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Chairman Tim Muris.

And both General Pate and Chairman Muris have quite a few significant accomplishments, but I won't take away from their important time at the podium by going into them. Suffice it to say that they are welcoming you, and also to the audience that is listening in on the 800 telephone line to this important conference.

And we hope to obtain some valuable information which will inform our activities in the future, as a result of the conference. So, let me turn it over right now to General Pate.

MR. PATE: Thanks very much, Alden. Thanks to the Federal Trade Commission for providing this great facility to host our look into the operation of the merger guidelines, and to consider improvements -- we hope -- in thinking, or developments in thinking, in the way that the agencies carry out their responsibilities under Section 7 of the Clayton Act and under the FTC statute.

I think that it's fair to say that this is one part of a very significant amount of policy activity that's going on at the two agencies. And frankly, I think Tim Muris deserves the lion's share of the credit for that, in terms of bringing forward the concept of joint work between the two agencies.

That has been producing a great deal of

1 antitrust world, certainly different from cartel
2 enforcement, where there is little or no serious
controversy about the need to aggressively intervene
where cartel activity is detected.
5 It is different, too, from the unilateral
conduct sphere, where it's very important for the
agencies to have a very high degree of caution about
where they intervene, because of the possibility of
chilling competitive conduct in the guise of combating
10 anti-competitive conduct.
11 Obviously, it's a gross over-simplification,
12 but I suggest that merger enforcement falls somewhere in
1 the middle, that there is a broad consensus about what we
1 are trying to achieve, but plenty of room for debate and
15 discussion about what the best use of the tool set that
1 we have to evaluate mergers.
1 Obviously, merger enforcement requires us to
1 make predictive judgments. Section 7 is described often
1 as an incipiency statute. That's obviously true, but
20 that term can carry different, very freighted meanings,
21 depending on who the speaker might be.
22 And what we're about here is to try to
2 determine how best we can make predictive judgments about
2 proposed transactions to make sure that those that would
25 bring efficiency and better outcomes for consumers are

allowed to go forward. And likewise, that those that have the real prospect for substantial lessening of competition don't happen.

Obviously, the Horizontal Merger Guidelines are the Agency's most important statement of how we go about doing that. The merger guidelines of 1982, which have been revised now several times -- in 1984, 1992, 1997 -- revised with some significant language changes, and some significant changes in approach.

Certainly the agencies, even apart from those textual changes, have, throughout this period, incorporated advances in economic thinking and improvements in our own practices and learning.

The guidelines are flexible, they are practical. At the same time, I think it's fair to say that both agencies are in a period of trying to emphasize

not warranted.

And I think you can see that in terms of the release of data that has preceded this conference. The agencies jointly, as you know, have released data on merger challenges from 1999 to 2003.

The Federal Trade Commission has now released significant data on cases in which a challenge was not brought, and also issued some data that shed light on other factors, customer complaints, hot documents, other things that the agencies looked at in evaluating a proposed merger. And we hope very much that this will set the stage for some very interesting discussion and improved learning in this conference.

Transparency, as I have said, is important, not only for the repeat players in the merger bar who are likely to be most interested in this, but for other enforcers, both here and internationally. I think that we need to be very mindful, not only of enforcing in a sound way, but explaining what sound enforcement entails.

Whether we like it or not, the two federal agencies are not the only game in town in terms of how merger policy is going to go forward, and it's incumbent on us to show our reasoning and be part of the broader discussion of what appropriate enforcement criteria are. And I hope this conference will contribute to that.

We certainly have a wide range of topics and a wide range of speakers, most of whom are very familiar to anyone who is involved in merger policy. If we had an antitrust ego-meter to put up here on the podium during the next three days, it would break.

Fortunately, we have got some very good moderators, mainly from the two agencies, who have put a great deal of time into preparing to keep these panels under control and hope to get some insight from them.

One thing you might ask is, "What is our goal here?" Well, it's certainly not the case that this conference has been called because anyone thinks something is broken. Nor is it the case that the conference has been put together because there is some pre-ordained goal of producing any particular output from the conference. I think that's a question that we're not really in a position to answer until we get the benefit of hearing what reactions and thinking, based on the data that's released, based on work that many of the panels have done independently over the past several years.

Until we hear that, it's hard to say whether and what might come next. But just as with the process side, where both agencies have done a good deal to try to improve our procedures, this conference does demonstrate our open-mindedness to try to make sure that we are

1 keeping up with the best thinking on substance.

2 So, with that, I will conclude simply with a very big thank you to those at both agencies who have put a great deal of time into organizing these panels. I

5 look forward to participating in some more of this, including a round table Thursday afternoon, and will keep things moving now by introducing my good friend, Tim Muris, for his opening remarks to help us kick off the conference. Thanks very much for being here.

10 (Applause.)

11 MR. MURIS: Thank you very much, Hew. It is

12 certainly a pleasure to be here. This should be an

1 interesting three days. Hew and the Department of

1 Justice are, obviously, our most important partners and

15 colleagues, and I greatly appreciate their help and work

1 on their effort.

1 And I wanted to thank our staff at the FTC and

1 the Justice Department staff. The data we released,

1 which I will discuss briefly here in a second, is quite

20 interesting, and I am sure many of those who will be

21 talking over the next few days will remark on that data.

22 I particularly wanted to thank our economist

2 who worked on that data. It was a lot of work. I see a

2 few of them out there in the audience. It required a lot

25 of people to read a lot of our memoranda from the past.

1 It is certainly a pleasure to me, and an honor,
2 that -- I noticed Hew's interesting comment about the
ego-meter -- that we will have so many prominent
practitioners, academic and enforcement officials here
5 over the next few days.

I won't repeat the mistake I made about a
decade ago, when I was at a gathering of -- a conference
with many of the leading economists, and I was on a
panel, and I said, "This is the greatest gathering of
10 $500-an-hour economists every assembled." This was a
11 long time ago when billing rates were lower. And one of
12 them took great offense, and it was immediately obvious
1 to me and everyone else that this person billed
1 considerably higher than $500 an hour.
15 (Laughter.)
1 MR. MURIS: And the others were all making
1 notes. And I felt like a facilitating practice, so --
1 (Laughter.)
1 MR. MURIS: As Hew mentioned -- you know, well,
20 whatever one's billing rate -- we are going to discuss
21 the impact of the guides. And as Hew mentioned, they
22 have an impact not only at the federal level, but also at
2 the states and internationally.
2 There are over 60 countries that have merger
25 control regimes, and you can see the influence on the

1 guidelines almost everywhere.

2 Let me tell you what my view of what we can achieve over the next three days. The guidelines, as I think we all know, are not a cookbook. They don't

5 provide specific details on every aspect of a merger investigation. They do detail a methodology, whether to analyze -- to analyze whether a merger is likely anti-competitive. And what the workshop is going to do is explore state of the art application of the guidelines by

10 those with the most experience at using them.

11 We will publish an edited transcript on our

12 website so that people can refer to it. I know there are

1 a lot of people at the FTC -- I'm sure at Department of

1 Justice -- listening on their computers. There are other

15 people listening on their 800 number. We are actually

1 going to film this so I can watch it on my exercise bike,

1 decisions to challenge mergers in a wide range of product
2 markets. And then a few weeks ago, the FTC released data
on 151 horizontal merger investigations from the
beginning of fiscal year 1996 through the end of fiscal
5 year 2003.

1 important issues in merger analysis. One involves the
2 long-standing debate about the significance of
concentration and HHI numbers. I hope the data we
released and the breadth of analysis we will hear this

consideration of other conditions that help predict whether price increases are likely, post-merger.

Thus, the pre-eminence that some would continue to give to concentration or HHI numbers is misplaced. State of the art merger analysis has moved well beyond a simplistic causality of high concentration leading to anti-competitive effects.

The number of competitors is certainly important. Four to three gets our attention quicker than six to five. But current merger practice does not elevate a single fact or number to dispositive significance. The totality of the evidence must point to an increased likelihood of anti-competitive effects before we act.

Much of this experience with merger investigations is captured in the guidelines themselves. One of the salutary effects that the guidelines have is the transparency they help bring to government. They help us clarify enforcement policy and doctrine so that practitioners and their clients can make better judgments.

Government officials should explain the basis on which they exercise their authority. Stakeholders can expect clear and consistent enforcement actions. Of course, application of the guidelines is not always

obvious. Hence, the high billing rates.

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1 monopolist test, and I believe Adelman probably was the
2 first one to have it. His 1956 article has been quoted
more widely, but I just dug up this 1953 article last
year.

5 The 1982 merger guidelines did a lot to develop
this basic idea into something quite useful for market
delineation. And revisions of the guidelines in 1984 and
1982 fine tuned that approach. Our panel today is going
to draw on experience of 20 years plus in applying the
10 hypothetical monopolist test, and offer insights on
11 possibilities for refining its application further.

12 I won't waste any time on introductions of our
1 speakers, I will just turn things over to our first
1 speaker, John Harkrider.

operational."

(Laughter.)

MR. HARKRIDER: Well, history has proved that that concern is overstated, as there clearly are data and quantitative methods that will operationalize the hypothetical monopolist test.

It is important to note that using reliable data is critically important. Because without such data, we quite frequently resort to the Brown Shoe factors that the hypothetical monopolist test was meant to supersede, or at least clarify.

My remarks address how to render the hypothetical monopolist test operational by using sound, empirical methods that answer the question posed by the guidelines market definition test.

At the outset, it's important to realize that the hypothetical monopolist test asks two subsidiary questions. The first is, what volume of lost sales will make a SSNIP unprofitable? And second, what volume of sales will, in fact, be lost as a results of a SSNIP? Much of the economic literature has focused on the first question. And that is, in fact, the question that critical loss attempts to answer.

The second question, however, what volume of sales will be lost as a result of SSNIP is frequently not

historical evidence may provide an incomplete answer to the forward-looking inquiry of the guidelines.

When considering historical evidence, it is important to distinguish between two types of evidence. First, evidence that consumers switched in response to past price changes, and second, evidence that consumers did not.

If a significant number of consumers switch from Product X to Product Y in response to a small but significant price change in X relative to Y, this seems to be evidence that the two belong in the same relevant market.

The criticism that the price change on X may be cost justified or not sufficiently long in duration would simply suggest that even more consumers may switch from X to Y if the price increase were not cost justified, imposed by monopolists, or of longer duration.

Alternatively, evidence that customers did not switch from product X to Y in response to a small but significant price change in X relative to Y, may have little bearing on whether the products belong in the same relevant market, as customers may be more likely to switch if the price increase were not cost justified, imposed by a monopolist, or of longer duration.

Another form of historical evidence are natural

1 experiments. In an extreme case, if the firm is selling
2 the products in the proposed market, and had in the past
engaged in cartel activity, there should be little reason
to doubt that the market is properly defined.

5 One court wrote that, "Every price-fixing
conspiracy thus identifies directly, in a real-world
context, a group of firms which is insulated from outside
competitive pressure." This is precisely what
conventional market definition evidence attempts to
10 identify artificially.

11 Another example of a natural experiment is the
12 court's analysis in Staples. In that case, the FTC's
1 various price studies which, on the whole, the court
1 found persuasive, tended to show that a hypothetical
15 office superstore monopolist could impose a SSNIP on the
1 sale of consumable office supplies, because when it was
1 an actual office superstore monopolist, that is precisely
1 what it did.

1 A form of historical evidence is econometric
20 evidence. Econometric evidence uses historical evidence
21 in a controlled and scientific manner to answer the
22 hypothetical monopolist test.

2 In fact, Judge Easterbrook, just a few weeks
2 ago, in Menasha Corp v. News Corp criticized a plaintiff
25 for failing to introduce econometric evidence of any kind

in defining the relevant market.

There are many types of econometric analysis that can be used to answer the hypothetical monopolist test. One type of the sort used in <u>Staples</u>, which, in effect, allows for a controlled natural experiment. This type of analysis requires geographic variation as to the number of competitors, as well as information on pricing, number of competitors, and factors that may influence the price of goods.

A second type of analysis directly estimates market elasticities. To be done properly, this type of analysis requires time series consumer-level information on price and quantity. While there is general agreement that in appropriate circumstances, econometric estimates of elasticities can provide perhaps the best evidence as to market definition, there are significant issues with respect to its use.

One issue involves the ability of data. It is quite unusual for private parties to have access to price and quantity information from all market participants. This is, of course, less of an issue for the government, but it raises important issues about transparency, as the government may be unable to share this data typically collected through the CID process with the merging parties.

1 litigants in merger cases frequently use affidavits. A
2 review of cases involving the use of affidavits revealed
two frequent errors. First, affidavits frequently ignore
the presence of switching costs. And second, affidavits
5 frequently do not cover a representative sample of
consumers.

As to the first question, if consumers will not
switch between the products being grouped together for
the purposes of applying the hypothetical monopolist
10 test, it may not be meaningful to ask whether they would
11 switch to a product outside of the proposed market
following a SSNIP. For example, in Englehardthe use of affidavits r

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of customers, and it's important to consider this point in the context of critical loss. Consider, for example, you hire Barry Harris, and he tells you that in response to a SSNIP, a hypothetical monopolist would find it unprofitable if it lost 8 percent of its sales.

Then, imagine the government goes out and interviews 100 customers, randomly selected -- which, it is doubtful, that that is the case, but let's say that they interview 100 random customers. And let's say that 92 of them say that they wouldn't switch and eight of them say that they would. And let's assume that all the customers purchase an equal level of the good. In that case the government may very well win.

Now, the government frequently doesn't have a random sample. And so, when you think of it this way, if the government has 100 affidavits or 200 affidavits, or if a private party has 100 or 200 affidavits, that may not be meaningful if there are, of course, more than 100 or 200 customers out there.

And two cases make this very point. In <u>Englehard</u>, the 11th Circuit said, "It is possible that only a few customers who switch to alternatives to make the price increase unprofitable, thereby protecting a large number of customers who would have acquiesced to higher GQA prices."

No matter how many customers in each end-use industry the government may have interviewed, those results cannot be predictive of the entire market if those customers are not representative of the market.

In SunGard, the court made a similar point. The court wrote: "The sampling of customer statements before the court is minuscule when compared to the entire universe of defendant's shared hotsite customers. Although the government has submitted approximately 50 statements from customers stating that they either would not or could not switch from shared hot sites, there were more than 7,500 customers that currently used defendant's shared hotsites. Without more information, the court simply cannot determine whether these 50 declarations are representative of the shared hot site client base."

In some instances, a few customers, however, may be able to speak to the overall demand elasticities

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including whether a customer would switch in response to a SSNIP. Well, that may not be an affidavit; what it really may be is a survey.

And so, if the goal of a client is simply to obtain as many affidavits as possible without taking the time to create detailed, customer-specific affidavits, it may be advisable to conduct a survey instead. Indeed, if conducted properly by an expert trained in acceptable survey methodology, surveys should carry more weight than even an allegedly representative sample of affidavits.

For example, surveys may have more methodological controls concerning leading questions, selection bias and randomness. Surveys may also make it easier to organize customers by key competitive traits, reflecting the probable elasticities of their demand. And perhaps, as an added benefit, it's very difficult for the government to depose survey respondents.

For the hypothetical monopolist test to serve as something more than an instructive theoretical paradigm, litigants, agencies, and courts should look to empirical evidence that can directly answer the question: How many customers will switch in response to a SSNIP?

Well, historical evidence, affidavits, econometric evidence, and survey evidence can all be subject to criticism. There can be little question that

they are better than conjecture on what is a critical question on market definition.

MR. WERDEN: Thank you, John. And now the cross-examination phase.

MR. HARKRIDER: Do I sit over there for this, or --

MR. WERDEN: Wherever you like. You're supposed to stand in the dock, I believe, as the defendant.

MR. HARKRIDER: Fair enough.

MR. WERDEN: I am intrigued by your suggestion that we should care whether price increases are cost-justified in examining historical evidence of how customers reacted to price changes.

I don't know how customers would know, and I don't know why they would care, whether price increases are cost-justified. So, would you elaborate your thinking on this subject?

MR. HARKRIDER: Yes. I'm not sure if it's particularly important whether they are cost-justified or not. The point I'm trying to make is that prices frequently change in an industry. And in response to those price changes, which may very well be cost-justified price changes, you need to look at that context of a price change in order to determine whether it's

1 instructive on the hypothetical monopolist test.

2 I'm not sure if I'm making a significant point as to whether they're cost-justified or not, just simply pointing out that they may very well be cost-justified.

5 MR. WERDEN: Okay. Let's turn to your suggestion that somehow switching costs have to be taken into account in market delineation. Let me give you a very simplistic hypothetical, because any real case is way too hard to do in the time we have.

10 Let's suppose that all the current users of a

11 product are totally locked in, but there are new users.

12 The hypothetical monopolists might be limited to

1 exploiting the current users, and giving up on any new

1 customers, or might be able, in some circumstances, to

15 discriminate between the two.

1 In either event, my question is: Is there any

1 way that the presence of switching costs would cause you

1 to depart from the standard 5 or 10 percent price

1 increase as the significance threshold for market

20 delineation?

21 MR. HARKRIDER: Yes, I think you make an

22 interesting point, and I think the court in Englehard

2 makes this very point. When you're dealing with

2 customers that may be locked in, the dynamic of

25 competition you may want to be looking at is the

1 competition for new customers. I think that's the first
2 point.

I think the second point is that in order for
any test or hypothesis to have any meaning, I think a yes
5 answer needs to mean something different, or lead to a
different conclusion than a no answer.

So, if you ask someone whether they would
switch in response to a SSNIP to another product that you
believe is in the relevant market, and you ask them the
10 same question with respect to a product that is not
11 within the relevant market, and the answer to both of
12 those questions is no, they would not switch, in order
1 for that test to have meaning you cannot reach different
1 conclusions with respect to whether one is in the
15 relevant market or the other one is in the relevant
1 market.

15 So, if the customer would not switch -- in

that there isn't any competition between the merging firms, and that would be an interesting thing, if that was the conclusion.

But that's not what we're asking when we're delineating the market. We are asking whether a hypothetical monopolist would raise price significantly. And I am really having trouble seeing how switching between incumbent sellers of the relevant product who are, by everyone's estimation, in the same relevant market, how switching among them is relevant to the question that market delineation poses.

MR. HARKRIDER: Well, I think you're actually answering the question the same way that I would answer it. I think the answer is no, it's not particularly relevant, and so the point I was making is that affidavits that ask the question that you say is not relevant are probably not relevant to the issue of market definition.

So, if the court -- if both the agency and the court had focused on those customers that are not locked in, I think that those are the questions that they should have asked. But asking the hypothetical monopolist test to customers that are locked in answers nothing, other than the fact that these customers are locked in.

MR. WERDEN: It seems to me that the theory of

the case might be that the locked in customers will be exploited, and that the merging firms will quit selling to new customers. If that's the theory of the case, then of course, evidence has to be mustered to show that that's a sensible strategy after the merger.

But if that is so, then clearly the focus in market delineation ought not to be on the new customer, should it?

MR. HARKRIDER: Well, I think it's important -- I am an antitrust lawyer, and you're an economist. And not to make that distinction, but the court in Englehard certainly gave no weight to the affidavit statements, because of the presence of switching costs.

And I think that unless you're arguing and can persuasively argue that Englehard is wrong, I think that it's very difficult to argue that switching costs don't matter in that context.

MR. WERDEN: Well, I have it here.

MR. HARKRIDER: Okay.

MR. WERDEN: And I don't read it that way. But we don't have time to go into it.

(Laughter.)

MR. WERDEN: So we're going to move on to our next speaker, Barry Harris.

MR. HARRIS: Thanks, Greg. Two comments,

1 first. Just -- you mentioned about being in the dock. I
2 actually testified a few months ago, and there was a
federal judge in Rhode Island that actually makes the
witnesses stand.

5 And I didn't understand that, I thought the
chair was just missing, and I went to bring a chair over
when it was time to testify, and they told me, "No, we
don't do it that way, so you have to" -- and I guess it's
an incentive to give short answers.

10 But in any case, second thing, everyone is
11 talking about 20 years of experience. I am getting old.
12 I will be -- it was 30 years ago that I came to work for
1 the Antitrust Division, so I hope senility hasn't set in.
1 The one good thing about having done it so long is that I
15 am now able to do analysis by anecdote, so let me start
1 by telling a story about a hypothetical monopolist case.

1 I started working in the Antitrust Division in
1 October of 1974, and a year or two after that I was asked
1 to draft an affidavit on a case that I was working, a
20 merger case, for a possible challenge.

21 And I looked at some old affidavits, and as I
22 went through them I learned, "Hey, I'm supposed to define
2 a market." And being recently out of graduate school, I
2 didn't have a clue how to define the market. So I did
25 what seemed to me to be obvious, I went around and I

talked to senior lawyers and senior economists, and they gave me a lot of different suggestions.

The lawyers gave me the Brown Shoe standards, and some of the economists said, "Look at price correlations." Some others said, "Look at cross-elasticities." But none of the suggestions -- not one -- had anything to do with the actual exercise of market power, it had to do with things that you might observe if market power were being exercised, but it wasn't a kind of a logical progression.

So then I finally did what I should have done first, and I went to see my boss, who was George Hay, and he suggested looking at it as a hypothetical monopolist. And it was the first I had heard of it. I wasn't like Greg, I hadn't gotten to reading books from 1952 in a systematic way, and probably should have.

But in any case, once the question was put with that type of framework, it all started to make a lot of sense to me. And that ultimately gets to what is the logic of the hypothetical monopolist principle. And at least as I understand it, the point of it is simply to identify a group of producers that would be able to exercise market power if -- and this, for me, is a key second part -- if they were able to coordinate their pricing output decisions.

So, it's basically a two-step process. One thing that I notice that I think often is not done properly is that when you're considering whether or not the group can coordinate, it seems to me you have to ask what the nature of the coordination is going to be, and it has to be consistent with the logic of what that hypothetical monopolist is going to do.

In other words, as Greg points out, the basic principle is would the hypothetical monopolist price in a certain way and would it be profitable. Well, if you're going to ask the questions about coordination, the second step, it seems to me you have to go back to your definition when you're doing your competitive effects analysis.

Let me just reiterate that. The hypothetical monopolist proposition tells you what the hypothetical monopolists would do. You look at that, and then when you do your competitive effects analysis it seems to me it's incumbent upon you that you look at that in the context of what that hypothetical monopolist would be doing.

And let me give you an example. Let's say that a hypothetical monopolist prices differentially -- so it might be unilateral effects, might be something more complicated than that. Analysis of that market must

consider the likelihood that the coordination of this
type of differential pricing could actually be achieved.

The basic concept related to the hypothetical monopolist principle brings me to the focus of the outline that I provided Greg for this session. As John pointed out, I often use critical loss both before the agencies and in testimony. And recently there have been several questions raised about the use of critical loss. Is it appropriate? Under what conditions is it appropriate?

And to understand, let me just give brief background on critical loss. In my mind, what critical loss basically does is it makes the hypothetical monopolist principle operational.

And all critical loss is is a two-step process that first identifies for any given price increase the sales that can be lost before the price increase becomes unprofitable. So, in effect, it's setting a target. How much sales have to be lost before it becomes unprofitable?

The second step considers whether the actual sales loss associated with the hypothesized price increase will exceed the calculated critical loss. So it's two distinct steps. And one might even argue it's a third step, because this form of the critical loss looks

1 at a particular price increase. And in fact, the profit-
2 maximizing hypothetical monopolist can charge any number
of prices. So, a full application of critical loss would
look at a variety of prices and try to answer that
5 question.

Now, a practical consideration is -- as the
size of the price increase goes up, the confidence you
have in any answers you get seem to me to become less and
less. For example, you have grlm(7)nltlaul connand

1 through testimony. And this, in part, was what John had
2 talked about in the previous talk.

Now, one of the questions that has been raised
about critical loss concerns the relationship between
5 cost price margins and demand elasticity. There have
been three or four articles that raise this point. But
in particular, Michael Katz and Carl Shapiro have raised
the point that economic theory indicates that high
marginal cost margins tend to imply that actual loss

1 to look at, and one of those, I think, is that the use of
2 the Lerner Index for this purpose fails to distinguish
between margins that are based on marginal cost --
meaning the margin of the last unit -- and those that are
5 based on the average variable cost of a significant
increment of quantity, where the answer may be quite
different.

The correct margins used in a critical loss
analysis should consider the actual average variable cost
10 associated with a significant loss of sales, often more
11 than 10 percent of current sales. And just to give an
12 example, one of the situations where I presented critical
1 loss was the Poplar Bluff Hospital merger case. It's FTC
1 v. Tenet.

1 And there, when we went back and we looked at
1 the costs, the question we asked -- and there is a little
1 bit of a chicken and egg thing there, and you have to be
1 careful -- but we knew from previous work that margins
1 for hospitals were somewhere in the range of 60 percent,
20 because there are a lot of fixed costs there, a lot of
21 fixed staffing.

22 So, what we did there was we got a hold of the
2 accounting system, we sat down, we worked with their
2 internal cost accounting system, and went through, item
2 by item, and asked the question in conjunction with

business people, "What would happen if you knew you were to lose 10 percent of your sales for a year? Like, let's say you lost a big managed care contract. What would happen to the individual cost elements?"

So, in effect, asking what's variable over the course of the year. And the answer we got was what we used, and we ended up with margins there that were similar to other hospitals. But lesson learned -- not a surprise -- that if you took greater change in demand, say 20 percent, or took a longer period of time, say two years, then a lot of costs that are not variable under the hypothetical that we presented become variable, and the calculated margins change.

So, I guess the lesson from this is simply get the right costs. Make sure that it fits the situation and the questions being asked for the specific case.

Now, second point with regard to the Lerner Index, going back there, is that the relationship that it describes is limited in some sense. It applies to monopolists and dominant firms, and it also applies to industries where Bertrand-type competitors sell differentiated products.

Now, and despite the fact that many, many years ago I majored in math, I don't consider myself a mathematician, so this is -- when I went back and looked

1 at Cournot models, you don't get the relationship in
2 Cournot models -- at least my understanding of that.
Now, it seems to me that if you're going to be
questioning things like critical loss, or anything else
5 based on particular models such as Bertrand-type models,
then the analysis in the case has to fit that model, and
has to incorporate all the implications of the specific
form of the Bertrand model -- in this case, that applies.
So, for example, Bertrand models tend to apply
10 best for differentiated products. But the relationship
11 that you have -- the relationship that Katz and Shapiro
12 talk about that comes from the Bertrand model doesn't
1 tell you a whole lot about closeness of substitutes.
1 Again, my understanding is that it doesn't tell
15 a whole lot about cross-elasticities. But when you're
1 analyzing differentiated products, a key issue is are
1 these close substitutes, and what happens, for example,
1 if you raise the price of one of them. The relationship
1 doesn't apply there.
20 And ultimately, this all brings us back to the
21 hypothetical monopolist principle -- I see my time is
22 running out. My overall view is that the application of
2 the guidelines is a major leap. Although there are
2 probably very specific circumstances where other
25 principles can apply, what it does is it focuses analysis

specifically on the questions that it's supposed to be asking, and that is can market power be exercised.

Actually, I assume my time is up, so I'm just going to just say thank you, and leave myself open to Greg's questions.

MR. WERDEN: Thank you, Barry. I want to ask you a couple of questions about your reaction to Katz and Shapiro, and I want to start at an extremely basic level.

Their most basic point is that anybody who is trying to make something out of high margins ought to have some idea of what competitive process produced those high margins, and be able to construct a comprehensive argument that takes into account the competitive process that produced those high margins. Do you agree with that?

MR. HARRIS: I mean, it seems almost tautological. Of course you want to understand the process. The question, I think, is -- where we differ is -- the last unit may be very small, but the question is what does it look like over the range of the lost sales. And that is basically a function of the cost structure in the particular market is a market that has high fixed costs. In the case of the hospitals, does it have high minimum staffing that's not going to change?

Ultimately, any firm has to recover its costs,

1 or it goes out of business. And the high margins may
2 simply be reflecting high fixed costs.

MR. WERDEN: Well, unfortunately, Mike can't be here today to say no, that isn't right, so I will say it
5 for him.

I think what Mike would say is, "Have you got it backwards?" Prices aren't high because fixed costs are high. If fixed costs are high, then some competitive process will, in equilibrium, allow you to recover those
10 fixed costs, and that may mean that there isn't much
11 competition. Because if there was competition, you
12 wouldn't be able to recover those fixed costs.

1 So, whatever the facts are, there is a
1 competitive process out there that's producing those
15 margins. And what Mike and Carl say you need to do is to
1 examine that process and try to make sense out of it.

1 broad ones?

2 MR. HARRIS: I think it's going to depend --
and I'm not sure I completely understand the question --
but I think it's going to depend -- because in the
5 Bertrand model, you have differentiated products and you
may very well have different margins with the different
firms.

But that doesn't say anything is -- ultimately,
you know, you're getting to the merger, you're asking
10 what the cost elasticities are between different firms in
11 the market. That's important when you're dealing with
12 differentiated products, and I'm not sure --

1 MR. WERDEN: And they say it is.

1 MR. HARRIS: That --

15 MR. WERDEN: That the result is that if you're
1 in this Bertrand world with very high margins, then it
1 turns out that you need very little substitution, very
1 low cross elasticities among the firms in the industry in
1 order for the right conclusion to be that they form a
20 relevant market.

21 MR. HARRIS: Well, I mean, in the simple model,
22 for example, let's say you just have two firms and they
2 produce similar products but have different costs -- not
2 exactly the same products, but have different cost
25 structures. You're going to have one firm that has much

larger margins than the other. They compete, they're close competitors, but if that firm with the better cost structure is fully maximizing price, it's going to have the large margins to move up to the cost structure of the other firm. But if it raises it any further, it loses sales. I mean, that's basically the <u>Cellophane</u> issue.

So, again, I'm not sure that I am understanding your question, but I don't see that there is a conflict there.

MR. WERDEN: Well, the question is: Aren't they right in their case? In the Bertrand world, isn't it true that high margins are almost always going to lead to narrow markets because even if there isn't that much competition among the firms in the market, there is enough so that the market elasticity is enough lower than the individual firm elasticities which, of course, have to be low if the firms have high margins?

MR. HARRIS: I guess I just don't know the answer.

MR. WERDEN: All right. Thank you, Barry.

MR. HARRIS: Okay, thank you.

MR. WERDEN: Our next speaker is Will Tom.

MR. TOM: Thank you, Greg. I'm not quite as old as Barry, but I'm getting there. And I think back to my first year as a young lawyer in the Antitrust Division

in 1979. And despite the fact that sophisticated thinkers like Greg were already using the hypothetical monopolist test, according to Greg at least since 1978, I was there as a brand new lawyer, given my first merger matter to look at, and I have to say I had a complete sense of befuddlement about what to do, how to define a market, and how to start thinking about this case.

And had I had more sense, I would have went up a flight of stairs and asked Greg what to do, just as Barry was able to get good guidance from George Hay. But I didn't, and so I muddled along as best I could. From that perspective, I think the 1982 merger guidelines was really an advance. And if any ego-meters should be going off the charts or breaking here, I think it should be the ones in front of the people like Greg, who were actually involved in that effort and in developing the guidelines and propagating its use.

From that perspective, I think what I have to offer are really just a handful of modest suggestions. I think, on the whole, the guidelines are working well. I think the guidelines approach is a good one, and notwithstanding the quote from George Stiegler that John mentioned, it really is operational, by and large.

And my handful of modest suggestions come under two headings. Heading one, we ought to have a more

1 explicit recognition of the role of uncertainty as we
2 apply these guidelines. And heading two, I think, is
that we ought always to bear in mind that the underlying
purpose of market definition is the assessment of
5 competitive effect. I think that's a truism, but I will
try to put a little bit of flesh on it as I go along.
Under the role of uncertainty, I guess my first
suggestion is that the staff be aware of the tendency of
the iterative hypothetical monopolist test to
10 unconsciously reverse the burden of proof.
11 Now, I know that the guidelines explicitly say
12 this is not intended to say anything about burden of
1 proof, burden of persuasion, where that lies, or anything
1 else. But there is a natural human tendency to put the
15 burden of proof on those who are asserting that something
1 inherently uncertain will occur, as opposed to those who
1 say that something inherently uncertain will not occur.
1 And if you think about how the iterative
1 hypothetical monopolist test works, you start by positing
20 a 5 percent -- or, you know, some other significant non-
21 transitory price increase. So, the price increase is
22 taken as a given, that's a fact. Now you ask, well, what
2 would happen in response to that price increase by a
2 hypothetical monopolist if that price increase were to
25 take effect? Would competition come into this tentative

market to defeat that price increase? Right?

And so, you know, the real answer in many cases is, well, who the hell knows? Right? But since that really is a non-operational approach to the practical question of getting through the analysis of a particular merger, you know, the next step is to say, well, what do we think is going to happen?

And it is a very small step to slide from there to saying, well, parties, you know, prove to us that the price increase by this hypothetical monopolist will, in fact, be defeated, right? And you go through enough iterations, you know, prove that the price increase would be defeated, and you end up with, you know, a very high threshold, I think, of establishing that the market is as broad as maybe it really is.

And so, there may be a certain inherent bias in favor of markets that are too narrow. And now, I can't prove it, it's just an intuition, but I think that that may be just a natural consequence of the way we approach questions that are inherently uncertain.

My second point about uncertainty is in a similar vein. And it's not really a market definition question as such, it's a question of, you know, the next step after market definition, and the next step after that, and how it relates to the process of market

1 definition.

2 And I am reminded of a scene in the play or movie, "Amadeus," where the Emperor Joseph says of a Mozart opera, "Well, the only problem here is too many

5 notes." And there may be a sense in which the effect of the many steps in the merger guidelines process is to lead to some errors in situations of an inherent uncertainty.

And to take a very stylized example, imagine a

10 merger investigation in which the analyst concludes that

11 there is a 51 percent probability that the merging

12 parties A and B are actually in the same market

1 though he is not currently selling the product without
2 substantial cost in a very rapid period of time.

Well, let's suppose you can reject that

proposition, again, by a 51 to 49 percent margin, right?
5 There is only a 49 percent likelihood that uncommitted

to be uncommitted entry? What are the participants in the market?

Well, more likely than not, there is not going to be uncommitted entry, so we will reject the argument that the parties are advancing about uncommitted entry. Now, you know, is there going to be entry as the guidelines define it? Well, more likely than not there is not going to be entry, right? So you have got, you know, two merging parties in the same market. Nobody else in that market, no entry likely to come in. Therefore, we should challenge the merger.

It is, I think, really difficult for the merging parties counsel to know when the staff is thinking this way. You have a somewhat asymmetric process whereby the staff is properly reticent about sharing information that they are learning from third parties, and that can sometimes inhibit the dialogue. And if they are thinking this way, it's sometimes hard for the parties even to know it, let alone talk them out of it.

So, I throw that out as something for the agencies to at least be cautious about in their internal deliberations.

Third uncertainty point, if you want to call it that, is the whole issue of customers say they wouldn't

switch. And we're talking about that at some length this morning about affidavits and survey evidence, and so on -- particularly in intermediate goods industries, where the staff is relying on customer telephonic interviews in ways that they probably are not in consumer goods.

Again, it can be hard to tell what's actually going on there behind the curtain. I think John pointed out that when you're doing survey evidence, your survey experts will take quite a lot of pains to work with you to get the biases out of the questions and to, you know, avoid some of the more obvious errors about how the questions are phrased, and the sample of respondents they're posed to, and so on.

Where you're relying on the telephonic interviews with customers, the danger of badly worded questions eliciting misleading information about the inherently unknowable is probably at its highest. And it is also the situation in which fruitful dialogue between the party's counsel and the staff is at its most difficult because of concerns about third-party confidentiality.

And it is very easy to slip into highly unproductive dialogues that start and mostly end with staff saying, "Well, customers say they wouldn't switch." And I know Greg has been preaching this for a very long

1 time, and I think, by and large, the agencies are doing
2 this: The dialogue is much more productive if you ignore
what the customers say they would do and focus all of
your attention on the reasons that they give for what
5 they say what they would do, and really dig into the
objective facts that make switching more or less likely,
because that is something that the parties generally can
engage on.

And it is a lot more concrete and reliable, I
10 think, than the speculation about what, you know, what
11 third parties -- what customers say they would do under
12 circumstances that they may not really have faced and
1 really may not have thought through.

1 All right. Well, let me turn to the other
15 major heading, which is that assessment of competitive
1 effect is the underlying purpose of market definition.

1 And I guess the first question I want to
1 address is when should we depart from five percent? You
1 know, the guidelines say that in appropriate
20 circumstances, we can use numbers other than five percent
21 as your SSNIP, but they don't say what those appropriate
22 circumstances are.

2 And let me take you through an example that's
2 already covered by the guidelines, because I think it's
25 easier to understand and then go from there to situations

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maybe has made the guidelines just a little bit less transparent to pick up one of the themes raised by our keynote speakers.

And given the amount of time, I am going to drop my last supply substitute ability point, which Greg tells me fits better in another session, anyway, and open myself up to the cross examination.

MR. WERDEN: Okay. Thanks very much, Will. I want to explore some of these suggestions you made, and I want to start with the issue of the upward departure. It might not be an accurate characterization, but we will use that as a shorthand.

And the case -- I think the only case -- that really focused on this issue is the Olin case in the 9th circuit where, in order to sustain the FTC's decision that the merger was unlawful, the 9th circuit had to be persuaded that a 5 percent price increase ought not to be looked at, but rather a 10 or more percent increase needed to be looked at. And it maybe needed to be more than 10.

And the FTC did persuade the 9th circuit of this, and I think this illustrates what I think you had in mind by an upward departure. And what I want your comment on is whether you think the FTC and the 9th circuit had it right.

1 MR. TOM: All right. I am not going to comment
2 on the specific case, only because I haven't studied it
recently. And giving the advancing age I alluded to at
the beginning, one of the first things that goes is
5 memory.

MR. WERDEN: Well, neither of us actually knows
the facts of the case, so that's not really what my
question is. My question is: Is the idea if for a 15
percent price increase these two swimming pool sanitizer
10 chemicals would be in the same market, should you just
11 say, "Well, okay, put them in the same market?"
12 MR. TOM: Yes, I think it depends. If there is
1 a credible theory of competitive effect that says, in
1 effect, that, unless we do something there will likely be
15 an anti-competitive effect -- I wonder whether we ought
1 to let market definitions stand in the way.
1 And I alluded to the hypothetical situation in
1 which you have got three players, and they really aren't
1 -- back up a second, because I didn't go into this
20 hypothetical too deeply.
21 I posited three players, because you can
22 imagine a two-player market in which a five percent price
2 increase would not bring one of the party's closest
2 competitor into the market. I mean, yes, let's start
25 with not a hypothetical monopoly, but an actual monopoly.

Even a five percent price increase will not bring the closest competitor in.

And you say, should you, let A merge with B, its closest competitor? And I think most of us would say intuitively, no. It wouldn't make any sense to allow what would be a fairly dramatic competitive effect under that circumstance.

Well, one might cavil about whether that hypothetical is realistic in the first place, because if a five percent price increase by the monopolist wouldn't bring closest competitors in the market, then why isn't the monopolist pricing it at that level already?

And so, I posited another competitor, B, that is closer than competitor C that A is acquiring. So the current price is constrained by B. And that's why prices haven't gone up already.

Now, the question is can the acquisition still make a difference? I think there are certainly models in which the acquisition of the next closest competitor does make the difference.

In such a circumstance, doescloaohfl

1 likely to happen? Are you convinced as a factual matter?

2 MR. WERDEN: One last question relating to your
comment on tolerance level. I think it is important, as
you suggest, to recognize uncertainty in our forecasts.
5 But I want to try to flesh out exactly what you're saying
here.

Let's suppose we had a unilateral effects case
in which the government believed that the result of a
merger would be one merging firm would increase price
10 eight percent, and then the other one would increase
11 price four percent, for a market-wide average price
12 increase of three percent, or make it two percent.

1 The three and the two percent are below the
1 magic five. In fact, even the four percent for one of
15 the merging firms is below the magic five. Assuming that
1 there isn't a tremendous amount of certainty, so that we
1 really don't know anything, do you really believe that
1 the agencies should say, "Well, eight percent, four
1 percent, forget it. It's not that much."

20 MR. TOM: The assumption was there is not a
21 tremendous amount of uncertainty, or --

22 MR. WERDEN: Well, not so much that we really
2 don't know anything. There is always significant
2 uncertainty.

25 MR. TOM: Yes. No, I'm not proposing selecting

1 a magic number of five percent, or whatever, as a

2 tolerance level. Yes, I do think that, in circumstances

where we can be pretty confident about the upper bound of

harm, and we can't be at all confident -- or we can be

5 somewhat confident, but only barely so -- that there is

any harm at all, I think we ought to very seriously

consider letting that one through.

MR. WEMe canEN: An99oTeleveasN2g8n84o2hink that, in circu

Salieri. And I'm pretty sure Tim Hulce was the one who said it, but we're going to have to go back and check the tape. I'm not going to dwell on that point.

The second thing where I think we had a little bit of disagreement -- and again, it was sort of a throw-away line by Will -- was the observation that, all in all, the guidelines are working well. I'm going to spend more time on that one because, to me, I mean, the guidelines are working well, I suppose, but only because most of the people who are using them know what the code words mean, and are largely ignoring them as the recipe for which they were originally intended.

And that's really the point where I am going to devote most of my remarks, but let me first begin with a little bit more on the areas of agreement -- or I think agreement -- among us all.

The hypothetical monopolist test has basically won. I mean, I think pretty much all analysts adopt it, most of the commentators adopt it. It is not universally adopted in the courts, but it has largely prevailed in the courts. We generally know which tools work. We had some tools as early as 1983 or 1984. Those, obviously, have been amended substantially.

We had a pretty good set of information about which tools do not work. I agree completely with John

Harkrider and Will Tom, that affidavit battles are not an especially productive or illuminating form of arms race.

I agree with Will on the issues of burden of proof, and biased narrow markets, although whether it's too narrow is sort of a judgment call we can talk about. But unilateral effects, I agree with Will about his supply-side point that he didn't make here, but you will have to read the paper.

And basically, I think pretty much all of us would say that if market definition is to remain a discreet early step in merger analysis, that the hypothetical monopolist test is the right test.

Now, to the disagreement, let me be a little bit incendiary at least, and pose to you the question of whether, in fact, we ought to be retaining market definition as a discreet, early step in the analytical process as it is used nominally, under the guidelines.

For at least five years now -- and just watching the way we work, watching the way the agencies work -- I have been posing to people the question of whether market definition is an input into the competitive analysis, or whether it isn't really an output. And I think that Greg has largely convinced me that it's neither, it's really an issue of simultaneous determination.

1 But the one thing that I think is fairly clear

2 -- at least the way that most of us go about our business day to day -- is that it is not a pre-standing form of analysis done by reference to a hypothetical monopolist test, where you then plug that answer into the stuff that

1 aware of that fact when I cited both of them in the paper

2 that I guess has not yet been released or put out front,

information. I mean, where is the value in the deal? You want to hear whether it's on the price increase side or the cost decrease side. We take it as a given that the assets are going to be more profitable in the hands of the buyer than in the hands of the seller. Otherwise, presumably, a deal wouldn't happen. Presumably, there is some margin increase somewhere, and the question is what's the source of the margin increase.

And in terms of what customers are going to say, that's partly just to find out what's going to happen if we do get into an affidavit battle, and it's also to poke and probe a little bit about, well, why are the customers going to say that? Why do they care? Why don't they care?

And it's really that third question, the what's going to happen to price, what's going to happen to other competitive variables. We want to hear the answer. And as often as not, you will pose the question 15 different ways. One of the ways I'm fondest of posing it is, "Well, in which of your products are you most likely to have a price increase that sticks?" And sometimes they will say, "Well, it's this grouping right over here," and then you poke and probe on that.

But I would suggest to you that if you really want to handle the merger efficiently -- if we all want

1 to handle mergers efficiently -- and I pause a little bit
2 before saying this, but I think we will say it anyway, we
have a lot to learn from the doctors.
I mean, when you go in and you have a problem,
5 typically what the doctor does is take a bit of the
history and formulate some hypotheses, and then you flip
into a mode of rule out a problem. And the way the
medical profession does it is they run a bunch of tests
sequentially to rule out this problem, rule out that
10 problem. And at the end of the process, if you have
11 tests that are consistent with the problem, then you
12 treat the problem.
1 And if at the end of the process you don't have
1 a problem, and you can't come up with any other
15 hypotheses, well, then you move on.
1 Now, the issue we all have is how do you
1 translate this into legal doctrine in a system where you
1 have case law that has very, very strong authority on two
1 propositions?
20 First, you have to define a market. And
21 second, the market definition is step one of the
22 analysis. And I muse a little bit about that in the
2 paper that will eventually be forthcoming. I mean, there
2 are several approaches, none terribly satisfactory, that
25 one might come up with to try to reconcile case law with

1 the mode of analysis that's actually practiced.

2 And it seems to me that if we were going to try to take the next set of steps and conform guidelines to

undertake a process of revising the guidelines, because I know how complex that is and how burdensome that can be. So I'm not going to say that.

But I will say that the time probably should come one of these years -- almost certainly not before the election, but maybe 2005, 2006 -- it probably would be productive for people to sort of sit back and say, "What do we mean by market, and how, really, are we going to try to operationalize what we're doing, if what we're going to seek in the way of guidelines is a pretty transparent set of recipes that depict the enforcement practices to the public?"

And with that, any questions, Mr. Moderator?

MR. WERDEN: I have a few. First, I'm actually quite confused about what you mean when you say that the guidelines are misleading on how the analysis is conducted. I'm not sure that they tell anybody how the analysis is supposed to be conducted, so I don't know how they could be misleading. What is it, exactly, that you have in mind?

MR. BLUMENTHAL: Well, I guess I'm using misleading in the FTC Bureau of Consumer Protection sense.

(Laughter.)

MR. BLUMENTHAL: Which basically means that you

1 have a population of readers that are interpreting the

2 words in a way that is not entirely consistent with what

the words literally are intended to convey, that you have

1 And if viewed in that light, is there anything
2 misleading about the guidelines? Is there anything
problematic about the way they choose to organize these
issues in a manner, as you commented in some of your
5 articles 20 years ago, fairly consistent with the case
law that constrains how the government can litigate its
cases?

MR. BLUMENTHAL: Yes. I think with that
qualification, the guidelines remain reasonably accurate.
10 I'm not sure about a separate 35 percent test for
11 unilateral effects -- which I think is still in there --
12 well, depends on how you define the market, I suppose,
1 which is sort of the point.

1 But I'm not sure that that component is
15 something that withstands challenge. But that's a really
1 minor quibble. And yes, subject to the observation that
1 the disclaimer says they are not a recipe, and that the
1 public -- if you're going to say the public shouldn't use
1 them as a recipe, then they hold up pretty well. The
20 problem, of course, is people do use them as a recipe
21 because they don't have any other recipes.

22 MR. WERDEN: Okay. Thanks very much, Bill. I
2 have a large number of prepared questions. But before I
2 launch into them, I want to offer the panelists an
25 opportunity to respond to what else they have heard thus

far.

MR. HARRIS: I actually have a question of you. I think it was you asking questions about when there were switching costs and issues with exploiting the installed base, and at least it wasn't clear to me exactly what you were asking, so I ask that you kind of elaborate on it and explain better the situation that you have in mind where a merger might harm competition.

MR. WERDEN: Well, sure. I had in mind a very simple-minded situation in which every current user is locked in to his supplier, for whatever reason. Don't ask me to explain, I think it will be hard to explain that. But suppose it is so.

The hypothetical monopolist could exploit these guys, because they're locked in. And then the issue would be, well, what about new customers? That's usually where the competition is, of course, to attract the new customers and to sign them up and to get them locked in. And a hypothetical monopolist might be able to discriminate between the two, and might not.

And one would have a somewhat different analysis of the merger, depending on which of those circumstances you thought you were in. But one clear possibility is that you can't discriminate, so all a hypothetical monopolist could do is exploit the guys who

1 are already locked in.

2 And my question is, well okay, in that event is there any way that you would specially account for switching costs in the application of the 5 to 10 percent

5 price increase test, and my answer would be no. You don't do anything different or special in that case, not in delineating the market.

MR. HARRIS: But you would not ignore it in looking at competitive effects, is that accurate?

10 MR. WERDEN: You would not ignore anything in

11 looking at competitive effects.

12 MR. HARRIS: I understand.

1 MR. WERDEN: But part of what the guidelines

1 are trying to tell you is what category various issues

15 fall into. And the guidelines say, "Well, some issues

1 are market delineation and some aren't." And a whole lot

1 of them aren't.

1 MR. HARRIS: Okay. And then I guess the

1 follow-up question I have in the context of a merger, if

20 these customers are locked in, is your suggestion that

21 there is a way in which the merger can make that

22 situation worse? And if so, what is that?

2 MR. WERDEN: Oh, that's an excellent question.

2 It isn't necessarily so that the merger can make the

25 situation worse, and that's where the competitive effects

1 analysis ought to be. It may very well be that when you
2 get to the competitive effects analysis you conclude that
the locked-in customers are exploited as much as locked-
in customers can be exploited, and the merger doesn't
5 affect that, and the focus ought to be on the new
customers, because that's where all the competitive
action is. I have certainly seen mergers where that was
my view.

But you can imagine, certainly, that the
10 switching costs between incumbent suppliers are much
11 smaller than the switching costs between an incumbent
12 supplier and somebody outside the candidate market, in
1 which case it may very well be that there is some effect
1 on the degree of exploitation of the locked-in customers,
15 because they're not completely locked in.

1 Anybody else have any comments or questions?
1 No? Okay. The hypothetical monopolist test has come in
1 for almost entirely praise from our panelists today. And
1 my question is has it completely won the intellectual and
20 legal battle -- and those are two different battles --
21 and I think the answers may be different.

22 Put another way, is there an alternative that
2 makes any sense to use? And I think this question has to
2 be posed in two different ways. One, an economic/policy
25 perspective, and the second one, a legal one. And with

respect to the economic perspective, I pose the question to Barry. Does economics offer any alternative?

MR. HARRIS: Well, the first thing would be my disclaimer, "Never say never." But I'm hard pressed, with a few exceptions, to think of something that performs better, and it gets back to what question are you asking: What is the group of competitors, that if they were able to coordinate, could exercise market power?

Now, it seems to me -- alternatives that -- at least the ones I have seen -- are inappropriate. Maybe I haven't seen them all. Or, alternatively, they default to the same question asked in a different way.

And just as an example, I think it was John, in his talk, he mentioned successful price fixes, and he also mentioned the Staples case. Well, I think it is fair that if you can look at real-world information, it may tell you what the market is. But what is a successful price fix? At the end of the day, assuming all the conditions are reasonably similar, what you have done is you have done the hypothetical monopolist test, you have just run it out in the real world.

Same in Staples. My understanding of that case -- which is imperfect; I didn't work on it -- but despite all the talk about econometrics, at the end of the day,

1 if you read the decision, you will see the judge kind of
2 ignored everybody's econometrics. But my understanding,
an important fact of that case was that the two companies
each had pricing zones that were defined by the existence
5 of the other company, and these were the low price
pricing zones.

Well, again, you can say that's real-world
information, and it's a different way of going about it.
But at the end of the day, it's telling you an answer to

1 analysts, and the antitrust cognoscenti.

2 With respect to the courts, I think,
increasingly, the test is the decisive test. But there
still are some courts that are laggards. I think the
5 question, in large part, turns on how economically
sophisticated the judge is. I think it turns, in large
part, on how facile the judge is on reconciling the legal
standard which perhaps she believes makes sense with what
she thinks she has to put down to avoid getting reversed
10 by the court above.

11 So, as an evidentiary matter, the courts
12 continue to rely pretty heavily on Brown Shoe. And the
1 practical indicia, of course, are a submarket test. But
1 as Brown Shoe says, a submarket can, itself, be a market.
15 So it all gets completely commingled.

1 And I think that for a long time to come we
1 will continue to see courts citing to the tests that have
1 been articulated by other courts, it's just that we're
1 beginning to see more and more courts speaking favorably
20 about the guidelines, about the hypothetical monopolist
21 test, and that then creates a body of precedent where,
22 sooner or later, courts will be able to rely just on that
2 without necessarily linking it back.

2 MR. WERDEN: Let's get a little more specific,
25 and talk about the Staples case. There is, you know, at

1 least three or four pages in the Staples case relating to
2 the practical indicia.

MR. BLUMENTHAL: Yes.

MR. WERDEN: Is there doubt in anybody's mind
5 here that the only fact -- and it may be more than one
fact, but I will call it "a fact" -- that ultimately
persuaded the reasonably skeptical judge about this
funny-looking market was that there was very clear
pricing evidence that the number of office superstores
10 really was affecting prices?

11 MR. HARKRIDER: Greg, if I can make a point?

12 MR. WERDEN: Sure.

1 MR. HARKRIDER: I think that Staples actually
1 provides an illustration of the relationship between
15 Brown Shoe and the hypothetical monopolist test. I think
1 that the hypothetical monopolist test is frequently used
1 as an economic test as opposed to Brown Shoe, where there
1 is quantitative evidence of the sort, or very clear
1 evidence of the sort that directly bears on the
20 hypothetical monopolist test.

21 I think where there is very little evidence as
22 to whether a hypothetical monopolist could, in fact,
2 impose a SSNIP – which -- and by that I mean there is no
2 econometric evidence, there is no natural experiment,
25 there are no surveys, there are no affidavit evidence --

1 extent, one of the Brown Shoe factors.

2 And you really see courts -- and I think this

is one of the problems, is that the courts really haven't

figured out where the hypothetical monopolist tests

5 relate to Brown Shoe.

I think that once you get outside of the merger

context, you see that a great number of courts, whether

in a Section 1 or a Section 2 context, where a definition

of the relevant market is important, are not in fact

10 looking at the hypothetical monopolist test, although it

11 clearly is an increasing trend to do so.

12 MR. WERDEN: All right. Let's try another

1 topic. An early criticism -- and not necessarily just an

1 early criticism -- of the 1982 merger guidelines approach

15 to market delineation was that it would systematically

1 bias the analysis -- yielding overly broad markets. And

1 hence, understating market shares.

1 I didn't think anybody believed that any more

1 until a week ago, when the American Antitrust Institute

20 released a statement in conjunction with this workshop,

21 which they officially filed with the Agencies as their

22 comments, which asserts "that there are common market

2 definition procedures" in the guidelines that "create the

2 potential for systematic errors in defining markets."

25 They don't explain.

1 But my question for the panel -- and I will
2 start with Will -- do you believe that the guidelines'
articulation of the hypothetical monopolist test gives
rise to the sort of systematic errors that people were
5 worried about back in the mid-1980s?
MR. TOM: Certainly to the extent that people
were worried about a systematic bias toward overly broad
markets, I think probably most perceptions of the time --
and certainly subsequent experience -- has shown that to
10 be completely unfounded.
11 I have suggested a reason in my opening remarks
12 why we might have a systematic bias toward overly narrow
1 markets. Not because of anything analytically wrong in
1 the guidelines, but simply because of some perhaps
15 unfortunate interaction between the guidelines and human
1 nature. That is the tendency to treat one side of the
1 equation or one hypothetical part of the analysis as fact
1 and another hypothetical part of the analysis as
1 speculative.
20 But other than that I don't see any particular
21 systematic biases at all.
22 MR. WERDEN: Can any of the panelists think of
2 any matter they worked on, or one they didn't work on,
2 where the guidelines, as opposed to some view of the
25 facts, led to a market that they thought was overly

1 broad?

2 MR. HARRIS: I'm not sure that I can answer
that, but a curious fact that I have raised with Greg in
a different context was -- must be 10 years now -- in the
5 Dubuque hospital case, there was an oddity there, and
that was that the lesser of the two hospitals in the
period before the merger had lowered their prices by
roughly 40 percent in an effort to get more patients and
get more managed care plans. And they had gotten
10 virtually nothing.

11 And for some reason, they left their prices
12 down. They had an experiment sitting out there that
1 said, oh, they could raise their prices 40 percent, get
1 back where they were, and presume the elasticity
15 symmetric, and they didn't do that.

1 So, that sort of raises the question -- and
1 it's not exactly your point -- but how low does the
1 market have to be in a situation like that to include the
1 merging parties? So it's sort of a related question.

20 An attempt to answer it directly, the only
21 thing that comes to mind -- and I didn't look into this,
22 and I may have the facts wrong -- but I have a memory of
2 the antacid case that had very, very different looking
2 competitors in there. And that might be a candidate for
25 a very broad market in which a case was brought on that

1 may or may not have been supported. But it's at least
2 one that comes to mind.
MR. WERDEN: We referred to that one as stomach
remedies.
5 MR. HARRIS: Okay.
MR. WERDEN: Because it included a lot more
than antacids.
MR. HARRIS: Yes. And again, I don't know the
process that got to the market, and I don't know very
10 much about the market, except that my doctor tells me to
11 take two every day for the calcium. I think that struck
12 a lot of people at the time, and it certainly struck me
1 at the time as being a market that was way too broad.
1 And that was based on just kind of being a consumer,
15 rather than any antitrust analysis.
1 But other than that, I am hard-pressed to think
1 of one.
1 MR. BLUMENTHAL: Well, I don't know that it's
1 possible for the guidelines, if applied literally, to
20 yield an overly broad market. It depends a little bit on
21 what we mean by overly broad.
22 But if the breadth from which you were either
2 too broad or too narrow is what you would otherwise get
2 by reference to the standards in the courts, the non-
25 guideline standards, it seems to me, as it does to Will,

1 that there is almost a chronic bias in the direction of
2 narrow markets.

Whether that's appropriate or not is something we can talk about, but for 20 years I have been saying
5 that a 5 percent one-year test is going to lead to markets that are a lot narrower than what business people conventionally think of as being the market. And the reason for that is that business people tend to take more of a strategic perspective on things. And you don't see
10 a whole lot of shifting for five percent one year.

11 MR. WERDEN: Of course, it's not one year in
12 the 1992 guidelines, it's for the foreseeable future.

1 MR. BLUMENTHAL: Yes, foreseeable future. Fair
1 enough, fair enough.

15 MR. WERDEN: Okay. Do you have any theory for
1 why people like Bob Pitofsky thought what they thought?

1 MR. BLUMENTHAL: You know, I was not among
1 those who thought it at the time, and I didn't understand
1 it at the time. And I went in writing in the other
20 direction at the time.

21 Recalling the political climate in 1982, when
22 the guidelines were released, you know, as much as
2 anything else it seems to me sort of a knee-jerk reaction
2 to a perception that this was what some would have called
25 Reaganism run wild.

And that, from my perspective, at the time was what was motivating it. And after the fact, 20 years after the fact, that wasn't what was motivating it. That's the best I can come up with.

MR. WERDEN: Okay, thanks. Next topic. A long-standing issue in the application of a hypothetical monopolist test is how to account for pre-merger elevation of price above cost. The merger guidelines say that we generally use the prevailing price, but there are provisions in there referring to possibility of pre-merger coordinated interaction that say maybe not.

The AAI statement that I alluded to a few minutes ago issued last week argued as a general matter, that the "use of the prevailing price should be carefully evaluated in every merger investigation." And of course,

1 but you can think of many different contexts in which you
2 may be uncomfortable using the prevailing price, and I
think at least one context you're talking about is where
there is some evidence of pre-merger coordination.
5 And I think that you would want to use the
competitive price, as you defined it, if there were
evidence that absent that coordination or collusion, that
price -- that goods were, in fact, being sold at short-
run marginal cost, which may not be the case.
10 I think that I can imagine many instances in
11 which the prevailing price, but for coordination, may
12 not, in fact, be short-run marginal cost. And I would be
1 inherently suspicious of efforts to calculate short-run
1 marginal cost. That's both because the goods may not be
15 sold at that price, but also because people may be
1 relying upon accounting data in order to calculate it.
1 So I would be very nervous about agencies
1 trying to calculate that price, and then going to
1 customers and saying, "Okay, well, would you switch," in
20 response to a SSNIP on that.
21 So, I think the bias should be towards using
22 prevailing price, and I think you should use something
2 other than prevailing price and, in fact, the competitive
2 price as you defined it -- if there is evidence but for
25 collusion goods would be sold at that price.

1 short-run marginal costs, and it seems unclear why you
2 should be using that as the relevant benchmark.

I can also imagine industries where even in the absence of coordination, because there are differentiated
5 products and there is some degree of market power exercised by or held by each individual firm, that goods would also not be sold at short-term marginal costs.

So, I just think it's very dangerous to have a bunch of economists calculating what the price would be
10 without any clear evidence of what, in fact, the price
11 would be.

12 MR. WERDEN: Okay. In fact, the guidelines
1 don't use the competitive price as an alternative to the
1 prevailing price; they refer to the use of a price that
15 is -- I forget the phrase, but "closer to" is kind of the
1 concept -- the competitive price, i.e. a lower price.
1 And they don't say which one.

1 But, Will, I will put it to you now. If you
1 thought you had pre-merger coordination, and certainly it
20 is possible -- and that might even be the theory of the
21 case, that the merger may help that coordination persist
22 where it might not otherwise -- what price would you use?
2 How would you come up with some alternative?

2 And then if you did come up with some
25 alternative, how would you implement it?

to find some other price benchmark, but it's not obvious what it is.

MR. HARRIS: May I?

MR. WERDEN: Yes, but let me throw one thing out before.

MR. HARRIS: Go ahead, sure.

MR. WERDEN: I limited my question to the scenario of pre-merger coordination because that is the only scenario which the guidelines endorse using a price other than the prevailing price. But if anybody wants to suggest that there are other circumstances in which you should do that too, feel free.

MR. HARRIS: I mean it strikes me in listening to this that let's say you do have coordination, and somehow you have reason to believe you have coordination. Well, in effect, whether it's legal or illegal coordination, you have what we were talking about before, the price fix that defines the market for you.

So, it seems to me -- taking Greg's advice from before -- is the market definition and the competitive effects are two separate analyses. Well, from the pure market definition point, if you really have coordination, and you're in around where the monopolists would price, well then you have kind of defined your market in advance, and a further price increase would be going past

what the monopolist wants.

But when you're asking the competitive effects question, it seems to me the question you want to ask is is there something about this merger that makes it more likely that you will be able to continue to coordinate. But as far as the pure market definition point goes, I think if you really understand that there is coordination there, that, in effect, has defined the market for you.

MR. WERDEN: Thank you, Barry. Next question. The hypothetical monopolist test, as articulated in the merger guidelines, includes what's referred to in the guidelines and elsewhere as the smallest market principle.

Interestingly, in last week's AAI statement, it is asserted without any elaboration: "The smallest market principle should be deleted from the guidelines entirely."

I want to throw out to the panelists whether they think that makes any sense, and whether they are inclined to make offensive use of the smallest market principle. But I will start with a question to Barry. Do you think the existence of the smallest market principle in the guidelines has caused the agencies to miss significant competition between the merging firms?

MR. HARRIS: I think the answer is no, and I

think the reason for that goes back to what Bill Blumenthal said, and that is in the real world what the agencies seem to do is they basically do a hunt to see where the problem may be. And from -- and then they work to an answer from that.

And I don't know that the narrowest market principle really has much of an impact on how they address the issues. How they present it is a different question.

Another thing is -- maybe this is sort of a question for Greg -- but I always thought of the narrowest market principle as basically having two different possibilities, one that I think is appropriate and one that I think may not be.

The one that's appropriate would be, well, let's say we have a well-defined market, the hypothetical monopolists could raise price profitably. Let's just say it's for cars, automobiles. And then the car monopolist goes out and buys General Mills, as opposed to General Motors, you know, making cookies and things.

Well, clearly, the analysis should be in the car market, not in the car-plus-cookie market. But the hypothetical car-plus-cookie monopolist certainly could raise the price of cars. So, it struck me that the narrowest market principle was intended to exclude those

1 kinds of circumstances.

2 What I think it doesn't exclude, and probably
should not exclude, is let's say there are a variety of
strategies that a hypothetical monopolist could take.
5 And one involves, let's say, four firms and a different
equally plausible strategy involves seven firms.

It would seem to me that there is a separate
market that would encompass, depending on what
competitive issue you're trying to address, would address
10 the four firms, and a separate one that would address the
11 seven firms. And I don't see that the narrowest market
12 definition says you can't look at the issues involving
1 the seven firms.

1 And again, it may have to do with differential
15 prices, or what's the next best alternative to the
1 hypothetical monopolist, rather than just the merging
1 parties, or things like that. But I don't see the
1 principle -- cutting it off at just the fourth firm
1 situation and saying you can't go look at the broader
20 market that includes seven.

21 MR. WERDEN: The 1982 and 1984 guidelines had a
22 lot of qualifying language in there about independent
2 competitive concerns in the larger market. That was
2 taken out in 1992. So the suggestion may be that you
25 can't look at that seven-firm market. But I think,

clearly, that hasn't been the practice.

John, a question for you. If you come in to lobby the Agencies, are you prepared to try to use the smallest market principle offensively and say that under our own guidelines, the merging firms don't compete in the same market?

MR. HARKRIDER: Yes, absolutely. I would have no hesitation doing that. And let me give you two examples where we have done that.

I have been involved in three scientific journal mergers, all of which got similar requests, and I know of a fourth. And in each one of those cases, it was very clear that somebody who is buying a journal on brain surgery is probably not going to switch to one on foot surgery in response to a SSNIP. And if they do -- if you're a patient, you're in a lot of trouble.

So, I think an argument can be made -- and a very strong argument can be made -- that each one of these scientific journals do not belong in the same relevant market. That being said, and in due respect to the Agency, in each case they were explaining a different theory, which was a portfolio theory, where they weren't necessarily looking at bundled goods, but they were trying to figure out, okay, well, if you increase the price of a very expensive journal, does this cause some

1 sort of externality that is, to some extent, outside of
2 that narrow market where the library, who is buying 1,000
journals, drops something else. It doesn't technically
compete.
5 I think that's an instance where the Agencies
didn't necessarily follow their guidelines but were
looking at competitive effects where they could find
them. And you know, thankfully, in each one of those
cases the government chose not to challenge the merger.
10 I think another instance where that occurs is
11 in software cases. I have definitely been involved --
12 and then gone down to the Agencies -- where my client may
1 have a sort of software, let's say, that does sort of
back-office sorts of things. And, within a given

1 request was issued. And I think, for the purpose of
2 trying to figure out, well, do people buy these as
suites, are they within some broader relevant market.
But certainly, I think in highly differentiated goods,
5 especially with software goods, it frequently is the case
that goods may be either compliments -- but certainly not
substitutes, although it kind of looks to somebody who
doesn't know much aboutnc.

1 same theory, where the guidelines, in fact, would seem to
2 suggest to you that the products don't compete.

MR. WERDEN: Well, I won't comment on what the theory of any of those investigations was, because I
5 don't know. So, let's move on to another topic.

Section 1.11 of the guidelines states that what constitutes small but significant non-transitory increase in price will depend on the nature of the industry and the Agency, at times, may use price increases larger or
10 smaller than 5 percent.

11 Will has already addressed this subject of
12 using price increases greater or less than five percent,
1 but there is one particular question I wanted to ask him
1 about on this subject that he didn't already address.
15 And that is the case of a low profit margin industry.

1 There is some commentary, including from Bob
1 Pitofsky, and some precedent -- I think all the FTC
1 supermarket cases, but I don't have any inside
1 information on that -- have used a price increase smaller
20 than five percent on the theory that it was appropriate
21 because profit margins were low.

22 Do you think that's right? What do you think
2 about the import, if any, of low profit margins?

2 MR. TOM: I wouldn't think that one should
25 systematically adopt a percentage increase less than five

1 percent in all low-profit margin industries. I would be
2 a little worried about the implications of that.

I in part, for the reasons that I articulated
earlier, which is you are getting down to finely granular
5 judgments about what the competitive effect is likely to
be in situations where the unknowability of it all may
simply swamp what you're trying to achieve.

And given the fact that we're dealing in an
area where there are very likely pro-competitive effects
10 from mergers, you know, I would be concerned about it. I
11 recognize the intuition on the other side is with profit
12 margins very low in an industry, you know, a relatively
small price increase is more significant to the players

all your problems. Because a five-percent price increase is going to be increasing profits like three or four or five-fold.

So, what that means is if you don't have some flexibility in situations like this, you have basically defined away those industries because basically, all the problems are solved by entry in those kinds of markets.

MR. WERDEN: But there is no necessary reason why the entry analysis has to perfectly parallel the market delineation analysis.

MR. HARRIS: I --

MR. WERDEN: And the question I put was for market delineation.

MR. HARRIS: I agree. But again, you have to be careful how you use the market. If you're going to go against what Tim Muris said and start talking about shares and things in that market, those shares don't mean a whole lot if you're looking at a five-percent price increase, because entry or uncommitted entry, I mean, depending on the circumstances, is very important.

That's going to drive the competitive analysis. So I think almost as a way of screening within the Agency, it seems to me more prudent to be looking at smaller price increases and asking questions there. But maybe not.

1 But it strikes me as a danger in setting five
2 percent as a threshold and not being able to do this type
of analysis in these kinds of industries -- not because
it's going through a cyclical margin, but rather because
5 it's inherent in the make-up of the particular industry.
MR. WERDEN: My suspicion is if one seriously
considered only a one or two percent price increase for
supermarkets, you would find that supermarkets a couple
of miles apart aren't in the same market, and that --
10 although I have never worked on a supermarket merger, I
11 have worked on a lot of local market retailing-type
12 mergers, and I can't imagine that you actually get the
1 right answer, in some sense, from using such a tiny price
1 increase, because you're going to keep the merging firms
15 from competing with each other.
1 MR. HARRIS: Actually, I didn't mean that you
1 wouldn't necessarily use one or two, I meant that you
1 shouldn't limit it to the use of five percent. So I
1 wasn't suggesting that should be a standard to only use
20 one or two. So I don't know that your comment actually
21 applies, then. Maybe I was just not clear.
22 MR. WERDEN: Okay. Well, thanks. Final topic
2 -- and Bill already touched on this quite a bit -- Brown
2 Shoe, I think perhaps more than any other case, holds
25 that you cannot challenge a horizontal merger without

1 pleading a relevant market, and coming up with some
2 shares, and et cetera, doing the structural analysis.

But that's a long time ago, and antitrust law has evolved considerably. And in the Section 1 area, the

slow steps.

MR. WERDEN: Go ahead.

MR. BLUMENTHAL: Can I just add one thing? Just to be clear, what I said is I don't define markets on the defense side. But I raise that not just to be defensive here, but also to go on to say that on the plaintiff's side it seems to me -- at least if you're a private practitioner -- it's virtually malpractice per se not to define a market, given where the courts are today.

And I would think that while the Agencies, as a matter of not so much prosecutorial discretion, but as a matter of wanting to move an enforcement program in a particular direction, might try to do otherwise.

MR. HARKRIDER: I think that that's fair. And while I do agree -- and I'm sure -- you know, obviously, I can't speak for you, so I won't try to -- but while you certainly say that you don't define relative markets, I am sure you're aware of sort of the precedent.

For example, if you're doing a deal in aluminum, or you're doing a deal in polypropylene, and you may say to your client, "Okay, gee, there have been, you know, 10 other cases either litigated or consent decrees. The DOJ has defined the market, the FTC has defined the market, and looking at our concentration numbers, you know, we have a post-merger HHI of 1,000," I

would be very concerned that if, at the end of the day,
the Department of Justice said, "Okay, yes, I know. We
have defined markets this way and I know the guidelines
say that, you know, we have a post-merger HHI of, you
know, 35, but we're going to go and look to see if there
is a competitive effect," I just think, given the level,
there are, what, 2,000 HSR's that were filed last year,
there are 30 or 40 second requests. I would not want to
open up the possibility of second requests on the
balance.

MR. TOM: Can I just add one thing?

MR. WERDEN: Sure.

MR. TOM: While I agree with all that, I think
that the legal barrier to bringing a merger case without
defining a market is the -- "in any line of commerce, in
any section of the country," language in Section 7 of the
Clayton Act. Of course before there was a Section 7 of
the Clayton Act it was established that mergers could
also be challenged under Section 1 of the Sherman Act.
And the Supreme Court has now made clear that in
challenging conduct under Section 1 in the Sherman Act
you don't have to define a relevant market.

So, you know, if one were pressed to it, and if
one, for whatever reason -- which I'm having trouble
imagining -- I wanted to try to do a run around the case

law that says define a market in a merger case, there is your precedent. Indiana Federation with the old Section 1 merger cases, and you have got a legal theory.

MR. WERDEN: And I could add that in the Rockford hospital case, Posner held that the substantive Section 1 standards for merger are identical to the substantive Section 7 standards. So there is no higher burden for the government if they went under Section 1, at least if they went into the 7th circuit.

MR. TOM: Right.

MR. WERDEN: Let me, in the closing minutes, pose a fall-back to going into court without a market. And the fall-back is that instead of leading with the market, you trail with it. You lead with your competitive effects story -- and this is the way you write your briefs, this is the way you try your case, this is the way you do your oral argument.

Say, "Look, we've got this straight-forward competitive effect story. Here is evidence that supports it. And if you demand that we talk about markets, we will, but we're also going to explain to you that it's not really going to help you understand the story. In fact, it's going to be affirmatively misleading, because you could say the market is this, but that ignores this factor; you could say the market is that, but that

1 suggests that somebody is more important than he really
2 is, et cetera."
What would you think about litigating a case
that way?
5 MR. HARKRIDER: Well, I would think that the
district court would be very concerned that if they
didn't start off with relevant market they probably would
run a significant chance of being overturned on appeal.
So I think that if you're end game is to get
10 away from relevant market, that's probably the first way
11 to start, so you could have a district court, say
12 something in what may effectively be -- you had to find a
1 relevant market, but it really wasn't necessary.
1 And that could be the first part of the step of
15 getting away from relevant market. I think that, as I
1 said before, if that's your goal, probably the way you're
1 suggesting it is the safe way to go, and I'm sure the
1 court, as the safe way to go, would probably say, "We
1 don't need to, but we're going to define a relevant
20 market in case you do think we need to."
21 MR. WERDEN: Anybody have any view on that?
22 Yes.
2 MR. BLUMENTHAL: Well, I think for the
2 foreseeable future, whatever the mode of analysis is
25 internally, by the time it gets to court it has to be

1 translated into the framework with which the court is
2 familiar.

And the way the jurisprudence on something like this tends to evolve, the cutting edge stuff happens at
5 the Agency. It slowly seeps into the courts, but for a long time, the courts hold to the old framework. And at a certain point, some wise judge looks back and says, "Look what we have been doing for the last 10 or 15 years, let me try to translate it in a way that is
10 consistent with what the Agencies are doing."

11 But for purposes of pleading, for purposes of
12 the theater of the courtroom, I would think that that
1 approach is still a little bit perilous.

1 MR. WERDEN: Okay. Well, I think we will end
15 it on that note. I thank our four panelists for an
1 interesting discussion, and that will conclude the first
1 session of the workshop.

1 (Applause.)

1 **(Whereupon, at 12:00 p.m., a**
20 **luncheon recess was taken.)**
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1 **A F T E R N O O N   S E S S I O N**

me, is going to talk about whether the empirical evidence in economics relating prices to concentration and a bunch of other things, or profits to concentration and a bunch of other things, does that say anything very specific about the extent to which concentration ought to underlie the guidelines or underline merger policy?

And then finally, we're going to have a talk from Vincent Verouden, from the EC, about the EC guidelines and the way that those guidelines treat market shares and concentration.

Now, with the exception of Vincent, who is going to get 10 or 15 minutes to say what he wants to say, the rest of them, in extremely impressive display of ego on the conference call last week, suggested that each speaker take maybe five or 10 minutes, and everybody else pile on.

So, I am expecting great things from them. And to sort of up the ante and make them feel as embarrassed as possible if they don't come through for me here, I will mention that at the beginning of this conference call last week, when I had my sort of reasonable -- not very inspired way of allocating speakers and time and questions, someone -- in fact, everyone here has denied that they are that someone -- said, "David, have you any idea of the amount of ego on this conference call?"

So, that argues to me that these folks -- well, if it was you, you must have had a cold, or tonsilitis.

MS. MCDAVID: No, it was Steve.

MR. SIBLEY: Okay. So, anyway, it's going to be a little like an economic seminar at the University of Chicago, where the speaker gets maybe 10 minutes, and then the audience piles on.

So, with that, we will start with the first question. What should future guidelines say about how concentration and market shares are defined, analyzed, used, whatever? And we will start off with John Kwoka.

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1 case of unilateral effects. In the case of unilateral
2 effects, what matters is demand substitutability between
the merging firm's own products. Substitutability hinges
on elasticities. Those may be informed by diversion
5 ratios. And in turn, some light may be cast, under
certain conditions, on diversion ratios and elasticities,
by market shares.

So, that's an informational content to market
shares in the case of unilateral effects, but I believe
10 that their concentration plays no analogously important
11 role in theories of anti-competitive harm that derive
12 from unilateral effects.

1 In fact, there is a conceptual matter. The
1 guideline's exercises involving market definition,
15 product heterogeneity and entry conditions do not matter,
1 either. Careful measures of the relevant elasticities
1 incorporate essentially all of the information that one
1 would otherwise seek on those questions.

1 Thirdly, firms may engage in any competitive
20 conduct against their rivals. And merger may make this
21 more profitable, more feasible, and therefore, more
22 likely. Raising rival's cost, foreclosure, disciplining
2 behavior, and so forth, are different insofar as they do
2 not involve efforts directly to raise product price. But
25 rather, are intended to handicap rivals, and thereby

1 diminish their competitive effectiveness.

1 The present guidelines approach is, of course,
2 rooted in earlier versions that were explicitly and
exclusively concerned with coordination. But that
approach is not an equally logical statement with the
5 analytical process for mergers that involve unilateral
effects or strategic behavior.
What should be done? The problem is clear, but
the practice is a good deal less so. In principle, one
can envision a triage system, whereby there is a prior
10 determination of which theory of anti-competitive effect
11 is the concern. Cooperation, unilateral effects, or
12 strategic behavior. And then, based on that assessment,
1 one could set forth the relevant information and decision
1 rules appropriate to that category of concern, much as is
15 done now for coordinated effects.
1 Now, I recognize -- and my panel members here,
1 I'm sure, will be quick to explain -- the practical
1 problems with such a triage approach. And I do
1 understand that there is information value in some of the
20 other exercises that the guidelines suggest, even for
21 non-coordination concerns.
22 But I would urge that the logical structure of
2 the guidelines could be revisited so that the world of
2 concentration versus shares and other factors can be
25 better matched to each theory of competitive harm so as

1 to better inform outside observers as to the method of
2 analysis that compares with modern economics of mergers
effects.
The second disconnect, as I said at the outset,
5 that I would like to discuss briefly, stems from the fact
that the guidelines are supposed to inform outsiders as
to the criteria by which the Justice Department and
Federal Trade Commission evaluate those mergers.
That the guideline standards do not really
10 reflect Agency action has been no secret for quite a long
11 time. In December, the Justice Department and FTC
12 released data on their challenges to mergers, and early
1 this month the FTC released additional data on their
1 investigations and resulting cases.
15 The data offered considerable new insight into
1 enforcement practice, and raised some additional
1 questions about that enforcement. Merger challenges data
1 revealed that very few mergers with HHIs less than 2,000
1 are challenged, as are very few mergers with changes in
20 HHI less than 300.
21 In fact, more than three-quarters of all the
22 challenged mergers involve markets with HHIs in excess of
2 2,400 and simultaneously with changes in HHI greater than
2 500 points.
25 In these respects, the de facto standards

1 differ considerably from the thresholds written into the
2 guidelines. That is not such large news. There is
significant variation in these patterns by industry.
That, I believe, is to be expected, since the threshold
5 levels of concern under any theory -- for example,
cooperation -- should differ, depending on other factors
that arise that are specific to each industry.

The more recently released FTC data on
investigations in cases corroborate this impression of
10 enforcement as very heavily focused on large mergers in
11 the most concentrated industries. Very few
12 investigations of mergers in markets with HHIs less than

1 action in a merger subject to investigation, and looks at
2 the relevant importance of the factors that do matter at
all.

The results demonstrate statistically that both
5 HHI and changes in HHI matter. That is, they affect the
probability of an enforcement action following an
investigation. The estimated coefficients imply that for
every 1,000 point higher HHI, there is an additional 5.75
percentage point risk that an investigated merger will
10 trigger an enforcement action. And every 1,000-point
11 greater increase in the change in HHI, results in an 8.5
12 percent added probability of a case.

1 Now, the results, which are explained in
1 greater detail in my written comments, can be used to
15 predict the probability that any investigated merger
1 might ultimately be subject to some enforcement action.
1 And they could also be used to define combinations of the
1 HHI and changes in HHI that result in a given probability
1 of enforcement.

20 The latter exercise is very close to a test of
21 whether the standards in the written guidelines in fact
22 reflect current agency enforcement. And once again, it
2 is no surprise to anyone that they do not.

2 While the statistical results imply bright
25 lines, of course, lines are not bright. Some

1 investigations above any line end up not resulting in
2 cases. And others -- at least a few -- below any line
you might draw occasionally, for good reason, do trigger
an enforcement action.
5 The data do not make clear which theory of
anti-competitive concern is at issue for any of the cases
that are enumerated in those data. Concentration matters
more for some theories, market share matters more for
other theories.
10 I think it would be useful to know, from the
11 FTC and hopefully from DOJ as well, what the relevant
12 theory is, so as to be better able to assess Agency
1 behavior against alternative theories of anti-competitive
1 harm. And I would urge both agencies to consider such a
15 breakdown in their future data releases.
1 Let me thank you again for the opportunity to
1 summarize these remarks.
1 MR. SIBLEY: Okay. Thank you, John. And you
1 may have noticed the recurrence of the phrase "may have"
20 a lot in John's remarks, so he is emphasizing subtleties
21 and fine distinctions, and sophisticated behavior by
22 firms.
2 Now, I hope we're going to get an opposing view
2 from Steve Newborn.
25 MR. NEWBORN: Well, I have no regressions to

1 run, sorry.

2 MR. SIBLEY: You're ahead of them already.

MR. NEWBORN: I have no website, either, I don't think. But other than that, we don't disagree

5 horribly. I am very disappointed, John, that we don't, because you seem to think predictability is very important, and I was hoping that you were going to say getting to the truth was more important. And my thesis is that getting to the truth is far less important than

10 predictability, and that's what I want to explore today.

11 Now, you in the audience who are government

12 officials always know that we're supposed to say -- or I

1 was supposed to say once -- that, "The comments I'm about

1 to make are not necessarily those of the Agency or the

15 Department." I will just say that because David asked me

1 to take a rather extreme position, the comments I'm about

1 to make are not necessarily my own.

1 (Laughter.)

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than gettingit riught, and Ibelieave thatiat's far mor.

who are making a lot of money, predict the ability of to the merger through. And by getting it right, I mean there is some ethereal other dimension where economists know this is the right way of doing it, and we should be doing it this way. And I do believe predictability outranks that getting it right.

So, why is predictability so important? By the way, I wrote these notes down last night, so excuse me if I'm a little disjointed. Why should we care about predictability? And I always knew we should care about predictability.

First of all, I will give you a few quotes in a second about what the whole concept of the guidelines was at the beginning, in 1982. I'm sure many of you -- I think, Rick, you might have been there at that time, and been part of it, but I think predictability is very important to the business community for a number of reasons.

One, a failed merger is a terrible thing. It's just a terrible thing for the acquiring company. You lose money, you lose time. But for the acquired company, not only do you lose money and time, the morale of your people is completely shot. You're losing business in the marketplace. And in the extreme case, you fail. You fail because you weren't able to predict whether or not

1 that merger could go through.

2 And therefore, predictability is so incredibly important. And predictability is even more important than that, because if you are doing a merger that

5 ultimately gets challenged, you're not doing a merger that might not get challenged.

And if people believe -- and there are economists in this room, I know, who believe -- that most mergers are benign, and there are efficiencies to be

10 obtained in those mergers, you are losing the opportunities of obtaining those 1 Tho believe -- that most10

guidelines radically so that the new theory is not the unilateral theory, or the close substitute theory, or the coordination theory, as shown in our guidelines, but some theory which sounds so good today, and tomorrow is going to be rejected by the same person who authored it today, because it doesn't make any sense.

So why are we considering radically changing the guidelines -- and people are considering radically changing the guidelines now.

So I think that we don't disagree, John. The present guidelines, in numbers, do not reflect Agency policy. But the present guidelines in concept absolutely reflects Agency policy, as it should, and I have done a million cases already and I haven't seen anyone go beyond the guidelines, except one Justice Department case, which I will have to talk to you about later, Dave.

People sometimes e to talk tl raso3es in concept absoieoxc

1 percent of the other deals that fall into that category
2 are not going to be challenged.
I don't want to go too much on this, because I
don’t want people to come down on me -- but I have a
5 modest proposal that probably everyone is going to
disagree with. By the way, you know a modest proposal.
Most of you are literary types, and you know that
Jonathan Swift’s "Modest Proposal" for eliminating the
population explosion in England -- or Scotland, maybe --
10 was for parents to eat their children.
11 And so, I don't propose quite that. My modest
12 proposal in changing the guidelines, though, is, I think,
1 a good one. But two parts. One part is pretty easy.
1 That is, the guidelines should not be modified
15 unilaterally by either the Department of Justice or the
1 Federal Trade Commission. It should be a joint effort.
1 I think that's great that they have joint guidelines. I
1 think it makes shopping -- although it exists and is
1 useful -- less useful, and that's important. But I think
20 that should be kind of the law of the land.
21 But my other proposal may be a little radical,
22 and that is I really do believe that the economic theory
2 du jour is only for the day, or it's only for the year,
2 it's only for the decade. It's going to change. And so,
25 why do we have to adopt it? I think it spoils the

1 predictability.

2 So, here is what I suggest to avoid that happening. I think that if there is a new economic theory that should be made as part of the horizontal

5 guidelines -- I am only talking about the horizontal guidelines now; it should be proposed in one administration, and accepted by the next administration. That means the test of time has been met. Maybe we should put it in the guidelines.

10 The last thing I want to say is that

11 predictability is not something peculiar to antitrust.

12 It's something that is important to law in general.

1 And I will read you just a short quote from

1 Lord Eldon. Lord Eldon was a judge in England, I guess

15 in 1803. And what he said was, in a very similar

1 situation, where people were talking about making sure

1 that things were kind of modified so that it would serve

1 the purpose for that particular case, he said, "It is

1 better that the law should be certain and perhaps wrong,

20 than that every judge should speculate upon improvements

21 in it."

22 MR. SIBLEY: Okay. Thanks very much. Now, at

2 this point, the panelists should feel free to say

2 whatever they like to. In fact, the audience should, as

25 well. So I will throw it open to everyone.

1 MS. MCDAVID: Well, as a practitioner, I second

So, I would second what Steve has said about predictability, and tweaking around the edges, if we're going to tweak.

MR. RULE: I think the lawyers are all going to agree on predictability. In part, because, frankly, it makes our job a little easier when we're advising clients.

I will say -- and I think when Jan and I talk I will say some more about this, but it's always struck me that per se rules, particularly in this area, are important, but they are important as safe harbors, not as determinants of when a transaction gets challenged.

It's important to be able to tell your client, a businessman or woman, "Look, if you're within this range, unless there is some data that we didn't quite get so that the market definition changes, or whatever, you really don't have to worry very much about antitrust. You can go worry about, the various other things that stand in the way of putting a deal together.

It's less important, it's always been my view, that number is not just a safe harbor; it's the line between legality and illegality. Again, I will talk a little bit more why I think an HHI is a bad determinant of whether something is truly anti-competitive.

But my view has been -- and still is -- that

1 companies may decide that notwithstanding they are
2 outside a safe harbor, that there are reasons that the
transaction ought to be blessed, because it doesn't
threaten competition. And it's important in those cases
5 for the agencies to apply a fulsome and well-advised and
well-informed rule of reason analysis.

So that I agree 100 percent, it's very
important to understand the predictability of where the
safe harbors are. I would disagree a little bit in
10 saying that when you get beyond that, I don't think
11 predictability of knowing that the deal can't go forward
12 is the right way to go, because a lot of times business
1 people will decide that, "Yes, there are reasons that
1 this deal ought to make sense to the agencies, and we are
15 willing to take the risk that we can persuade them of
1 that."

1 And I think that the guidelines are good in
1 that sense -- allowing that sort of rule of reason
1 analysis when you get outside the thresholds. And I
20 think it would be a mistake to move away from that.

21 MR. SIBLEY: John?

22 MR. KWOKA: Let me take you up on your
2 challenge to be a little more provocative here, David. I
2 hear a round of endorsements of predictability, and there
25 is no quibble with that. The question, of course, is at

1 what cost do you achieve predictability.

2 What I haven't really heard expressed here is what trade-off anyone thinks is an appropriate trade-off for the virtue of predictability against getting the

5 story right. And I would offer, as evidence, that there is an important trade-off there, the following two observations. One is that a view of what the numerical thresholds mean has surely changed between the 1968 guidelines and the present. If you want predictability,

10 take the 1968 guidelines.

11 The second factor is that there are new

12 theories, and some of them, like unilateral effects, have

1 wide acceptance in the economics community. And while

1 that adds unpredictability to the process, it does -- I

15 think in principle at least -- substantially improve the

1 likelihood of getting it right.

1 Those two factors I think prove that we do make

1 those choices between the continuum of getting it right

1 and predictability. And I would simply caution that we

20 need to think very carefully about the type of errors

21 being made for the virtue of predictability. I'm not

22 sure anyone would disagree with that, but I am also not

2 sure I am hearing people say that.

2 MS. MCDAVID: Well, I think in a way, David,

25 that takes us to the question that Rick and I were going

to talk about, because that takes us to the question of what is the role of concentration.

MR. SIBLEY: Well, it does, but I want to torment Steve a little bit here.

MS. MCDAVID: Okay, go right ahead.

MR. NEWBORN: No, not tormented at all. I was kind of hoping no one would put their finger on that particular matter. Of course we're always making that choice between predictability and getting things right.

And you're right, I wasn't thinking of the 1968 guidelines so much for predictability, I was thinking of the practice that, as Justice Stewart said, government always wins. That's the only universality in the 1960s.

But having said that, I guess my point is not that we don't change. My point is that we change only for a very good reason, and the reason I haven't seen an economic theory -- not that I would understand it if I did see it, I might add -- but I haven't seen a consensus behind any economic theory that's greater than that in the guidelines right now. And when we do, I think my modest proposal should be invoked.

MS. MCDAVID: And the data that were put out by the FTC a couple of weeks ago also show that almost as important as concentration levels and increases in concentration levels are the factors like the existence

or non-existence of a complaining customer and the existence or non-existence of hot documents. And those may be as outcome-determinative as concentration levels.

My guess is this 1,400 case that you have pointed out John, in your statistics, had oodles of both.

MR. SIBLEY: Now, that sort of bright line stand may also run into problems with one of Rick's, you know, favorite clients. Microsoft and other firms are what we would call members of network industries, where the more people that use a product, the more it becomes useful. In cases like that you would expect market shares of these successful firms to be extremely high.

And whatever bright line thresholds might be for the cement industry, they might be unduly constraining for a network-type industry.

MR. RULE: Right. And that certainly is true. The one point I was going to make is -- in response to John's -- it is certainly true that guidelines that generate false negatives have a cost. The thing that certainly has never been done -- maybe it's just because it's impossible to be done -- is some analysis that suggests that -- let's just take a number -- mergers that result in HHIs of above 2,000 and an increase of greater than 50 but less than 200 somehow have generated any economic harm.

1 I don't know of any evidence to suggest that is
2 true. And I certainly haven't heard of any evidence that
would suggest that if you use the current thresholds,
that transactions that aren't brought have generated any
5 economic harm.

Indeed, I am not sure I am aware of an example
-- but maybe you can enlighten me -- of a single merger
that fell in those areas where an economist has been able
to show, going back, that there has been harm.

10 Now, there had been harm, arguably, from
11 certain transactions that were consummated. But
12 typically, if you go back and look at those, at the time
1 they were consummated for various reasons the Agency let
1 them go, even though the HHIs were greatly exceeded.

15 So, while I think John is right, I think we
1 always have to be worried about false negatives. I think
1 the cost to the economy of those has never really been
1 established, there has never been a study that says that.

1 And I think if one moved -- as we will talk
20 about -- moved the thresholds up substantially but
21 maintained that predictability, I think the burden would
22 be on those who wouldn't move it up to prove that the
2 cost to the economy would be great. And I just don't
2 think the evidence is there.

25 MR. SIBLEY: Let me sort of make a comment, and

there is a cost to predictability.

But if it's only slight, and it's only a few aberrations, then it's not something that we ought to be terribly concerned about.

MR. SIBLEY: Let me ask Steve a bit more about predictability here. Certainly one aspect of predictability are specific numbers, like, say, what a safe harbor would be.

Now, in that sense, the guidelines are extremely predictable. Now, there are lots of other things that we look at all the time with mergers, which are not numerical, but nonetheless you can see them listed as factors that we might take it into our heads to think about.

Would the guidelines become less bright line if following John's suggestion, we thought of four or five things that had to do with firms' strategic behavior to make other firms less competitive, that might conceivably be enhanced by a merger? Is that just sort of too much?

MR. NEWBORN: Well, I was going to say that there were two points I would make, two observations, as someone once said.

One is that, obviously, the more factors you put in there, the less predictable one would think it would be, unless those factors are measurable, and you

1 could make it even more predictable with more factors. I
2 mean, you could construct something where you have 40
factors and they are all measurable, and you know your
deal is going to go through or not.

5 That's not what you're thinking of. You're
thinking of five more variables that one has to think
about before you know whether or not the deals go
through. I suspect that would make it less predictable,
but not significantly less predictable, unless they were
10 broad.

11 Second thing I think it's important -- and Rick
12 put his finger on it I think, or at least implied it --
1 is that predictability is most important when we're
1 talking about safe harbors. When I talked about a high
15 predictability for high HHI mergers, that's one thing.
1 And I actually would give ground on that one, because I
1 understand that companies, as long as it's not a hostile
1 deal, can make intelligent decisions as to whether or not
1 they're willing to undergo this process.

20 However, for low HHI deals, for safe harbor
21 deals, I think the Agency should just cut it off if it's
22 1,800 or less, or less than 2,200 in the new guidelines,
2 whatever they are, there should be no new theory coming

1 I think that's very important, and I really
2 think that both the Justice Department in a case I did
last summer, the FTC in a case I'm doing right now are
both exploring those type of theories, and I think it's
5 just the wrong thing to do, for the reasons we have
talked about.

I will give you one more quote, because I love
quotes. This is from the european round table, and they
were trying to figure out why predictability is
10 important. I just found this now, so I haven't explored
11 it too much -- but they go so far as to say, in light of
12 the new EU guidelines, the stability of the framework
1 within which companies act is decisive for economic
1 growth and development.

1 So, I think the more predictability we get --
1 and I want to be more provocative now -- despite the fact
1 that we're pretty sure the economic theory we're working
1 under now in the guidelines is wrong, is what we should
1 be seeking, rather than going further to some ethereal
20 feeling of --

21 MR. SIBLEY: Okay. We do need to move on to
22 the next topic. Now, in fact -- you have all fulfilled
2 the promise you made to me to talk a lot -- but before we
2 do, I would sort of like to poll you on whether the safe
2 harbor should be raised from 1,800 to, let's say, 2,200.

Starting at this end, Craig, do you have any views on that? I guess, judging from your paper, you can't, actually, but --

MR. NEWMARK: Yes, I would say I don't have enough evidence to know, and I would adopt Steven's point that if I don't, then I should stick with what we have got.

MR. SIBLEY: Okay. Steven?

MR. NEWBORN: Okay, and I am going to deviate from my point, since I don't care what the evidence is. Since the policy of the Agency is clearly to not challenge deals in the 2,200 or under range, let's make it 2,200, and start anew.

MR. SIBLEY: Stop pretending?

MR. NEWBORN: Yes, stop pretending.

MR. SIBLEY: Yes.

MS. MCDAVID: It matters less to me what the exact number is than that we understand what role it's serving so that we can take it into account in our counseling, for the reasons that I am going to explain.

I would probably raise the break-point more to around 1,800.

MR. SIBLEY: Okay. When you talk about clarifying the role, do you mean that you want to distinguish between a bright line in the sense of go or

1 no go, or bright line in the sense of safe harbor, and

2 take your chances after that?

MS. MCDAVID: In the sense of where do I expect

that the Agency is going to focus.

5 MR. SIBLEY: Mm-hmm, okay.

MS. MCDAVID: First screen.

MR. KWOKA: Two comments. One is that I think

1 even defining markets in that context is a bit dicey.
2 But one can bite the bullet and perform such aggregations
and calculations.

My point is, however, that the anti-competitive
5 effect is really much more a function of if you had them,
the elasticities, or if you don't have them, diversion
ratios. If you don't have those, then market shares will
give you some information.

But it doesn't really depend on the broader
10 level of concentration in the industry, because it does
11 not presume, does not focus on the prospects of
12 coordinated behavior amongst a larger number of parties
1 in the industry. That's not the competitive theory.
1 And so, you know, in response to Steve's point,
15 too, the safe harbor for coordinated effects may well
1 deserve to be higher, but interpreting that as a safe
1 harbor against all anti-competitive theories of mergers
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1 to say at this point?

2 MR. VEROUDEN: Yes. The same for me, I guess. It's not really for me to say in what direction the U.S. guidelines should go.

5 MR. SIBLEY: Of course.

MR. VEROUDEN: Well, I could say at this point that actually we have adopted what one could call a safe harbor approach in the EU guidelines with respect to HHI, and the level is 2,000. That's the only thing I would

10 like to say at this moment.

11 MR. SIBLEY: All right. The next question,

12 some variation of do the agencies place too much or too

1 little reliance on shares and concentration, and the

1 lead-off hitters there will be Jan McDavid and Rick Rule.

15 We will start with Jan.

1 MS. MCDAVID: My view in merger analysis is

1 that it does no more than set the stage for us.

1 One of my concerns about concentration for

1 years is that it creates a false and artificial sense of

20 precision that doesn't actually exist in a transaction.

21 You start with the fact that it's based on

22 market definition. Market definition is rarely as

2 precise as a lot of lawyers and economists might pretend

2 it would be. There is a lot of movement at the edges.

25 For example, in the Carnival Cruise lines case

markets, I rarely present HHI calculations to the agencies. I use them in understanding whether this is a transaction on which the agencies are likely to focus and devote resources, or is it a transaction that's likely to get a pretty easy pass.

There is no bright line that separates those deals, and there is no industry, as the data that have been presented by the FTC and the Justice Department show, where the numbers are absolutely critical. This is a game that we play between the 20-yard lines on either end of the field. And what the concentration statistics give me is the ability to determine whether I am between the 20-yard lines or in the red zone on either side.

There are benchmarks that are useful for the bar to explain to our clients to understand the transactions that deserve further analysis. And the guidelines actually make this point themselves in the introduction, where they say, "Mechanical application may provide misleading answers." And the guidelines should be applied reasonably and flexibly to particular facts and circumstances.

So, the role that I use the guidelines for, and I think the role that the agencies actually use the guidelines for, is to provide a framework for analyzing the transactions on which additional work is desirable.

And then we get to the fun part, and that's all of the other factors that are in the guidelines, which really are the outcome-determinative issues in most instances.

Is entry possible? What are the characteristics of the buyer? What's the nature of the product? Is demand lumpy? Is there a General Dynamics defense that would suggest that market shares of the past are not indicative of ongoing future market conditions? Is one of the firms failing?

Is there some other fun fact about the particular industry that means that the statistics that provide, in my view, an interesting and useful first screen for both the agencies, in terms of where they devote their resources, and the bar and the business community, in terms of the transactions on which they're prepared to devote resources where we can start playing with all of the other factors, which is where the game really gets decided.

MR. SIBLEY: Rick?

MR. RULE: Thank you. When asked to participate in this, and after our little conference call, it seemed to me that we ought to subtitle this -- and I'm even more convinced of that after hearing what's been said so far -- "Lies, Damn Lies, and Statistics."

It is the latter category, the worst and the

least reliable that HHIs fit into. A couple of anecdotes are kind of interesting in terms of understanding the guideline's numbers.

When Baxter set about rewriting the guidelines I was not actually there. I came shortly after they were published, and then wasn't involved in the 1984 revision. But the story was that Baxter initially set out to find the magic number.

He told Tyler Baker, who was the special assistant who was focusing on the guidelines, to go off and figure out a way to incorporate all of the relevant factors and come up with a number that would determine

pretty innovative, and there are a lot of other innovations -- at least since I have been told -- that the thresholds that were used in the 1982 guidelines were, in some ways, designed to sort of mimic the four and eight-firm concentration ratio thresholds in the 1968 guidelines.

So, you know, if you thought that Baxter, as smart as he was, and all the folks around him, and Greg Werden, and everybody else sat around and really came up with a great new idea about where the thresholds ought to be, think again. It was really Don Turner, and God knows how he came up with the 1968 guideline thresholds.

And finally, in the mid to late 1980s, you know, we just sort of took the guidelines. And at that point I think we viewed the thresholds as safe harbors, and then if you got past them, the government would look at all of the factors, the ones that Jan talked about and other things, to try to determine whether or not there was a threat to competition.

But we kept hearing these stories about practitioners who would sit around once a week and have a meeting, and try to come up with the new secret guidelines numbers.

And apparently, the number was fluctuating all over the place, and it always kind of amused us because,

1 follow the 1968 guidelines, and notwithstanding that
2 everybody sort of understood that nobody was
3 realistically going to bring a merger case that had a
4 post-merger HHI of 1,001 and an increase of 150, nobody
5 had the political courage in 1984 or 1992 or thereafter
6 to raise the thresholds. And I think there is a question
7 as to whether or not they would do it today.
8 So, as a practical matter, those are purely
9 arbitrary numbers. They probably always will be purely
10 arbitrary numbers, but that's why I go back to the point
11 that I made with John, that, in having predictability
12 there is always going to be an element of arbitrariness.
13 And I think the burden is on those who would say that,
14 "Gee, the thresholds are wrong, and there is a lot of
15 harm being done to the economy" to prove that if they
16 want to change the thresholds.
17 So, you know, I think that's the situation.
18 The bottom line is that it's bad to use concentration
19 numbers to decide whether to block a merger. Again, I
20 don't think that at least since the mid-1980s, that the
21 agencies have relied on numbers to block transactions.
22 I think since, really, around the mid-1980s,
23 what's really become important is looking at all the
24 factors and engaging in a pretty fulsome rule of reason
25 analysis to analyze a deal. I think that as Janet

1 pointed out, if you look at the FTC numbers, there are
2 factors, principally the two that Jan mentioned, customer
complaints and hot documents, which probably play a much
more significant role when there is actually a
5 significant investigation. But there are other factors.

Now, having said that, again, as we have
discussed, that doesn't mean that the numbers are
irrelevant. They are important to predictability and
they should be around. That, then, brings me to the
10 question of whether or not there should be an update.

11 I generally think that there probably ought to
12 be. I mean, there is always a downside to getting into
1 too much changing of guidelines. It's never easy to
1 write guidelines, it's become more complex when you get
15 the FTC involved. But I do think the numbers ought to be
1 updated, and I think the statistics that were published
1 support that.

1 At the very least, it seems to me that those
1 statistics indicate that the thresholds should be post-
20 merger HHIs of greater than 2,000, and changes in the HHI
21 of greater than 200, because if you take out petroleum
22 mergers and banking mergers, then you will see that less
2 than 2 percent of the challenges came below those ranges.

2 And frankly, from my perspective, you could
25 probably raise the thresholds to greater than 2,400 and

1 greater than 300, and again, you would only be cutting
2 off a little bit more than 10 percent of the transactions
that are challenged.

I think when you look at those numbers, you
5 really do have to throw out petroleum mergers and banking
mergers. I'm not quite sure what fever afflicted the FTC
in the late 1990s about petroleum mergers, but they acted
way too emotionally, and I don't think based on very
sound evidence in the way they defined certain markets
10 and the challenges that they brought, particularly in
11 local petroleum retailing and wholesaling markets.

12 Jan and I were victimized by that, but I don't
1 think there really was a very credible theory, and it was
1 just more or less a concern about changing times.

15 Banking, as anybody who has been in the
1 Department knows, is an exception. They basically send a
1 letter off and indicate they have got a problem. And the
1 way bank mergers have been analyzed for the last 20 years
1 is pretty much by rote, using numbers.

20 Arguably, the Department ought to update its
21 practice, but the result of that is that, you know,
22 banking mergers are handled much differently from all
2 other mergers. And if you take those out, then I think
2 that the case is extremely compelling, based on the
25 practice of the agencies, that the thresholds really are

1 too low and ought to be 2,000 and greater than 200.
2 And the final point that I would make is -- we
haven't discussed it, but it's real relevant to what John
talked about -- the merger guidelines have not been
5 updated with respect to non-horizontal merger concerns
since 1982.
And if you go back and look at those, even the
theories and the sort of analysis on which they're based,
you could defend them maybe, but they certainly reflect
10 nothing of the concerns that the agencies have when they
11 have looked at those mergers. And there is literally no
12 guidance provided by the merger guidelines, in terms of
1 non-horizontal merger concerns.
1 And it's something that the agencies ought to
15 look at, and I think they ought to work on trying to
1 develop thresholds, safe harbors, that practitioners can
1 use to know when a deal is clearly not going to raise a
1 vertical or non-horizontal problem.
1 MR. SIBLEY: I would like to just comment on
20 the last thing that Rick said about looking at non-
21 horizontal mergers, and this is really quite an
22 interesting area. Over the last roughly five to 10
2 years, there have been some nice new papers in economics
2 which have looked at that.
25 And the general theory, the sort of intuition

behind them is that you can imagine the situation where we have two upstream suppliers of an input to a pair of downstream firms. If there is a vertical merger, you can imagine the situation where the remaining un-merged, downstream firm chooses to buy from the upstream division of the new merged firm at an inflated price, instead of buying from the unintegrated upstream firm at a lower price, solely because that reduces the incentives of the merged firm to compete on price very vigorously downstream.

There are lots of very nice intuitions that way. It is not easy, I would say -- speaking as one who spent as much as a half-hour trying -- to come up with ways of sort of making these theories testable. But they certainly are intriguing.

Okay. Any other comments on these remarks?

MR. KWOKA: Let me offer a couple of observations on Rick's very thoughtful comments. One is that there is probably no more sweeping expression of the value of predictability than critical values in concentration ratios.

Because apart from safe harbors, the rest of what, the guidelines have said does not represent statistically observable bright lines in the empirical work and economics.

1 I think Craig will talk about some of that
2 work, and there are suggestions in the literature -- to
which, once upon a time, I contributed a modest amount
myself -- that shows that there may be some indication of
5 break points at 35 percent for two-firm ratios, or 50
percent for four-firm ratios, and all of that. Many of
us are familiar with those.
But one would not predicate sound economic
policy on the belief that those really are hard and fast
10 break-points in behavior. The very point of the
11 guidelines is to enumerate all the other factors that
12 bore those lines. We understand the importance of those
1 other factors.
1 But there is value, nonetheless, to break-
15 points, or articulating something as simply raising
1 degrees of concern, but not necessarily tipping a merger
1 from one category unambiguously over into another.
1 Another comment that Rick has made a couple of
1 times now concerns the lack of proof that some mergers
20 that have been allowed to occur may have caused harm.
21 You know, it's a concern of many of us
22 empirical industrial organization types that there really
2 aren't very many studies of the effects of consummated
2 mergers showing their anti-competitive effect, and there
25 are few. There are not none, but there are few.

1 There are reasons for that, methodological
2 reasons for that. And I think the methodological reasons
are, in the first instance, the explanation rather than
the substantive conclusion that there are no such
5 anticompetitive mergers, that have been allowed to occur.
Let me just take a moment and sort of contrast
this with a kind of standard exercise in empirical
economics, where one looks at the impact of, say, a
regime change, a deregulation in an industry, looking at
10 the effects of a merger is really very much different.
11 You don't have a whole industry, you have an
12 individual firm. The signal to noise ratio in your data
1 is much lower. There are many other contravening factors

1 would agree -- that there are too few follow-up analyses
2 of the consequences of consummated mergers for us
3 reliably to know precisely what to conclude about the
4 impact of policy decisions not to act.
5 MS. MCDAVID: But as David pointed out, the
6 Federal Trade Commission has done a few retrospective
7 analyses, and I have always found them extremely useful.
8 And we may have the opportunity to see more as the
9 records in the cases that they have been litigating
10 involving closed mergers become available.
11 The most recent Evanston hospital decision, and
12 Chicago Bridge and Iron, they may yield information, but
13 one of the things that I tell all my clients -- because
14 they will look at a particular transaction that was
15 allowed to proceed, and they will say, "Well, if they can
16 do that, why can't we do this" -- is that every merger is
17 sui generis.
18 And that's one of my concerns about the
19 concentration data, is that they blur the things that
20 make these transactions sui generis.
21 MR. RULE: John, let me just ask you, and
22 really make it clear. There have been some attempts -- I
23 think they have been somewhat feeble -- to look at
24 transactions that were investigated and were allowed to
25 go forward. Typically, those have been above the

1 thresholds. In fact, in all the cases I think they have.

2 And my point is -- and really goes to Steve's
-- the predictability in establishing a safe harbor. And
it seems to me that, unless you can show that currently
5 that a great mass of transactions that are operating in
the safe harbor are having some sort of systemic adverse
effect on the economy, you would have to say that at
least the current thresholds are okay. But maybe I'm
wrong about that.

10 But then you go beyond that to look at the data
11 that you have now, and you basically see that the
agencies -- notwithstanding TT2 1 Tfwecl5(agencies -(3)Tj/T1hresholo
harbors than wT2 1we have now, and that, even though
there may be, somewhere down in the bottom, a few
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likely outweigh1 Tose costs?
2 h 5 10 MR2. KWOKA1: - I(think
likely value of raising TTem.
us here probably agr

1 useful for enforcement and for the private bar in
2 advising clients.
Now, I have no quarrel with that, whatsoever.
I think that your point is well taken. Larry White and I
5 put together something called the "Antitrust Revolution,"
which is a series of case studies. Some of you may have
seen this, and every edition that comes out, we always
ask our authors of cases that moved from edition to
edition to go back and evaluate the consequences of
10 actions taken, or some instances actions not taken as,
11 essentially, retrospectives.
12 These are people familiar with the industry,
1 familiar with the data sources, probably follow this over
1 time. And we have very few instances in which people are
15 in a position to make that evaluation. And these are
1 skilled, informed observers of these particular
1 industries. It's just extraordinarily hard to make
1 meaningful analyses after the fact. And again, it is for
1 the reasons I have said before.
20 I think that is one of the challenges. And as
21 -- rightly points out, the agencies have offered now at
22 least the information necessary to do some of that. And
2 I know that David, is fostering that kind of analysis,
both withsteringngencies have o8 -2001 m0onin, it is for23
in a position to make that ev/F1 1 gn, e.001 Tc think kin

1 extraordinarily helpful in thinking about the

2 consequences of policy.

MR. NEWBORN: To increase the predictability,

which seems to be something that everyone seems to agree

1 this by heart -- something to the effect that the

2 agencies are unlikely to oppose a merger? Would you like

it changed to "will never?"

MR. NEWBORN: Yes, yes, that's exactly what I'm

5 talking about.

MS. MCDAVID: What do you do, Steve, with an

industry with, for example, a history of collusion? I

would really love to know what the 1,400 case was.

MR. NEWBORN: Well, my feeling about the

10 history of collusion is if you had to collude, then the

11 merger really wasn't particularly relevant; you colluded.

12 And I understand the history of collusion seems to be a

1 big thing.

1 as a safe harbor, mainly you're saying don't make it
2 worse by adding more half-baked theories until they're
fully browned, or something like that?

MR. NEWBORN: Yes, I think that's fair.

5 MR. SIBLEY: Now, you know, currently the
guideline consists of these numbers, whatever they are,
plus a bunch of other stuff you ought to look at. Would
you -- if you were revising the guidelines, would you
take things off the table? You say there are too many
10 theories, or too many factors right now, proposed as
11 things we ought to consider.

12 MR. NEWBORN: If I were rewriting the
1 guidelines in one administration and it was approved in
1 the next -- if that's your question -- I think I would
15 probably make it far simpler than it is, yes.

1 MR. SIBLEY: Okay, so rough justice but
1 extremely swift justice.

1 MR. NEWBORN: Rough justice is the right way to
1 go.

20 MR. SIBLEY: Okay.

21 PARTICIPANT: There is nothing swift about it.

22 MS. MCDAVID: No.

2 PARTICIPANT: We don't want it to be swift,
2 let's not get carried away.

25 (Laughter.)

MR. NEWBORN: The reason it's not swift is because of all the variables that are written into the guidelines. My problem is that there are people who want to change the guidelines in a radical way that don't make it any more predictable; make it far less predictable.

MR. SIBLEY: Are any of them in the audience, by chance, who would like to speak up and expose him for the troglodyte he seems to be here?

MR. NEWBORN: Thank you.

(No response.)

MR. SIBLEY: Well, if there are, they're not saying. Okay. Anyway, we have been talking glibly about the relationship between enforcement and market shares and stuff, which might suggest that economists have a trove of knowledge that is fairly precise relating concentration to something like prices or costs or profits we might be interested in.

Craig Newmark has written a very readable and enjoyable statement containing more quotes to be refuted than I have ever seen in a single paper in 30 years of being a professional economist.

You know, most of us will sort of start a paper by saying, "So and so said such and such," and then you sort of refute it. Well, that's not good enough for Craig. He has five or six pages of so-and-so's saying

1 various things he's going to refute. In any case, Craig,
2 tell us the awful truth.

MR. NEWMARK: Well, I'm torn. After listening to three prominent attorneys say negative things about
5 economics, part of me wants to give a wringing defense of my profession. But unfortunately, at least in one stream of literature, I have to support them and agree with them. But nothing is perfect.

I want to talk about price-concentration
10 studies. John Kwoka has already talked about how we have
11 relatively little direct empirical evidence on the effect
12 of mergers, and I think we could all agree that we would
1 like to have some empirical evidence. Economists have
1 lots of theories, but the theories don't make sharp
15 predictions. So any number of people said, "What the
1 guidelines do is dependent, in part, on empirical
1 evidence, but we don't have direct empirical evidence."
1 So, what kinds of evidence do we have? Well,
1 there are several types. I'm going to focus on one
20 called price-concentration studies. The idea that if you
21 have a market that's defined locally -- grocery,
22 retailing, most banking products, gasoline retailing --
2 that you go and you track the concentration levels in
2 various local markets, compare them to their prices, and
25 try to get an idea whether concentration is, in fact,

1 associated with price.

2 One of the speakers earlier this morning called

Northwestern says, "They're the most commonly used econometric technique in current merger evaluations." Messrs Baker and Rubinfeld recently wrote that they are the "workhouse empirical methods for antitrust litigation."

So, they seem to be popular, they seem to be used at the investigation stage. We do know that something like a price-concentration study played a role in the Staples case.

In fact, in much of the public statements the FTC made about Staples, an example very much of the price concentration ilk was proffered. You go to Leesburg, Florida, and you go into the office supply store that's there -- there was only one firm that was there, it was Staples -- and they would charge you $4.17 for a box of file folders.

You go 50 miles away, said the FTC, to Orlando, where there are three office supply superstore firms, and it costs you $1.95. QED. In fact, it's reliably reported that that very example played a role in Chairman Pitofsky's support for the case. So, the antitrust agencies use them, at least currently.

Third, I think they have good growth prospects. We have some sectors of -- at least the retail sector -- that are consolidating. Again, grocery retailing,

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record, my impression, I think, is that there is a large number of people who believe that they are useful evidence. They do tell you something about the likelihood of increased problems as concentration and market share rises.

At least one key problem, as I see it, with these studies is that there are two types of competition that exist in the economy. And for one type of competition, the price-concentration studies might be very reasonable, although I still would have some problems.

I will call the first type of competition Wal-Mart competition. Wal-Mart is currently running ads, at least in my area, where the little cartoon character comes out and says, "Look out below, prices are falling again." This is the kind of competition we economists stress in our early courses. If there is some industry with a couple of firms making a little extra money, what happens? Firms coming piling in, competition breaks out, they drive those prices down and down and down and down to a minimum average cost, and the operative means of competition is through price.

But that's a bit of a simplification. It is a simplification that we make so as not to complicate the theory and completely bore the freshman. What we really

want to talk about is quality-adjusted price, and then that leads us to a second form of competition, which I will label Starbucks competition.

Lots of people can make you a hot cup of coffee. It's not hard. You have lots of choices. You can go into Starbucks and you can get a very nice cup of coffee served by an uncommonly polite young person in a wonderful ambiance and you can pay $1.85 or more for a cup of coffee. How can they do that?

The answer would seem to be that something about the coffee seems to appeal to people. And that's a very important ubiquitous powerful form of competition. Competition through quality, amenities, and services.

And if we agree that that's powerful -- and I could demonstrate that some more, but let me just add two other pieces of evidence to support that it's important -- Dennis Mueller, who studied the success of firms over long periods of time, says that if you find a dominant firm in the United States, and possibly his evidence applies elsewhere -- it is not likely to be a firm that is selling at a lower price.

The first competition, the Wal-Mart competition, is certainly possible, but Professor Mueller says that by far, the more likely instance is a dominant firm is selling at a higher price a branded product that

people think is superior.

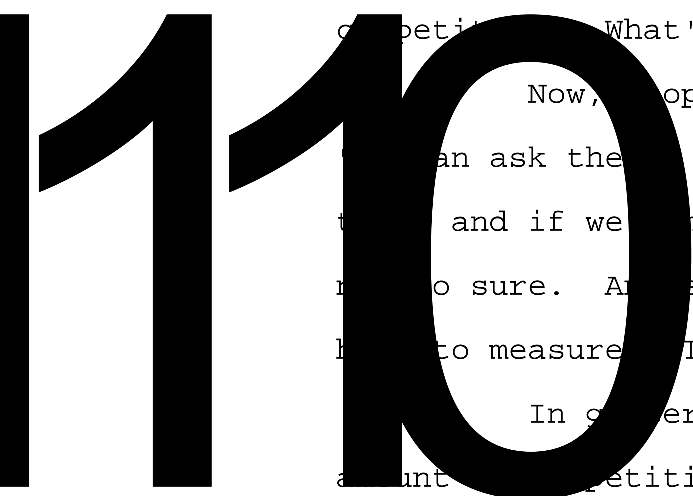
The second thing I would throw in for those of you in the Washington area, supermarket chain Wegman's is going to open a grocery store at the end of the month near Dulles. That grocery store will have a cappuccino bar, a sushi bar, a patisserie, offer cooking classes, European bread, and a wood-fired brick oven, among other things.

Now, maybe around Dupont Circle that's a big yawn. But in most parts of the country, that's a heck of a supermarket. Presumably they're going to charge higher prices in that supermarket, and people will find the bundled services and amenities useful.

So, if we accept, for the sake of argument, that this form of competition is important and very intense and very powerful, what problem does that pose for price-concentration studies? It simply poses a problem of interpretation. You can no longer associate the high prices that you might see with high concentration with consumer harm. They might be all paying Starbucks prices and being happy to pay it.

In other words, superior firms compete through non-price competition, they concentrate the industry, and yet we see higher prices. So the positive correlation between concentration and prices -- which I know in the

1 And my answer is, "I don't think so." I offer
2 three brief responses to the notion that this can be
statistically controlled for.
Response number one: I think it's very
5 difficult to figure out -- at least for an outsider, or
even for an insider -- all the various forms of non-price



c petiti What's going to be important to consumers?
Now, ople in the antitrust community says,
an ask the We can bring them in, we can interview
t and if we n't know, they surely know." Well, I'm
n o sure. A even if they do know, it's going to be
h to measure Two quick examples.
In g ery retailing, there is an enormous
a unt petition on consumeron cEl, I'mteion. c(1nimpetition c

1 shelves? Maybe somebody is imaginative and can do it; I
2 think it would be hard.

The second little incident is an example that
applies to Staples. Apparently, according to an article
5 in Fortune magazine recently, up until recently the
managers of Staples -- the very top managers of Staples
-- did not have a very good understanding of their costs.
And if I went to them and asked them, I say, "What drives
your costs," apparently they weren't going to be able to
10 tell me -- at least completely accurately.
11 They used to devote a lot of floor space to
12 furniture and computers, and they were very happy with
1 that. They said, "Oh, these things make us high-gross
1 margins." Well, a couple of years back, the vice-
15 president of finance put in a new software program that
1 looked at a variety of factors and their costs, and -- lo
1 and behold -- she discovered -- those file cabinets and
1 those desks and those personal computers really aren't
1 that profitable. By the time you allow for storage and
20 insurance and transportation and damage -- in fact, you
21 probably need more sales help with some of those things -
22 - they actually weren't that attractive. They now devote

were driving their costs, which tends to make me question, at least, that if I went to them and interviewed them, and said, "What should I have in this equation," that the answers might -- at least in some cases -- not be accurate.

A second related point is -- at retail, at least -- a lot of products are jointly demanded and jointly supplied. This has been noted in some of the literature, but at least as far as I'm aware, hasn't been resolved.

So, for example, I care something about one of the items in my grocery cart. But what I really care about is the cost of the entire cart, along with the services and amenities that are provided. If I am an airline traveler, I am interested in, for one thing, the number of flights I can get, where they go to, and I care, obviously, about the price I pay on any individual point-to-point trip.

That second dimension, cno-2r at 97 s e of

isolation, you don't necessarily pick up the entire economic decision-making that the firm and the consumers are confirming.

Those drearily provided items that require cost, somebody has to pay for them. Somebody has to pay the price for the hubs, somebody has to pay the price for all the research that goes into laying out the stores better. And therefore, any individual item or sets of items is going to have trouble reflecting that jointness in supply and demand.

But third and last -- and probably the most serious problem -- why can't I put these costs and quality variables in the equation to control for them, is if you do, you once again get an interpretation problem. The firms control things, obviously, that affect their costs and their quality. If I have those on the right-hand side of a regression equation, I am implicitly measuring a price-cost margin. I am implicitly measuring something like profits. That's the problem we had in the old literature, that's the problem why we started doing price concentration studies.

You have an interpretational problem.

Starbucks coffee, with the cost of their beans, the cost of training those nice young workers, even the cost of their rents, Starbucks earns a higher margin on

1 their costs. We come back to the same problem, though.
2 Why are they earning that higher margin? It's a good
argument it's at least possible that they are earning it
not through any kind of consumer-harming behavior, but
5 they are earning it because they are competitively
superior. They are offering consumers a better product
that, even at a higher price, is attractive to them and
beneficial to them.

So, this problem of non-price competition,
10 which is acknowledged, and it has been recognized, but
11 there is usually a qualification, "Well, if we have got
12 good econometricians, we get good data, we can control
1 for that problem," I am very skeptical of.

1 Therefore, most price-concentration studies
15 that I am aware of have an interpretation problem. They
1 don't offer an good evidence that higher concentration or
1 higher market share is damaging consumers.

1 I will concede my time. Let me just mention
1 briefly at the end, Staples is the leading example of
20 such a case. Staples, there is an extra dimension. In
21 Staples, you have data over time, as well as across
22 cities. So the Staples research potentially offers some
2 gains that is not available to the standard price-
2 concentration study, but I will simply add that there are
25 problems with doing it over time, as well.

MR. SIBLEY: Do you want to start off the response?

MR. KWOKA: I think Craig's comments really are quite useful. He has made them elsewhere and previously. And I think they're good reminders to the profession about some things that one needs to be mindful of.

Real question is what should one conclude from this. I said in my opening remarks -- but I have said it a thousand times -- is that there is no such thing as a perfect empirical study. I once told someone that I could deconstruct any empirical study ever written, there is always something that one has not measured perfectly, or has left out, and I think that one could walk through the 100 price concentration studies and find some limitation on every one of them.

The question becomes whether those factors are, on their face, important, or whether what we know of their quantitative importance can account for the effects that we observe.

I notice that when he first enumerated the studies, he mentioned -- groceries, gasoline, and banking, I think, were the three you mentioned, Craig -- my colleague at Northeastern, Steve Morrison, has co-authored a large number of studies of airlines.

Airline studies that they have done typically

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reliable.

But if you have an econometric study of some sort that some economist trots out, there is a tendency -- I think on behalf of the lawyers, because I have always believed that the incentives generally for staff -- I think they want to do the right thing, but all things being equal, they would rather bring a case than not bring a case.

So, if somebody can give them a hard and fast number that makes it look like I can predict this is a problem, they will use it. And there is a tendency, if you are a lawyer, you know, gazing at all this Greek on a page, to say, "God, it must be right, because I can't understand it at all." And so, it lends a sort of degree of certainty that is often hard to refute.

It has created, although this is good for the economic profession -- it's created sort of this cottage industry for always doing studies. And even though you may think that they are dangerous, and it's a bad idea, it's kind of like the old story about a lawyer who is the only lawyer in town going broke, but as soon as another lawyer moves in, they're both fat and happy.

And so, you have got to hire an economist to go out and do your own study so that you can refute why, "Gee, you know, whatever study you're looking at -- DOJ

1 or FTC -- is really not very reliable."

2 But I think it is always important for folks to remind themselves that economics is not really completely a science, it's more of an art, and that ultimately, when

5 agencies make decisions, they have to be careful and they have to understand that inevitably there is some subjectivity and inherently some degree of uncertainty, because they're trying to predict the future, which is, in almost any endeavor, a dangerous one.

10 MR. NEWBORN: I agree with much of what Rick

11 says, but I have got to tell you I disagree with your

12 comment that lawyers look at these studies and they

1 inherently say it must be right.

1 I have got to tell you I think almost every

15 lawyer I have ever met who has been at the Agency -- and

1 I worked there for 20 years -- looked at these studies

1 with an incredible amount of skepticism. If it helps

1 them, they will use it; if it doesn't help them, they

1 will ignore it. And I don't believe they have a lot of

1 get to the right answer.

2 I don't believe that the staff has much faith in those internal economic studies, either.

MR. RULE: This is one of the reasons that, if

5 I had my druthers in most deals, I would never do a study, because it never helps you, it only hurts you.

MR. NEWBORN: It almost never helps you.

MR. RULE: But you end up often having to do it because you think it's going to be done internally by the

10 staff.

11 MR. NEWBORN: I agree with that 100 percent.

12 MR. RULE: And the problem is for lawyers -- I

1 don't mean to suggest that the lawyers are going to buy

1 whatever the study is, I'm just saying that if there is a

15 study that they can do internally, and their economists

1 are willing to swear by, that basically is a

1 justification for bringing in a case. They will jump on

1 it pretty quickly.

1 MR. NEWBORN: I have got to tell you, Rick, the

20 reasons for bringing a case come down to what the FTC

21 report said they are. They come down to -- the two most

22 important things -- they come down to hot documents and

2 they come down to customer complaints.

2 If you don't have customer complaints, you are

25 almost never going to bring that case. If you have hot

documents, you're looking for other ways to bring that case. But you really need the customer complaints. And those industries where you have customers who might be complaining -- other than supermarkets --

MR. RULE: Yes.

MR. NEWBORN: But let me just say -- and you can respond to that in a second -- I want to say I love that kind of talk, I think that stuff is very interesting, and I think it's very useful for all practitioners to know all those things.

But I kind of agree with John, and maybe everybody, that no study can survive a good cross-examination. Just can't do it. It's impossible. There are so many assumptions in the study, and so many other counter-assumptions one could make, whether it's the internal rate of return, or the cost-of-living index, or whatever the heck you're using in that study, there is another one that someone could equally use that's going to change the study in some minor way -- occasionally in some major way.

So, I'm not sure about the studies you're referring to. I still believe in Bain, so what am I doing talking here?

MR. KWOKA: This is where we should ask David to comment on what value the Division -- or some

representative of the FTC may wish to comment on what value you put on the economic studies you receive.

MR. SIBLEY: Well, let's see. We have had three complaints filed since I came to the Division. And in fact, at least our witness for one of those cases is here in the room; the other may be, for all I know.

One was a coordinated effect story where, there was some talk about market shares and capacity constraints, but a lot of it had to do with a hot document where somebody said to somebody else, "Come on, let's collude." I'm sure that didn't help the merging parties.

Another one we had, which we have decided to put in our "win" column, anyway, we did a lot of sort of sophisticated analysis, none of which gave us much of anything.

In the end, I think one reason things came out the way we kind of like them, was that we had a bunch of customers saying that they didn't like it for reasons we could sort of understand, but we never actually modeled much. And so I think the other side decided it wasn't going to be officious, government regulators with too much time on their hands getting in the way of progress, it was going to be, "My God, are we going to litigate against our biggest customers?"

Then, in the third case that I'm thinking of, there actually is some econometric stuff. Fortunately, the data is very disaggregated. We know tons, even apart from the econometrics, about what was going on. And I have a lot of confidence in the results there.

I was going to try to smoke Craig out a little bit more, and I will just give myself a minute or two, and then we will go to what the EU has to say.

Suppose that we didn't have any Merger Guidelines, but we did have all this literature that you discussed here, and let's apply the Steve Newborn test, which is you're not going to have anything in the Guidelines which are not fully accepted over at least two administrations by economists, the administrations, and I guess their barbers, or something.

MR. NEWBORN: And you have to eat your children; that's part of my --

MR. SIBLEY: If that's the test, and I were to say to you, "I, David Sibley, am charged with drafting the world's first merger guidelines," and I want the admi 1 TflikelTc(1deldT2 1 ldT2 -2 Ttero ftn; thughe to be, "All thi

MR. VEROUDEN: Both are fine, I think. We normally say the EU guidelines, yes.

MR. SIBLEY: Now, I have actually met a couple of times with folks from the Commission, and sooner or later the word "modalities," whose definition I am unsure of, gets used. I hope you don't say it.

(Laughter.)

MR. VEROUDEN: I don't think I will.

MR. SIBLEY: Thank you.

MR. VEROUDEN: I have prepared a few slides. I would like to use these final minutes to talk about the use of concentration and the market shares in the EU merger guidelines.

As you may know, actually these guidelines are very recent. We published them about three weeks ago, on the 30th of January, and they are actually part of a wider package. They complement the new EC merger regulation, which was also adopted in January of this year. And actually, both texts will become applicable as of the first of May 2004.

A brief word about the background of this merger regulation, because, in fact, as you will see, the market shares and concentration that are in our guidelines are also linked to what is the new substantive standard in our new merger regulation.

The background of this new package, the new merger regulation, is that there were a couple of issues. There were, on the substantive side, two issues that kind of influenced the debate in Europe as to the merger control test.

As you know -- or as you may know -- this test has always been the so-called dominance test in article two of the merger regulation. And there was some debate as to how this compares to the substantial lessening of competition test that is used in the U.S. Is it the same, or are there differences? The second substantive issue that I will just mention is actually the role of efficiencies in merger analysis.

The existing test is whether a merger creates or strengthens a dominant position as a result of which effective competition would be significantly impeded. Now, and the main question here was, what if a merger involves of two significant companies, and together they will have market power, significant market power, but nonetheless they are not, let's say, dominant in the usual meaning of the word -- for example, being the largest company in the market?

What if you have a concentrated market and the merger results in only the new number two in the market? Can our existing dominance test still capture, if need

ways in which a merger can cause harm to competition, to consumers.

And it is indicated that -- I'm coming now to the test -- unilateral effects may arise, in particular, when the merger leads to a dominant position. This comes a little bit back to the general idea that while -- the larger the companies involved, the higher everything else being equal -- the anti-competitive effects that one could expect to take place in the markets.

We have two sets of indicators in our guidelines, market share indicators and indicators based on HHI. Let's start with the first, the market share indicators.

Historically, since we always had this dominance test, the research question in any merger investigation was often, "Well, will the new entity have a new dominant position post-merger?" And this leads one, naturally, to look at what is their likely market share, for example, what is their likely market position in the future?

And so, a lot of experience has been built and case law has been established on the notion of dominance, and what we have done is to adopt two indications by the court. The first is that when a merger produces a company with more than 50 percent market share post-

1 merger, then this, in itself, could be evidence of the
2 existence of a dominant market position. And this is
something that the European Court of Justice has
established in a number of cases. It may also be below
5 this 50 percent if other factors are present, as well.
The second indicator is that when, the merged
entity will have a rather small market share, so to
speak, a limited market share, then there is unlikely to
be any anti-competitive effect. And according to case
10 law, when the combined market share is less than 25
11 percent, there are unlikely to be problems.
12 The exception is, however, for coordinated
1 effects, where this 25 percent market share indicator
1 does not apply.
15 On HHI -- like I said, with our traditional
1 test, which was the dominance test, we have often focused
1 on only the market share of the companies and their
1 combined market share post-merger. We didn't kind of
1 routinely look at HHI levels in our previous cases.
20 But still, we thought it was useful to have

That is that the commission is unlikely to identify competition concerns when either the HHI is below 1,000 and in such cases it's not even really necessary to do further analysis.

For intermediate levels of HHI -- that is, between 1,000 and 2,000, and a delta below 250 -- it is equally unlikely to identify competition concerns. And the third range -- that is, the higher HHI levels above 2,000, but where the delta is below 150 -- the merger is also not likely to produce negative effects.

So, this structure, in terms of intervals of HHI and then a delta which goes with it is, of course, you know, familiar to you. It's also in the U.S. guidelines, so we took it as an example.

Where, however, we decided to take a different approach is that the message that we kind of connect to these levels is different. It follows what we could call a soft safe harbor approach. So it distinguishes it a little bit from the hard and fast safe harbor. It's not hard and fast, but it does give a very decent -- hopefully -- indication.

A further difference is the following. When we looked at our previous cases, in trying to find a level below which, let's say, there would be no problems from a competition point of view, it was, of course, very

difficult to really get such a level, which in a clear and informative way, would separate cases that are unlikely to give problems from other cases.

But we also found that quite often there were specific circumstances which meant that actually the HHI, which was present in that case, was not very informative. Now, not very informative, of course, that sounds like a very broad thing. We actually have opted to list the special circumstances in our guidelines.

It's not necessarily exhaustive, but it's informative in its own right. And I must say that on this part, we actually followed the merger guidelines which also had a similar approach.

Anyway, so we say, "Well, if your HHI levels are below the levels indicated, then you are fine." That's basically the message, except when there are objective or reasonably objective circumstances, and I have listed all six of them here. Some of them are actually quite obvious, and I don't think they are giving rise to much debate, in the sense that -- at least that's what I think -- if a merger involves a recent or potential entrant, then, you know, that's a special case.

The same we say may indicate when merging parties are innovators, for example, with pipeline products, or when there are significant cost share

1 holdings between the players in the market.

2 Then we have two which are related to possible coordinated effect scenarios, so that's indications of past collusion. We thought we could single out that one

5 also as a specific circumstance.

And the final one, actually, has to do with our test -- I mean still the dominance part of our test -- and that is when a party has more than 50 percent market share pre-merger. Well, then, we don't really want to

1 levels, which obviously don't create problems. So why
2 don't you further increase the levels? Or why don't you
increase the levels, let's put it like that.
And here, I think we should say that it doesn't
5 really matter that there are many cases above the
thresholds that are giving rise to problems. What does
matter, really, is whether by increasing the levels you
kind of start missing cases that actually do give rise to
concerns. So this is the consideration that we have made
10 in putting the levels at the -- at where they are now.
11 Okay, thank you.
12 MR. SIBLEY: Getting close to the end. Any
1 quick comments or questions on --
1 MS. MCDAVID: I am reminded by these fine
15 slides about one of the issues that we really didn't talk
1 about, which is the issue of innovation, and what market
1 share and concentration statistics may tell us about
1 competition to innovate and its importance in all of
1 this.
20 And it's not something we can cover in four
21 minutes, but it certainly is an interesting and important
22 issue, and one that the FTC grappled with recently in the
2 opinion that Chairman Muris wrote back in January.
2 MR. SIBLEY: Well, actually, the two other
25 economists here are much more empirically oriented than I

am, but in my dim memory is that people who have tried to relate concentration, however defined, to innovation haven't had much luck. Is that correct?

MR. KWOKA: Not much luck. I think that's right. If you're not happy with the relationship between concentration and price, you're definitely not going to like the one between --

(Laughter.)

MR. NEWBORN: Well, there is another panel tomorrow on them, so we can defer to them.

MS. MCDAVID: That's right.

MR. SIBLEY: Any other questions for Vincent?

(No response.)

MR. SIBLEY: Okay. Now, you will notice Greg Werden is here. Greg being in the audience is generally a reliable signal that someone is going to be corrected.

(Laughter.)

MR. SIBLEY: And in fact, today's lucky winner is Rick Rule. So, Greg, what did Rick do wrong?

MR. WERDEN: Well, he should have known better than to talk about history he didn't live through.

MR. RULE: That's right. I learned it all from you.

MR. WERDEN: Not from me.

MR. SIBLEY: This is what you call a coup, by

the way.

(Laughter.)

MS. WERDEN: Turner's guidelines, which took three years to write, were meant to pull back significantly from where the case law was going. And clearly did, in relation to Pabst and Von's, and cases like that, for which Turner was roundly criticized, mostly from within. And interesting for the discussion today, he was criticized even more for creating predictability in enforcement.

Staff hated that. They loved the effect of random merger enforcement. They loved the in terrorem effect.

(Laughter.)

MR. WERDEN: 1982 -- Baxter came to the division on March 1st of 1981, already knowing that a 1,000 HHI was the magic number, and basing that, it seems mostly on the kind of studies criticized here, or an

1 FTC came up with the brilliant remark that we should
2 split the difference, and we did. You can't say we
didn't take any of their comments.

(Laughter.)

5 MR. WERDEN: The 1982 guidelines were meant to
be a pull-back from the 1968 guidelines. There very much
was a significant difference. There was an effort to
compare how the HHI numbers matched up with four-firm
concentration ratio numbers, and they showed that,
10 assuming that we really enforce at the levels of the 1982
11 guidelines, and we had really enforced at the levels of
12 the 1968 guidelines, that enforcement was becoming less
1 strict, because that was the thinking of the day, that
1 enforcement was a little too strict.

15 But on the other hand, in 1982, 1983, and 1984,
1 we enforced at the levels of the guidelines. And as you
1 do know from firsthand experience, that changed during
1 the second Reagan administration quite a bit, and that's
1 where we started to depart, in some people's estimation,
20 from what the guidelines say.

21 But that, in fact, isn't true, because the
22 guidelines were revised in 1984 to slightly change the
2 wording associated with the numbers in a very crucial
2 way. It only says these numbers mean something unless we
25 decide that they don't. It says, "Unless all of the

other factors listed in the rest of the guidelines lead to the conclusion that the merger really isn't the problem." Well, oftentimes that happens.

So, I think that's enough of a history lesson.

MR. RULE: I distinctly recall there was an analysis, somebody wrote a paper that compared the 1968 guidelines to the 1982. And I don't think there was much of a difference.

MR. WERDEN: There are several. Not a huge difference, but a difference and a difference that was on purpose.

MR. RULE: But not very significant.

MR. WERDEN: Not huge. History is very inaccurately misrepresenting where Baxter was, vis a vis where Shenefield was. They weren't dramatically far apart on merger enforcement. The guidelines weren't dramatically far apart on merger enforcement. The second Reagan administration versus the first Reagan administration, that was huge.

MR. SIBLEY: All right. In the zero seconds left, any questions? I'm sure most of these folks wouldn't mind sticking around for a couple of minutes more. Go ahead, Alden.

MR. ABBOTT: David, I just wanted to make sure the announcement got out that all the materials from the

1 candidates will be posted on the FTC's website as soon as
2 they're available to us from the authors, and presumably
on DOJ's website, as well.

MR. SIBLEY: Okay. Anything else? Yes, Eric?

5 MR. GRANNON: What are your concerns about
consumer welfare?

MR. SIBLEY: Well, it sort of depends on what
your priorities are. I guess I will have to be Steve
Newborn for a while. He would say that, you know, that
10 taking a swift justice is better than rough justice
11 approach. Consumers are probably well served, because at
12 least efficiency-enhancing mergers will know where they
1 stand, and they won't be held up in deals ruined because
1 of the time it takes to investigate and litigate things.
5 I would say something like that.

Admittedly, he wasn't real clear about that.

Then you would say that overall, the impact on consumer welfare of having safe harbors that allow most of what are not going to be problematic deals to go forward, even though you have a few false negatives, is worth it at the end. And I have always felt that, in terms of particularly looking at guidelines, it's important to build in the sort of cost of enforcement in deciding what are appropriate rules.

And I think, to some extent, at least subconsciously, that's what we were doing in the 1980s. But again, I think that is more relevant when you're talking about creating safe harbors, as opposed to trying to come up with a precise number that divides legality from illegality.

MR. SIBLEY: Well, let me just close with a speculation here. Actually, this bright line debate is really quite interesting. One of the potential downsides of being transparent and having bright lines is that the easier it is for that process to be manipulated.

It is possible -- I don't know how likely -- that what Greg called the in terrorem policy, which is, "We're kind of random, you never know, we might just say no because we feel like it, or might say yes because it's that kind of day," or whatever, may be in a sort of kind of random but possibly horrifying regime like that, the

1 only mergers that would get through are ones that are so
2 transparently wonderful and good that they can survive
all that stuff, and there is certainly no manipulation.

Now, I haven't thought through how a
5 transparent process of the sort Rick's probably thinking
about could be manipulated in public harm, but I wouldn't
rule it out.

MR. RULE: Well, the one thing I will say is
that, you know, Greg is absolutely right, because I was
10 there for the 1984 guidelines, and those words that came

1 worthwhile because we're supposed to be doing the public
2 good. But it's not easy to convince staffs of that.
MR. SIBLEY: Okay. One more question, I guess.
MR. STARGARD: Maybe I missed the point here,
5 but if we separate the U.S. side and the EU side, Mr.
Verouden, your very last comments seem to indicate that
at the EU commission you are worried about false
negatives. That was basically your very last sentence.
"We don't want false negatives."
10 And on the U.S. American side, I hear, "Oh,
11 we're worried about false positives. We don't want to
12 over-enforce it, we want to keep things going." Is there
1 a huge divider here or am I misinterpreting?
1 (No response.)
15 MR. RULE: The one observation I will make, and
1 then Vincent should speak to it -- I think the difference
1 is, with all due respect and humility, the United States
1 has had a lot longer experience with our guidelines. I
1 mean, their guidelines, after all, won't go into effect
20 for a couple of months.
21 And I think if you look at the data that the
22 agencies have provided, given the small number of
2 transactions, for example, that are challenged even
2 within a certain range, like 1,800 to 2,000, and that
25 sort of thing suggest that, you know, to me, why they are

as low as they are. Because there is a cost to all those investigations, there is a cost to people, in terms of uncertainty.

So, moving it up suggests to me you're not going to miss very many. So the number of false positives would be small. I can say that with some degree of confidence because of what those numbers look like to me.

For the Commission, this is sort of new ground, I mean, in a lot of ways it's new ground, because it's not just a new set of guidelines, it's a new kind of theory and approach. And based on that, it's understandable that they would be somewhat cautious and worried that, "Gee, maybe we set the number wrong," both on the downside and the upside.

And so, I think what Vincent is saying is he's right. Wherever you set that line, particularly if it's a safe harbor, it means that there are going to be deals above the line that get through.

But you know, that doesn't mean that you ought to raise the line -- I think he's right -- because, to some point, when you raise the line too far, you are getting too many false negatives as compared to false positives, and that's kind of a trick of figuring out where that line is.

1 MS. MCDAVID: Well, and you have to come back
2 to the fact that this is not where the decision will
actually be made, based on these kinds of numbers and
statistics. In the end, it will be a much more rigorous
5 and granular analysis than HHIs would suggest.
MR. VEROUDEN: Yes, and in any event I would
say that our message is only that below certain levels
there are unlikely to be problems. We don't say that, by
contrast, if you're above the levels there are likely to
10 be problems.
11 So, in fact, the only kind of mistakes we have
12 to worry about are the false negatives. We don't have
1 these false positives. So that is a difference between
1 the EU and U.S. guidelines, which is simply related with
15 the choice of having a safe harbor approach versus the
1 bright line approach, which is currently still in the
1 U.S. guidelines.
1 MR. RULE: I dare say, though, you will
1 probably still make some false positives along the way.
20 (Laughter.)
21 MR. SIBLEY: All right. Well, thank you very
22 much.
2 (Applause.)
2
25

1 **MONOPSONY**

2 MR. HEYER: Okay, so we're ready to begin.
Thank you for attending what I think will be a very
interesting session.

5 One interesting thing to me about having a
separate panel on monopsony and mergers is that a number
of economists have the view that there really isn't very
much difference between monopsony and monopoly. They are
the two sides of the transaction, every transaction has a
10 buyer and a seller, and it's the same basic framework
11 that you'd use.

12 Why special attention to monopsony? Well,
1 there has been a great deal of attention to monopsony,
1 per se, particularly in the agricultural and health care.
15 Two of our panelists are particularly prominent in
1 looking at the agricultural sector.

1 And there has been discussion of whether the
1 antitrust agencies should be paying more attention than
1 they currently do to mergers that might create greater
20 power on the buying side, rather than just the selling
21 side.

22 And whether or not one thinks that a different
2 framework needs to be applied to monopsony, it does seem
2 as though there are some interesting questions that are
25 worth considering, and our panelists are going to get

into some of them. And if they don't, I will ask, or you can ask, hopefully, after their presentations.

For example, it does seem to a casual empiricist that a great deal more cases get brought and serious investigations get conducted that involve market power on the selling side relative to on the buying side.

And so, whatever one thinks about whether the same framework is appropriate or not, it does seem an interesting question that a good deal more attention by the agencies seems to have taken place, at least in terms of filed matters, in the monopolization rather than monopsonization area. So we will hear a little bit about that, hopefully.

And there are issues that have come up having to do with vertical integration, particularly in the agricultural area. Economists often think that vertical integration among suppliers of complements is a presumptively good thing. There are certain well-known efficiency properties, reducing double-margins, things of that sort, and yet there continues to be concern, perhaps rightly, over some things that have been going on in the agricultural sphere, and a couple of our panelists will talk about that, as well.

We're lucky to have three very fine panelists here. Let me briefly introduce them before turning the

floor over to them. Bob Taylor is the ALFA Eminent Scholar in Agriculture and Public Policy at the College of Agriculture at Auburn University. He previously held positions teaching at Montana State University, at Texas A&M, and at the University of Illinois.

And among his professional activities, he is on the executive board of the American Agricultural Economics Association. He has authored or co-authored five books, and has literally dozens of refereed journal articles. He is going to be talking a bit about some of the issues that have come up in the agricultural area, in particular, and I found his remarks very interesting.

Peter Carstensen, I think I first came across Peter's name when reading about the testimony he recently gave before Congress on some competition issues involved in the agricultural area. He is the Young-Bascomb professor of law at the University of Wisconsin Law School. He did his undergraduate work at the University of Wisconsin, has a law degree and a master's degree in economics from Yale.

I did not know this, but from 1968 to 1973 he was a trial attorney at the Antitrust Division of the Department of Justice -- prior to even I getting there -- and has been a member of the faculty of the University of Wisconsin Law School since 1973. His research activities

1 have focused on antitrust and competition law.

2 He has served as a consultant or expert witness in a number of antitrust proceedings, is currently the chair of a drafting committee for a proposed ABA

5 antitrust section monograph on statutory exemptions from antitrust law, and is a member of that section's newly established task force on antitrust exemptions and immunities.

Finally, Marius Schwartz, currently a professor

10 of economics at Georgetown, where he has taught since

11 1983. Marius earned his Ph.D. from UCLA, and before

12 that, was at the London School of Economics. He

1 specializes in industrial organization, competition, and

1 regulation.

15 From September 1998 to April 2000, he served at

1 the Antitrust Division of the United States Department of

1 Justice as the Economics Director of Enforcement and for

1 six months was the Acting Deputy Assistant Attorney

1 General for Economics.

20 During this period, he oversaw the DOJ's

21 economic analysis of numerous matters, including in

22 particular, the challenges to the Aetna Prudential and

2 Cargill Continental mergers that raised the sorts of

2 buyer power concerns we will be discussing today.

25 Prior to that, he was a senior economist at the

1 Council of Economic Advisors, and he has written widely
2 about issues involving, among other things, vertical
integration.
I think we have arranged to have Bob speak
5 first. And so, let me turn things over to him.
MR. TAYLOR: Monopsony has been a problem
throughout much of the history of agriculture. Sometimes
it's severe, and sometimes it isn't. I am going to start
with some very general comments about the food system.
10 It's getting to be a global food system.
11 I suspect that very few of you really have an
12 agricultural background. And these days, when you ask
1 kids where food comes from, they say, "The grocery
1 store," so I take every opportunity to talk a little more
15 about the evolving food system and some concerns I have
1 with it.
1 The last five or 10 years there has been
1 massive consolidation -- horizontally and vertical -- in
1 the global food system. It's unprecedented in the
20 history of agriculture and the history of man. Most of
21 my comments will pertain to the livestock and poultry
22 industries.
2 There are monopsony concerns with other
2 commodities, but there is a lot of blood on the floor in
25 the livestock industry, going back to the late 1800s,

1 when the meat packers -- terminology: packers slaughter
2 and process beef and pork -- the packers had written
agreements to collude. In 1920, they were broken up.
Before they were broken up, the 5-firm concentration
5 ratio was 40 percent.

In 1921, we had the Packers and Stockyard Act,
which goes further than antitrust law, and prohibits
unfair, deceptive, discriminatory preferential and anti-
competitive practices. The FTC was involved then, and
10 again in the 1940s. Since the 1982 merger standards have
11 come out, the C-4 has gone from 35 percent to 85 percent.
12 There are many faces of power. There is
1 nothing new or unique about these. One is from sheer
1 size, which HHI and CR ratios attempt to estimate. Size
can influence market prices, or in a verticallywere broken up, the 5

independent.

In recent years, the giant agricultural cooperatives turned themselves into vertical supply chains, and were not very successful. In addition, they have been co-opted by private corporations cutting deals with the agricultural cooperatives.

In the poultry industry that I will talk a little bit more about, attempts by contract growers to form associations have been quickly killed, because the organizers have been instantly put out of business by the integrators.

Asymmetric information favoring giant ag business firms over farmers and ranchers, price discrimination, preferential deals, barriers to entry -- because agriculture is vertically and horizontally concentrated, you can't look at a barrier just at one level, you've got to look at it in a vertical chain, and with preferential deals, a firm can control entry or exit.

Also, increasing control of innovation, elements of a threat system, Agency capture -- not Justice or FTC, but possibly others.

(Laughter.)

MR. TAYLOR: Agriculture associations, some of them have been captured by large agribusiness firms.

1 Possibly land grant capture. This is a way-
2 oversimplified diagram of the structure of the food
system, starting with agricultural inputs at the bottom,
then farm and ranch production, and coming all the way up
5 to the food consumer.

But between the farm and ranch gate and the
final consumer, the grocery store, there has been massive
consolidation and integration and a lot of firms have
deals with each other. So it's more of a spider web than
10 it is any clean delineation, as this diagram suggests.
11 It's just a general statement. There is
12 probably an evolving balance of power between ag
1 processing and food retailing. And I look at things more
1 in terms of a balance of power than just a number of
15 firms.
1 The growing imbalance of power between food
1 retailing and the food consumer, big imbalance of power
1 between ag processing and farm and ranch production.
1 That's where monopsony power comes in. We have also had
20 tremendous consolidation of agriculture input suppliers
21 -- seed and chemical companies -- so farmers and ranchers
22 feel that they're really squeezed from both sides with
2 monopoly power for ag inputs and with monopsony power in
2 the markets where they sell their commodities.
25 I will talk briefly about the poultry industry,

1 and then I will talk about the cattle industry. They are
2 totally different. And the manifestation of monopoly
power differs considerably from one industry to another.

All production is under contract, the industry

1 accept whatever contract terms the integrator offers, and
2 they change that when they see fit. And there are very
few opportunities for a grower to change to another
integrator because of the pay system. And the fact that
5 an integrator doesn't have to deliver chicks, means that
the growers can instantly be made bankrupt.

Economists, as I mentioned, talk about it as a
tournament pay system, but it has aspects of a feudal
system. And some describe contract poultry production,
10 or contract poultry producers, as serfs. But serfs with
11 a mortgage.

12 In the cattle market, the -- I'm talking about
1 the slaughter cattle, fed cattle -- in the last 15 years
1 they have partially integrated vertically. And in my
15 opinion, they will never fully integrate, for good
1 reason. They have partially integrated with what's
1 become known as captive supplies. Part of these are
1 owned and part contracted.

1 Throughout economics, antitrust economics,
20 industrial organization, we talked about buyers and
21 sellers, and a buyer is a distinct entity from a seller.
22 And in a sense, there is a fence between the buyers and
2 the sellers.

2 In this market, the packer can be both buyer
25 and seller at the same time, because of the contract and

1 supplies. And this makes analysis very, very difficult,
2 because they go back and forth. And it's not just one
market, you've got beef packers that have captive
supplies that they own or control.
5 They are also out there in the cash market,
generally buying but they may decide to sell some cattle.
But they are also over in the futures market as both
buyers and sellers. And there is a lot of room there for
mischief, and for big meat packers to exert power and
10 influence prices.
11 The captive supplies are running about 50
12 percent, about 5 percent through direct ownership, 5
1 percent forward contracts tied to the futures market, and
1 then marketing agreements tied to a cash market price,
15 which dominate captive supplies.
1 These captive supplies vary considerably from
1 week to week. It's also international captive supplies.
1 We're really in a world market. And if you look at CR-3
1 ratios for the major trade, the actual flow of
20 agricultural commodities throughout the world, the CR-3
21 ratios are going to be very, very high, and much higher
22 than CR-3, 4, or 5 ratios just based on domestic
2 production. We don't know much about international
2 captive supplies.
25 This has an effect on incentives. Marketing

1 agreements account for most of the captive supplies. The
2 base price on a typical marketing agreement is tied to
the cash price in which the packer is an active
participant, primarily as a buyer but every once in a
5 while as a seller.

This gives the packer a multiplier incentive to
manipulate the market and all of the three major packers
have extensive captive supplies like this. If you have
one pen of cattle that you own, and you can go out and
10 buy another pen of cattle on the cash market -- it's
11 basically a weekly market -- and you, the packer, expect
12 price to be going down that week, whose cattle are you
1 going to slaughter? You are going to slaughter what you
1 own and wait for price to go down, so you wait to enter
5 the cash market and it affects price.

1 Sweetheart deals for the chosen ones, the
1 chosen packers. Supply response, cash price goes down,
1 also allows them to control entry and exit. And it's not
1 really any one of these factors I have mentioned, but all
20 of them taken together can result in a significant and
21 more than additive effect on a cash market, and it makes
22 analysis very difficult.

2 Before I go to this, eight years ago cattlemen
2 filed suit against Iowa beef packers alleging
5 manipulation of the cash market with captive supplies.

1 think we should treat monopsony any different than we
2 treat monopoly, but the characteristics of buyer power
may differ considerably from seller power -- the
characteristics or manifestation, however you want to use
5 it -- and may differ considerably from industry to
industry, even beef compared to poultry.

The issues, the characteristics, the way in
which power can be exerted varies considerably. And I
think the growing economic power is something that needs
10 to be looked at.

11 I know this probably goes beyond the authority
12 of Justice and the Federal Trade Commission, but it's
1 clear that in the last few years, when farmers and
1 ranchers have tried to get state or federal legislation
15 to balance out power, that it has not happened, probably
1 because of the economic and political power of the giant
1 ag business.

1 I would say the five percent rule can be a
1 problem on the monopsony side because in some industries
20 like farming and ranching, the margins are really, really
21 thin. And without buyer power being exerted, they may be
22 making a small profit. But five percent would take them
2 from a small profit to a huge loss. And so that is a
2 problem.

25 CR-4 and HHI indices are not very predictive,

1 be included in these discussions, and a special privilege
2 to be in a panel with these distinguished scholars.

As was mentioned, about 30 years ago I left the Antitrust Division Evaluation section to go and become an

1 thinking and modernization.

2 Bob didn't put the dollar number on what the
jury found, but it's a $1.28 billion verdict that single
damage award. I would say the instructions the court
5 gave were Section 2 monopoly instructions, and the
questions that were asked were Section 2 questions. So
what the heck? I think conform the pleadings to the
proof -- and throw in a reasonable attorney's fee.

(Laughter.)

10 MR. CARSTENSEN: But I've always been a little
11 bit of a bomb thrower, and those are Alabama juries,
12 after all.

1 Well, I think one of the problems we had, and
1 one I want to kind of focus on a little bit is that anti-
15 trust law lacks at present a kind of robust and fully
1 developed set of economic criteria for determining likely
1 competitive harms that come from increased buyer power.

1 We do have underground observations that are
1 suggestive of the kinds of concerns that ought to be
20 considered. Moreover -- and this is important -- we have
21 commitment both from the previous administration and the
22 present one that they will look seriously at buyer power
2 issues and how to respond to those.

2 What I want to do in the next few minutes is to
25 present some of the ways that I think buyer power issues

are different from the general seller side kinds of evaluations, and therefore, to illustrate and to argue for my kind of proposition, we need metrics that measure both power and effects grounded in the economic realities of the buying side of the market, and some of the points that Bob has just made, in terms of both of the markets that he has talked about.

So, for me, the metaphor that we often hear that monopsony is a mirror image of monopoly stands in the way of critical thinking about, and thoughtful evaluation of, transactions where there should be a focus on the buying side and the public policies that ought to apply.

Now, this doesn't mean we walk away from our standard kinds of concerns with exploitation and exclusion. Those occur on both the buying and the selling side. Most of the effects that are prominent on the buying side also can be found with analogs on the selling side of the market, so it's not like a whole new vocabulary.

The analysis of buyer power requires many of the same tools and economic sensitivity to coercion, to exploitation, to efficiency that affect merger analysis. But the particulars of the effects to be measured, what are the likely effects, the more specific typology of

1 those effects, the kinds of market shares that ought to
2 trigger concerns are the one that, I think, need to be
turned to fit the buying side of the market. And that's
really where I want to turn.

5 Now, I should also acknowledge, as Assistant
Attorney General Pate did in October, when we were

occurs on the selling side of the market.

And here, this central thing is because this is collusion about the price that will be paid, rather than the price that you're going to be charging to sell your products. And I think that's a fundamental point to think about, in terms of how these markets -- these market situations -- differ when you're looking as a seller at a powerful buyer, as opposed to buyers -- in terms of the other way around.

That is, the buyer wishing to compete on the buying side of the market has to raise the price to the seller. This raises the buyer's cost of doing business, it makes its downstream products more costly.

Now, that means all buyers are going to have a shared interest in keeping the cost of their inputs down, cheating -- which, in this case, involves raising the price you pay for your input -- does not immediately increase either your sales volume or your profits. If anything, it's going to put a squeeze on your profit margin as well, because if you buy more you sell more, and now there is more pressure on the other side.

So, there are some implications from that. First of all, with respect to coordinated effects, it means that it's going to be easier to coordinate larger groups of competitors because cheating is more costly and

1 difficult, and because there is more of a shared
2 incentive to engage in this activity.
Secondly, and something that Bob was just
illustrating for you, even in the absence of tacit
5 collusion, any buyer with any oligopsonistic, or
monopsonistic power is going to have an incentive to try
to push input prices down, to try to increase the spread
between its input and its output market.
So, what that means, again, is that there are
10 all kinds of incentives. And again, we said some of
11 those are illustrated in terms of incentives to
12 manipulate. Whenever you're a volume buyer -- in beef,
1 for example, where there are some markets out there in
1 which modest quantities of goods are being transacted
15 which become the marker for all kinds of other goods --
1 I'm going to use that to set the price on your captive
1 supply, my incentives to manipulate, especially as I am
1 buying larger and larger quantities, my customers have
1 more difficulty switching, is an enormous kind of
20 problem.
21 We have an example of this in the cheese
22 industry, where Kraft manipulated the price of cheese in
2 the old Green Bay Cheese exchange, in fact, drove down
2 the price of cheese there, the biggest buyer of cheese,
25 about 30 percent effect on dairy farmers because, in

1 Wisconsin the price of milk is a function of the price of
2 cheese, so that you get that.
The second thing, again illustrated by Bob, is
an enormous capacity for price discrimination. And here
5 I am indebted to Professor Schwartz's discussions of
price -- of switching costs and the difficulty of making
changes on the supply side of the market so that it
becomes much easier to engage in a variety of
discriminatory unilateral practices, and we have seen
10 that in the livestock markets.
11 There is a second area of this problem that I
12 see as a recurring one, and that's what I think of as
1 high volume buyers. And I illustrated that a little bit
1 with cheese and other examples where you can manipulate a
15 public market price for your commodity, which is a low-
1 volume commodity markets. This is true in butter as well
1 as -- and cheese. Those are the two examples that most

Think about it this way. You are selling, you need to sell through lots of outlets. Suddenly 20 percent of your outlets are going to go away? What are you going to do about that? You're going to start doing whatever that 20 percent tells you to do over a wide range of choices.

And so, what we see is volume buyers forcing the prices down in order to get an economic advantage. They exercise their buyer power on the upstream supplier, which may then try to pass it off on to further players up the field.

The other thing we see recurrently from Interstate Circuit and through to Toys R Us is the use of that buying power to disadvantage competitors, and sometimes more efficient competitors.

So, again, we have these kinds of effects that exist. Another one that I reference here is the spheres of influence, the kind of conduct that we would think of on the buying side -- on the selling side, rather -- where you have two goods that are particularly good substitutes for each other, and then you have others that are in the broader market but are not nearly as good substitutes, that kind of cross-elasticity.

Well, on the buying side of the market in oligopolistic markets, there is a strong incentive to

1 carve up. You look at poultry, you look at beef, you see
2 where those facilities are located. Everybody tries to
get their sphere of influence. When you start looking at
the interactions there, you get a variety of
5 opportunities, again, both to discriminate and to create
your own little domain where you have significant
influence over your suppliers.

Another point -- and it's what I illustrated a
second ago with the cheese example -- why more of the
10 impacts of monopsony power get reflected up a chain to
11 some more distant point. And again, Bob's diagram of
12 farm to processor to retailer. The retailer puts the
1 screws to Tyson on poultry. Tyson doesn't sit there and
1 eat it, he passes it back to the folks that are raising
15 the chickens on their farms. Put the screws to Tyson as
1 a beef producer, that gets reflected back up the stream.

1 And so, to understand where we're going with
1 some of this stuff in terms of effects, you need to look
1 not just at the most immediate party and can they take
20 it, does this look like just creating more efficient
21 transactions at that transactional point, but how do
22 these things play out up the line, if you're going to
2 have a full analysis of these effects.

2 My final point in terms of the overview
25 situations is -- concerns both allocative and productive

1 efficiency on the buying side. I am -- and I hear this

2 all the time -- there are all these negatives, "Oh, we

transfer is one of fairness. I look at it in terms of

looking at more direct kinds of buying situations where you're actually dealing with the basic inputs themselves. Fairly narrow markets because, again, with this discrimination potential, switching is hard. Switching is difficult, unless you really have lots of other options close at hand.

And here, again, I come back to thinking market definition needs to focus a lot on the kind of unilateral effect market analysis when we look at substitutability or switchability between particular outlets, in terms of the analysis of specific transactions.

I am going to suggest that we need lower thresholds for when we start taking critical looks at mergers where there is a significant buying side factor, because of the reasons I set forth earlier. That is, the incentives are high, the barriers, the obstacles to achieving that are relatively weak, and that, therefore, we need to be very concerned about combinations that reduce us to less than five or six major firms in a market.

We need to take a critical look at that point. And then I think that means an HHI of around 1,600, a concentration change of 150 points or so.

Competitive effects analysis, again, remember the location of competitive effects can be remote.

Unilateral effects, a merger creating buying power creates incentives to manipulate the markets, incentive to engage in discrimination. Creates capacity of buyers to manipulate public markets.

Coordinated effects I have already touched on repeatedly. That is, there are strong incentives to collude, directly less incentive to betray that conspiracy. The buyer may find it attractive to create geographic -- or buyers find it attractive to create geographic spheres of influence which indirectly affects competition.

Fourth, it seems to me the defenses of efficiencies are very limited in most of these cases. Entry barriers -- and again, I am indebted to Bob for this -- is very high in most of these markets, very difficult to enter, and that therefore we need to be very, very concerned about even modest increases in concentration.

I think antitrust law has long recognized that buyer power creates competitive concerns, just as seller power does. However, for too long, a primary focus, especially in mergers, has been on the selling side. It's time to redress that balance, and this session is a step in that direction.

Enforcers, however, need to develop a deeper

understanding of the unique characteristics of the buying side of the market. This calls, in my mind, for appropriate metrics. A mindless transposition of seller-side criteria for market shares or competitive effects will only result in an inadequate analysis of buyer power implications of mergers.

Mergers that create serious competitive risks in one or more buying markets will be ignored because of the failure to employ appropriate market definitions and competitive effects analysis. It is my hope that the FTC and the Antitrust Division will make more sustained efforts to understand the different aspects of buyer markets and buyer market power. Only with that kind of effort can merger enforcement continue to fulfill its assigned responsibility.

(Applause.)

MR. HEYER: Our final presenter is Marius, and I am sure there won't be any mindless extrapolation.

MR. SCHWARTZ: Thank you for your patience. I know that listening at 4:30 in the afternoon is not the most tantalizing prospect, unless I am mistaken, but I doubt it, so thank you for your interest.

One of the questions posed to this panel in the press release was how, if at all, should the agencies assess the creation of buying side market power

differently than selling power, and that's the question I am going to address.

And by "assess," I mean two things. Should we analyze it differently? For example, should we use different information or different concentration thresholds for deciding that there may be a price increase or a price decrease -- say a "price change" -- to be neutral?

And secondly, should we employ different criteria when deciding whether to bring a challenge? For example, is a price change as a result of the merger enough to bring a challenge, or do you also need to show that there will be a significant reduction of quantity -- the latter being the metric that is more associated with efficiency.

Now, during my time at the Antitrust Division and outside, I have heard arguments on both sides of this, that on the one hand, we should be less stringent when challenging buyer market power, and on the other hand, as Professor Carstensen would say, that we should be more stringent.

So, my position is going for half a loaf to each side, which means a full loaf to no one, and that's because my position is that I don't know of anything in the economics literature that would justify adopting a

differential treatment of buyer versus seller, per se.

The reasons that I have heard advanced for adopting a differential treatment, on closer reflection, are either present also in the case of seller power, or reflect some other characteristics of the marketplace, not the buyer/seller distinction, per se.

So, let me try to divide these points a little bit, first by taking up arguments that we should have less stringent treatment of buyer power, then turn to arguments that say we should have more stringent treatment. Again, by "buyer power" I mean buyer power as compared to seller power.

One question that I have run up against is whether to justify a challenge of a merger, say, must there be harm to consumers? And that sometimes gets in the way of bringing a challenge to a monopsony merger, because you are saying consumers, the end users, may not suffer. And I will come back to this in a second.

But the threshold issue is when people say antitrust "protects consumers, not competitors," what they really mean is not consumers, literally. What they -- the way I take that to mean -- is trading partners. So the thrust of the statement is that just because a merger is going to hurt competitors of the merging firms, that's not enough reason to bring a challenge. A merger

1 that's efficient will also harm competitors.

2 So what you're worried about are trading

partners. Trading partners could be the buyers or

sellers. And to bring that point home, suppose,

5 hypothetically, that you have a group of consumers large

enough -- a large enough percent of consumers -- getting

together depressing the price and reducing the amount of

output that they buy from farmers.

Well the result is that economic efficiency

10 decreases, and that's because of the reduction in

11 quantity. So that says that gains to the consumers from

12 the lower price are less than the harm that is imposed on

1 the farmers. Should we let that slide, just because it's

1 the consumers that are gaining at the expense of the

15 farmers? I see no reason why, and nothing in economic

1 theory or economic analysis will give you any reasons for

1 why.

1 So, I think we should be symmetric in our

1 treatment of consumers versus producers, firstly. Second

20 point to make is that most monopsony concerns arise when

21 you have a merger of intermediaries. Not a combination

22 of final consumers, as in my previous example, but a

2 merger of intermediaries.

2 Well, in that case, those intermediaries are

25 acting as buyers for one side of the market and sellers

1 to the other side. In that case, a merger that allows
2 the merged firm to depress price to suppliers, is not
likely to benefit consumers, and in fact, is likely to
harm them.

5 It's conceivable that there may be no effect on
consumers, that the effects will be confined to harming
the farmers. That could arise, for example, if the
merging firms are perfectly competitive on the output
side but enjoy monopsony power on the input side.

10 That was the case that we encountered in the
11 Cargill Continental merger. Cargill and Continental were
12 grain merchants. Grain prices to final users were
1 determined in the world market, so the Department did not
1 allege that the merger would increase these grain prices
1 worldwide. What they did allege is that the merger would
1 allow the merged firms to reduce prices to farmers in
1 selected localities because, on the input side, the
1 markets were more localized.

1 So that's a case where farmers would have lost,
20 consumers would remain unaffected, and yet a challenge
21 would be justified, and in this case, was brought.

22 Outside of this special case, where there is
2 perfect competition on the selling side, you might, in
2 fact, expect -- in fact, you would expect -- that a
2 merger that increases monopsony power will also harm

consumers. And the basic reason is if the merged firm is to bring about a lower price for the input only because it's buying less of it, that's going to translate into less output, which can't benefit, and more likely will harm consumers. Okay.

So, the quick answer to that one -- that took a rather long time to make that perhaps obvious point, but it comes up a fair bit -- is you shouldn't just care about harm to consumers. Trading partners, okay?

Next question is, well, is countervailing power an acceptable defense? So suppose that you have a merger that has actually reduced prices to suppliers. Is it an acceptable defense to argue that the merger, while reducing price, will reduce it towards the competitive level as opposed to below the competitive level? The theory being that there is some pre-existing market power on the seller's side which is keeping the price initially too high, and the merger is correcting that distortion.

Well, there are arguments to be made on both sides of this, whether you should accept countervailing power as a defense, and maybe we can talk about it later. But my second point here is whatever position you take on that, on whether you accept countervailing power as a defense, that issue arises equally in the case of buyer mergers as in the case of seller mergers. There is

nothing unique about buyer-side mergers to raise that as a possible defense.

Next question. Putting aside the countervailing power issue, suppose that initially we have perfectly competitive sellers. The merger, by increasing monopsony power, will depress the price below the competitive level. But it's not predicted to have much of an effect on quantity. And that can come about for at least two reasons. One, the elasticity of supply facing the merged firms may be very low -- at least over the relevant price change -- so you're not going to get much of a quantity reduction.

The second means by which it comes about is one that Professor Taylor emphasized, and that is if the nature of the contracting process is richer than simply prices, but encompasses both the price and the quantity, a two-part tariff, or any other such scheme, then what the merger may well do is depress the total revenue that's being paid to the other side without affecting the quantity.

So we now have no quantity effect, but a significant revenue reduction. Should we oppose such a merger? That question is sometimes framed as, “Are wealth transfers enough to justify an Antitrust challenge?” Well, again, there are two possible answers

1 to that.
2 One is you may care about efficiency, per se,
or about distribution, per se. The second one was the
reaction that Professor Carstensen gave, which is in the
5 long run, reducing the wealth to one side of the market
may well reduce the resources that go into that sector.
So, even if in the foreseeable future you have no
quantity effects, in the long run you probably will.
Whatever the answer to that, again rather
10 tedious point by now is that the question of whether you
11 require a quantity change in order to bring a challenge
12 could be posed equally well in the case of a seller-side
1 merger as in the case of a buyer-side merger.
1 So, this is part one, and I won't abuse my
15 time. There is no reason to be any less stringent on
1 buying-side mergers than on selling-side mergers. And by
1 buying-side mergers, I mean mergers where the alleged
1 concern is on the buying side of the merging firms.
1 Now let's turn to the second point, which is
20 should the treatment be more stringent in the case of
21 buyer-power mergers? First point I want to make here,
22 which is one that maybe I should have begun with, but I
2 didn't because it may be a little more abstract and I
2 didn't want to turn people off, is that the designation
25 of which party is the buyer and which party is the

seller, at least from an economic standpoint, is often arbitrary.

Think of any transaction. Who is the buyer, who is the seller? When they're giving things to each other, it's an exchange. So you might say, "Well, okay, fine. The buyer is the one that is giving the cash, or generalized purchasing power, in exchange for a specific commodity."

All right. How about the case of a financial intermediary, like a bank or a savings and loan? It's taking deposits, which means it's taking cash now in exchange for cash tomorrow, and on the lending side its giving up cash now in exchange for cash tomorrow. When is it the buyer and when is it the seller? Well, it's arbitrary.

However, you can easily see that the merger between two financial intermediaries could cause harm on either side of a transaction. So it's unlikely that the competitive analysis or the thresholds or the decision-making criteria should depend on whether you're calling it a buyer or a seller-side transaction.

Now, finally, even in the case where you think that it's obviously the buyer, because he is paying cash, and the other side is giving an object in return, again, a simple reformulation of the transaction can change the

identities of the parties.

So, for example, if a manufacturer is selling this product to a distributor, he is the seller. If that same manufacturer changes the contract a little bit where he retains title to the goods and just lets the distributor keep a percentage of the sales price, you can now think of it as buying distribution services from the distributor.

One would think that a merger between distributors that would increase the distributors' market power is going to have pretty much the same effects on the manufacturer in the first scenario as in the second, okay?

So, the point of these examples is to really stress that it's unlikely that the labels "buyers" or "sellers" can possibly form a basis for different treatment. Now, let me just address two or three of the specific examples that have been brought up.

One is that the anticompetitive harm from a merger in the case of a buyer-side merger may only be felt several layers away. And I agree with that. An example was given, I believe in your testimony, was that if you have a merger of grocery stores in a concentrated market they may pass the price to manufacturers, who in turn pass the price increase all the way up the chain.

1 Well, that's true, and that -- it does flag an
2 important point, which is antitrust enforcers should not
construe the lack of complaints by trading partners at
the next level as evidence that there is no problem. I
5 agree with that, because the effects may be passed
through.

But exactly that same problem can arise when
you're dealing with a seller's merger and that's simply
going to pass most of the price increase to one level
10 over. So, again, there is nothing to distinguish this
11 issue as being a buyer-side-specific issue.

12 Next point, again, one I agree with. Certain
1 buyer-power abuse is not reached by antitrust. So
1 unfairly low prices to farmers, or paying lower prices to
15 farmers that are selling on a market as opposed to so-
1 called captive farmers that were under long-term
1 contracts, you know, some people might think that's
1 unreasonable. I take no position of that because I don't
1 know these industries.

20 But the simple point is there are practices by
21 sellers that are also out of the reach of the antitrust
22 laws. Charging a monopoly price by a seller, if the
2 monopoly was legitimately acquired and maintained is,
2 again, not unlawful. You may not like it, but it's not a
25 violation of the antitrust laws.

1 Finally, and maybe the most interesting one,
2 the claim that lower market shares can suffice for buyer-
power cases than in seller's cases. And there are two
possible points. And it has been noted that low market
5 shares at the national level are consistent with the
existence of buyer power.

1 putting in too high a bid for the services they were
2 selling.

So, the fact that we have anticompetitive
behavior in auctions possibly more frequently than in
5 other forms of exchange, may say something about the
auction process, but it doesn't say anything about buyer
versus seller cases, per se.

Fine. Not to belabor this, but when scholars
such as Professors Carstensen and Taylor and others argue
10 that we need a more stringent treatment of buyer cases, I
11 think that most often -- I would bet -- that it's driven
12 by familiarity with a particular industry or a particular
1 case where there are other things going on that may well
1 say there is a problem at lower concentration levels, or
15 there is a problem even where you might not normally have
1 thought there would be a problem.

1 have very much more time. And so, consistent with anti-
2 trust focus being primarily on the consumer, I wanted to
begin by asking if anyone in the audience who has
bothered to stay around this long and listen to the
5 remarks had any questions before I ask the panelists if
they want to direct any questions to one another. I see
a hand. That would be you, Sheldon.

Mku-2 TDTj/TT2T2 9be you, Sheldon.

1 was more sharing and the integrator and the contract
2 producers were pretty much on equal footing, from a power
standpoint.

1 perhaps, would be a way of gauging whether the
2 arrangements in the marketplace are efficiency-enhancing
versus anticompetitive.
Now, there may be wealth effects on the two
5 sides of the transaction, but I'm wondering -- Sheldon
seems to be getting largely at the issue of whether
looking at the output of the market is a good test for
whether it's performing well.
MR. SCHWARTZ: Well, in general, if you could
10 properly measure output, that's certainly the place you
11 would want to start. There is the comment that I believe
12 Professor Newmark made earlier, that there is quality-
1 adjusted output, and so on. But certainly as a first
1 approximation, if output, properly defined, increases
15 then something good is happening.
1 MR. CARSTENSEN: But you would also want to
1 consider your time period. That is, you have got a 30-
1 year chicken coop. There is often cost there, and you
1 stay in that business a long time, and you might actually
20 be under enormous pressure to increase your output if
21 you're paid on a per-chicken basis, even if it's chicken
22 feed, because of the structure of the situation.
2 So, I would sure want to make sure I got the
2 right measure of quality, and there are some real
25 interesting questions about the quality of a lot of the

livestock and chickens that are coming to the market today. And I want to look at that -- maybe 40, 50, 60 years even -- well, that's pushing it too far.

(Laughter.)

MR. CARSTENSEN: But 20 to 30 years we should get those kinds of big investments, but you just can't switch it. I mean, that's all those chicken coops --

MR. KIMMEL: Just a brief follow-up. If you look at the most recent Census of Agriculture, you will see a page on historical statistics, and it will show you that production has tripled from the 1960 census to the most recent census, and that increase had not been slowing down. That's all the data we have.

MR. TAYLOR: Per capita consumption is just about flat recently, but let me give my overall subjective impression, and a lot of this is backed up with fact.

When the industry first integrated in the 1950s, there were tremendous gains in efficiency. They brought a better bird to the market, much more uniform quality, and so forth. The inflation-adjusted price has gone down, but recently that's because feed is cheaper, not because of efficiency gains.

The poultry system is highly efficient, in my opinion, and the issue is not efficiency -- and

theoretically, I can show that when the integrator is putting producers into an all or nothing decision setting.

There is no social welfare loss triangle, though. It is highly efficient, but the integrator is increasingly appropriating returns. And the producer is no longer involved in innovation anyway, and I think it's almost flip-flopped to where now the managers they have out there every week -- and in some cases every day -- know less about raising chickens but they are getting orders from up above.

So, I think a highly efficient system is evolving to where it's less and less efficient. But it's hard to see that from any industry statistics.

MR. HEYER: There was another -- I'm sorry?

MR. SAWYER: It seems to me that there are more enforcement actions taken in mergers to sellers than buyers. And I'm wondering if the panel can share their views on why that might be. Is it because there are different standards or there is less buyer concentration in the economy than selling concentration? I'm wondering what you --

MR. HEYER: Marius, you want to go first? You thought the treatment should be similar.

MR. SCHWARTZ: I knew I shouldn't have said

that. That's a good question. First of all, I don't know what the statistics are. It would be nice to know. And assuming the facts are right -- and economists can assume things -- assuming the facts are right, I guess one -- the natural conjecture would be the concentration may be typically higher on the selling side than on the buying side.

Exactly why that would be I'm not sure. A simple example that would make the point would be at least in the interface between final consumers and whoever they're buying from, you would expect that the market power would really be on the sell side.

So, one factual question would be, suppose you stripped out cases that involve final goods industries. Are the enforcement patterns still as skewed as they appear to be today -- as they would appear to be in the overall sample?

If that's true, I guess the next question would be to take a little closer look at concentration levels on both sides. One exercise that I think would be worth doing would be to put the burden on folks that think that we're being -- "we," the Agency; I still think of myself as an alumnus -- that we're being too soft on buyer power would be to come up with some cases where we fail to bring a buyer power case and point us to cases where we

1 brought a seller-side case under similar circumstances.

Same concentration, same this, same that. You

1 recognize issues and to examine issues -- and I point to
2 the recent FTC decision Wal-Mart's acquisition down in
Puerto Rico, where buyer power issues were raised, they
got, in effect, the institutional back of the hand, "Oh,
5 we don't care about it, we have thought about it as much
as we think needs to be thought about it, and there is no

1 protect sellers -- is there a sound economic reason to
2 not allow the agriculture market operate on a free-market
basis as we see in other segments of the economy?
MR. TAYLOR: That's a tough question. I can't
5 give a simple or a short answer, but I will just take a
couple of minutes to say that in some ways food is
different. There are food security issues, rather than
just opening the market up completely.
A fundamental problem, a fundamental economic
10 trade-off, problematic trade-off, is that we want to make
11 sure we have enough food around. That means high stocks.
12 Any time you have high stocks that means low price. So
1 there is that trade-off.
1 Another complicating factor is we now have a
15 farm bill that can best be described as a mess. It is a
1 farm bill written by and for giant ag business to
1 maximize volume with a lot of money, taxpayer money,
1 thrown at farmers. But because of the big volume,
1 consumers pay less for food, so they pay more in taxes
20 and less for food. There are many, many complications
21 there.
22 There is also the issue of preserving some ag
2 land for the future. And if we just let all of the ag
2 land go to strip malls, it's not irreversible, but there
25 is a high cost of bringing that back into agricultural

1 production if we should need it in the future. So there
2 are a lot of problems.

efficient market, and we're thinking -- a lot of those government subsidies and other distortions that are out there that we tend to ignore.

MR. HEYER: Okay. Thank all of you for staying as long as you have. I want to thank our panelists and also announce that tomorrow morning, bright and early at 9:00, day two begins in the workshop: Non-price Competition and Innovation. And I will see you all back here then. Thank you.

(Applause.)

(Whereupon, at 5:10 p.m., the conference was adjourned to be continued at 9:00 a.m. on Wednesday, February 18, 2004.)

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