialogue

1 and wish you the best as you sort through the
2 process of trying to deal with that.

3 Since this panel is on
4 efficiencies and since I think I'm the sole
5 economist on the panel, I thought it might be
6 useful just to begin with just a discussion of
7 what efficiencies are in the first place. I think
8 we can all define things to mean whatever we want
9 them to mean, but clearly there's a difference
10 between the way economists view efficiencies and
11 the way many attorneys, and, in fact, the law views
12 efficiencies.

13 I think if you poll a hundred
14 economists, a hundred an economists will say
15 the appropriate measure of efficiencies would
16 center on total welfare. When you look at the law,
17 the law really deals with the issue of consumer
18 welfare and the competitive effects on consumers.

19 I think it's useful just to
20 kind of keep in mind what the economic
21 arguments are for the total welfare standard as
22 opposed to the computer welfare standard. This is
23 not because I'm of the opinion that somehow in
24 revising the guidelines that standard is going
25 to be changed; but because I think it helps kind of

1 cast a way for one to think about presumptions
2 and burdens as one is thinking about some of
3 the impacts of mergers that might not be
4 counted formally in the courts as they're
5 contemplating the impact of efficiencies on
6 consumers, rather than the overall economy.

7 The reason economists favor
8 total welfare over consumer welfare is that in
9 the long run it's total welfare that's going to
10 affect the health of the economy, total welfare
11 being defined as the sum of consumer surplus and
12 producer surplus. And, obviously, in the long run
13 if the U.S. economy doesn't economize on the use
14 of all resources, we're going to be producing
15 goods and services at a cost that's more expensive
16 relative to what we could be producing those goods
17 and services for. I think that's especially
18 important in an area where the buzzword certainly
19 in business schools and around the globe is the
20 term sustainability, okay.

21 So if you think of a merger, for
22 example, a hypothetical merger that was going
23 to save lots and lots of resources, say less
24 money spent on electricity, for example. If those
25 savings were in the form of fixed cost savings and,

1 therefore, not passed on to consumers, should they
2 count?

3 From an economist's viewpoint,
4 to the extent they improve the overall
5 efficiency of the allocation and resources,
6 they might be relevant for considering to
7 offset price increases. However, if you look at
8 the law, maybe those efficiencies wouldn't be
9 included. And indeed, a lot of the issues that
10 we've dealt with earlier today and this morning
11 really stem from issues that center around
12 differences between total welfare and consumer
13 welfare. For example, when Kevin Murphy
14 talked about defining a market sufficiently
15 small that some consumers are harmed from
16 repositioning, that's because that just seems
17 like a silly notion of welfare to focus on that
18 one small group of consumers.

19 Lots of the issues that really
20 center around the discussions for debate I
21 would argue center around this dichotomy that
22 we have between a focus on total welfare and
23 consumer welfare.

24 Why might we care about total
25 welfare over consumer welfare? Well,

1 ultimately to the extent that one thinks that
2 those savings on energy that accrued to a firm
3 that contemplates a merger in this hypothetical
4 that I proposed, if you imagine that those
5 gains, those savings are going to accrue to
6 shareholders, those shareholders are themselves
7 ultimately consumers and one might argue should
8 be counted in that.

9 But I'd make a broader point, to
10 the extent that those savings accrue in the
11 profits of firms, those profits are taxed at
12 the corporate level and then again at the
13 shareholder level so that well over half of
14 those efficiency gains are going to be tax
15 revenues to the federal government that could
16 then use those revenues to redistribute incomes
17 among disadvantaged parties.

18 I guess the big point I'd like
19 to make is that total welfare is certainly an
20 important issue to take into account as one is
21 evaluating antitrust policy.

22 I'm no fool. I recognize the
23 law focuses on a consumer welfare standard.
24 But it's important to keep those things in mind
25 as one is trying to calibrate the competitive

1 effects of a merger. It's useful to keep in the
2 back of your mind that there may be social benefits
3 that are accruing to the economy as a whole that
4 aren't being manifested or accounted
5 for in the analysis of the merger.

6 That said, let's talk a little bit
7 about the nature of efficiencies. If you take a
8 close look at the guidelines, it's pretty clear
9 that the nature of efficiencies that are
10 contemplated in the guidelines are things like
11 production costs, transportation costs and the
12 like. The obvious question that arises then is
13 whether one wants to make a distinction between
14 efficiencies that save fixed costs versus
15 efficiencies that save marginal costs.

16 The traditional story from an economic
17 viewpoint is if you're focusing on total economic
18 welfare, certainly reductions in fixed costs count.
19 But if one is looking at a measure
20 of consumer welfare, using traditional models,
21 it's kind of hard to understand how reductions
22 in fixed costs might ultimately impact consumer
23 welfare.

24 If you look at the way the economy has
25 evolved over the course of the

1 past decade-and-a-half, there have been
2 tremendous changes in the nature of the
3 economy that blurs the impact of fixed
4 costs and marginal costs on the overall
5 efficiency of the market.

6 I would argue in addition to
7 production costs and transportation costs,
8 there are a number of synergies that might
9 arise through merger that are quite difficult
10 to quantify, but nonetheless, I would argue,
11 should be counted as efficiencies in any event.

12 Just to give you a couple of
13 examples, one can imagine a merger that might
14 hike the informational advantages and the IT
15 capabilities of firms in a manner that allows
16 them to procure cheaper inputs. Whether or
17 not those cheaper inputs, ultimately are passed
18 on to consumers in terms of lower prices,
19 they represent savings. The point is that many
20 of the costs to achieve those savings might
21 accrue through forms of various fixed costs.
22 It's very difficult to associate those particular
23 fixed costs and those synergies with the actual
24 reductions that might occur in the procurement
25 of input prices.

1 Another example would be in the
2 area of coordination of R & D efforts. It
3 might well be that a synergy that arises as a
4 result of a merger might allow firms to more
5 effectively engage in research and development.
6 Again, that's not something that's going to be
7 directly related to marginal costs. It might be
8 related to fixed cost efforts of the firms and,
9 therefore, difficult to actually account for in
10 formal efficiencies analysis the way it's
11 traditionally done.

12 Another example is in the online
13 area, the impact of reputation and service
14 quality, for example. One can imagine where
15 one firm has a comparative advantage in
16 production or distribution. Another firm has a
17 comparative advantage in advertising or
18 reputation. And it may well be the merger of
19 those two firms creates value in the form of
20 better information transmitted to consumers and
21 ultimately better service quality. Again, those
22 types of efficiencies are things that are not
23 typically accounted for if you're using the
24 standard fixed cost versus marginal cost analysis
25 based on income statements, yet, these efficiencies

1 stemming from those synergies can be very, very
2 important.

3 I have a number of other examples that
4 I'll talk about if we have time later; but the key
5 point of all this that I'd like to make is that I
6 think looking at the current state of the economy,
7 it's very difficult for individuals to actually
8 link underlying merger activity or the prospects of
9 a merger, the impact of that on the ultimate
10 synergies that will be realized from the merger.
11 It's very difficult to quantify.

12 The typical story is that the
13 parties have better information about the
14 efficiencies that would stem from a merger than
15 the government and, therefore, it makes
16 sense to have the burden of demonstrating those
17 efficiencies on the parties rather than the
18 government. While I am somewhat sympathetic to
19 the fact that firms often have better
20 information than does the government about
21 traditional types of efficiencies, like unit
22 costs and production and so forth, I think in
23 terms of the ability to actually quantify many
24 of the synergies that arise through mergers,
25 particularly in the new digital age, I think

1 it's very difficult for firms to formally
2 quantify the benefit of those synergies.

3 The big picture that I'd like to leave
4 with you as you are contemplating revising the
5 merger guidelines, I'd like to see a little bit
6 more discussion about the nature of the
7 efficiencies, recognizing that efficiencies don't
8 only manifest themselves in shifting production
9 from a high-cost firm to a low-cost firm, but can
10 also manifest themselves in various synergies
11 really on the demand side that improve the
12 quality of the product that consumers receive,
13 as well as the nature of services that they
14 receive. Those things are incredibly hard to
15 quantify; and it would be very useful, I
16 believe, for the guidelines to provide some
17 guidance about how parties might realistically
18 attempt to make those efficiency gains cognizable.

19 MR. FEINSTEIN: Thank you, Mike. I
20 should mention before John begins, there's a
21 handout so people have the ability to
22 take a look while John is offering his remarks.

23 MR. TREECE: Thanks, Rich. Yeah, I
24 think you'll find it helpful. It's very, very,
25 very simple, but I'm going to be referring to

1 them.

2 I want to start by thanking the
3 Department of Justice and FTC, specifically
4 Molly Boast and Rich Feinsein for arranging
5 this workshop and inviting me to participate.
6 It's an honor. I also want to thank Henry Butler
7 of the Searle Center for hosting. This is the
8 second conference in as many months I've
9 attended here recently. I received an excellent
10 research paper from the Center on Consumer
11 Litigation. And Henry's done a terrific job in a
12 very short period of time to establish the Center
13 as a place where important work is done well, and
14 all of us Chicagoans look forward to seeing the
15 Center assume an ever-important role in our
16 community.

17 Efficiencies and mergers
18 analysis. Well, some of my defense bar
19 colleagues might say the empirical evidence
20 would suggest that if we're talking about the
21 role of efficiencies, this must be the last
22 panel of the day. So here we are.

23 I think I have a very common
24 perspective on the overall enterprise. I agree
25 that it is time to revise the guidelines; but

1 like many people, I think it should be done
2 with a relatively light touch.

3 The guidelines have served us well
4 by providing broad principles that have
5 permitted our understandings evolve, to the
6 point, in fact, where it's now appropriate to
7 capture the evolution in a revised set. But I also
8 believe that the revision process should be limited
9 and have very well-defined objectives.

10 The most important objective in my view,
11 is to reflect the reality of how the Agencies do
12 their work. That is important not only because
13 the guidelines should provide the bar and their
14 clients with an ability to predict the
15 government's treatment of the transactions, but
16 also because they are relied upon by the courts
17 to identify the right questions they should be
18 trying to answer.

19 In that respect, I'd echo what
20 Paul Denis said, the point is the guidelines
21 should highlight the questions, not the
22 answers. That means the guidelines should
23 not be so detailed as to lay down prescriptive
24 rules that try to answer all possible questions
25 in all possible factual circumstances.

1 Although a couple of the comments that
2 I've read seem to rehash significant arguments that
3 perhaps have been lost at the agency level, I think
4 there's relatively widespread agreement that the
5 guidelines should not be too detailed.

6 But the other side of the no-
7 prescriptive-rules coin is that the guidelines
8 should not, without very good reason, foreclose
9 or appear to foreclose particular types of
10 analyses that in a way could hinder further
11 evolution of our thinking. Just as the agencies
12 should not insert new rules into the guidelines
13 that are overly prescriptive, they should also
14 consider deleting overly descriptive language
15 that's currently in the guidelines.

16 If we look at the efficiency
17 section, let's begin by acknowledging, I think
18 it's fair to say, that the general perception
19 among defense lawyers is that the agencies are
20 too skeptical, perhaps too dismissive of
21 efficiency claims. I think that perception is
22 probably overblown. After all, I assume that the
23 agency attorneys and staff ask themselves the same
24 initial question that we ask our clients, why do
25 you want this deal. The answer almost always

1 evokes a host of consumer benefits. I agree
2 with Roxane Busey that we ask our clients a whole
3 set, a panoply of questions, but almost always we
4 start with that. Certainly, efficiencies
5 asserted with the transaction are acknowledged
6 in consideration of the competitive effects.
7 The two concepts are completely intertwined.

8 But there's nonetheless a view
9 that the agencies are too slow to acknowledge
10 the efficiencies that are usually the very core
11 reasons for the deal. That reluctance has
12 been reflected in the existing guidelines.

13 On the one hand, for the existing
14 guidelines there seems to be an almost universal
15 agreement that the core notion of cognizable
16 efficiencies asks exactly the right questions. Are
17 the asserted efficiencies merger-specific? Are
18 they verifiable? And by the way, that does not say
19 quantifiable, but verifiable. And do they arise
20 from anticompetitive output restrictions?

21 But then the existing guidelines
22 seem to me to proceed to undercut that
23 simplicity by suggesting that efficiencies, and
24 I'll quote here, "relating to research
25 development, procurement, management, or

1 capital costs are less likely to be verifiable,
2 merger-specific or substantial, or may not be
3 cognizable for other," and I will point out,
4 "completely unexplained reasons." This passage in
5 the guidelines, in my view, is more fiat than logic
6 and should be deleted. In any specific case,
7 obviously one must determine whether R & D,
8 procurement, management and capital cost
9 efficiencies are cognizable. But there's no reason
10 to pre-judge that issue.

11 Footnote 36 of the guidelines, in
12 my view, suffers the same problem. It seems to
13 cabin the consideration of certain cognizable
14 efficiencies without adequate reason. Footnote 36,
15 which is on page 1 of the handout, describes when
16 efficiencies created by a merger in one market
17 might be considered to justify it, despite some
18 anticompetitive effects in another market. I'll
19 just read part of it. "The agency normally
20 assesses competition in each relevant market
21 affected by the merger independently and normally
22 will challenge the market if it is likely to have
23 anticompetitive effects in any relevant market. In
24 some cases, however, the Agency, in its
25 prosecutorial discretion, will consider

1 efficiencies not strictly in the relevant market,
2 but so inextricably linked with it that a partial
3 divestiture or other remedy could not feasibly
4 eliminate the anticompetitive effect,"
5 et cetera.

6 Now, I want to discuss Footnote 36
7 for three reasons. First, if one purpose of
8 revising the guidelines is to clarify them, the
9 question of cross-market efficiencies deserves
10 some attention because it's not immediately
11 obvious what it means. For one market to be
12 inextricably linked with another, to me the term
13 has a mysteriously talismanic ring to it, which
14 suggests that the exercise of prosecutorial
15 discretion may prove to be more arbitrary and
16 less transparent than we would like.

17 Second, the inextricably linked
18 language seems to establish a threshold
19 question designed principally to foreclose
20 consideration of legitimate efficiencies. That
21 is, the footnote acknowledges that a merger may
22 create substantial and legitimate efficiencies
23 in markets other than the market under
24 consideration, but nonetheless suggests that
25 for largely unexplained reasons they won't be

1 seriously considered.

2 Third, my experience is that
3 when antitrust rules don't accurately reflect
4 how businesses actually strategize about their
5 competitive responses, and more often than not
6 we need to rethink our rules and our language
7 rather than condemn the strategy. In this regard,
8 I think antitrust lawyers and economists sometimes
9 tend to think narrowly in terms of relevant
10 markets, I think that was Kevin's point, but
11 businesses certainly don't. When they formulate
12 competitive responses, they look at all the tools
13 they have, including their entire arsenal of
14 products, business methods, distribution
15 channels and R & D.

16 The footnote fails to acknowledge
17 this reality by continuing to limit the
18 consideration of efficiencies within single
19 relevant markets that more often than not
20 because of the unilateral effects analysis have
21 been narrowly defined by the agencies.

22 An easy example, of course, is
23 the economies of scope that often create cross-
24 market efficiencies. The joint production of
25 multiple products, the manufacture of distinct

1 products in a single facility can reduce the cost
2 of producing products other than the product that
3 is in the relevant market under scrutiny. In fact,
4 depending on the relative size of the markets or
5 sales volumes of the products, it may be the case
6 that most of the efficiencies accrue to products
7 that fall outside the market that's under
8 consideration. Furthermore, there are efficiencies
9 which seem in many cases to satisfy easily the
10 guidelines test for cognizable efficiencies.

11 A second example is research in
12 basic science or common research and
13 development that may support multiple products,
14 product lines that are properly deemed to be in
15 separate markets. Spreading the fixed cost of that
16 research across multiple products, some of
17 which are acquired in the merger, may not only
18 lower the cost for all products, it may very
19 well incentivize R & D investment that might
20 not otherwise occur. So while there may be a
21 debate about how to allocate those savings across
22 the product lines, they don't seem to inherently
23 fail the cognizable efficiency test.

24 Finally, joint sales and
25 promotions, of course, of multiple products

1 have the same effect. Significant savings are
2 realized when a sales force is able to present
3 multiple products as they knock on doors. And the
4 same comment about cognizable efficiencies applies
5 there well. These are all legitimate and
6 potentially significant efficiencies, but it's very
7 hard to see why they should not be routinely
8 recognized in merger analysis.

9 Now, in addition to cross-market
10 efficiencies associated with economies of
11 scope, I would argue that recent scholarship
12 has suggested another form of efficiency that
13 we had seen in conglomerate merger analysis and
14 back in some of the doctrines about
15 retrenchment and that concept. These are pricing
16 efficiencies, including the effects of bundled
17 product competition. I think it's fair to say that
18 we've thought a lot more about bundled
19 competition than we did even a few years ago. One
20 of the benefits of the bad decision in LePage's has
21 been a proliferation of scholarship on the issue.
22 And I don't see any reason why some of that
23 learning can't be applied in a merger context.

24 Now, as a disclaimer, I'm not an
25 economist, or frankly, a mergers maven; but I

1 draw some experience from a case we tried a
2 couple of summers ago in which the evidence
3 provided some useful examples. The core fact in
4 the case, illustrated on Page 4 of the handout, was
5 a significant procompetitive price effect of
6 competition between symmetrical bundles.

7 Very briefly Johnson & Johnson and
8 its rival, U.S. Surgical, together sold more
9 than 90 percent of sutures and/or 90 percent of
10 medical devices called endo-mechanical products
11 or endos. Beginning in the 1990's, both
12 companies marketed their sutures and endos
13 to hospitals through group purchasing organizations
14 in bundles. In J & J's case,
15 the hospital got the lowest price if it
16 purchased both 90 percent of its sutures
17 and 80 percent of its endos from J & J. Our
18 expert, who was Kevin, showed that as a result
19 of this bundled competition, prices for sutures
20 remained flat for eight years, and this is shown on
21 the page of the handout, and prices of endos
22 declined about 20 percent.

23 So for fun I've illustrated on the
24 next three pages one way, and there are
25 several, one way in which we explained to the

1 jury why bundle-to-bundle competition is so
2 powerful.

3 If you look at page 5, we first
4 ask, well, who's going to win a suture contract
5 in a single-product line competition. And the
6 answer is that while you can't confidently predict
7 a winner, J & J certainly seems to have the edge.
8 The next page we ask, okay, who's going to win the
9 endo contract in a single-product line competition
10 for endos. U.S. Surgical has the edge. Finally,
11 we asked the jury who's going to win the combined
12 suture/endo contract. Well, in addition to
13 increasing the financial risk of losing the entire
14 contract, by creating the bundle, the advantages
15 that one company has over the other are diminished.

16 The companys' product offerings
17 become more homogeneous, uncertainty
18 increases, bidding becomes more competitive,
19 and prices decline.

20 My point is that the
21 price-lowering effects of this bundle-to-bundle
22 competition were all totally predictable. Even
23 commentators like Barry Nalebuff, who tend to
24 find bundling anticompetitive, are extremely
25 clear that the procompetitive effects of

1 bundle-to-bundle competition are obvious.
2 Professor Hovenkamp is commenting that bundle
3 pricing, even by a monopolist, should be, per se,
4 legal if any firm in the industry could offer a
5 competing bundle of the same or nearly the same
6 products, even if none are currently doing so.

7 In our case we had testimony on how
8 customers reacted when U.S. surgical had
9 expanded its sutures business through an
10 acquisition that laid the groundwork for this
11 bundle-to-bundle transaction. That transaction can
12 be roughly characterized in the next two pages.
13 The next page shows the pre-merger shares, and
14 you'll see U.S. Surgical starts out with 10 and it
15 has an acquisition of another suture company, and
16 of course, the next page shows post-merger
17 structure. One of our witnesses had worked in the
18 purchasing department at a hospital
19 buying group. He testified that when they
20 heard that U.S. Surgical had bought another
21 suture company, they flooded out of their
22 offices and they danced in the halls. Not because
23 U.S. Surgical's expanded business would constrain J
24 & J's suture prices, but instead because the
25 hospitals could continue to buy U.S. Surgical's

1 endos to satisfy its doctors demands, and yet
2 constrain its endo price increases by
3 threatening not to buy U.S. Surgical's sutures,
4 a business that it had just invested in heavily.

5 So in short what the agencies
6 might see as a suspect 3-to-2 merger of the
7 sutures market clearly empowered the hospitals
8 to pit two more relatively symmetrical bundles
9 against each other, countering each company's
10 strength.

11 Now, I submit that if a hospital
12 purchasing department knows enough to dance in
13 the halls to celebrate this glorious
14 development, the agency should be keen on
15 noting the effects of this merger, the suture
16 merger to the endo market, even when the suture
17 market might be asserted to be the relevant
18 market for the analysis.

19 I tell this story not to suggest
20 that any revised guidelines should frame rules
21 about how to consider price lowering effects in
22 one market that are occasioned by a merging in
23 the second. I think that would be a serious
24 mistake. Rather, the story illustrates the
25 fact that our thinking about markets evolve,

1 and here, our thinking about how bundling works
2 and continues to involve.

3 Any revised merger guidelines
4 should not foreclose, or even appear to
5 foreclose, consideration of all effects of a
6 transaction.

7 I would suggest deleting the
8 last paragraphs of the efficiency section of
9 the guidelines and in Footnote 36 before the
10 mention of the inextricably linked markets.

11 I'd like to make one final
12 comment, this about process. I would
13 encourage that the agencies make any draft
14 of revised guidelines available for
15 public comment, which I understand was
16 not the process that was followed in the
17 '92 or '97 revisions. This request actually
18 came to me from a client, and I thought about
19 it and agreed with it.

20 I think, first, the draft would
21 naturally elicit more focused comments. And
22 second, I am concerned that antitrust practice
23 is increasingly seen as an inside-the-Beltway
24 practice; and for that reason, I certainly
25 appreciate the agencies holding this workshop

1 here in the Midwest. I think exposing a
2 draft revision to public comment would help
3 ameliorate that perception.

4 MR. FEINSTEIN: Thank you, John.

5 MR. Thomson: Rich, I want to thank you
6 for inviting me to participate today. This is
7 a particularly enjoyable time for me to be here
8 because I started my academic career here at
9 Northwestern Law School back in January
10 of 1973. So it's great to return to this great
11 law school.

12 What I'm going to do I have seven
13 slides that I want to go through. Let me simply
14 outline for you first the position I'm going to be
15 taking here. In a 1968 article that many of you
16 are familiar with in the American Economic Review,
17 Professor Williamson, who won the Nobel
18 prize in economics this year, and who is now at
19 Cal-Berkeley, provided a theoretical
20 justification for the efficiencies defense.

21 As we know, the DOJ/FTC merger
22 guidelines and court cases take a cautious
23 approach in dealing with efficiencies. Former FTC
24 Chairman Muris and others have argued that
25 efficiencies should in many cases trump the

1 anticompetitive effect. That is, with significant
2 efficiencies, the authorities should be less
3 concerned about the anticompetitive effect.

4 Now, on the basis of the analysis
5 in my paper entitled "A Critique of
6 Williamson's Case for an Efficiencies Defense
7 The Rectangles Are Rarely Larger than the
8 Triangles." I argue for a continuation of the
9 cautious approach that is currently in the
10 regulations. Now, I do not address other
11 objections to an efficiency defense, such as
12 Posner's view that all the costs are not
13 reflected in Williamson's approach. So I'm
14 focusing simply on the theoretical
15 justification.

16 Let's start with the traditional
17 presentation of the Williamson justification.
18 This is a graph based on his 1968 article in
19 the American Economic Review, his 1997 article in
20 the Penn Law Review, and the presentation of this
21 issue in the ABA's third edition of its
22 antitrust book, the 6th chapter dealing with
23 efficiencies.

24 So this graph, which started in
25 '68, has life today as reflected in this ABA

1 treatise, which was written a year or so ago.

2 Now, let's make sure everybody
3 understands this graph. I'm sure many of you
4 are completely familiar with it; but there may
5 be someone uninitiated in the audience, and let
6 me just take a minute and tell you what the
7 graph is telling us.

8 This graph is showing a market
9 that moves from a competitive market to
10 an anticompetitive market -- not completely
11 to a monopoly market, but to a market that
12 is not competitive.

13 The initial price for the product
14 in this, in this marketplace before the merger
15 takes place is at P_1 , which is AC_1 , average
16 cost 1, which is a surrogate for marginal cost.
17 And we see that quantity is Q_1 , so that the
18 quantity under competition is Q_1 , the price
19 under competition is P_1 , and then the firms
20 merge. And as a result of the merger, price
21 goes up to P_2 and quantity goes down to Q_2 .

22 Now, however, something else
23 happens as a result of the merger. There is an
24 efficiency and a reduction in cost. So cost drops
25 from AC_1 to AC_2 .

1 And Williamson's insight is that
2 if the cost savings here, which are reflected
3 by A2 and A1, are greater than the dead-
4 weight loss to consumers, which is reflected in
5 B1, then this merger increases total welfare
6 and arguably should be permitted even though
7 there's a huge wealth transfer from consumers
8 to producers, and the wealth transfer is in
9 B2.

10 So that's his insight. His
11 insight is that A2 plus A1 exceeds B1 so
12 that in many cases the efficiencies resulting
13 from a merger will overcome or swamp the dead
14 weight loss.

15 All economists agree that B1 is a
16 detriment to society. But if there's an A2
17 and an A1 and an efficiency associated with
18 the merger and that efficiency overpowers the
19 dead-weight loss, then under a total welfare
20 approach, which is what Mike just talked about,
21 arguably this merger would be permissible, even
22 though consumers are harmed because consumer
23 welfare is reduced by B2.

24 Now, notice a couple things about
25 this graph. One, it has a concave demand

1 curve. Not a linear demand curve, but a
2 concave demand curve.

3 Now what I have done here is taken
4 this basic Williamson graph, and made the demand
5 curve linear. And I asked the question what
6 happens to the triangle and what happens to the
7 rectangle.

8 I also assume that as a result of
9 the merger there is monopoly pricing, so I draw
10 a marginal revenue curve. And the marginal
11 revenue curve is the second slanted curve.
12 It's the red curve in the middle. It's a
13 marginal revenue curve.

14 I made the demand curve in the
15 Williamson analysis linear, and I've added a
16 marginal revenue curve. I needed a marginal
17 revenue curve in order to determine the actual
18 monopoly quantity and monopoly price.

19 Okay. Now, how do I determine a monopoly
20 quantity and monopoly price? I determine it by the
21 intersection of the marginal revenue curve and the
22 average cost curve. So we see then that initially
23 as a result of the merger when we move from
24 competition to monopoly, the price jumps from P_1 not
25 to P_2 , but to P_m . So it jumps quite high. Huge, a

1 huge jump.

2 But we also have efficiencies, the
3 same efficiencies we had in the first graph.
4 The efficiencies here are represented by the
5 yellow rectangle.

6 The efficiencies cause the
7 quantity to go up from Q_m to Q_{me} , that is
8 quantity with monopoly but efficiencies, and
9 the price to drop from P_m to P_{me} , that is
10 price under monopoly with efficiencies.

11 So some you might say that some of the
12 benefit of the efficiencies is being passed on to
13 consumers in the form of a lower price, a price
14 that is lower than the monopoly price would be if
15 there were no efficiencies.

16 Then I asked the question, well,
17 what happens to the triangle, the dead-weight
18 loss. That's the red area in this graph. And
19 how does it compare to the efficiencies gains,
20 the yellow area. And in this case the triangle
21 exceeds the rectangle. Even though in this
22 particular situation, even though in the
23 Williamson presentation of the efficiency gains,
24 the efficiencies are about 18 to 19 percent of
25 costs. So there are cost savings of about 18 or to

1 19 cost savings. But even with 18 to 19 percent
2 cost savings, the rectangle is not larger than the
3 triangle.

4 So this causes me to say, hey,
5 Williamson's got it wrong, when he says it
6 is evident that relatively modest cost
7 reductions are usually sufficient to offset
8 relatively large price increases.

9 This graph leads me to believe that that
10 statement is not accurate in many cases, which
11 leads me to believe that, apart from any other
12 reason for being against an efficiency defense,
13 there may not be a solid justification for an
14 efficiencies defense.

15 And that leads me to my policy
16 descriptions. In any merger giving rise to a
17 significant increase in market power, the size
18 of the efficiency rectangle is not likely to be
19 substantially larger than the consumer and
20 (producer welfare triangles) and in many cases
21 may be smaller.

22 Now, notice I have "and producer
23 welfare triangles" in parens. Why do I have
24 that? Because the Williamson analysis uses a
25 flat marginal cost curve.

1 In most industries the marginal
2 cost curve is upward sloping. If you have an
3 upward sloping marginal cost curve, in addition
4 to having a welfare loss from consumers or
5 associated with consumers, you will also have a
6 welfare loss associated with producer surplus.

7 So there's another element of
8 potential loss in welfare not reflected in the
9 Williamson analysis. Thus, I say that the U.S.
10 antitrust authorities should not consider
11 liberalizing the approaches to efficiencies
12 taken in the guidelines. The guidelines have an
13 implicit requirement that the efficiencies must
14 overpower the anticompetitive effect and keep
15 the post-merger price from rising. The EU
16 guidelines even provide that in certain cases the
17 parties will have to establish that the
18 efficiencies will be passed on to consumers.

19 At a minimum, I believe the
20 efficiencies should have to keep the
21 post-merger price from increasing; and if
22 there's any doubt that the guidelines adopt
23 this standard, the doubt should be eliminated
24 by clarifying the amendments.

25 This standard is most likely to be

1 satisfied when anticompetitive effects of a
2 merger are small and efficiencies are
3 substantial.

4 Now, as a way of conserving
5 resources for both agency officials and
6 parties, I suggest that the guidelines be
7 amended to provide that the antitrust officials
8 will consider efficiencies only in those cases
9 where on the basis of factors other than
10 efficiencies, the officials determine that a
11 decision to oppose the transaction or require a
12 divestiture or a remedy is a close one. In other
13 words, if on the basis of looking at market
14 concentration and other factors the issue is a
15 close one, you know, we may be prohibiting a merger
16 that's not anticompetitive, then consider
17 efficiencies.

18 But if it's not close on the basis
19 of those other factors, I think the agencies
20 should not consider efficiencies. If the decision
21 is not close, the officials would not consider
22 efficiencies and the parties would not have to
23 go through the expense of preparing white papers
24 supporting efficiency claims.

25 Only if officials decided that the

1 decision was otherwise close would the parties
2 be permitted to submit arguments regarding the
3 efficiencies to be realized in the transaction;
4 and in such cases, in evaluating the overall
5 transaction, the officials would take into
6 account any efficiency claims that satisfied
7 the merger-specific verification, cognizable
8 and sufficiency requirements of the current
9 guidelines.

10 Thus, the submission of efficiency
11 analyses would be permitted when the officials
12 decided on the basis of an analysis of other
13 factors that there was a significant concern
14 that a challenge to the transaction or a
15 requirement to divest may lead to type one
16 error, that is, a finding that the merger is
17 anticompetitive when it is not.

18 Finally, given the findings with
19 regard to the possibility that even a
20 significant marginal cost efficiency may not
21 swamp the welfare triangle, it would be
22 appropriate for officials to consider only
23 variable costs savings.

24 Now, in this connection, a 2009
25 FTC study of efficiencies found that both the

1 Bureau of Competition and the Bureau of
2 Economics are as likely to accept fixed cost
3 savings as variable cost savings at about the
4 same rate. Variable cost savings impact
5 price, but fixed cost savings generally do not,
6 at least in the short run. Unless the parties
7 can establish that fixed cost savings will be
8 reflected in price in the reasonable future,
9 they should be rejected.

10 Thank you very much.

11 MR. FEINSTEIN: Thank you, Sam. I'm
12 sure we'll have a lively discussion about what
13 we just heard, and that will probably begin
14 with what we're about to hear from Steve
15 Calkins.

16 MR. CALKINS: Thank you. A pleasure to
17 be here. All the same thanks as everybody
18 else. Henry Butler throws a great party and a
19 lovely event, and so we appreciate that.
20 Hopefully we'll get invited back regularly.

21 It has been a privilege to be here
22 listening to so many really distinguished
23 people, people who have played important
24 roles in leading cases, and especially the
25 people who played leading roles in the writing

1 of the big guideline revisions. I want to make
2 very clear that I had no role in that process.
3 I had a role only in that I was the general counsel
4 of the FTC back when the efficiencies section was
5 revised. So I did live through
6 that.

7 I want to assure you that it would
8 have been bad public policy to share all of
9 those drafts with the public for many reasons.
10 We can go into that later.

11 I emerged from that process with
12 mixed feelings about the efficiency section as
13 revised. It's not elegant and you can take
14 potshots at it. Indeed, I for a long time
15 reveled in taking pot-shots at it. For instance, I
16 have an antitrust case book out there, but at the
17 time I did not and I was using somebody else's case
18 book. And they reprinted the guidelines, including
19 the efficiencies section, without the footnotes.
20 And of course, it's in the footnotes that you get a
21 little bit of the tension with what's in the text.
22 You can see that the Federal Trade Commission is
23 made up of lawyers and economists. Sometimes they
24 get more their way in the text, sometimes more in
25 the footnotes. And if you read the efficiencies

1 section without the footnotes, you're really
2 missing much of what's going on.

3 So I made fun of the editor of
4 that case book and gave my students the real
5 efficiencies language and went through, and
6 there's some tensions here and I've made fun of
7 them in my classrooms many times.

8 I now had to think about these in
9 connection with this presentation. And I went
10 back and I looked at them; and I have come to
11 the conclusion that the efficiencies section of
12 the guidelines is, I think it is fair to say, a
13 work of pure genius. It really strikes precisely
14 the right note. It gets it about as perfectly as
15 can be done. My advice to be to leave it
16 entirely alone; do not touch a single word.

17 Efficiencies is a subject about
18 which there's some ambiguity, there's some
19 tension, there's some uncertainties. You want
20 to proceed a little differently in this case
21 than you might in that case, and you can do all
22 of that with the words as written. So I urge
23 you to leave them alone.

24 Now, you think I'm making fun of
25 this, but I'm not. For instance, there have

1 been learned people, the Antitrust Modernization
2 Commission Report being the most prominently
3 known. We heard it in previous sessions
4 today who said, by God, the guidelines are
5 terrible because they say look at marginal
6 cost, do not look at total cost.

7 But of course, they don't say
8 that. What do they say? If you happen to have
9 copies of them, you could pull them out. They
10 never say look only at marginal cost, ignore
11 fixed cost. We were too clever for that. What do
12 they say? They say, "The Agency will not challenge
13 of merger if cognizable efficiencies are of a
14 character and magnitude such that the merger is not
15 likely to be anticompetitive in any relevant
16 market." Is not likely to be anticompetitive.
17 That's the test. Not anticompetitive.

18 Does that say you have to look
19 only at price effects and you ignore quality?
20 No. It says not likely to be anticompetitive.
21 Does it say you have to look only at marginal
22 cost and not total cost? No. It says not
23 likely to be anticompetitive.

24 But then you say, keep reading, so
25 I do. "...the agency considers whether cognizable

1 efficiencies likely would be sufficient to
2 reverse the merger's potential to harm
3 consumers in the relevant market, e.g., by
4 preventing price increases in that market."

5 And I would like to remind the
6 lawyers and inform the economists that there's
7 a difference between i.e. and e.g. I.e., had
8 we used i.e., it would have meant reverse the
9 merger's potential to harm consumers, in
10 orders, by preventing price increases. But we
11 didn't say i.e.; we said e.g. And e.g. means for
12 instance. So one way you can show that
13 efficiencies should prevail is by saying that they
14 prevent price increases. But that's only one way.

15 Nothing in here requires someone
16 to come along and look only at marginal cost or
17 look only at price increases. This is an
18 invitation to be thoughtful.

19 And in case there's any question
20 about that, you then go down to the footnotes.
21 And in the footnotes, Footnote 37, a beautiful
22 footnote, talks specifically about how, yes,
23 "the result of this analysis over the short term
24 will determine the Agency's enforcement decision in
25 most cases," but, "the Agency also will consider

1 the effects of cognizable efficiencies with no
2 short-term, direct effect on prices in the relevant
3 market."

4 What could be more clear?
5 Sometimes the agencies will look at effects,
6 not only prices. Delayed benefits from
7 efficiencies will be given less weight, and
8 they probably should be. In short, the
9 efficiency section gets the tension and the
10 balance precisely right and ought to be left
11 alone.

12 People talk about pass-on and,
13 when that can be shown, that is a virtue if you're
14 a defense lawyer. But it's not absolutely
15 necessary under the guidelines as written.

16 Some people have complained that,
17 and indeed our missing colleague in his written
18 remarks did complain that the guidelines are
19 tougher on efficiencies than on competitive
20 effects, if you will.

21 And I frankly don't go as far as
22 Sam Thomson does; but in general, I think that
23 it makes sense to have a little bit more
24 skepticism about efficiencies than about
25 competitive effects.

1 Bob Pitofsky wrote an article
2 shortly before I went to the FTC in which he
3 came out squarely in favor of having a broader
4 efficiencies defense while at the same time
5 having a much more aggressive approach in
6 terms of competitive effects. I'm simplifying
7 this, but basically he said, you know, be worried
8 about more mergers but then look seriously at
9 efficiencies. And of course, it's all a
10 tradeoff.

11 If you're going to look at mergers
12 to monopoly, then there ought to be pretty darn
13 huge efficiencies that are going to overcome
14 that, indeed, that level of nervousness was
15 sufficiently great that there's that sentence
16 stuck in the middle of the guidelines saying
17 that efficiencies almost never justify a merger
18 to monopoly or near monopoly because of
19 nervousness about that. So if that's the kind of
20 mergers you're challenging, well, then you ought to
21 be pretty skeptical about efficiencies.

22 On the other hand, if we get back
23 in the world of challenging mergers going from
24 seven to six, or six to five, or something like
25 that, well, then it's more important to let

1 more mergers off the hook, if you will, because
2 of efficiencies. There's a tradeoff.

3 But in the world in which we are
4 living today with the kind of standards that
5 are actually applied by the agencies,
6 efficiencies aren't going to make a difference
7 except in mergers that raise all sorts of
8 questions that you ought to be thinking about.
9 And I think that it is appropriate then to
10 proceed with a certain level the skepticism.

11 Anybody who has practiced law or
12 worked with business persons has run across the
13 phenomenon of business leaders deciding to make
14 a transaction for reasons having nothing to do
15 with efficiencies and everything to do with
16 something else. You can list your different things
17 they might have something to do with. They
18 hire a consulting firm and suggest to the
19 consulting firm that it would be good for the
20 consulting firm to come up with a thick, glossy
21 document that shows this is a very pro-efficiency,
22 wonderful merger. And consulting firms are masters
23 at coming up with those sorts of studies.

24 In that kind of world, when we
25 know that business leaders are not always

1 motivated by reasons of efficiency, if we're
2 looking at mergers from 3 to 2, and 2 to 1, and
3 such, I think that it's appropriate to proceed
4 cautiously when it comes to efficiencies. But
5 that's all these say, is just be a little bit
6 cautious.

7 So where are we? That's sort of
8 my bottom line. Why then is there all of this
9 concern? Why all the upset?

10 I had a conversation with a leading
11 economist in the last week who said, by
12 God, the problem is not the guidelines, the
13 problem is with how they are being enforced. Why,
14 I went in to Carl Shapiro just very recently and I
15 said look at all these cost savings; and Carl said
16 to me, are they marginal cost or are they fixed
17 cost. And I said, Carl, give me a break.

18 There are two possible take-aways
19 from that. One is that the people who are
20 upset about the efficiency guidelines are
21 driven by individual experiences. We all
22 take the two experiences we've had and
23 generalize. The other possibility is that, in
24 fact, there are times when the agencies
25 mindlessly say I'm going to totally ignore

1 fixed costs no matter what.

2 I don't think the latter is true.

3 As was just referenced earlier, I think Sam
4 did, there was an article that came out of the
5 FTC the only this year that showed that fixed
6 costs are given serious considerations.

7 We know that fixed costs played a
8 part at least in the published comments about a
9 number of mergers, Jensen, XM Sirius, a number
10 of others; so it appears to me that the
11 agencies take fixed costs into account, and so
12 I don't think there's the problem that some
13 people think out there.

14 If you really insist on doing
15 something to this part of the guidelines, even
16 though it is about the most perfect part of the
17 guidelines, you could, without doing harm,
18 trying to be practical in my advice, do a
19 little search for the word marginal. And you
20 could simply delete the word marginal without
21 actually causing great harm. So that you can see
22 that there's an example in a coordinated
23 interaction context, marginal cost reductions
24 made coordination less likely or effective.
25 You could probably delete the word marginal

1 and not cause a lot of time. And if you
2 were to remove one or two or three of the
3 word marginals, you probably wouldn't
4 really change much of anything. I mean,
5 it really is true that, you know, marginal
6 or fixed depends on the time horizon that
7 we're talking about. So I think you could,
8 if you had to do something, you could remove
9 a marginal or two and not do any great harm.

10 If you insisted on doing more
11 serious surgery, you could delete some of the
12 last paragraph without causing a lot of harm.
13 When that was written, there was no commentary.

14 That sort of stuff is now in the
15 commentary, and so you can say we don't
16 need that kind of practical example kind of
17 thing because it's in the commentary.

18 If you have to do something,
19 those are the two things to do; but I really
20 don't think that you need to do something
21 because I don't think that the criticisms are
22 well- founded in how the guidelines are written
23 and how they at least ought to be applied.

24 MR. FEINSTEIN: Thank you.

25 What I'd like to do first before I

1 pose any questions is give each of the
2 panelists an opportunity to react to what
3 they've heard from any of the other panelists.
4 And why don't we do it in the order in which
5 they spoke, so we'll start with Mike.

6 MR. BAYE: Thanks. There's a lot to, a
7 lot to respond to, I guess.

8 Let me just first say that I agree with
9 some of what I heard. In particular, John
10 mentioned that there's an important difference
11 between verifiable versus quantifiable.

12 I guess part of my concern stems from the
13 fact that in many merger analyses, we're actually
14 able to do a fairly good job of quantifying price
15 effects. Increasingly over
16 the past decade-and-a-half we've had econometric
17 tools and the data and so forth to do so.
18 Staples/Office Depot is always kind of held up as a
19 poster child. But those types of analyses are
20 readily available now and guide analysis.

21 My concern is that within an agency, one
22 might expect the same level of rigor when it comes
23 to evaluating efficiency claims.

24 I guess the point I would like
25 to emphasize is that efficiency claims are

1 extremely difficult to quantify. If the government
2 had the burden to prove that
3 there were not efficiencies, there's no data to
4 prove that. Okay. And conversely. So the burden
5 matters there a lot. I can see that oftentimes
6 parties are in a better position to muster the
7 argument, and I think it's incentive-compatible
8 for parties to have to do that.

9 So I think in that sense we're
10 agreeable. I think where there's some
11 disagreement is between the asymmetry with which
12 economists view efficiencies and the way attorneys
13 typically have your efficiencies. I think
14 attorneys generically think of efficiencies in
15 terms of things like reductions in marginal costs,
16 reductions in fixed costs, economy of scope,
17 economy of scale. In my experience,
18 oftentimes when economists are talking about
19 efficiencies, they're talking about things
20 other than the traditional cost-based
21 efficiencies. Things that improve product
22 quality or network effects and things like
23 that, which are equally hard to quantify if
24 you're imagining what a merger might look like.

25 And I think there is some

1 evidence. Two of my colleagues mentioned this
2 study by Malcolm Coate and by Andrew Heimert,
3 both in the Federal Trade Commission. Malcolm
4 is an economist. He's in the Bureau of
5 Economics. Andrew is an attorney in BC. So
6 I think it's an interesting study. They looked
7 at memos that were written by the Bureau
8 of Economics and the Bureau of Competition in
9 the recent past. And it is true that -- I think
10 this is very, very important. I think the agency
11 does a very good job of evaluating efficiencies
12 claims. The memos clearly demonstrate that both
13 economists and attorneys are giving serious
14 considerations to efficiency claims.

15 One thing that strikes me as
16 interesting from that study is it turns out,
17 and there are many ways you can slice this, but
18 it turns out that BC memos, Bureau of
19 Competition memos, generally accept efficiency
20 claims about 8 percent of the time, whereas the
21 economics memos accept efficiency claims about
22 27 percent of the time.

23 There's a huge asymmetry
24 between the way economists interpret the term
25 what is a "cognizable" efficiency. Should we

1 just let parties blow smoke and say efficiency,
2 and therefore, get mergers approved; but I
3 think even within agencies, it's very helpful
4 to have a better understanding of what does it
5 mean for something to be verifiable. How
6 strong does that evidence have to be.

7 The commentary has some nice examples.
8 One of the best examples I've seen in a number
9 of years is in the commentary regarding
10 the eBay/PayPal merger where the DOJ ultimately
11 concluded, I believe, that the price effects
12 were very fairly small in the overlapping payment
13 systems because, of course, there's Visa
14 and MasterCard and other constraints that might
15 limit the ability to raise prices. But they
16 also recognized that there were potential
17 efficiencies as a result of the PayPal/eBay merger.
18 Efficiencies in terms of convenience
19 of transactions on the part of consumers and
20 reductions in fraud, which are presumably valuable
21 to consumers.

22 My point is, what would
23 have happened in that merger had it not been
24 demonstrable that there was something to limit
25 the price increases, that there wasn't Visa and

1 Master Card lurking in the background. My guess is
2 that the benefits, the reductions in fraud and the
3 increased convenience on consumers would not have
4 been quantifiable and, therefore, interpreted by
5 some not to be verifiable. And therefore, the
6 merger might have been blocked.

7 I'm not making any statement on
8 whether the Justice Department made the right
9 or wrong decision, but somehow one has to be
10 able to balance off those potential benefits of
11 cost.

12 MR. FEINSTEIN: Just before we get to
13 the others, Steve, when you were using the
14 example of merger to monopoly, or a three to
15 two on the one hand versus a seven to six, or a
16 six-to-five on the other hand, it seems to me
17 just sort of intuitively that one of the
18 reasons that the agencies may traditionally be more
19 comfortable relying on the efficiency arguments in
20 the less concentrated markets, I'll say, is because
21 I think it's easier to assume that because of the
22 competition that will remain, the benefits of those
23 efficiencies will likely be passed through to
24 consumers. Is that a fair statement?

25 In other words, if in the six to five

1 situation, wouldn't the merged party that is
2 capturing some efficiencies have a greater need to
3 make sure that its prices reflect the benefits
4 of those efficiencies?

5 MR. CALKINS: I think it really
6 depends. You could be in a situation where the
7 price isn't really controlled by those folks. For
8 example, it's a pricing situation that is
9 controlled by other people in the industry, and so
10 it's not really going to be passed on.

11 MR. FEINSTEIN: But wouldn't you expect
12 if there are five or six remaining competitors
13 that you're more likely to have a competitive
14 price at the end of the day.

15 MR. CALKINS: I guess in general I am
16 sympathetic to the idea that if we really are
17 saving a lot of money, that ought to count for
18 something.

19 And so in that sense, I'm with
20 Mike in saying that if I really am believing
21 that we're having substantial savings, that's a
22 good thing. And my guess is that it's going to
23 end up, to some extent, being passed on.

24 It's not going to be a usual
25 situation where no cost savings would be passed

1 on at all. That would be an unusual kind of
2 market. And so to that extent, I don't
3 personally think that one has to think only
4 about passing on savings in terms of money to
5 consumers.

6 It's a little bit more that my
7 guess is that in the six to five there's a
8 sort of unstated, unfashionable sort of
9 deep-seated belief that rivalry is a good thing,
10 it matters, and that the spur to competition
11 from having a couple of people out there is a
12 good thing and that bad things may well happen
13 if you simply get too concentrated.

14 I mean, I'm from Detroit. And
15 I've said this before, but it really is true.
16 When there was a Big Three and that's all
17 there was as a practical matter and they were
18 bargaining with the same union and facing the
19 same kind of costs and not feeling serious,
20 vigorous pressure and rivalry the way that,
21 say, the firms in Japan were feeling in
22 competing with each other, you had the classic
23 kind of, you know, quality slipped and costs
24 went up and contracts were entered into that
25 just made no sense in the long run, and feather

1 bedding went in, and poor management went in.
2 And having three firms was not enough of a spur
3 to competition. And you know, it was only once
4 that model was broken that the whole thing blew
5 up; but frankly the city of Detroit and the state
6 of Michigan have been paying a long, long, steep
7 price for having gone through a period of very
8 relaxed competition.

9 So I'm guessing the six to five is
10 less about the precise assurance that this will
11 be passed on right away and more about saying
12 that, gosh, if we're saving some resources and
13 we still got five firms left, we don't have to
14 worry so much.

15 MR. FEINSTEIN: That may well be correct,
16 and I guess the other way of
17 thinking about it is even if it isn't obviously
18 passed on, there's less concern about a price
19 effect in a six to five market because of the
20 remaining competition.

21 MR. CALKINS: Well, the price effect or
22 quality effect.

23 MR. FEINSTEIN: John, do you have
24 anything you want to say?

25 MR. TREECE: First of all, Steve, I

1 suggested we circulate a draft, not all your
2 drafts, back and forth. That was my
3 suggestion, and I stand by it because I do
4 think if we had a draft for public comment
5 we'd get a little more focused responses, and I
6 think would be helpful.

7 Really, based on what you said. I don't
8 think you and I are terribly far apart because
9 I just meant to be fairly complimentary on the
10 guidelines efficiencies.

11 I was really focusing on those
12 few instances, being the last paragraph of 36,
13 and my view that that deviated from the general
14 tenor of the drafting of that section. Generally
15 it was open-ended and said, yes, we're not saying
16 it should be only variable costs, we're not making
17 this prescriptive rules. But I did think that in
18 the last paragraph, and again, as I've said in my
19 remarks, Footnote 36 crossed the line.

20 Now, having said we don't disagree
21 very much, let me disagree. My clients aren't
22 the scoundrels that you make them out to be.
23 You know, my experience, at least recently, has
24 been when people come in with a merger, often the
25 justification is some kind of technology synergy,

1 that they're looking for some type of intellectual
2 property, but not in the sense I want this patent,
3 but rather, an expertise. This gets to what Mike
4 said. The problem is it's not quantifiable, and I
5 acknowledge that the long run for business people
6 is not the long run for economists.

7 What they're doing is they're
8 betting their business, their careers, or
9 whatever, and hoping that in the next five to seven
10 years, if I go through with this
11 merger I'm going to pick up some technology,
12 some know-how, some expertise, and I don't
13 really know that it's going to work out. I'm
14 hoping it works out. I'm making a bet. You can't
15 quantify it, but certainly it's real and it drives
16 the transaction.

17 And the problem is that it is
18 speculative, so does that mean we ignore it?
19 I don't think so because you are at the
20 same time rebutting a speculative anticompetitive
21 effect oftentimes.

22 In that respect, I mean, Sam, I
23 acknowledge your graph, but it assumes that the
24 conclusion of the merger is a pure monopoly.
25 A lot of times we don't know what the

1 anticompetitive effect is of the merger. We're
2 speculating, often I'm just speculating that no one
3 else is going to change, that we're facing a static
4 market. And yet, we've had lots of
5 discussion today about repositioning and other
6 competitive responses to that merger. So
7 nothing is going to stay the same. And you are
8 speculating about the anti-competitive effect.

9 There's a real tension, I think, among
10 practitioners, or sense among the defense bar that,
11 wait a second, your anticompetitive effect that
12 you're speculating about is being honored while my
13 pro-competitive justification or efficiency, which
14 we admit has some speculation to it, is not being
15 honored.

16 I will say also that -- I do a
17 lot work in pharmaceuticals, and that's an area
18 where I'm a little mystified with what the
19 agencies do. At one time I thought where they were
20 heading was that if a product was in a phase
21 three clinical trials, okay, that's not
22 speculative, we'll consider that and look at the
23 effects of the merger. Now you look at the cases
24 and they reach back farther and farther into the
25 pipeline. I also do some patent litigation, I have

1 some pharmaceutical patent litigations, I have
2 spoken to people who do medical development; and
3 you know, there's one kind of research and
4 development where, say, with certain types of
5 software, you know here's what I have, I want to
6 get here. There's some uncertainty, but by and
7 large, you may get there. When you're talking
8 about developing a drug, there is no way to balance
9 the concept that the possibility that, okay, if I
10 eliminate or I merge two research efforts, do I
11 reduce a chance of discovery. Or alternatively, am
12 I putting minds together that in fact increase the
13 chance of innovation. The fact is we don't know,
14 and nobody knows.

15 So I am a little mystified
16 sometimes by the willingness to reach back into
17 the pipeline to find a need to divest certain
18 research development efforts. And I think it's
19 entirely speculative and, really, not with
20 justification. I'll stop.

21 MR. FEINSTEIN: Sam?

22 MR. Thomson: I just have three points
23 to make. Steve mentioned that -- by the way, I
24 would associate myself with Steve's comments.
25 Maybe there's one thing that he said that I

1 disagree with, and that is searching for the word
2 marginal and deleting it, I would keep marginal in
3 there.

4 MR. CALKINS: That was only if they
5 insist on making a change. I recommend no
6 change as my opening position.

7 MR. Thomson: Efficiencies were one of
8 the factors that the DOJ considered in the XM
9 Sirius deal. I was listening to one
10 of the business shows about three weeks ago.
11 And the Chairman of Sirius was on talking about
12 their very good third-quarter report. And he said,
13 well, you know, one of the things is, if somebody
14 wants to be in satellite radio, they can only deal
15 with us. What he was saying is that we have
16 pricing power. You know, I think it was a huge
17 mistake for the DOJ to have credited those
18 efficiencies in that particular transaction.

19 Also, as I point out that in the
20 Williamson analysis, it is only a small price
21 increase that would be swamped by efficiencies
22 in general. We're talking about predictions about
23 what's going to happen on the price side. If the
24 merger goes through, the parties have every
25 incentive if they got any market power to raise the

1 price as high as possible. So we may be predicting
2 a low price effect when in fact there is a high
3 price effect, which, again, makes me skeptical of
4 accepting an efficiencies defense.

5 Finally, one of the
6 things I've sort of taken a look at is bank
7 mergers. I noticed in bank mergers, every one
8 that I've looked at, the DOJ and the Federal
9 Reserve Board, the Federal Reserve Board has an
10 antitrust screen for bank mergers, mergers
11 involved with bank holding companies. Every one of
12 those uses a concentration standard for determining
13 whether there's going to be an approval. It's an
14 HHI with a post-merger HHI of 2,000 with a delta of
15 200. If any of those
16 banking markets have a higher post-merger HHI
17 than 2,000 or a higher delta than 200, there's
18 an automatic divestiture in those markets. So it's
19 a pure Philadelphia National Bank approach in the
20 bank area. There's no discussion of efficiencies;
21 and indeed, in the commentary, the DOJ and the FTC
22 commentary, you go through, there's a beautiful
23 discussion of the efficiencies and the various
24 cases in which efficiencies they've been applied.

25 There's no discussion of applying

1 efficiencies in bank merger cases. So bank
2 mergers, to my knowledge, are an illustration of
3 where the authorities are taking a Philadelphia
4 National Bank basic concentration analysis; and
5 it seems to me that that is appropriate in
6 other markets as well.

7 That is, forget about
8 efficiencies, except in those rare cases where
9 the agencies themselves are afraid that they
10 may be making a mistake and prohibiting a
11 merger that's not likely to be anticompetitive.

12 MR. FEINSTEIN: Steve, did you want
13 to --

14 MR. CALKINS: I've jumped in. We've
15 only got ten minutes. I'll let you move on.

16 MR. FEINSTEIN: This isn't so much a
17 guidelines question, but it sort of illustrates
18 a practical challenge that I think the agencies
19 face on a fairly regular basis with respect to
20 efficiencies. So maybe it implicates the
21 guidelines.

22 In the interest of full disclosure,
23 this actually wasn't on the list of questions
24 that I circulated to you guys. But I think it's a
25 fair question anyway. One of the things we've been

1 talking about is what's quantifiable; what's
2 verifiable and what's speculative; and what's
3 credible at the end of the day because ultimately
4 we're trying to make as well-informed a prediction
5 as we can.

6 Steve, you alluded to the situation where
7 parties come in with studies at varying points in
8 the process, and sometimes there are studies that
9 can demonstrate -- and sometimes there are
10 contemporaneous documents that can demonstrate --
11 that efficiencies really were driving the deal from
12 the very beginning, or one of the things that was
13 driving the deal.

14 Sometimes that happens later in
15 the process and it can be characterized as sort
16 of a little bit of a post hoc effort. Doesn't
17 mean it may not be correct, but it's also not
18 uncommon for there to be situations where you have
19 a respectable efficiencies presentation, and you
20 also have business documents from senior people
21 in these companies which express a different
22 view.

23 They're not saying there are no
24 efficiencies. They're saying this is going to help
25 us because we're taking out a competitor,

1 or words to that effect.

2 MR. THOMSON: Whole Foods.

3 MR. FEINSTEIN: Well, for example. I'd
4 be interested in hearing your thoughts about that:
5 that could be viewed as uninformed, it could be
6 viewed as speculative, it could be viewed as
7 something that isn't necessarily credible. But it
8 sort of gets right to the ultimate trade-off where
9 there's some risk of reduced competition. But
10 there are also some potential for efficiency
11 gains.

12 I mean, does it make a difference
13 if we have that situation where, in fact, there
14 is some unvarnished intent evidence in terms of
15 how the agency should view efficiency claims?

16 What do you think?

17 MR. CALKINS: The intent evidence tells
18 you that the people whose words you're reading,
19 to the extent you're interpreting them
20 correctly, believe that the merger will result
21 in less vigorous competition, higher prices or
22 less direct rivalry from this firm, or
23 something whereby they're viewing it as their
24 lives will be better because this important
25 competitor is gone.

1 In general, business people know a
2 great deal about their business. They're not
3 always right; but you know, that's pretty good
4 evidence of what's going to happen. It's
5 not proof, but it's pretty good evidence.

6 So it tells you, it gets you along
7 the road of saying there may be a serious
8 competitive problem here. On the other hand,
9 it's possible as a matter of theory that a
10 merger that is motivated by take out this
11 important competitor might also be one that is
12 going to yield some very, very substantial
13 efficiencies and cost savings.

14 So at least in theory, even if you
15 prove the lessening of competition on the one
16 hand, that doesn't mean that there cannot be a
17 very great savings in terms of efficiency.

18 The fact that they're going the
19 route that they're going for reasons that are
20 anticompetitive makes one less likely to believe
21 the efficiency story; but you still have to take a
22 look at it. And even though that may not have been
23 how they stumbled across the idea, it might still
24 be correct. You still have to take a serious look
25 at it, I think.

1 MR. FEINSTEIN: Others reactions?

2 MR. TREECE: I agree with Steve that
3 intent evidence isn't really about intent, it's
4 about an understanding of how the market works.

5 But I think that in the example
6 you gave, the question is how, how does
7 competition actually work. In the example I gave
8 of my bundling case, obviously we had a plaintiff.
9 The plaintiff was a small company that made one of
10 type of endo-mechanical product. This was a
11 defense that we did not have the guts to raise in
12 front of the jury; behind the scenes we called it
13 the roadkill defense. And that is that all
14 economists said, yeah, the pro-competitive benefits
15 of the bundle-to-bundle competition the between
16 U.S. Surgical and J & J were enormous. Was there
17 some foreclosure of a small competitor? Of course.
18 Was that small competitor so fringe that the
19 pro-competitive benefits of allowing to say, well,
20 you can't bundle because we want the
21 small guy to be able to thrive? Every economist
22 who looked at this issue said, no, obviously the
23 pro-competitive benefits of the bundle-to-bundle
24 competition outweighed the anticompetitive effects
25 of whatever the foreclosure effect was.

1 That goes to the question which I
2 think Paul mentioned earlier, and that's
3 substantiality. You have to measure
4 substantiality within some market.

5 But there is a tradeoff, and I
6 would not be surprised at all to see the case
7 that you've described where, you know, the
8 merger has both components.

9 In addition to substantiality, I
10 think you have the difficult question,
11 well, what happens, going back to my
12 theme about cross-markets, what happens
13 when you have an anticompetitive effect
14 in one market and pro-competitive effect
15 in the other.

16 The example I gave from this case
17 was easy in the sense that you have the same
18 consumer. That's not always the case, of
19 course; and I think it's a very uncomfortable
20 position for the agencies to think about
21 favoring one group of consumers over another in
22 the context of a merger.

23 I don't have an answer, but I
24 certainly recognize the problem.

25 MR. FEINSTEIN: Sam?

1 MR. Thomson: I don't have anything
2 else.

3 MR. FEINSTEIN: Mike?

4 MR. BAYE: I would agree. I think
5 documents are useful pieces of information; but
6 as far as intent, I mean, if you look at the
7 academic literature on the value of mergers,
8 for example, McKenzie's study suggests that
9 over half of mergers lose value for the
10 acquiring firm's shareholders. Okay.

11 The finance literature, there's a
12 recent paper in the Journal of Financial
13 Studies which shows that in fact about
14 58 percent of mergers are overvalued, and of
15 those 58 percent that are overvalued,
16 shareholders lose about 14 percent of the value
17 of their company.

18 You ask yourself, well, what is
19 this? These are people, you know, excited about
20 the prospects of either foreclosing a
21 competitor or the synergies that are going to
22 arise in the market. People get that wrong. So I
23 think it's useful. It can point you to a direction
24 whether or not this is right. But certainly -- and
25 even in a case like Whole Foods, the documents

1 alone may point you in a direction.

2 But without additional evidence, I
3 think that the documents are not particularly --

4 MR. Thomson: Can I ask Mike a question
5 on a point you just made?

6 MR. BAYE: Sure.

7 MR. Thomson: You indicated that this
8 study showed that, and I assume that you were
9 talking about the acquiring company's shareholders
10 lose in 58 percent of the transactions. But
11 the target company shareholders win virtually
12 in all.

13 MR. BAYE: Well, that's because --
14 again, the reason is because people are paying
15 more than something's worth for the assets.

16 MR. Thomson: They're paying more than
17 the trading value of the stock. But there
18 still could be -- even though the acquiring
19 company shareholder's lose, there could still
20 be significant efficiencies in that merger. It's
21 just that the acquiring company has, in essence,
22 paid the cost of those efficiencies to the target
23 company's shareholders.

24 MR. BAYE: Exactly. There may be well
25 be efficiencies to the merger; but I guess the

1 point I'm really trying to make is if you see
2 the document that says we think we're going to
3 be able to raise price 20 percent post-merger,
4 maybe 5 percent.

5 We're going to save a gazillion
6 dollars in cost as a result of a merger. Ah,
7 maybe a half a gazillion.

8 I'm just pointing out that you
9 have to be cautious when you look at documents.
10 I think especially when you look at the type of
11 strategy, the type of MBA's that I teach,
12 they're good salesmen.

13 MR. FEINSTEIN: We have a question. Go
14 ahead, Jim.

15 MR. LANGENFELD: Just two quick
16 comments. One, in terms of how you weight this
17 stuff, a lot of times I've found that it's been
18 particularly useful to see if the company has a
19 track record in acquisitions, because that
20 gives you, and perhaps it's not a natural
21 experiment to see what type of credibility whatever
22 they're doing now.

23 Secondly, just a comment from one
24 of John's points. A lot of times when you see
25 a merger, you're going to take the narrow

1 approach, just look at whether the efficiencies
2 are specific to a merger, especially if the
3 market is narrowly defined. You can push off a
4 lot of those efficiencies.

5 I think one useful question is to
6 think, okay, if may affect several markets, as
7 John has pointed out. Even if you're going to
8 use are-the-customers-disadvantaged test, a lot
9 of times you'll find that not all, but
10 virtually all the customers that are buying
11 product A may also be buying product B, too.
12 Maybe 90 percent of them.

13 So that even though it may be
14 separate antitrust market, we're still going to
15 do the markets, right. Those same customers
16 may not on net benefit because of a price
17 increase of something else they're buying.

18 So I think that it's legitimate if
19 you're going to keep the consumer test to ask,
20 -- and you're going to keep it specific to a set of
21 customers, you need to look at all the stuff that
22 those customers are going to be buying from the
23 merged firm and balance that out to whatever the
24 best you can.

25 MR. Thomson: Can I ask you a question,

1 Rich?

2 MR. FEINSTEIN: Sure.

3 MR. Thomson: Am I correct that in bank
4 mergers the DOJ does not generally, or it maybe
5 never takes into account efficiency?

6 MR. FEINSTEIN: Well, I wish you had
7 asked that question while Molly was here.

8 MR. CALKINS: The FTC doesn't do bank
9 mergers.

10 MR. FEINSTEIN: We don't do banks. I
11 think it would be ill-advised for me to answer
12 that question definitively because I can't
13 really answer it.

14 MR. Thomson: Does anyone in the
15 audience know the answer to that question?

16 (No response.)

17 MR. FEINSTEIN: But it's a good
18 question.

19 MR. Thomson: Maybe I'll send her a
20 note and ask her.

21 MR. FEINSTEIN: By the way, if you
22 could, if you have a hard copy of your handout
23 if you could send it to me, just e-mail me, and we
24 can make sure it gets into
25 the record along with the transcript.

1 Any final thoughts in
2 thirty seconds or so from anybody on the panel?

3 MR. CALKINS: I would just observe that
4 I do think that it would be better if we developed
5 a little better shared understanding of what counts
6 as an efficiency.

7 MR. FEINSTEIN: Yeah.

8 MR. CALKINS: I remember -- and here I
9 may disagree with one of my colleagues here,
10 but I remember reading the reported opinion in
11 the Heinz baby food where apparently there
12 was a massive amount of litigation over whether
13 or not access to the better recipes of one
14 major baby food company by another baby food
15 company was a social benefit efficiency that
16 ought to justify a merger that was otherwise
17 anticompetitive. And I guess I just thought, my
18 God, if we can't expect baby food companies to
19 make a decent product without having an
20 anticompetitive merger, you know, we really
21 ought to send everybody back to business school
22 to try again. I thought that wouldn't
23 count.

24 I have seen debates about whether it is a
25 pro-competitive efficiency to let one firm buy

1 another firm in order to use tax breaks. And I
2 would have thought that depleting the
3 Federal Treasury of revenue would never
4 count as a virtue that would save what
5 would otherwise be an anticompetitive merger.
6 But I've seen a discussion of that.

7 Someday soon I'm sure that
8 somebody will say a merger should be
9 justified because it will let us become too
10 big to fail and then our cost of credit
11 will be less because there will be the
12 implied protection of the federal government.
13 And I hope that's rejected out of hand and
14 as not the kind of thing that counts.

15 But I don't want to suggest, by
16 saying I think the guidelines as written are
17 perfect, I don't mean to suggest this area is
18 perfect; and obviously, there's enough
19 disagreement about it that it could use some
20 more work.

21 MR. FEINSTEIN: Any other closing
22 comments?

23 MR. CALKINS: If we're actually done,
24 can I throw in one last caution.

25 MR. FEINSTEIN: Of course. Well, fine

1 then we're not done, but go ahead.

2 MR. CALKINS: I want to flat-out point
3 out one very wrong comment made earlier today
4 by the very distinguished Professor Gertner
5 when he said that it's very important in
6 writing these guidelines to remember that they
7 are not a litigation guide.

8 I would just like to point out
9 to you that any word that you issue, whether in
10 a draft or in a final document, will be used
11 against you with a vengeance in a courtroom.
12 I don't care how many disclaimers you put
13 on here about this is just to guide our
14 internal deliberations.

15 You know, you are a government
16 agency and the Department of Justice is part of
17 the government; and if you issue guidelines,
18 those will be used against you.

19 So that if, for instance, you
20 just amend the HHI thresholds by doubling them,
21 those will be used against you. And so you have to
22 think about how to proceed.

23 If you want to get people away from the
24 numbers, maybe go for a safe harbor thing and say,
25 you know, the presumption against it will start

1 here and beyond that we'll look at a bunch of
2 factors, including where you are or something.

3 But if you just go forth and inflate
4 the numbers to try to comport with reality,
5 that's a fine thing to do in terms of guidance;
6 but immediately that will become the minimum
7 threshold for any case you want to bring.

8 So yes, one of the problems of the
9 guidelines is they're addressing all these
10 different audiences: government officials
11 and business persons and academics and people
12 around the world and judges.

13 But as a government officials, you
14 can't afford to write a document that's going
15 to prevent you from winning an important case
16 in that last arena.

17 MR. FEINSTEIN: I don't disagree with
18 any of that.

19 MR. TREECE: As a litigator, let me
20 respond briefly, I agree entirely. If you
21 think of the guidelines as jury instructions,
22 my gosh, the incentives for the person with the
23 burden of proof to give expansive sway to his
24 burden and to crimp the affirmative defenses are
25 enormous.

1 I think that's part of the reason
2 the defense bar is skeptical of the treatment
3 of efficiencies. There seems to be a
4 reluctance to acknowledge the efficiencies in
5 the guidelines for exactly the purpose that
6 Steve has suggested. When you go the to court,
7 they don't want to see that.

8 MR. FEINSTEIN: Well, I guess the last
9 thing I would offer to say as evidence that
10 mergers don't always work out quite the way
11 people expect them to, as I was riding in here
12 this morning I heard on the news that today is
13 the day that AOL was moving forward on a stand-
14 alone basis. And I suspected that the
15 shareholders of AOL and Time Warner probably
16 don't look back fondly on the last ten years.

17 Let me, let me do two things.
18 First of all, I want to thank Henry Butler and
19 his crew here at Northwestern for being
20 wonderful hosts. This has really been
21 terrific. We appreciate it.

22 MR. BUTLER: My pleasure.

23 MR. FEINSTEIN: And then secondly, I
24 think this has been a really lively,
25 informative way to end the day, and I want to

1 salute the panel. So thank you very much.

2 (Applause.)

3 (Whereupon, at 4:37 p.m., the
4 hearing was adjourned.)

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1 STATE OF ILLINOIS)
2) SS:
3 COUNTY OF COOK)

4
5 JANICE M. KOCEK, being first duly sworn,
6 on oath, says that she is a court reporter doing
7 business in the City of Chicago; and that she
8 reported in shorthand the proceedings of said
9 hearing, and that the foregoing is a true and
10 correct transcript of her shorthand notes so taken
11 as aforesaid, and contains the proceedings given
12 at said hearing.

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Janice M. Koczek, CSR, CLR