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DEPARTMENT OF JUSTICE
FEDERAL TRADE COMMISSION

MERGER WORKSHOP

WEDNESDAY, FEBRUARY 18, 2004
9:00 a.m.

FTC Conference Center
601 New Jersey Avenue, N.W.
Washington, D.C.

Reported by : Rika M. Hemphill, C.V.R.

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P R O C E E D I N G S

2

WELCOME

3

MS. CALLISON: Thi i ~~the~~ econd da of ~~the~~

1 m fir ~~Kh~~ ~~gh~~ a ~~ko~~ eek in ~~fr~~ ~~om~~ ~~he~~ in e ~~kor~~
 2 ~~comm~~ ~~ni~~ ~~ch~~ didn't eem ~~ko~~ be repre ~~ent~~ed.

3 So I a ked m friend Tom, ho af ~~ter~~ all ha
 4 abo ~~ut~~ 1,000 pa ~~ken~~ , he ~~th~~er he co ~~ld~~ addre ~~ss~~ ~~the~~
 5 rela ~~ti~~on hip be ~~tw~~een compe ~~ti~~tion and inno ~~va~~tion ~~wh~~i
 6 morning. Well, Tom co ~~ldn~~ join , b ~~ut~~ he reminded me
 7 ~~th~~at he had addre ~~ss~~ed ~~wh~~i er ma ~~ke~~ back in 1889, hen
 8 omeone propo ~~sed~~ ~~th~~at hi firm, Edi on General Elec ~~tric~~
 9 and it's compe ~~ti~~tor, We ~~st~~ingho ~~se~~ Elec ~~tric~~ call a ~~cr~~uce in
 10 ~~the~~ir ar ~~re~~ ell elec ~~tric~~ ~~em~~ ~~co~~ ~~ci~~tie and ~~co~~n
 11 aro ~~und~~ ~~the~~ co ~~nr~~ .

12 Tom e plained ~~th~~at he ref ~~us~~ed ~~to~~ go along ~~in~~ ~~th~~
 13 ~~the~~ propo ~~sal~~ beca ~~use~~ , and I no ~~g~~o ~~ok~~e from a con ~~te~~mporar
 14 ~~let~~ter from Edi on: "If e make ~~the~~ coal ~~iti~~on, m
 15 ~~er~~ef lne a an in ~~en~~cor i gone. M ~~er~~ice ~~o~~ldn't
 16 be or ~~th~~ a penn . I can onl ~~y~~ in ~~en~~ ~~der~~ ~~th~~o ~~gh~~ of
 17 incen ~~ti~~ve. No compe ~~ti~~tion mean no inno ~~va~~tion."

18 B ~~ut~~ m real diffic ~~lt~~ ~~in~~ ~~th~~ ~~wh~~i ~~ca~~se ~~me~~nt,
 19 ~~th~~o ~~gh~~ I -- af ~~ter~~ I read it I no ~~t~~iced ~~th~~at it's a ri ~~sk~~
 20 on April Fool ~~Da~~ in 1889, o I don't kno ~~w~~ ho ~~m~~ch
 21 eigh ~~t~~ ~~ko~~ p ~~ro~~ on it, b ~~ut~~ ~~th~~at a ~~ca~~se ~~me~~nt from an
 22 impo ~~rt~~ant in ~~en~~cor.

23 Oka . With ~~th~~at, co ~~ld~~ I a k ~~SK~~e e ~~ko~~ ge ~~t~~
 24 ~~th~~at?

25 MR. SUNSHINE: Thank ~~o~~ . I m happ ~~y~~ ~~to~~ be here

1 This morning. I am not prepared to be the lead-off
 2 speaker. The lead-off speaker is the director of
 3 Professional Development. He is a former FBI agent and,
 4 therefore, could not be in. I seemed like a rather
 5 creative approach of doing this talk, but I did last
 6 night consider that.

7 I struggled for how to make this talk, and
 8 like everything else, the inspiration came to me because
 9 of something my 12-year-old son did. I am likening to
 10 this song by Sam Hoggins called "All Star," which I have
 11 never all heard. Don't worry. I am not going to sing
 12 it for you.

13 There is a line in there that says, "I am not
 14 Tj5.7108 -2 TD (Kobe Bryant and) no opinion can be a result

1 Innovation is an important dimensional reality
2 and indication of progress. I don't think there is a
3 lack of discipline for this point. I think the discipline that
4 has been done over time has aided innovation that
5 has been responsible for the vast majority of economic
6 progress that has been made over the last century.

7 Then, when we look at all applicable merger
8 analysis, can we actually predict the effect of a merger
9 on innovation? We will talk more about this later. I
10 think it is fair to say that the effects are uncertain.
11 Of course, it is probably also fair to say that the
12 effect of market structure on good and on the
13 relationship between market performance on good is not
14 a clear answer. I would like it to be a hell.

15 That leads me to this, I think, here we get
16 a little bit more into medicine, and other clearly have
17 different issues, the legal and economic issues. There
18 are legal issues here, too. We have been focusing mainly
19 on the economic, but there are legal issues here, too,
20 that legal and economic issues require a holding -- I
21 called it "probable effect on competition." When I say
22 "competition" here, I don't mean innovation competition. I mean
23 competition in the good market.

24 The General example, we will get to it, we all
25 have our issues on it, but perhaps General medicine is an example

1 here the chairman and the rest of the Commission
 2 basically followed the first three bullet points, though
 3 in the report there could be an effect on innovation, but
 4 found a lack of facts here the merger could not have a
 5 demonstrable effect on jobs, and hence, no case. If
 6 that had been the case, come in. Of course, the fact,
 7 we have to talk about.

8 Last, in terms of what does this mean
 9 practically? My general point on this is going to be
 10 that the practical application of innovation markets is
 11 infrequent. We are not going to see a lot of innovation
 12 market cases. They are more likely in certain
 13 industries, pharmaceutical being the obvious example,
 14 and that for reasons that I think some of my co-panelists
 15 will go into.

16 One of the main big problems with innovation
 17 markets is that they are really hard to define. How do
 18 you know an innovation market? We'd like to see a
 19 standard more than just a pointer, you know, I'll know
 20 when I see it.

21 We have to account for bringing to identify all
 22 the conceivable forces of innovation. We have to
 23 account for how do we know what the strength and
 24 significance of the population of innovation are.

25 Also, the type of innovation that's going on in

1 The market may be relevant to our confidence in market
2 boundaries. What do I mean?

3 Well, are there regulatory barriers that are
4 going to make innovation much more crowded? I
5 innovation tied to certain aspects of production,
6 here we know that people who produce aspects
7 really are not effective innovation?

8 For that, I would refer to the Department of
9 Justice complaint in the General Motors /ZF
10 Friedrichshafen case. That case of innovation aspects
11 to an extent of production aspects, and no one could
12 innovate new truck and transmission line that had
13 those aspects of process.

14 Then another aspect of innovation is
15 patents, but patents are really tricky. When you get to
16 patents, patents may mean there are a number of
17 aspects. It may also mean that market has been divided
18 up so that the merger are complementary. You have to be
19 really careful.

20 I don't go through the article that Professor
21 Gilbert and I wrote, but we identify certain aspects of
22 factors that you need to find in order to have some
23 confidence that you have an innovation market. If you
24 don't have that kind of confidence, then frankly you
25 should go home at that point. If you can define the

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1 i right ome time . Ma be Arro i right ome time , b
 2 e are no in the Arro camp in the e fact .

3 I checked on incremental er, re ol Kionar .
 4 Thi i an idea of ho big the inno aKion i . In ome
 5 a , incremental inno aKion ma be the one that are a
 6 little bit ea ier to nder and ho to proceK. It ma
 7 be ea ier to define here the orce of that inno aKion
 8 are going to come from. The e re ol Kionar inno aKion ,
 9 where much more profiK ak take, o where more
 10 incenKie to p r, e them, and ome time the are harder
 11 to Kell here the are going to come from, hat the
 12 orce of that inno aKion i going to be.

13 In the incenKie , I don K think o could
 14 nder and the incenKie to inno aKie nKil o
 15 nder and the nature of competiKion between the
 16 inno aKion . That going to require looking back at the
 17 do n cream le el.

18 Are o pharmace Kical companie going to be
 19 man fact ring e acKl the ame chemical compo nd that,
 20 o kno , once the get to the market, the are going to
 21 be in competiKion inK one anoKher, and there no orphan
 22 dr g kat . Yo kno , once the get to the market, the
 23 ill be in competiKion inK one anoKher.

That ma me7, that 1- 2. n1081re iT1 D(22)Tj anokpeKbTj1

1 different. The are going to be attacking different
 2 markets and there will be a high expected return, maybe
 3 there will be an incentive for both products to be
 4 developed. I don't know. Maybe the second innovation is
 5 going to open up some new applications and increase
 6 demand. There will still be a strong incentive to
 7 invest.

8 Confidence that the reduction in innovation
 9 will lead to an output effect. That goes to all the
 10 previous comments, too, but here, I think you have to
 11 take into account the cream competition. What if there
 12 are no cream products that are competing against your
 13 premium products, and those are going to continue to
 14 perform innovation.

15 I think that's all that is being said.

1 ie .

2 I think the anal i hold be here the deal,
3 here has life old be like ab en the deal, and i
4 the orld a better place or not, b k ko kr ko social
5 engineer efficiencie eem ko me ko be a mi g ided
6 approach.

7 What I e done b p kking efficiencie a park
8 of the competi e effect , I ha en k hiked the b rden
9 of the efficiencie ko the defendan k . I think ik i
10 will park of ho ing -- ko ho an o kp k effect.
11 E en k all , khi reall belong in the camp of the
12 plainkiff, beca e o can k ho the effect nle the
13 efficiencie don o k eigh the o kher benefik .

14 Enogh abo k economic . What abo k the la ?
15 I m r nning behind.

16 There ha e been a lok of con en k decree .
17 There ha been a complaink kha k the Departmen k of J kice
18 filed kha k did not go ko krial. There ha e been ome
19 o kher ca e here inno akion i or k of kalked abo k b k
20 not a kr e inno akion marke k.

21 Doe Section 7 reall allo ko ha e an
22 inno akion marke k? The fe ca e kha k e i k on khi , I
23 think, a kha k ikho k ack al ale and a line of
24 commerce, kha k perhap o don k ha e a marke k, hich if
25 kha k a kr e, kha k o ld doom Section 7 anal i .

1 That matter, and that Gilbert and I were in
 2 our article is that it would be misplaced for Section 7
 3 to not recognize an innovation market theory. The reason
 4 that I am saying, would come from, I think, a previous
 5 case proposition that a merger analysis would be
 6 designed to identify whether a merger would lead to reduction
 7 in welfare, to lower output.

8 The analysis that I intend through, if I
 9 can go through that analysis and come to the conclusion
 10 that output is reduced, I have identified that as the
 11 basic condition. Then the question on an innovation
 12 market, I think, is the innovation market essentially
 13 identifies the place of competition interaction here the
 14 problem arises, and when the output market does all
 15 define here the effect itself, and I define the line
 16 of commerce and the reduction of the consumer that the law
 17 is trying to protect.

18 In that case, I would draw a loose analog, and
 19 it is not a perfect analog, to a vertical merger. In the
 20 actual output market, there is no direct effect. You
 21 could look at input, you could look at innovation as an
 22 input or an upstream product in a vertical merger, but I
 23 would advise you look at the Medicorp. Human capital
 24 and some of the other capabilities cited in the brief that we
 25 wrote, there are some costs that have gone on other side,

1 because they are thinking cookie cutter, define a market,
 2 measure the market here, prima facie case, blah, blah,
 3 blah. That's one aspect of doing it.

4 The second point, can plaintiff prove a
 5 non-pecuniary effect in a reasonable amount of time? I
 6 think that proposition stands for itself. This would be
 7 a defense that I would ask if I am defending against an
 8 individual market case. This just goes back to the
 9 importance of being able to access all the documents,
 10 the market evidence, and everything else to show that
 11 this is a real problem.

12 I know I'm running short and I ask to leave
 13 time for some consideration. I don't spend much time on
 14 this.

15 Ron Davis, how are you going to lead off, are you going
 16 to a burden, here the beef? I am going to a,
 17 what all the fuss? The burden of proof is all on the
 18 plaintiff. We all know that. We know that PNB and Baker
 19 Highgate are upon the establishment of a prima facie
 20 case, that the burden of production shifts over to the
 21 defendant, but the burden of persuasion always remain
 22 with the plaintiff.

23 I think in the Genzyme case, while it is a just
 24 an intervention, it is an act of case, I have to imagine
 25 that the defendant satisfied a burden of coming forward

1 the evidence.

2 I seem to me that an proper application of
3 this kind of analysis would lead to the burden going back
4 to the plaintiff to persuade the jury all right.

5 If Commissioner Thompson dissenting opinion
6 means something else, in a pre-motion, when he means
7 something else, which I think is not in keeping with the
8 case law, perhaps enforcement of market, but certainly
9 not for innovation market for the reason that we have
10 talked about.

11 Problem of the internet. The first point,
12 I think, is obvious to everybody sitting in this room.
13 The internet has a duty to take the transaction
14 before it. In the transaction before us, if we see
15 serious competition in innovation, what are we going to
16 do? You have a duty to look at it. You don't ask to
17 just let the transaction go if you think there is going
18 to be a problem. You have to dig in.

19 The law in the wake of the economic, where
20 is no gap here, is there? We have just been
21 through it. I think the burden of proof, while there
22 could be some adjustment, depending on how involved,
23 the burden of proof is clearly going to be on the
24 plaintiff, and the plaintiff and the internet will
25 have to handle a number of difficult issues. Innovation

1 pace which will occur, the merger likely effect on
 2 innovation, the manner in which output will be reduced,
 3 and again, output in a good market, and hence
 4 the effect will be felt. Not exactly, right?

5 We are talking about doing this in at least two
 6 different markets, two different paces.

7 Again, a work of the literature of the
 8 importance of empirical evidence from
 9 the merging parties in the market cannot be overemphasized.
 10 Without the evidence, the economic isn't going to get
 11 all the way there. You are going to need the
 12 evidence.

13 I don't go through this in any kind of detail.
 14 I just thought through the question on how I might think
 15 about doing an innovation analysis.

16 Innovation an important dimension of
 17 rivalry? The answer is no, forget it. What about? Look
 18 for price effects. Go talk with your colleague for a
 19 beer.

20 Second question, will innovation effects
 21 be increasing product market in a reasonable amount of time?
 22 The answer is that is, let's not worry about
 23 innovation markets. I would like a good market to me.
 24 Let's do a competitive effect on the good market. A
 25 Gil will remember, this is the Microsoft/Intel case.

1 We would like bringing a case in an innovation market.
 2 We would like have a real market here, how are we bootstrapping?
 3 Innovation is an important dimension of competition. If
 4 one of the players is in the market, when we have a
 5 potential competition case.

6 I had thought back for a second and a , I think
 7 a potential competition case is easier than an innovation
 8 market case? Well, there is.

9 Can the boundaries of the innovation market be
 10 determined? We went through that. It's not child
 11 play. Does the merger provide incentives to innovate?
 12 Again, I put the efficiency in the obligation of
 13 the plaintiff. Again, if the plaintiff job is
 14 how there is an effect, when the plaintiff holds also
 15 be comfortable holding the efficiency doesn't weigh
 16 the other effect.

17 And when looking at the harm to the open market,
 18 it's not like a piece, not only do we have an economic
 19 problem, but we clearly have a legal problem as well.

20 With that, I know it's all painstakingly clear.
 21 Thank you very much.

MR. FRANKENA: Thank you. Ann?

1 These mean all of these are certainly a are these e
 2 have been having a debate in the antitrust world for well
 3 over a decade about what the antitrust agencies should do
 4 about the concept of innovation market, and essentially,
 5 should there be an enforcement action in this area?

6 As you know, there are those who believe that
 7 because the empirical economic data has not been
 8 conclusive in showing a correlation between increased
 9 concentration and reduced innovation, that really the
 10 antitrust agencies should just throw up their hands and
 11 walk away and not think about bringing enforcement
 12 action in this area.

13 There are others, and I come myself in this
 14 group, who believe that preferring competition at the
 15 research and development stage is really important, but
 16 recognize, as Steve has pointed out, that there are some
 17 real problems and a lot of difficulties in really
 18 achieving how innovation markets should be defined and
 19 what the antitrust agencies role really should be there.

20 First, let me just give you one reason why I
 21 think that it is vital for the agencies to prefer e
 22 competition and be vigilant in protecting competition at
 23 the R&D stage.

24 First of all, because in the long run, a merger
 25 that reduces the pace of innovation can be far more

1 harmful to consumers than a merger results in a
2 price increase of global decrease.

3 Second, because in the real world, here
4 companies compete everyday, it is clear that
5 competition is the primary incentive that pro-
6 duces level of innovation.

7 In preparing for this workshop, I re-read the
8 Commission that the FTC received during the 1995 hearing
9 on global competition. What struck me is that although
10 the economic could only agree that it is a really
11 inconclusive and the evidence here has the evidence
12 showed, the business official testified during the
13 hearing here, and I'm quoting the word of the staff
14 report, "Unanimous and emphatic in their view that
15 competition is the primary incentive for innovation."
16

17 I spent over a decade at the FTC as an
18 assistant director in the merger division. I have seen
19 hundreds of documents, and talked to dozens of business
20 officials, who told me that the supposed that
21 conclusion.

22 When you look at the reality of the business
23 companies make their decision, I think it is clear that
24 typically business is in a more resource, work harder
25 and work more quickly in their research and development
effort when they are faced with the possibility that

1 The bill be beaten to the market by another firm that
2 is working to develop a competing product.

3 We have evidence in our investigation that
4 companies often spend a great deal of time tracking the
5 research and development projects of other companies that
6 are working in their general area. Companies seek
7 information about the schedule and progress of competing
8 R&D programs, and they make investments and priority
9 decisions based on the level of competition they believe
10 to be on the face.

 The witness also confirmed that being the first to

1 whether the merged firm will have both the ability and
2 incentive to reduce the pace of innovation after the
3 merger, and finally, even harder to decide has the type of
4 efficiency, if any, the merged company will be able to
4

1 market, where hold er be a pre_mption of
 2 anti-competi e effect an le el of competi ion, and
 3 econd, monie of ha Gen me might ell, for
 4 f re Commi ion enforcement deci ion .

5 On the fir point, I a frankl p led b
 6 the eeming impoance ha all the kaemen placed on
 7 whether or not where hold be a pre_mption of
 8 anti-competi e effect . Someho , ha left me ith the
 9 feeling ha in e i King good market , here
 10 pre_mption are rai ed a m ch lo er concern ion
 11 le el han a the ca e in Gen me, b the anti-
 12 agencie bring an enforcement action e er time a
 13 pre_mption of legal i rai ed. We all kno ha
 14 nohing co ld be f rther from reali .

15 I think ha the da ha the J vice
 16 Departmen and the FTC relea ed o eek ago on
 17 hori onal merger and the concern le el and high
 18 one re lked in enforcement er, clo ing, make it er
 19 clear ha e en in e i King good market , there are
 20 highl concern ed market here merger ma red ce the
 21 n mber of competi or from three o o and e en o o
 22 one, here in ome ca e , the Commi ion did not bring an
 23 action or the J vice Departmen did not bring an action.

24 What doe the pre_mption mean? It onl mean
 25 ha the merger de er e a reall clo e cr in , and

1 The agency in question will spend a much longer time and
2 has developed an independent fact-based analysis.

3 I don't think there is an one of the Commission
4 who believes that Gen. me did not deserve that kind of
5 closure. Both the agency staff and all of the
6 Commissioners spend a great deal of time and effort in
7 analyzing the large in-house record, and in
8 agreeing that the facts were and that the analysis
9 should be, and that is really what I think the
10 pre-emption means, that it is a case that arranges that
11 kind of closure.

12 Finally, let me just talk for a minute about
13 that the impact of Gen. me is and that it will be about
14 the Commission and its likely enforcement in the
15 innovation market.

16 First, I think clearly the Commission
17 decision indicates that the current Commission is likely
18 to approach an innovation market analysis with a lot of
19 caution, but there are four reasons that I think
20 shouldn't read too much into that the Commission may do
21 in other cases based on the Gen. me decision.

22 First of all, I think it is important to note
23 that not one of the three statements that were issued are
24 signed or co-signed by any other than the author of that
25 statement. Two of the Commissioners, Commissioner

1 S indle and Lear , altho gh the o ked clo e the
 2 in e igation, did not join in an of the kement kha
 3 ere the p blic kement kha ere i ed.

4 Second, in the Gen me ca e, both companie ,
 5 Gen me and No a me, ere act all in the late clinical
 6 age of dr g de elopment, hich i earlier than the
 7 other inno ation market ca e here the Commi ion ha
 8 in e igated and taken action before, and that mean that
 9 the likelihood of both prod ct making it to market i
 10 le than in the other ca e the Commi ion ha looked at
 11 in the pharmace ical area.

12 Third, the dr g igation ere covered b
 13 the Orphan Dr g Act, hich grant a e en ear market
 14 e cl i ik to the fir st dr g that make it to market. I
 15 think that fact al o make it le likel than in a
 16 traditonal pharmace ical market that both dr g old
 17 in fact compete in a fre good market, and finall ,
 18 the Gen me acq i sition a not reportable, nder the
 19 Hart-Scott-Rodino Reporting Act, and the tran action had
 20 clo ed ell before the Commi ion a in a po sition to
 21 a e it legalik .

22 Tring to de ign a remed in an inno ation
 23 market in a con mmed merger here the core a e are
 24 cientific per onnel, kno ho , acce to academic
 25 re earcher , and man other h man factor , reall

1 pre-emptive litigation, and the majority of
2 cases that the agencies face, which in the typical
3 Hark-Scott-Rodino pre-merger review, I don't think raise
4 the same level of difficulty in designing and
5 implementing a remedy.

In place

1 look of participation or mortification on his face, is one
2 of those. I am not going to know what my point of view is
3 not shared by everybody in my firm.

4 I do find myself once again a devotee of the
5 the group, in trying to repeat the results of
6 innovation market analysis.

7 For those of you who do not know me, I am not
8 a representative of the industry position in which I
9 not because I am an anti-innovationist generally, but
10 the good government should not put a rain, etcetera,
11 that is a poor characterization of me is about almost
12 everything else.

13 I am an opponent of the use of innovation
14 market analysis frankly for an arcane epistemological
15 reason, and that is there is an absence of underlying
16 theory, and in a nutshell, that I mean is that anti-
17 work itself is based upon economics. Economics is
18 a science. What that means is that it is a scientific
19 explanation, a hierarchy of general laws and laws like
20 quantum mechanics.

21 The horizontal merger guidelines are a
22 wonderful example of economic science for policy
23 purpose. The SSNIP test and other devices in the
24 demand elasticity, which is right in the main stream of
25 the law of economic science, going all the way to the

1 la of demand.

2 Co rnoK elfare Kriangle, SKigler Kheor of
 3 oligopol , all nderpinning of Khe merger g ideline are
 4 inherentK, and Khe g ideline ha e a Krong KheoreKical
 5 ba i . B Khe a , e ob er e con i Kenc iK empirical
 6 factK a ell. ThatK i econdar a far a I m
 7 concerned. I care mo K abo K Khe factK KhaK inno aKion
 8 marketK anal i i ba icall rea oning b analog . The
 9 polic premi e, a I ee iK, i Khe propo iKion heKher
 10 Khe ocial gain from Kopping an R&D merger e ceed Khe
 11 ocial gain from leKking iK go Kthro gh i predictKable,
 12 KhaK o can Kell hich a KhaK ineg alik ill r n.

13 I Kthink Khe onl ba i for KhaK KhaK I can
 14 percei e i an analog Ko Khe relatiK hip beK een
 15 competiKion, g anKik and price in good marketK , and
 16 Khe analog i fal e. I on K d ell on KhaK. I roKke an
 17 arKicle, a man of o kno , in 1995, KhaK capK re m
 18 ie abo K KhaK bjeck.

19 Looking no in Khe fi e minKe I ha e, beca e
 20 I ill noK impinge on Khe di c ion period, here o
 21 geK Ko drag o K of me in con er aKion, leK me make j K
 22 Kthree g ick pointK , K o of Khem relatiK Ko Gen me and
 23 Khen an aKempK Ko be a likKle con K r oKi e in Kead of
 24 being a na a er. SKe en here i ick of ha ing Ko
 25 acc e me of boKhering an gl bab . LeK me ee if I

1 can do something better than that. Who else is that?

2 I am going to point out -- I'm going to go through

3 this hole slide -- it's really the first point that I

4 in his remark to go about, and that is that I am an

5 admirer of Chairman Muriel Kamen in General. It is

6 remarkable to me for the fact that it changes the basic

7 policy rule. It has to do, as Ann described earlier,

8 with peculiar circumstances of the case, but one would

9 not lose sight of the point on the word "competition."

10 What are we talking about now in a race to

11 monopolize. It has nothing to do with the kind of

12 competition that is going to be expanding, price reducing

13 competition, the kind of which we talk about when we

bother when we go on the common sense

1 That's my quick second reading of the major
2 is point is that all of the reasoning that follows.

3 All I wish to do is to do an analysis of
4 incentive, it makes a great deal of sense to me. It
5 goes to the point. That doesn't bother me as an economist.
6 The latter in the group can consider how it would play
7 a Section 7 or FTC Section 5 enforcement, but I think
8 is minimal.

9 My real focus is on Commissioner Thompson
10 directly, because I have a role in the debate between the
11 economic and the other factors in the innovation market
12 approach, as far as I'm concerned, I can be both a
13 player and a referee, but I have a role as far as I'm
14 concerned, my reading of Commissioner Thompson directly
15 led me to a game over, I think.

16 This is a likelihood of that can go wrong if merger
17 analysis is applied, using either premise, that is to
18 a reason to be analog to the good market.

19 You talk about a merger, a monopoly, and peak
20 about market power, even though there are no good around
21 and market power in the industry.

22 I know about the promotion of anti-competitive
23 effects in either theoretical or empirical basis.
24 There is this -- no one is getting back to the latter
25 thing that I would tell on one can get to the

1 concern action park -- when I check me a extraordinary .

2 There is a difference to be expected in the
3 resource allocation of Genzyme, arising from the
4 difference between bringing to get the first approval in
5 orphan drug class, to a whole lot of children
6 live and make a ton of money, and bringing to get first
7 approval in orphan drug class for a longer period
8 of time for the sake of first mother advantage.

9 I can go along with all of those who have
10 competition pr innovation. I make a certain amount
11 of sense. You see how the notion can be, I would say,
12 misleading. I represent to me a believer in competition,
13 certainly an oddball crabbled piece of human nature.

14 There is a further likelihood of error, error in
15 economic and logic, but I believe here, in Commissioner
16 Thompson's direction, we can talk about them if you like,
17 more or less. I think some day President Kerr might appoint a
18 Commission with this frame of mind, and that is the
19 reason for a line of broad and large sensible -- I think a
20 nonobjectionable -- to me, under a sensible decision both
21 by the Pivof Commission and the Merri Commission, are
22 not good evidence that we are okay in the innovation
23 market concept.

24 Let me see if I can do that Chairman Pivof
25 did to me at the 1996 hearing, to let me and find some

1 M a k e m p a a c o n c r o k i e e n d k o m
 2 e k r e m i k k a l k h e r e i k o a k h a k k o k h e e k e n k k h a k e
 3 a r e -- l e k m e p k i k i n k e r m k h a k m a r k e d h e n h e
 4 r o k e a e r i e o f p o i b l e g e k i o n k o d i c .

5 I k h i n k k h e d i k i n o k i o n b e k e e n i n n o a k i o n
 6 m a r k e k k h a k p a a k k e n k i o n k o R & D e f f o r k , a b o k h i c h e
 7 k n o e r l i k k l e a n d p r e d i c k e r l i k k l e , k h e d i k i n o k i o n
 8 b e k e e n k h a k a n d f k r e g o o d m a r k e k , h i c h k o m e m e a n
 9 k a k i n g o n l k h o e c a e h e r e e c a n a c k a l l f o r e e e
 10 h a k k h e g o o d a r e a n d h a k k h e n u m b e r o f p l a e r , k h e
 11 n u m b e r o f p r i c i n g o i c e i l l b e , a n d m a k e o m e a k k e m p k
 12 a k d o i n g h o r i o n k a l m e r g e r g i d e l i n e a n a l i .

13 T h a k d i k i n o k i o n b e k e e n i n n o a k i o n m a r k e k o n
 14 k h e o n e h a n d a n d f k r e g o o d m a r k e k i e r g r e a k , a n d
 15 a f a r a I m c o n c e r n e d , o n e k h a k h o l d k r i e a n d b e
 16 e l l , a n d k h e o t h e r h o l d g i e k l g o a a .

17 T h a n k o .

18 M R . F R A N K E N A : T h a n k o . J k f o l l o i n g p o n
 19 k h a k , I d l i k e k o a k A n n a g e k i o n . L e k a m e b a c k
 20 i n 1995 , k h e a n k i k r k a g e n c i e h a d c o m p l e k e l l i k e n e d
 21 k o h a k D i c k a i d , a n d h a d a i d k h a k h e n c e f o r k h , i n g o i n g
 22 f o r a r d , e o n k b e d e f i n i n g i n n o a k i o n m a r k e k . W e
 23 k h i n k i n n o a k i o n i i m p o r k a n k a n d e k h i n k c o m p e k i o n
 24 m a a f f e c k k h e r a k e o f i n n o a k i o n , b k e r e n o k g o i n g k o
 25 d e l i n e a k e i n n o a k i o n m a r k e k , o e d o n k a n k o r k a f f

1 to be doing that.

2 M g e K ion for Ann i h a K difference o ld
3 that has been made in the K pe of in e K g a K ion , K h ing
4 like that?

5 MS. MALESTER: I think there are maybe K o
6 e ample K a K I can e K o h o h I K h ink Dick
7 approach present enormous danger to competition, that
8 o ld allow merger to proceed, that I think o ld have
9 really, really serious anti-competitive impact.

10 The firm might be similar to the case that the
11 Justice Department brought, and I think it's during the
12 time that we saw there, Lockheed/Northrop Grumman.

13 It's a really a step further back from the
14 Boeing example that Dick and Chairman Pickoff talked
15 about, here the Justice Department raised the concern
16 that there were only three companies left in the K o n K
17 that really had the capabilities of designing military
18 aircraft, and if Lockheed were permitted to buy Northrop
19 Grumman, that o ld be reduced to K o .

20 There were no specific plan for a fighter
21 aircraft, but as we all know, in military procurement,
22 there are essentially that arise that are quickly turned
23 the Defense Department into needing something new to meet
24 a new military challenge.

25 Even though there are a number of things good, a

1 specific program or product on the drawing board, both
2 the Justice Department and the Defense Department felt
3 that one of the reasons to block the
4 merger is to preserve the capabilities of designing and
5 producing a particular weapon platform.

6 I think that is a departure from
7 the position of the House to have a specific good that
8 we are looking at, even if the first one hasn't been
9 produced yet. I think that is a case that if allowed to
10 proceed would have an anti-competitive effect
11 for our economy, and in that case, for our national
12 security.

13 The second point I want to make is moving even
14 further back a bit from the free market, and when
15 maybe something is specific to the pharmaceutical
16 industry, and that is an industry that I did a lot of work
17 in, but maybe applicable to other. I'm not sure.

18 That is apart from looking at the impact
19 of eliminating the merger is on the free market,
20 it is going to mean that there will only be one company
21 selling a product at one point.

22 There is actual competition going on during the
23 research and development phase when two companies know
24 that they are both trying to develop the drug, and are
25 to get approval first. Those companies will, for

1 e ample, do clinical trial that in ol e man more
 2 patient , to make re get a broader range of
 3 patient in different kind of erio ne of di ea e.

4 The kind of clinical trial the do, the
 5 amount of effort and o reach to patient the do, there
 6 are benefit right no in the present of having o
 7 companies competing to develop a drug, complete
 8 separate from the actual benefit , potential benefit ,
 that e are not re pnot re pnot r -5.1fTD(e ample, do clinic

1 Ye . There ill be a good market, b KhaK
 2 good market i a long a off. U all o ide of haK
 3 e normall con ider Ko be iKhin the reach of Section 7
 4 of the Cla Kon Act.

5 Inno ation market i an immediate Kep Ko
 6 iderKif here the acki ik of the Ko companie come
 7 together and here there might be an act al red on.

8 In the ca e KhaK Dick p for ard, there ill
 9 be le inno ation compKition in de eloping the ne
 10 engine ome ear off, hich ill Kran lake ik elf inKo
 11 o Ko K.

12 If o ank Ko a , no, no, KhaK nok an
 13 inno ation market, KhaK a f re good market, fine.
 14 No e are talking emanKic .

15 MR. RAPP: Are e talking emanKic when if e
 16 r le o the applicaKion of the inno ation market concepK
 17 Ko the Gen me ca e? There, there i no predicKion KhaK
 18 e co ld make abo Ko ho man good o ld other i e go Ko
 19 market, haK the f re market o ld look like. There
 20 are no ch good .

21 I ee KhaK a a harp diKinon. In oher
 22 ord , m primar criKeria i KhaK the anal i nok deal
 23 iKh i e like the degree Ko hich R&D pending ill be
 24 cK back or red ced. IK ha Ko do iKh an anal i of
 25 ome f re, ome predicKion abo Ko a f re good market.

1 on the cable is for an airplane that require advance in
 2 science and advance in material science or something
 3 here where is some probability that engine on work.
 4 So, I don't know with certainty there will be such an
 5 airplane in need of such an engine.

6 I would be curious if the panel could generally
 7 could just peak to how that analysis might change if
 8 that were thrown in.

9 MR. SUNSHINE: I think it's an essential part
 10 of the analysis. Again, the idea has got to be a focus
 11 on what are the incentives of the parties, and
 12 what effect is the combination going to have, factor in
 13 terms of are there efficiencies that come from it, the
 14 necessary elements, because of the size of the project
 15 and the risk of the project, whether it require one firm
 16 in lead of it.

17 All those considerations go into the question
 18 of whether they make sense or not. For all the reasons
 19 we have talked about before, applying the horizontal
 20 merger guideline standard to this innovation question is
 21 misplaced.

22 If this project is so risky that the firm need
 23 to do it together or it can't get done, I think that
 24 an error of the question.

25 Let me stop there. I'm sure Dick doesn't feel

1 different about it. I don't know, Ann, if you have a
2 different idea.

3 MS. MALESTER: I seem to me it is not only
4 the question of the standard Dick proposed for and
5 requiring that we know that a particular product be
6 successful, that the bill in fact design an engine,
7 which I think really is a pretty extreme position, but I
8 would like the added step of asking if there are only a
9 few small number, in which case, the companies, that have
10 the technology and know how and expertise to design
11 aircraft engine, when we would be concerned about
12 allowing that merger for future aircraft engine
13 development that aren't even on the drawing board,
14 and that a really high I brought up Lockheed/Northrop.

15 Skalkh Technology. That is another reason
16 that the Defense Department and Justice Department felt it
17 is critical to keep a number of companies that know how
18 to --

19 MR. RAPP: The quick mental analysis that you
20 did to reach that conclusion doesn't really have much to
21 do with an analysis of how it is going to happen to R&D
22 effort. It has to do with being able to forecast, even
23 if it is a decade down the road, how many good are going
24 to be available at the end. I'm okay with that because
25 it is probable in economic, as opposed to a certain

1 about whether more R&D or less R&D effort will arise and
2 whether that's a better or a weaker thing. This slide
3 come here in there, but I don't know whether it's

4 A decade or so ago, we had 27 drug companies,
5 big drug companies. The evidence, we have seen of them.
6 I am not prepared to say that a major loss of R&D
7 effort has arisen because of the combination of those?
8 I don't think we are in a position to say that the
9 connection between concentration and innovation --

10 MS. MALESTER: I think that's a fair, very
11 different proposition than that we have really been
12 talking about, which is competition or the lack of
13 competition, not whether or not there are 27 or 10, I
14 don't think in an current good market that would
15 concern.

16 I do think -- I don't think any one on this
17 panel has said that we can look at the dollar spent on
18 R&D and say that more or less and that means we are
19 going to get a better product, we are not.

20 Those are really not the issues on the table.
21 The question is whether having competition in designing a
22 new weapon, for example, is going to provide the
23 purchaser with a better product in the end, a more
24 innovation, a more radical breakthrough.

25 I think there are quite a number of historical

1 a e menK o can look atK Khak a e , Khe do.

2 MR. HOVEN: I m John Ho en, J Kice DepartmenK.

3 I d like Ko make Khe pointK Khak each of o

4 ere j K Kalking aboK Kool in Khe hed, and Khere are

5 man oKher , and o r are rele anK for ome p rpo e and

6 noK for oKher . I Kthink Khe Lockheed/NorKthrop merger i

7 a good ill Kration of Khak.

8 The pre mpKion of Khe inno atKion marketK

9 anal i i Khak inno atKion i a er predicKable

10 proce , j K like b ilding brick . Yo pend Khe R&D

11 and o getK a prod oK.

12 A good e ample i Khe e peckaKion Khak Khe kind

13 of inno atKion e are looking atK i inno atKion Khak ha a

14 kno n idenKifiable prod oK atK Khe end. I Kthink Ko ome

15 e KenK, Khak a Kr e, and Ko ome e KenK, Khak a noK

16 atK all Kr e in Lockheed/NorKthrop, Khak inno atKion in man

17 ind Krie i a proce of idea coming Kogekher in

18 ne pecked a and o anK Ko pre er e an ind Kr

19 Kr oK re Khak allo Khak Ko contin e Ko happen, and in

20 partic lar, in ome ca e , an inno atKion Kr oK re Khak

21 generake idea , prod oK Khak nobod can Kthink of eK.

22 I Kthink Khe general proce of inno atKion

23 anal i o ghK Ko be one in hich one ing ire ho doe

24 inno atKion Kake place in Khi partic lar ind Kr , and

25 ma be iK Khe kind of approache o are di c ing, b K

1 there are a lot of other things that should be examined a
2 ell.

3 MR. SUNSHINE: I think certainly in the
4 framework that I prefer, and I think in the framework
5 that all Merit prefer in the Commission, is
6 the recognition of that good and is all right.

7 The question is should we examine the
8 innovation market and under that circumstance can we
9 accomplish innovation effect. It is a small
10 minority of cases. If you can have the confidence to
11 predict it, then you should go home.

12 Once you are there, when if you're talking about
13 innovation effects, there are three categories of that
14 can happen. It can be innovation that will be used in
15 the future product. It can be innovation that are used
16 in existing product, or it can be innovation that can
17 be used at all.

18 That last category I don't think antitrust
19 enforcement should care about. For the first two
20 categories, none are talking about legal theories, is
21 it a competitive effect of a good market, is it a
22 potential competition case. I don't care about the answer
23 to that. When you get into a court, you are going to
24 have to have developed your legal theories and prefer
25 for that.

1 To me, ~~that~~ ~~the~~ ~~connection~~. Find ~~the~~
 2 ~~innocent~~ ~~effect~~, ~~put~~ ~~in~~ ~~his~~ ~~confidence~~, ~~under~~ ~~the~~ ~~given~~
 3 ~~set~~ ~~of~~ ~~facts~~, if ~~you~~ can. If ~~you~~ can ~~do~~, ~~you~~ ~~shouldn't~~ ~~be~~
 4 in ~~the~~ ~~business~~. Identify ~~an~~ ~~object~~ ~~effect~~, and ~~then~~
 5 ~~there~~ ~~is~~ ~~a~~ ~~case~~.

6 MR. RAPP: ~~May~~ ~~I~~ ~~just~~ ~~add~~ ~~a~~ ~~sentence~~ ~~in~~ ~~that~~
 7 in mind? ~~It~~ ~~is~~ ~~perfectly~~ ~~consistent~~ ~~with~~ ~~the~~ ~~majority~~
 8 ~~opinion~~ ~~in~~ ~~General~~ ~~me~~, ~~but~~ ~~I~~ ~~think~~, and ~~that~~ ~~is~~ ~~the~~
 9 ~~pro~~ ~~blem~~ ~~from~~ ~~my~~ ~~point~~ ~~of~~ ~~view~~, ~~that~~ ~~it~~ ~~is~~ ~~also~~
 10 ~~consistent~~ ~~with~~ ~~the~~ ~~decision~~, in ~~that~~ ~~Commission~~ ~~Thompson~~
 11 ~~made~~ ~~the~~ ~~same~~ ~~reasoning~~ and ~~had~~ ~~sufficient~~
 12 confidence in his ~~ability~~ and ~~that~~ ~~of~~ ~~his~~ ~~advisor~~ and
 13 ~~afford~~ ~~to~~ ~~bring~~ ~~the~~ ~~issue~~. I ~~think~~ ~~it~~ ~~is~~ ~~an~~
 14 ~~example~~ ~~of~~ ~~how~~ ~~can~~ ~~happen~~ ~~in~~ ~~an~~ ~~innocent~~ ~~market~~
 15 ~~analysis~~ ~~go~~ ~~wrong~~.

16 MR. SUNSHINE: I agree ~~with~~ ~~your~~ ~~criticism~~ ~~of~~
 17 ~~Commission~~ ~~Thompson~~ ~~decision~~, and I ~~think~~ ~~it~~ ~~is~~ ~~wrong~~.
 18 I ~~think~~ ~~in~~ ~~that~~ ~~decision~~, he ~~does~~ ~~make~~ ~~a~~ ~~fair~~ ~~analog~~
 19 ~~is~~ ~~a~~ ~~good~~ ~~market~~, for ~~the~~ ~~reason~~ ~~he~~ ~~has~~ ~~talked~~ ~~about~~,
 20 ~~that~~ ~~is~~ ~~improper~~. If ~~that~~ ~~were~~ ~~the~~ ~~policy~~ ~~of~~ ~~the~~

1 "anal i ," of ~~the~~ ~~reason~~ ~~on~~ ~~the~~ ~~effect~~ ~~on~~
2 ~~incentive~~ ~~and~~ ~~of~~ ~~for~~ ~~it~~?

3 MR. RAPP: Ye . I m comf~~or~~~~table~~ ~~in~~
4 "anal i " a long a ~~it~~ ~~reache~~ ~~the~~ ~~concl~~ ~~usion~~ ~~that~~ ~~i~~
5 ~~functionall~~ ~~the~~ ~~eg~~ ~~ualen~~ ~~of~~ ~~not~~ ~~making~~ ~~inno~~ ~~ation~~
6 ~~market~~ ~~polic~~ .

7 One of ~~the~~ ~~rea~~ ~~son~~ ~~that~~ ~~I~~ ~~admire~~ ~~has~~ ~~the~~
8 Chairman ~~W~~~~al~~~~ter~~~~doe~~ ~~i~~ ~~that~~ ~~in~~ ~~rea~~ ~~son~~ ~~en~~ ~~abl~~ ~~b~~
9 ~~anal~~ ~~ing~~ ~~the~~ ~~incentive~~ ~~to~~ ~~an~~ ~~o~~ ~~come~~ ~~that~~ ~~a~~ ~~le~~
10 ~~lea~~ ~~e~~ ~~hi~~ ~~alone~~, ~~and~~ ~~has~~ ~~I~~ ~~find~~ ~~hard~~ ~~to~~ ~~imagine~~, ~~and~~
11 ~~ma~~ ~~be~~ ~~it~~ ~~the~~ ~~hor~~ ~~rage~~ ~~of~~ ~~imagina~~ ~~tion~~ ~~on~~ ~~m~~ ~~par~~
12 ~~a~~ ~~great~~ ~~deal~~ ~~of~~ ~~re~~ ~~pe~~ ~~ct~~ ~~for~~ ~~o~~ ~~r~~ ~~former~~ ~~chairman~~ ~~ho~~ ~~o~~ ~~ld~~
13 ~~ad~~ ~~oca~~ ~~ke~~ ~~hi~~ ~~polic~~ , ~~of~~ ~~S~~ ~~te~~ ~~en~~ ~~and~~ ~~Rich~~ ~~Gilber~~
14 ~~the~~ ~~paren~~ ~~t~~ ~~but~~ ~~I~~ ~~cannot~~ ~~imagine~~ ~~a~~ ~~ell~~ ~~rea~~ ~~oned~~
15 ~~economic~~ ~~W~~~~al~~~~ter~~~~doe~~ ~~--~~ ~~a~~ ~~W~~~~al~~~~ter~~~~doe~~ ~~that~~ ~~i~~ ~~ell~~ ~~rea~~ ~~oned~~
16 ~~in~~ ~~economic~~ ~~that~~ ~~a~~ ~~and~~ ~~no~~ ~~le~~ ~~it~~ ~~in~~ ~~ter~~ ~~ene~~.

17 MR. FRANKENA: Taking a broader ~~ie~~ ~~here~~, ~~one~~
18 ~~of~~ ~~o~~ ~~r~~ ~~panel~~ ~~it~~ ~~ro~~ ~~ke~~ ~~in~~ ~~the~~ ~~mid~~-1990 ~~an~~
19 ~~and~~ ~~merger~~ ~~enforcement~~ ~~in~~ ~~par~~
20 ~~fficient~~ ~~l~~ ~~on~~ ~~the~~ ~~con~~ ~~eg~~ ~~ence~~ ~~of~~ ~~mar~~
21 ~~pace~~ ~~of~~ ~~ind~~ ~~trial~~ ~~inno~~ ~~ation~~.

22 I m ~~i~~ ~~W~~~~al~~~~ter~~~~doe~~ ~~broa~~
23 ~~the~~ ~~agencie~~ ~~are~~ ~~doing~~ ~~ork~~ ~~of~~ ~~the~~ ~~right~~ ~~am~~
24 ~~m~~ ~~ch~~, ~~and~~ ~~of~~ ~~for~~ ~~it~~.

25 MR. SUNSHINE: Tho e ord ~~o~~ ~~nd~~ ~~W~~~~al~~~~ter~~~~doe~~

familiar. I don't know where he came from.

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1 The fact that we are only doing it into one
 2 merger, or it may be benign. At least in my view, the
 3 opposite is true.

4 MS. MALESTER: I think really the reading of
 5 that global report and that the Chairman, I
 6 think, alluded to, is implied the conclusion that an
 7 national theory is probably the most likely if we are
 8 going to apply an innovation market at all, and generally
 9 speaking, we are looking at a smaller number of
 10 companies that have specialized areas, or to speak,
 11 to be innovating in the market before we are even
 12 starting to think about national theories. That really
 13 is the impact of that.

14 MR. RAPP: I don't disagree.

15 MS. MALESTER: In terms of our point of view,
 16 it is radical because here it makes a difference, we will
 17 just turn it around and it makes a difference, and
 18 from my point of view, because I think protecting
 19 competition here it makes a difference is important, I
 20 think it is the right place to put our effort.

21 MR. RAPP: If that statement were all a
 22 preface to the prior statement, that the reason to be
 23 concerned is that we are dealing in a realm of
 24 uncertainty then we can't be all that confident that the
 25 decision that we make will be the correct one, if it

1 eren for , I could go along ea il . The
 2 combination of the o thing together make me a
 3 problematic, m onl point.

4 MR. SUNSHINE: Let me ask you one question
 5 to Gen me. Suppose the drug in question did not
 6 qualify for orphan drug . Does change the
 7 outcome of the case? Orphan drug , for the of
 8 who are not pharmaceutical, it not a inner take

1 fair, forgive me.

2 Are there or have there been interaction
3 between the agencies about the difference in the
4 application of it? I don't ask for specific. That
5 the comparison. Obviously, the FTC, which focus on
6 drug gets a lot more care here and barriers are high
7 and things like that. I'm curious to know about whether
8 or not there is interaction between the agencies on
9 enforcement of innovation market.

10 MR. FROEB: Not on specific case, but
11 certainly on general policy matter, I'd agree.

12 MR. WERDEN: None that I participated in.

13 MR. SUNSHINE: I thought Greg and I were
14 working on the 2004 innovation market merger guideline.

15 MR. FRANKENA: Thank you very much. I'd like
16 to thank both our panelists and the audience.

17 (Applause.)

18 **UNILATERAL EFFECTS**

19 MR. FROEB: Welcome to the session on
20 unilateral effects analysis. We have five speakers
21 today.

22 We have Greg Leonard. He's here. I know he
23 here. We'll start with Valerie Raba from the
24 European Commission, followed by Joe Klevorick, Greg Werden,
25 and Tad Lipkin, and then Greg Leonard, if he gets here in

1 time. He will bring p the rear. There he is .

2 I am Ko thank the panelists for agreeing Ko
3 come on relatively short notice. I also am Ko thank
4 the staff who have put together this conference, and also
5 worked on the enforcement data, getting the enforcement
6 data together, and releasing what a part of our desire
7 to be more transparent to the external bar and the
8 external community .

9 I also am Ko acknowledge the efforts of my
10 predecessor, David Scheffman, who began much of the work
11 that is now being done for us.

12 By 1999, we had displaced the traditional re-
13 conduct/performance paradigm in industrial organization
14 economics, thinking on pricing and cooperation in
15 oligopoly had evolved considerably from the time that
16 we made coordination almost infeasible.

17 While economists never entirely rejected
18 coordinated effects theories for merger, we did reject
19 the reliance on them, and we had more plausible
20 theories for antitrust. Thus, a notable re-orientation
21 that unilateral effects analysis appeared prominently in
22 the 1992 horizontal merger guidelines, which were jointly
23 promulgated by the FTC and the Department of Justice.

24 The unilateral effects analysis affirmed the
25 antitrust demand for implementation that we could

1 under and explain to a judge, and at the same time,
2 in a field the economic demand for more rigorous
3 analysis. It is long before economic began, in
4 a general theoretic model to make a general

1 theorie .

2 What follo i e ill hear from Valerie
3 Raba a, Jo eph KKKan, Greg Werden, Tad Lip k , and Greg
4 Leonard on khi and more general topic . Let Kark off
5 iKh Valerie.

6 MS. RABASSA: Thank o , Mr. Chairman.

7 Let me Kalk abo K the Lagardere ca e. It a
8 E ropean ca e hich Kook place la K ear in France. It
9 a anal ed b the E ropean Commi ion. It i one of
10 the leading 2003 ca e of the media ind Kr .

11 Let me Kalk abo K the Kran acKion. It a er
12 imple. The Kran acKion concerned a Kran acKion bet een
13 the fir K and econd pla er of the book ind Kr . The
14 book ind Kr in E rope i characKeried b a er high
15 le el of erKical inKegracKion. DifferenK animal in khi
16 ind Kr . In the p Kream markeK, o ha e the
17 p bli hing rightK, and ho ell the right K to the
18 p bli her, and di Krib Ke the book K to the reKailer ho
19 di Krib Ke or ell the book K to the final con mer. And
20 gi en the parkic larik of the e ca e a an economeKric
20 K f7h -8rie. on folr the pommi ion. b aProfe lrK

12 I ldoi and diK K f7e. oa cal l the EeferoK of Khra h ad
123Tj11.722ree in K the do nreainKegomng rbeca e ci a he

1 a final decision. In this case, the result in effect
 2 means, as you know, the entire concentration, the firm
 3 in price, and when we have the impact on the final
 4 consumer who produces and chooses a profit of the firm.

5 So when we have the launch of VUP, if Lagardere
 6 had decided to increase price obligations generally,
 7 one of the final consumers would turn to the other
 8 competing publisher, who may reach VUP. So I see all a
 9 the result of the concentration in VUP has had a
 10 subsidiary of Lagardere to accept part of this
 11 competition pressure, and so can recover part of the
 12 economic loss.

13 In this case, we see a different model, the
 14 new logic model, which is quite adapted to the book
 15 industry, which is characterized by differentiated
 16 products. The logic model, as you know, is from the
 17 family of the discrete choice model, which is
 18 interesting in this case because obligations cannot be
 19 so minimal a book.

20 The consumer in this case made a discrete
 21 choice, a model, a different set of economic and when
 22 chooses a book on the concerned list. Simulation is
 23 conducted in the Bertrand Model of competition and the
 24 estimation of a three-stage game.

25 So the reason for this is interesting in

1 became the end price of the book were
2 significant increases in the downstream segment.
3 Obviously, we were looking at the consumer price and we
4 found that consumer price will also fall significantly,
5 which is a negligible part of the
6 turnover of industry in the field I'm generally tied to.

7 What a strong objection there is that the
8 price increase is linked to the market size, and we
9 were able to reconstruct the market size in this case.

10 Again, we decided to receive -- the relevant
11 evidence to incorporate into the final
12 decision, and we have used a bookkeeping method to
13 construct confidence intervals that are generated
14 in the economic field and we found that there is only
15 five percent variability that the price rise to the
16 concentration could be including significant a
17 significant interval of plus or minus one percent, in
18 the mean value of the price change.

19 Relevant evidence became of the very
20 high number of observations to at least 10,000. The
21 differences that are significant, and
22 the main parameter, I mean the marginal ATAF of a given
23 book and the intra-brand correlation were quite stable.
24 Altogether I feel that reasonable to give robustness
25 for when we decide to incorporate this economic model

1 inKo the final deci ion.

2 Thank o er m ch.

3 MR. FROEB: Joe, o re ne K.

4 MR. KATTAN: I anK Ko Kalk abo K, I Kthink,
5 difference beK een the a KhaK la er K end Ko look aK
6 unilaKeral effectK and the a economi K do, and
7 partic larl inK reference Ko the ne model , the merger
8 im laKion KhaK are being done increa ingl in
9 unilaKeral effectK ca e .

10 I anK Ko begin b j K Kalking a littl e biK
11 abo K the 1992 g ideline and haK the a , and Ko
12 conKra K KhaK a littl e biK inK the ne im laKion model
13 and po e the g e Kion heKher e are a king the ame
14 g e Kion , KhaK i do the g ideline gi e g idance or do
15 the e im laKion model an er the ame g e Kion KhaK
16 the g ideline are a king.

17 I Kthink inK preK clear KhaK the 1992
18 g ideline reall changed the a KhaK people look aK
19 unilaKeral effectK before 1992. UnilaKeral effectK ere
20 ba icall K ho ghK of in Kerm of monopol or dominance,
21 and the in ighK of the g ideline a KhaK unilaKeral
22 effectK can ari e o K ide the monopol conK e K.

23 The merger of Daimler and Chr ler doe noK
24 e aKl ha e the ame effectK a the merger of Daimler and
25 BMW, and if o ere j K looking aK HHI and marketK

1 hare , o ma ge a mi leading an er.

2 Some people who ghe ere re rning ko
3 bmarket , hich a a term that had been di credited at
4 lea in khin the Bel a . Certainl , if I ere
5 likig a ca e on behalf of the agencie , I old rel
6 on the bmarket nomencl re impl beca e i i
7 omehing that the co rks are familiar in and are
8 comforable in , regardle of heher that nomencl re
9 reall make a lok of en e in term of the a e do the
10 nilateral effeck anal i .

11 I think i i certainl the ca e that incl ion
12 of nilateral effeck a the mo imporkant change in
13 merger la ince the 1982 gideline , and had a er
14 profo nd effeck on merger enforcement , and i a n that
15 er long ago that one old hear people talking abo
16 heher nilateral effeck a in fact the onl alid
17 theor for looking at merger . I think the pend l m ha
18 ng back a litkle bit.

19 I think i fair ko a that hat e a in
20 the gideline i a nthe i of good economic theor ,
21 b al o practical j dmen abo the g alie of the
22 ool e ha e ailable ko in merger in e igation ,
23 and ho refined a j dmen e can make abo the effeck .

24 To repeat er briefl hat the gideline a ,
25 no ko that the ob io , b ko gi e a benchmark for

1 hark e are looking at, the guideline focus on racial
 2 eparation between product and product pace. The focus
 3 is on localized competition here certain other compete
 4 more closely with one another than with other either ho
 5 are in the same product market.

6 According to the guideline, that require that
 7 there be a significant loss of share of consumer who
 8 regard the product of the merging parties as their first
 9 and second choice, and certainly the a that later go
 10 about applying the guideline is by asking whether
 11 about whether they are dealing with first and second
 12 choice. That one of the first screen one applied
 13 when trying to look at a case for the first time.

14 We have a 35 percent screen for the merged
 15 entire market here, the debate whether that is a safe
 16 harbor or something else, but in fact, we have seen a case
 17 here the market here were lower than that that have
 18 been brought.

19 I think that reflects a pragmatic tradeoff
 20 between quality of the analytical tools that are
 21 available in merger investigation and the theory. It is
 22 certainly possible to argue, in fact, it has been argued
 23 by Greg Werden and others, that you can have an
 24 anti-competitive effect in a merger where the merging
 25 parties are not the first and second choice of

1 c Komer , and o can certainl dra the theoretical
 2 pick re that o ld be pporKed and ha e n mber Ko
 3 pporK iK.

4 The ge Kion certainl in 1992, and not
 5 acco nKng for all de elopmenK and the anal Kical Kool
 6 that ha e Kaken place ince then, a ha are the Kool
 7 that e ha e and ho refined a j dmenK can e make, and
 8 the j dmenK a , aK lea K at that point, e are going Ko
 9 look aK ne K be K b K iK e .

10 No , the a that the la er K end Ko approach
 11 the i e of nilaKeral effecK i , I K hink, familiar Ko
 12 mo K people here. Yo look aK markeK , fir K of all.
 13 Yo define a markeK, and o do that beca e not onl the
 14 g ideline a that, b K Section 7 ca e la a that.

15 More broadl , I K hink doing an anK iK r K ca e
 16 iK ho K defining haK the markeK i i a recipe for
 17 di a K er.

18 There a a recent ca e in ol ing Ramb
 19 Compan that i in the ne , here Infinion bro ghK boK h
 20 anK iK r K and fra d claim again K Ramb . The anK iK r K
 21 claim ere Khro n o K beca e Infinion forgoK Ko define
 22 a geographic markeK for memor chip K echnolog , omeking
 23 that probabl o ld ha e Kaken K o paragraph in the
 24 e perK report .

25 I K hink economi K ofK en Kake the po iK ion that

1 defining market is perfectly if she can get to the
 2 an ever more directly, and that may or may not be right,
 3 but certainly from the perspective of the court, if you
 4 don't define the market, you may find yourself in the
 5 creek, given a case like Infinion v. Ramb, here the
 6 definition of the geographic market is clearly a red
 7 herring.

8 Once you define the market, I think the latter
 9 focus on the issue of need be brought. What?
 10 Because that's the guideline, and the analysis
 11 is driven by the evidence and documents. A latter fact is
 12 that a lack for a common document or that you can have
 13 both and both of documents packed up in the hallway.

14 I think there is a critique that one hear from
 15 the economic that the latter model but don't
 16 articulate them in the efficient particular.
 17 Certainly, the legal method does not require articulation
 18 of the model that the economic method does, and then
 19 you look at the economic model, it's well that the
 20 assumptions are and if assumptions are not made, that
 21 the limitations are. Later don't tell you exactly that
 22 the model are.

23 The model effectively if we look for
 24 significant market share. We look for need be
 25 brought, and that embodies certain assumptions on the

1 effect of the internalization of local sale. That is
 2 sale which would have been lost to the merger partner
 3 which is internalized as a result of the merger, the
 4 effect of which on the merged firm is incentive.

5 It certainly is the case that the economic model
 6 predicts their assumption with greater particularity.
 7 Later has an advantage. The decision maker and the
 8 courts are later. You cannot have a legal argument
 9 through on Daubert ground, or know, the economic
 10 model, which may be equally valid, are subjected to a
 different kind of scrutiny.

1 The in in a~~tion~~ are i~~kh~~ , and I ~~think~~ ~~the~~
2 are going ~~to~~ be i~~kh~~ for a long ~~time~~, he~~ther~~ or no~~t~~
3 ~~the~~ la~~er~~ like i~~kh~~, e are going ~~to~~ ha~~e~~ ~~to~~ deal i~~kh~~
4 i~~kh~~.

5 Modeling im~~pl~~ation can be m~~ak~~ al if e are
6 all comfort~~able~~ ~~that~~ ~~the~~ are a~~sk~~ ned ~~to~~ ~~the~~ market~~er~~
7 reali~~tie~~ , ~~that~~ ~~the~~ are ba~~ed~~ on defen~~ible~~ a~~mp~~tion ,
8 and ~~that~~ ob~~io~~ l here ~~the~~ deba~~te~~ ha~~e~~ been.

9 One cri~~ti~~ci m ha~~e~~ been ~~that~~ a mall difference
10 in ~~the~~ a~~mp~~tion can make e~~r~~ big difference in ~~the~~
11 re~~l~~ . The an~~er~~ ~~that~~ I ~~think~~ o~~ll~~ ill hear from ~~the~~
12 economy ~~is~~ ell, e ha~~e~~ differ~~ent~~ a~~o~~ of doing
13 ~~th~~ing , e ho~~ld~~ probabl do i~~kh~~ more ~~than~~ one a~~o~~ and
14 impo~~e~~ ome kind of reali~~ty~~ check on o~~r~~ anal i and
15 al o~~r~~ ~~to~~ e ~~the~~ metho~~d~~ ~~that~~ ~~the~~ mo~~st~~ con~~er~~ a~~ki~~ e
16 from ~~the~~ ~~stand~~point of ~~the~~ par~~t~~ ~~that~~ o~~are~~.

17 I ll po~~e~~ ~~the~~ ge~~ne~~tion he~~ther~~ ~~there~~ i a
18 con~~er~~ a~~ki~~ e a~~mp~~tion from ~~the~~ ~~stand~~point of ~~the~~
19 plain~~t~~iff, a~~ll~~ ~~the~~ e model eem ~~to~~ be de~~ig~~ned ~~to~~
20 ho a price increa~~e~~.

21 Par~~t~~ of ~~the~~ i~~te~~ ~~that~~ I ha~~e~~ i price
22 increa~~e~~ are a~~o~~ med in ~~the~~ e model ba~~ed~~ on ~~cr~~ ~~o~~ ral
23 a~~mp~~tion , e en~~tho~~ gh e are ~~cr~~ ing ~~to~~ r~~n~~ a a from
24 ~~cr~~ ~~o~~ ral anal i .

25 The ge~~ne~~tion i~~te~~ ha~~e~~ are e~~cr~~ ing ~~to~~ ho

1 here? Are we bringing to the magnitude of the
 2 price increase. I think everybody will tell me no,
 3 that's not what we are bringing to the table, but I think that
 4 here it comes.

5 When you get somebody telling me that I can
 6 predict with 95 percent degree of confidence that I
 7 have a price increase of 7.4 percent, you know, some if
 8 it's even has a decimal point, it's a good precision that
 9 you can debate that. Of course, there's a footnote that
 10 a, well, if you accept all major assumptions and that
 11 also before I take into account the like reporting
 12 of production and efficiency.

13 There is a risk, I think, of false empiricism
 14 here that have the results which are so precisely given
 15 with high degree of confidence and decimal point, you
 16 know, somebody is telling me that is the price increase
 17 that we are going to get.

I think that is fairly paradoxical, but that's

1 because the model will predict a price increase in
 2 the action here the merger would not be enough a second
 3 look under the guideline, things that are below 1500.

4 The economic analysis itself, we are not
 5 really trying to predict the price increase, we have to
 6 take into effect the repositioning and efficiencies,
 7 but in fact, if you accept the methodology, then what
 8 you have done is really shifted the burden of proof to
 9 the merging parties, because you have laid on the basis
 10 of some data analysis that you have a price increase
 11 unless the other factor come into play, you no longer
 12 prove to me that the price increase will not happen.

13 In fact, we really are the parties in motion
 14 cause prove repositioning, because anybody that has done
 15 a look of merger will know that most merger, the
 16 efficiencies that we see are not efficiencies that affect
 17 the incremental cost in a meaningful way. Most of the
 18 efficiencies that I see tend to be overhead
 19 energy. They are very important and they are very
 20 real. The drive merger economic efficiencies, but at
 21 the end of the day, they are not the type of efficiencies
 22 you can expect to translate into a beneficial price
 23 effect. That is kind of a defense of labor. It
 24 is very hard to do that, particularly when you are
 25 talking about differentiated product markets, here you

1 have large in e ~~men~~ ~~in~~ ~~grated~~ ~~in~~ ~~h~~ ~~differentia~~ ~~tion~~,
 2 ~~that~~ ~~i~~ ~~promot~~ ~~ion~~, ~~ad~~ ~~er~~ ~~ti~~ ~~ng~~, and ~~al~~ ~~o~~ ~~d~~ ~~i~~ ~~scri~~ ~~ption~~
 3 arrangement.

4 The parties are no in a position of being sold
 5 or merger in anti-competitive, so have no pro e in
 6 not going to have a price effect, and really or re or
 7 i repositioning. Repositioning is pervasive. It
 8 common. At the same time, we are in effect shifting
 9 implicitly the burden of proof to the merging parties b
 10 effectivel auming a price increase and really aing
 11 the only issue is how big a price increase.

12 Another question to ask is what happen to the
 13 new be b b the anal i . We talked at the
 14 beginning about what the guideline a . The guideline
 15 a , ell, we look at whether the product of the merging
 16 parties are first or second choice of the large share of
 17 the consumer, and what evidence are legitimate, and
 18 really in stead of being differentiated b product
 19 advertising or promotional issue, products are
 20 differentiated b their sale level. That is the form of
 21 differentiation that the anal i a me because that i
 22 really what we are looking at.

23 Of course, we are assuming identical cross
 24 elasticity of all products with respect to a given
 25 product, which given the assumption that some products

1 are closer, but each other, in
2 seem to at least some extent.

3 The more complex model, the more great
4 cost. The high and invariable application for data. There
5 are increasing retail level data as a pro for
6 household competition.

7 David Scheffman and others have published a
8 detailed analysis of this, and deal both with
9 implementation issues, how do you do when a price
10 increase takes place in mid-week, but the data you have
11 collected price on a weekly basis, a well a conceptual
12 issue, what household price no really are to
13 partitioned and relatively fixed and a variable element,
14 and overall consumer price are an one partition.

15 The issue that I give I will end with
16 whether the model follows the guideline. If the
17 source of anti-competitive, natural effects that the
18 guideline are talking about has to do with the partial
19 separation of products, are the real object that issue
20 by looking at model that are defining differentiation
21 effects based on the level of sale, are also
22 shifting the burden of proof to the merging parties
23 implicitly by doing that.

24 I actually heard to see that one of the
25 recent presentations I heard had been in that to the

1 co of doing the e pe of anal e . The fact i
 2 an bod ho i doing a merger no i kind of forced to do
 3 that a a defen i e mea re beca e the economi are
 4 going to come to and a , ell, thi i ha DOJ i
 5 going to be doing, and e need to do thi beca e
 6 other i e, e are going to be nprepared for their ca e.
 7 It another b rden of merger enforcemen on top of the
 8 endle bo e of doc men .

9 M feeling i that the c rren model are going
 10 to ha e problem in co rk, b k at the ame time, mo
 11 ca e are decided in fron of the agencie , and partie
 12 ill be foolhard to ignore the e model beca e the
 13 ha e become part of that deci ion making proce , and
 14 ha need to be done, hich i er diffic l beca e e
 15 don ha e the in e riga i e tool to look at con mmed
 16 merger and ee ha happen and calibrate the
 17 a mpion in the e model to act al market re l , i
 18 to r to refine them and make them bett .

19 MR. FROEB: Thank o , Joe. Valerie, i
 20 beca e Joe rai ed thi g e ion, did o look at the

1 book retailer and how to do a sale of book
 2 the final consumer. We had many problems getting
 3 right data. We can talk about this problem later, the
 4 problem of getting data.

5 MR. FROEB: Thank you. Greg?

6 MR. WERDEN: Before I get too much prepared
 7 remark, I am going to respond to a couple of things Joe
 8 said. The first one is a serious question of
 9 mine. He paraphrased the guideline, which I will
 10 acknowledge, and when I disagreed. I
 11 don't.

12 The sentence I will quote is "Substantial
 13 unilateral price elevation in a market for differentiated
 14 products requires it to be a significant share of sales
 15 in the market accounted for by consumers who regard the
 16 product of the merging firm as their first and second
 17 choice."

18 I would all agree that it is a very nice set of
 19 principles, notice it said significant share, not
 20 a large share, I think Joe said it is a large
 21 share, and I don't need a large share. Second, he
 22 said when we rank these things in a global
 23 ranking of the product, one, two, three, four,
 24 and the merging product has to be close in this
 25 global ranking. That is wrong.

1 The crucial thing to know is that typically in
2 differentiated products, different consumer rank the
3 products differently. That is, some people buy one
4 product and some people will buy another one.

5 What the guideline is, which I would all agree
6 is, is are you getting a significant number that is
7 interested in the first and second choice.

8 Secondly, the biggest thing modeling, the kind
9 that economists do, merger implications and other things,
10 is more likely to find merger problematic than have
11 it in the latter do in fact. I find this a remarkable
12 statement because it is completely contrary to my
13 experience.

14 One of the reasons I like and I got into this 12
15 years ago is the latter had tremendous exaggerated
16 notion of likely anti-competitive effects of merger,

1 modeling, b^ut when mo^ust of the modeling aid there a no
2 significant effect, e didn't bring the case, in e'er
3 single one of the case that I know of.

4 I think modeling has probably kept the agencies
5 from bringing some case, although it might have caused
6 them to bring some other one the hold has brought,
7 and in both case, that a for the better.

8 Starting with my prepared remark, the concept

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1 er pla ible the merger ill ha e ome efficiencie .
 2 er ea Ko take who e inKo acco nK in merge
 3 im laKion and er ea in ome ca e Ko ho KhaK
 4 pla ible the neK effect i a price decrea e, noK a price
 5 increa e. We don t bring who e ca e .

6 Merger im laKion can be an ef l a Ko foc
 7 an in eKigaKion or Kr b idenKif ing high factKor or
 8 a mpKion reall maKer. If o can ho in the
 9 modeling e erci e KhaK one a mpKion gi e o one
 10 re lK, another a mpKion gi e o a er differenK
 11 re lK, then it become a er cr cial factK high i
 12 high of who e a mpKion i the right one or the beKer
 13 one. That can be a er ef l proce .

14 Yo can al o find ome thing reall don t
 15 maKer m ch, o o holdn t p o r re o rce on
 16 fig ring who e thing o K.

17 LimikaKion . The f ndamenKal limikaKion i no
 18 economic model i going Ko capK re e er nance of
 19 competiKion in the real orld, b t o don t ha e Ko.
 20 All o ha e Ko do i capK re eno gh Ko be able Ko
 21 ef ll predictK.

22 Second. Price increa e predictioK can be
 23 an beKer Khan ro gh e KimaK . There i a hole loK
 24 going on KhaK in in the model. All kind of thing
 25 are going Ko happen in the orld KhaK o can t po ible

1 anticipate. You are only given some idea of the likely
 2 effect of the merger, but that's a hole lot better than
 3 no idea of the likely effect of the merger.

4 Third. Merger implementation is basically designed
 5 to predict price effect, possible other short-term
 6 effect of the merger. It's never going to predict the
 7 long-run evolution of the industry, but the good news is
 8 Section 7 doesn't care that much about the long-run
 9 evolution of the industry, which in an event, we have no
 10 tool in labor or economic to really predict everything in
 11 motion, so that merger implementation gives us
 12 something that the labor is looking for, or that it can
 13 give.

14 The basic theme of market is that before you
 15 see a merger implementation trial, and for that matter,
 16 before you see it for any other purpose for which you
 17 give significant weight to the actual prediction, it
 18 should have to pass an administrative screen from the
 19 rule of evidence. Rule 702 interpreted by cases like
 20 Daubert, Joiner, Kumtira, and many others is a case of
 21 low prominence.

22 What I take away from Rule 702 and the case law
 23 applying it is that it applies to economic testimony in
 24 antitrust cases if that testimony is admissible if the
 25 witness is an expert in the relevant field of economic,

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1 That might be for in law, although hardly
 2 an bod doe , a not grounded in the economic reality of
 3 the industry . This is the only knock on the model
 4 perhaps , although I happen to read the case a a ing
 5 there are like a different a in which is a not
 6 grounded in the economic reality of the industry , so I
 7 think all of the criticisms are fair criticisms .

8 The court said there is nothing wrong with the
 9 model as a matter of theory , it is a sound method, but
 10 it is not the right method for that case . I think that
 11 is about the kind of inquiry a court should do, and I
 12 think in the case of Concord Bank, the court is about
 13 right, it is not the right model for that case, and in
 14 particular, at least the model as calibrated by
 15 Hall, it predicted that the defendant would not have more
 16 than a 50 percent share in the engaging in the
 17 challenged practice .

18 The fact is the defendant had a 75 percent
 19 share before engaging in the challenged practice , and I
 20 would say that goes to be improper calibration. Not the
 21 only problem with the model the court pointed out, and
 22 one of the other one I think are important as well.

23 As I believe all know case by perhaps a more well
 24 known economist, Frank Fisher and Kimon are included in
 25 the Bookeller case for purpose of at least determining

1 damage , which a pre-K important in K case, because
 2 it contained too many assumptions and implications
 3 which were not supported by real world evidence.

4 I will not comment on the merits of Fisher
 5 or Kimon or the court analysis of it, because I don't
 6 know enough about either one, but I will comment on the
 7 language used by the court here in concluding the
 8 Kimon . I think this is the right approach to
 9 think about some economic evidence and if it is the right
 10 approach to think about the evidence, and the right
 11 conclusion is that it should be excluded. If it depends
 12 on too many assumptions and implications which are not
 13 supported by real world evidence, then it does not fit the
 14 fact and it is inadmissible evidence.

15 What are the key elements of fitting the fact ,
 16 and I will emphasize the key elements because this
 17 has to be a case by case determination, depending on what
 18 the facts are, what the model is , and how they are fitting
 19 to do with the model.

20 An oligopoly model used in litigation has to
 21 reflect critical aspects of competition in the horizontal
 22 market. That does not mean it has to reflect all
 23 aspects of competition. It is not going to. You have to
 24 have a basis for saying it reflects the critical one .

25 Some factual analysis by a reporter has to

1 lead to this conclusion, and he has to be prepared to
 2 convince the trier of fact that he is right in thinking
 3 about the industry and the model in this area.

4 The model also has to explain the recent past
 5 at a fairly high level of generality, especially the
 6 intensity of competition, as I like to think about it, as
 7 reflected in price cost margin. There is a lot that can
 8 be explained by model, however the industry has responded to
 9 shock, the level of price as compared to cost. A
 10 model should be able to explain the evidence, not
 11 necessarily with great precision. There is no reason
 12 why a model should explain data or data price movements.
 13 We don't care about data or data price movements.

14 The likelihood is, another aspect of requiring the
 15 fifth requirement, is that every modeling choice should
 16 be justified on some basis. It could be dictated by
 17 economic theory, for example, the assumption of profit
 18 maximization, and need no further justification. That
 19 is how economists do. If you don't ask somebody to
 20 assume that, don't call an economist.

21 It can be supported by industry data, for
 22 example, if the model is calibrated properly, that fits
 23 the price and share of industry, that kind of data I
 24 have in mind. Also, the data may peak to determine
 25 ratios or demand elasticities. There are lots of

1 different a in which model could be reported or
2 reflected by data.

3 It should be considered which limited factors of
4 the industry. How does competition work? What are the
5 important elements of competition?

6 If you have a typical differentiated product
7 case and in addition a retailer, how does the
8 manufacturing sector interact with the retailer and
9 how does the retailer behave?

10 There are the kind of limited factors that have
11 to be studied before you can properly model an industry,
12 and you should be prepared to explain how the factors
13 support the particular modeling choice.

14 For which, some modeling choice may not be
15 be important. You may be able to make a particular
16 differentiated choice. There may be a major difference in
17 choice. You may find out for which particular thing, the
18 model does not really matter. That is a perfectly fine
19 justification.

20 Finally, particularly when you can do an of
21 the above, it may be in addition to doing some of the
22 above, you can justify a choice by doing a sensitivity
23 analysis and showing that over the range of plausible
24 assumptions, you have picked one that is sufficient,
25 for example, lead to relatively small price increases

1 projection .

2 There are some modeling choices in merger
3 in litigation that you are not going to be able to justify, if,
4 and that that you have to do.

5 A couple of illustrations. This is, I think,
6 the easiest and best one of some kind of modeling choice
7 that you are never going to be able to justify based on
8 the fact of the data, and that is that the assumed
9 functional form for the demand curve?

10 Here I have plotted between the competitive
11 price over in the lower right and the monopoly price in
12 the upper left, for demand curve that have been used in
13 merger litigation. A you can easily see, going from the
14 competitive price to the monopoly price, it involves a
15 a much larger price increase for some demand curves than
16 others .

17 Where you are going to see one of the error
18 perhaps some other functional form is when you do a
19 merger litigation, and it's going to affect in a
20 substantial way the price increase prediction . If I'm
21 for the plaintiff, I would be using linear demand, which
22 produces small price increase, absent some strong
23 evidence I can't imagine ever having, that one of the
24 other functional forms fits better.

25 A final illustration has to do with demand

1 combination of parameter, a 4/10th of a price increase
 2 on, probably 1.2 percent price increase for the average price
 3 over the whole residential long distance, which of course
 4 include AT&T and all the other little guys which
 5 collected had, I think, around 70 percent a few years
 6 ago, so WorldCom and Sprint are already a relatively
 7 small portion of the industry, significant, but
 8 relatively small. So they are averaging out over the
 9 other residential long distance service companies which
 10 are going to have a smaller price increase than the
 11 merging firm. That is, the numbers are small.

12 If you do not increase .4 percent, it may be
 13 easier for merger specific efficiencies to appear, and
 14 for the net price increase to be negative. Up above one
 15 percent, that's not really so likely, and that's probably
 16 a price increase big enough that the agencies would worry
 17 about it, and you might have a more plausible WorldCom
 18 and Sprint are closer, but the Khan-Whi model
 19 assumes, if so, the price increase would be even bigger,
 20 and the counterfactual is also correct.

21 MR. FROEB: Thank you, Greg. Joe, do you have any
 22 equal time now or later?

23 MR. KATTAN: I'll ask.

24 MR. FROEB: Tad?

25 MR. LIPSKY: Thank you, Luke. It's a great honor

1 to be on the same page with each other in the
 2 practice of the various economic approaches to
 3 analyze it, and I have to admit that the
 4 general effect there, I would also be grateful,
 5 I suppose, that I have a merger before the Commission
 6 and before the DOJ here there is going to be
 7 innovation market or potential competition here no
 8 thing is applicable and I can do something because
 9 I have no current copy for both firms. That might be
 10 nice.

11 MR. WERDEN: You need an option model.

12 MR. LIPSKY: As I said before, I think we are
 13 focused on the wrong Frenchman. Bertrand is an IUV
 14 kind, and I said elsewhere many times before, pretty
 15 much has passed for antitrust economic rights not a
 16 all in the original core notebook back in 1838. I don't
 17 think general effect there in there. Maybe it's an
 18 option of the theory of monopoly.

19 I am going to go to some specific issues that have
 20 been addressed to both have been raised directly. Maybe
 21 I can give a somewhat different focus.

22 Who decide and how effects are the
 23 economic in this process. I'm going back over the
 24 firm principle that I don't remember thinking about
 25 since my first day in economic as an undergrad, and

1 probabl I hold ha e been thinking abo them a lo
 2 more than I ha e, b I think it help gro nd the
 3 di c ion and re eal m approach to ome ba ic point
 4 here.

5 Fir , there are fact , and ome fact are
 6 reall fact , like ho m ch and ho long it take to
 7 b ild a factor . There are model hich are ba icall
 8 mental con cr of mathematical model , oligopol
 9 model , ha ha e o . I ha e here ork of the cla ical
 10 model for merger la .

11 If an ind r i more concern d, the o p
 12 ill be lo er and price higher than if it le
 13 concern d, ceteri parib . Then there are
 14 vari ical ke hich are propo ion that gro o of
 15 the applica ion of a pecific econome ric metho d to
 16 e imake the paramer of a pecific model, and I ha e
 17 no idea ha I m a ing here. Ob io l , the ilicon-
 18 ba ed idge market doe n e i e cept in m head, b
 19 thi i the kind of a er ion o o ld find at the end
 20 of the articl back in the 1960 and 1970 a to ha
 21 o ack all needed to appl econome ric metho d to a
 22 model in a partic lar ind r .

23 I an to echo ome hing I heard Joe a
 24 earlier. Ma be I on p the ord in o r mo h. I
 25 think it ha do it the idea that e are all deci ion-

1 maker and we are not all judge, we are essentially
 2 later. There is a certain amount of money that we don't
 3 have enough economic or economic considerations and
 4 really has been contained in an amount like that, and
 5 that's one of the problems I'm going to get to a little
 6 later in the presentation.

7 The value of a market is the value of
 8 the parameter and all those are and all that means
 9 is that the economic roll around and that's the per-ade
 10 of that has been done in great or in a variable at
 11 least, let me give you a few concrete examples based on
 12 something we have heard of.

13 We had a description of a market to come
 14 for a model estimated in the context of the Bookeller
 15 merger. I happen not to know anything about that merger,
 16 but I will tell you right now, if the combined market
 17 share of those two firms in the defined book market are
 18 within the 5, 10, or 15 percent range, I can guarantee
 19 that I will find some problem in the economic model
 20 that's presented. If you get a much higher market
 21 share and you talk about entry and market condition and
 22 other sort of related facts about the publishing
 23 publishing work, I would be entirely prepared to accept
 24 that those market-related results are valid, but the key
 25 point is that the economic exercise is only valid if you

1 have a significant reason to doubt the validity of the
2 underlying model.

3 There is work of the red letter type
4 thing. That here I give order data to Greg Werden
5 and I tell him how our model is and he come back
6 half an hour later and says, oh, I created, I
7 forgot to adjust for elasticity or I have too many
8 multiple linear variables or whatever it is.

9 Even among the economic is done
10 perfectly, it does not mean anything if I have a
11 significant doubt about the truth of the model.

12 I think this has had a fairly profound impact
13 in my professional lifetime in the area of merger
14 analysis, which is when I entered grad school, people I
15 think were beginning to have doubts about this long
16 series of economic studies showing a correlation
17 between concentration and price or concentration and
18 profit, and looking back, I'm not sure how much the
19 more popular, based on our original work or recondom
20 performance paradigm.

21 What is that is a thought to apply
22 economic to the model 30 or 40 years ago, and now,
23 I think it would be fair to say that the type of
24 model has been fairly thoroughly discredited. It is a
25 process that not only in old "better economic."

1 I'm thinking particularly of Porter 1972 Review of
 2 Economic Statistics Paper, here he said, you can take
 3 the regression coefficients are being used as evidence that
 4 concentration and profit are positively correlated, and
 5 notice even though there is a claim for the validity
 6 of that relationship, the statistical tests that the
 7 coefficients are small and the statistical confidence
 8 intervals are rock.

9 I discovered one reason that might be.
 10 We divided the sample into two groups, one is sort of
 11 convenience good group, here is a food and drug store
 12 and grocery store, a small amount purchased an given
 13 time, very little consumer search behavior for the
 14 characteristics of the product, often very subjective
 15 characteristics of the product. You put that off to one
 16 side.

17 The particular model that had been applied
 18 worked pretty well in that case of industry, but it
 19 didn't work at all in a different case of industry,
 20 which is a thing like car or consumer durable, here
 21 you do have significant consumer search behavior and a
 22 lot of the other underlying variable represented by the
 23 method of retailing which are things that to be important.

24 Time marches on. It's not like you put it in
 25 at one end of the lab and get it out at the other and

1 ha e a high degree of confidence ~~that~~ it's right. ~~It~~
2 much more an art, a I think somebody else said.

3 Economic model is critical to the entire
4 process of antitrust decision making because you have to
5 decide a specific case, and ever litigant, a I put here
6 in the middle, ever litigant will a war, and ever
7 war has a model. Sometime the model is naked,
8 which is ever bad, and I agree with the earlier remark
9 that the focus on the unilateral effect of the merger
10 implementation approaches sometime get a long a b
11 making the a motion that the underlying model is
12 explicit, all a good thing to do.

13 Then the the economic model really come to
14 the floor in judicial decision making -- it's one of the
15 interesting phenomena, I think, in recent antitrust
16 jurisprudence.

17 In Market, for example, the narrow issue
18 decided by the Supreme Court a whether an expert report
19 about the possible existence of a predatory pricing
20 conspiracy could be admitted, with the majority saying
21 no, because it's crucial, essentially, and the minority led
22 by Justice White saying a minute, that is the
23 essential amendment for? A jurisdiction? Expert testimony?
24 What is this?

25 Justice White asked to precede, for purpose

1 of his earlier professional decision and opinion in Mack, Hicks,
 2 Khak the alidity of the expert testimony is a fact.
 3 I don't think Khak testimony is a fact. It's a
 4 something different. It's a model. It's a cor
 5 about a model. It's a cor about how a model should
 6 be applied to particular facts, but the facts Khak the
 7 Mack, Hicks majority and they are entirely entitled to
 8 disregard that expert testimony. I think it's a
 9 something of a turning point in anti-trust jurisprudence.
 10 Shake Oil . Khan. There is a very explicit
 11 example of flawed reasoning about monopolistic price
 12 agreements is wrong and, therefore, the per se is wrong.
 13

14 Brooke Group is kind of interesting because the
 15 oligopolistic disciplinary pricing model in Brooke Group,
 16 the plaintiff cor is a big name oligopolist,
 17 is firm. The major firm really marked to do it
 18 like cray, and the third largest firm decided to lower
 19 the boom on the major firm, confidence Khak the leader
 20 of the market, R.J. Reynolds with 38 percent of the
 21 market, repeatedly, could and but Khak William on
 22 disciplinary licensing, later owned by Brooke Group, and the
 23 company, maybe because the is represented by Phil
 24 Areeda, but the company and Khak could file, it could be an
 25 oligopolistic disciplinary pricing theory under the

1 Robin on-Packer Act, and one time I wonder and ask the
 2 same time feel thankful for the fact that there aren't a
 3 lot more cases. Maybe the Packer and Stockard Act has
 4 an oligopolistic disciplinary pricing theory that is
 5 being tried on in this case, but it's amazing
 6 that nobody else has tried that.

7 The Supreme Court also maybe considered
 8 under the Robin on-Packer Act. What the aid in that
 9 case also doesn't apply here. This is the IP in
 10 on milk and, for this point, Brooke Group's
 11 essential rejection of an expert report. An expert
 12 told me, I observed the factual precondition for and
 13 the theoretical apparatus for appreciating this
 14 oligopolistic disciplinary pricing theory in this case,
 15 and the court said no, that's crazy. It's inconceivable
 16 in the fact, not a crazy theory, inconceivable in the
 17 fact.

18 A particular fact that the court is dealing
 19 with is that the main underpinning for the oligopolistic
 20 disciplinary pricing theory is that the cigarette
 21 industry is an oligopoly, with high price, high
 22 profit, high price, high share, all those things
 23 are associated with oligopoly.

24 Well, it just so happens that I am senior
 25 economist for the plaintiff that testified in a number of

1 oligopol , price eren ~~kick~~ , ~~khak~~ profit eren ~~kick~~
 2 abnormal, and I ~~think~~ ~~the~~ ~~co~~ ~~r~~ had a hard ~~time~~
 3 allo ing ~~the~~ ~~e~~ ~~per~~ rel ing on a ~~theor~~ hich a
 4 e ~~en~~ ~~ciall~~ ~~con~~ ~~radic~~ ~~ed~~ b ~~the~~ leader of ~~the~~ plain ~~kiff~~.

5 We ha e ~~the~~ ~~ei~~ ~~rd~~ ~~in~~ ~~an~~ ~~tion~~ here ~~the~~ ~~idge~~
 6 are deciding economic i ~~e~~ . The are reject ~~ing~~ model .
 7 The are reject ~~ing~~ ~~e~~ ~~per~~ ~~ke~~ ~~kimon~~ . I ~~think~~ ~~the~~ ~~Da~~ ~~berk~~
 8 ~~Q~~ ~~ar~~ ~~ke~~ , ~~the~~ ~~fo~~ ~~r~~ ~~ca~~ ~~e~~ ~~khak~~ reall form ~~the~~ ~~Da~~ ~~berk~~
 9 line, are in a ~~en~~ ~~e~~ ~~an~~ ~~e~~ ~~ken~~ ~~ion~~ and ma ha e e en been
 10 ~~gge~~ ~~ed~~ b ~~Ma~~ ~~hika~~ and Brooke Gro ~~p~~ , chronologicall
 11 ~~ik~~ ~~ork~~ ~~o~~ ~~k~~ , I ~~ppo~~ ~~e~~ ~~e~~ ~~ill~~ ~~ne~~ ~~er~~ ~~kno~~ . Ma be 25 or
 12 30 ear from no hen ~~the~~ ~~paper~~ are di clo ed e ill
 13 find ~~o~~ ~~k~~ , b ~~the~~ ~~idge~~ are get ~~ting~~ more and more
 14 ~~ncomfor~~ ~~kable~~ ~~in~~ ~~h~~ economic ~~theori~~ ing.

15 The problem ~~khak~~ e ha e i , a ha been
 16 pre io l aid in ~~the~~ ~~panel~~ , ~~the~~ ~~la~~ ~~er~~ ~~con~~ ~~tr~~ ~~ol~~ ~~the~~
 17 proce . The la er pre ent ~~the~~ ~~ca~~ ~~e~~ . The la er are
 18 ~~the~~ ~~one~~ ~~ho~~ ~~are~~ ~~appoi~~ ~~nted~~ b ~~the~~ ~~poli~~ ~~ti~~ ~~ci~~ ~~an~~ ~~to~~ ~~hold~~ ~~the~~
 19 po ~~iti~~ ~~on~~ ~~at~~ ~~the~~ ~~agencie~~ . There are ~~the~~ ~~la~~ ~~er~~ ~~all~~
 20 o er ~~the~~ ~~place~~ .

21 What e er economic con ~~ten~~ ~~ts~~ ha been ~~ff~~ ~~ed~~
 22 in ~~ko~~ ~~an~~ ~~ki~~ ~~kr~~ ~~k~~ , I ~~think~~ ~~there~~ i a great deal of ~~it~~ , ~~it~~
 23 ha ~~to~~ ~~come~~ ~~thro~~ ~~gh~~ ~~the~~ ~~la~~ ~~er~~ ~~and~~ ~~idge~~ . There i no
 24 e i ~~king~~ in ~~kin~~ ~~tion~~ ~~khak~~ ~~fil~~ ~~ter~~ ~~o~~ ~~k~~ ~~the~~ ~~g~~ ~~ali~~ ~~k~~ of
 25 economic ~~ke~~ ~~kimon~~ and compare ~~the~~ ~~rela~~ ~~ti~~ ~~e~~

1 per a i ene of different economic ie of the e
 2 partic lar ca e that i reall de igned in a a o
 3 o ld an an in Kion de igned, Ko get Ko the Kr Kh
 4 of the maKer.

5 We ha e an ad ocac proce r n b la er . We
 6 don K ha e Kime Ko ik aro nd for the proce Ko ork.
 7 Yo ha e ome g ho i bringing ca e ba ed on the
 8 noKion that concentKion and profiK are Krongl
 9 correlaKed, e don K ha e Kime Ko ik aro nd and di co er
 10 that i rong.

11 Yo ha e a fail re in the anKiK realm.
 12 IK noK like the Challenger di a Ker, here the markeK
 13 blo p and e er bod a ho a, omeKthing reall enK
 14 rong. There are anKiK di a Ker .

15 I Kthink the UniKed Machiner ca e i an
 16 anKiK di a Ker. That compan dri en oK of b ine ,
 17 ca e fo nded, I Kthink, are illegiKimaK theorie of
 18 iolaKion, ing remed . UniKed Machiner a de Kro ed,
 19 b K ik Kook abo K 10 Ko 20 ear Ko happen. Yo can
 20 debaKe a Ko heKher the machiner ind Kr a reall
 21 one that a de Kined Ko remain in American b ine
 22 an a , gi en all the Kthing happening in the orld.

23 I ha e mmari ed MaK hika and Brooke Gro p.
 24 I menKioned the Da berK O arKer. I al o anK Ko foc
 25 o on the o rce -- j dge anKiK lake theiK

1 di a Ki fact ion i Kh Khe proce b hich economic
 2 e per Ki e i applied d ring an Ki Kr K ca e . The do i K
 3 in o Kher ca e , Koo.

4 J Kice Bre er I don K Kthink ha e er men Kioned
 5 an Ki Kr K in hi Kalking abo K Khi i e. I nder K and
 6 he ga e a Kalk a K AEI recen Kl on Khi ame Kthing, and
 7 might ha e men Kioned an Ki Kr K. Hi foc i more on
 8 Ko ic Kork and Kha K kind of cien Kific e idence.

9 He ha ba icall propo ed in a peech Ko Khe
 10 AEA a fe ear ago, e reall need Ko eed o K Khe
 11 crank . We need Ko ha e Khe AEA or ome re pon ible
 12 profe ional bod eed o K Khe people ho kno ha K Khe
 13 are Kalking abo K and Khe people ho don K.

14 I m no K o re Kha K a great ol Kion for
 15 an Ki Kr K. I can K imagine Khe American Economic
 16 A ocia Kion ha ing a g alifica Kion panel for an Ki Kr K
 17 economi K .

18 J dge Po ner, in HFCS, a er in Kric a Ke
 19 e plora Kion of Khe economic elemen K of Kha K ca e Kha K
 20 ere rele an K Ko Khe j dgen K of he Kher Khere i
 21 adeg a Ke e idence of con pirac . He pre K m ch bea K on
 22 Khe di Krick j dge and aid, look, hen Khi goe back
 23 do n Ko e plore Khi i e. No Kha K I ha e re er ed Khe
 24 mmar j dgen K in fa or of Khe defendan K , i K o ld be
 25 a reall good idea Ko e R le 706 of Khe Federal R le

1 be bound by the economic data?

2 David Scheffman, Hoover and I think a
3 other has mentioned this morning, the judgment on the
4 economic issue is done in principle, so can
5 separate them out. Read Fred Kahn's Kimon in the
6 Nabisco Brand case that's decided, here New York
7 challenged a merger that both Federal agencies had passed
8 on and found Hippocratic a non-fringed.

9 This is from the first sentence of the
10 Aphorism, his little saying about good medical
11 practice. Bill Baker is a great fan of Hippocrates.
12 Do no harm. That's the first sentence of the
13 Aphorism.

14 The first sentence is "Life is short, and Art
15 long, the crisis fleeting, experience perilous, and
16 decision difficult." That applies here, too.

17 There are some criticisms I have of typical
18 enforcement agency modeling. Market definition tends to
19 be narrow. The tendency focuses on isolated time period.
20 There tends to be, I think, headcounting of dynamic
21 effects, and it's wrong for obvious reasons. No one
22 necessarily does control, but it tends to
23 encourage the bringing of enforcement action here
24 whether someone's a little more related on who's
25 a monopsonist would have an concern.

1 Al o, where i a tendenc Ko go Ko e Kreme .
 2 We ill ofen hear arg mentK in Khe fronK office KhaK
 3 make iK o nd a if Khe parkie ha e been nable Ko agree
 4 on an Kthing in Kerm of Khe a mpKion KhaK are going
 5 inKo Kheir arg mentK , Kheir Kor .

6 I e mentKioned ome of Khe e alKernaKi e ,
 7 reliance on ne Kral e perK , R le 706. Do e need Ko
 8 ha e a caKegor of economi K ho ork for Khe agencie
 9 b K don K reall ha e a role in ca e , or ma be Khe
 10 ho ld be o K ide con lKank , people ho KheoreKicall
 11 on K ha e an percentKage in Khe o Kcome beca e Khe are
 12 noK going Ko be in ol ed in either Khe pro ec Kion or

12

defen e o .10 ? KhiKrg mea loKa e. Imink.97 0 T

1 inK the ild of economic theor , o elcome Ko the
2 ild .

3 MR. FROEB: Thank o , Tad. Greg? While e
4 are aiKing for Greg, I anK Ko a k Greg Werden a
5 ge Kion. Bokh Tad and Joe rai ed ge Kion abo K merger
6 im laKion, iK a eldom ef l e erci e, Koo co Kl ,
7 Koo Kime con ming, and iK per a i e onl hen e are
8 ing iK Ko j Kif omeKhing e alread kno , like from
9 the KKalik of the factK , e kno KhaK the merger i noK
10 going Ko rai e price, here an economic model KhaK a
11 KhaK.

12 Do o ha e an reacKion Ko KhaK? Ho
13 freg enKl iK i ed, ho freg enKl iK infl ence
14 deci ion making atK the DOJ?

15 MR. WERDEN: In the fir K place, I don K Kthink
16 eikher of them ere a negaKi e on merger im laKion a
17 o gge Ked the ere, parkic larl noK Tad.

18 MR. LIPSKY: I K helpf l Ko clarif . I o ld
19 agree the o Kcome i eldom er per a i e. I K doe n K
20 deKermine the o Kcome and ofK en i reall noK
21 fficienKl per a i e Ko ha e a major infl ence on the
22 j dgm enK.

23 MR. WERDEN: I Kthink Khere are K o kind of
24 major infl ence . One, atK a er earl Kage, Khere
25 cerKainl ha e been ca e here merger im laKion helped

1 decide not to proceed with an investigation. Very quick
2 and direct merger implementation, confirming that some people
3 already present, in preparation for this merger not
4 raise price much, to lower price, not case.

5 Also, there are a number of cases in which I
6 think appropriate analysis is a given a lot of eight in
7 the agency decision about challenging or not challenging
8 a merger.

9 MR. FROEB: Greg, go ahead.

MR. LEONARD: Thank you. Like, Greg and I here

1 c Komer , o forkh and o on. Then o ha e merger
2 im laKion.

3 The ho ldn K be b Kik Ke for each oKher.
4 The reall ho ld be complemenK . The bokh add
5 omeKhing Ko Khe part .

6 Merger im laKion ha K o piece Ko iK. The
7 fir K i haK I d call g e KimaKing con mer demand
8 f noKion . Yo can do KhaK ikh economEKric . Yo can
9 do KhaK po ibl b looking at doc menK , if Khe correct
10 one are o K Khere.

11 The econd ca e i Khe model of firm beha ior
12 o are going Ko e. People ha e been Kalking abo K
13 oligopol model . That haK I mean Khere.

14 The K o piece KogeKher are haK con Kik Ke
15 merger im laKion. When I Kalk abo K iK, I m going Ko
16 mean Ko incl de bokh piece .

17 Lek me fir K a haK doe merger im laKion
18 add here o ha e Khe doc menK . ANKorne cerKainl
19 like iK. With economi K , I o ld a Khe ha e al e.
20 What doe merger im laKion add? I g e haK I o ld
21 arg e i iK help mo e merger anal i clo er Ko haK I
22 o ld call cience. What do I mean b " cience?"

23 The mo K importanK Kthing i KhaK Khe anal i
24 i ba ed on a eK of Kheorie or a Kheor KhaK i
25 Ke Kable. That reall Khe e ence of haK cience i

1 about. We come up with theories. We test them. If the
 2 predictions are accepted, we keep working on them.
 3 Eventually, the model may be rejected, and we come up
 4 with a better theory. That's how the scientific method
 5 is all about.

6 Second, and has been mentioned earlier
 7 today, the underlying assumption of the analysis are
 8 clearly delineated. The third thing is the results
 9 of the analysis can be replicated by somebody else.

10 Finally, scientific analysis typically will
 11 allow you to calculate the precision of results. I
 12 think Tad mentioned that it is conditional on the
 13 assumption, and that is certainly true.

14 What would merger implementation be a
 15 science? I guess the first thing I think a probably the
 16 most important is to get closer to objectivity and
 17 further from subjectivity. That is again how science is
 18 really about.

19 Secondly, it provides some certainty. If you
 20 know the rules of the game are, and that's the whole
 21 purpose for the merger guideline, I think, to lay out
 22 some rules and to make sure that the game is going to be
 23 played, and then give people an idea about how the
 24 analysis will go and allow them to know how things
 25 are going to fall.

1 ha e the oligopol theor , hich a omeone a pointing
 2 o , i ba ed on infringement from man , man ear ago.
 3 It ha been arg nd for a long time.

4 We kend ko la o the a mpion , the
 5 nderling a mpion , er clearl , and khi i a er
 6 importan point. It a a mpion can ofen be
 7 ke ked. I think that i another a peck of all khi that
 8 i er importan.

9 For in kance, the demand model o choo e can
 10 be ke ked. We can di king i h been a logic model and
 11 an AIDS model perhap nder the right condition .

12 I can gi e another economi the data and I can
 13 a here hat I did, and that per on could hope ll
 14 get the ame re , replicaion.

15 There are going ko be choice along the a and
 16 e ma di agree abo who e, b ak lea e kno hat
 17 who e choice are, and the are ll de cribed.

18 Finall , o can get a kandard error for a
 19 predicd price change. Again, it i conditionl on the
 20 a med demand model and a med oligopol model , b
 21 hope ll again who e ha e been bjeck ko ome ke king
 22 along the a .

23 The o-called doc men approach, it i not
 24 reall a cience, ak lea in the ame en e. Fir of
 25 all, all not incredibl ell linked ko economic

1 re, but can be replicated, and lead in the same a
 2 that a merger in law can be, because you are going to
 3 have two different people look at the documents and
 4 review them and come up with different conclusions.

5 Finally, in terms of some questions that have
 6 been raised about merger in law. Is it a perfected
 7 technique? The answer to that is clearly no. That is
 8 true of almost any scientific inquiry. It is never
 9 complete. It is never final. Things are always refined.

10 It does not need to be finalized to be useful.
 11 Whatever the current state is, it can be useful in
 12 certain areas, even though it may be improved upon later.
 13 I think it is a theory of evolution.

14 In Darwin's original form of law, he thought
 15 that evolution occurred gradually over time. When he
 16 looked at the fossil record, you would find one organism
 17 that clearly evolved from an earlier one, but there were
 18 other differences, and it talked about a being gap in
 19 the fossil record, where missing the fossil for the
 20 organism in between.

21 The proposed equilibrium theory developed
 22 and basically had it as a minimum, evolution
 23 is gradual. It happens in horizontal and there is
 24 no change for long periods of time in between. It
 25 explains the fact better, and it is perhaps a better

1 Theor Khan the original one.

2 If you go back to the 1930 and 1940 , it
3 does not mean Darwinian formulation at all. In fact,
4 it formed a lot of scientific thought.

5 The second generation that come up is due
6 merger in Darwinian provide an answer. No, it does not.
7 That one of the consequence of the fact that in the
8 science, we have to go on and we have a problem, and
9 we might find the assumptions are not valid. Then the
10 merger in Darwinian is not going to be -- at least in that
11 format, it is not going to work.

12 It would be impossible to capture all the
13 economic process in a model that is going to work,
14 given we are not going to be able to do the merger
15 in Darwinian in that case.

16 If you contrast that to the document approach
17 here you can always get an answer, you can get an
18 answer you are within the bound of reason. You can
19 often get two answers, one for the defendant and one for
20 the plaintiff.

21 I would argue that because it is a science, you
22 are not always going to get an answer, and that is a fact
23 of life, I think.

24 Does merger in Darwinian in itself a choice? Yes,
25 it clearly does. The good thing is the choice are

1 clearl artic lated, and o can get do n Ko bra Kack
 2 and ha e the e perK on each ide arg e abo K haK the
 3 righK choice i . OfK en, the choice are bjeK Ko
 4 the King. Again, er imporkanK. That a a Ko re ol e
 5 the arg menK .

6 If o conKra K haK Ko the doc menK approach
 7 here the a mpKion are ofK en noK e pre l Kated and
 8 ofK en can K be K e K ed or cerKainl aren K K e K ed, I K think
 9 where the choice are o hidden. That make it er
 10 differenK. And the fact K haK there might be di p K e
 11 among e perK abo K haK choice Ko make. It doe n K
 12 make merger im lation an le a cience. ScientiK
 13 di p K e ha e e i K ed fore er. There are a Ko re er e
 14 them.

15 I merger im lation the onl co- cientiK
 16 merger anal i , and I o ld a no K haK. CerKainl ,
 17 there are oKher kind of anal e K haK are co- cientiK
 18 K haK are helpf l. We can look at haK happen in the
 19 ind K r hen one firm planK blo p and in K able Ko
 20 ppl the markeK an more, and ee here c Komer K rn
 21 Ko and haK oKher firm do in Kerm of price .

22 Yo can al o look at haK happen hen there i
 23 a ne prod K inKrod Kion. There are ob io l
 24 comple iKie abo K the e K pe of anal e a ell, and
 25 choice and e er K hing el e. In cerKain ca e , the are

1 going to be more appropriate.

2 FTC . Skaple is an example of that, here
3 the analyses were done based on looking at market here
4 where there are a different number of competitors or here the
5 number of competitors changed.

6 Should the merger impact approach replace
7 the document approach? As I said at the outset,
8 absolutely not. A lot of time, you can look at the
9 document and it is going to give you a very
10 qualitative information that allow you to fix the model
11 better and give you in a more detailed, and perhaps
12 even allow you to do some testing of the model, as I
13 said, is very important.

13 What I am going to turn to is one of the

1 ba icall cancel each other out and the fact finder
2 does not pass an antitrust test.

3 I think there is some of that. What Tim is
4 talking about before, perhaps having an idea of per se
5 rule or some of those things would be helpful in that
6 regard.

7 There are some that feel merger implications
8 should not be attempted in a courtroom. I think it is
9 crucial to send some more logical analysis. As
10 an example, I am thinking about intellectual property
11 damage cases.

12 What happened is basically had to have
13 where there are no acceptable non-infringing but they do
14 get an economic profit at all. Of course, there is this
15 reasonable rule of thumb. It does not mean
16 don't get an economic damage, but don't get an economic
17 profit.

18 In terms of the bare faced approach, it kind
19 of made things better, but again, it is based on
20 a position that an economic condition, I think, or
21 would not be a leak.

22 I think implications would really help in the
23 kind of case and hopefully will be used some time soon.

24 Greg already talked about this stuff, so I am
25 going to skip that. I just want to do one thing about

1 the effect of comparing prediction from merger
 2 in relation to actual outcome. It is about the a
 3 standard scientific practice to do that.

4 I have this paper in the Jerr Haman here e
 5 to do that a little bit, I think in the middle,
 6 but fairly positive.

7 Since ever since it is really different,
 8 I'm not sure how much it would help to a in the effective
 9 in the, the have validated the merger in relation
 10 approach. It's not clear to me how much that would help
 11 when we are applying it to the other one.

12 Finally, I guess I'll just finish by saying a
 13 I said before, this is a development process, a full
 14 science, and there are clearly areas where merger
 15 in relation can be improved. I think number one on the
 16 list is the old Darwin model. Bertrand has taken a
 17 beating today. It's about the time, just in economic
 gen terms, I would be imagining to them. pick me up

1 have er o ank.

2 MR. KATTAN: I ack all find m elf in
3 agreement ikh mo k of the khing kha k the economi k
4 have aid. Certainl hen the critig e the legal
5 method. I think the have a alid point. Their model
6 are o k there. Their a mpkion are clearl
7 artic lated, and e can beak p on them b a ing, ell,
8 I have a problem ikh kha k a mpkion or khi a mpkion.

9 The model kha k are e plici kl b la er are a
10 lok more diffic lk k o di cern. There i certainl a
11 difference in the le el of opaci k , and therefore, in the
12 cep kibili k of the model k o g e k ioning, and the deck
13 i kacked in k k ionall in fa or of the la er ,
14 largel beca e the con krol the proce .

15 To me, the i e i h k do I do hen I have a
16 ek of choice , each of hich i going k o predic k a price
17 increa e no m k k h k , and I m kold ba icall kake o r
18 choice, hich poi on do o ank.

19 I o ld a k Greg Leonard, ho do o ell k o a
20 client the idea kha k the reall have k o do khi , o
21 kno , ho e er man k ho and of dollar ik i going k o
22 co k k hem k o pa o , k o come ikh a model kha k ill
23 predic k the price increa e, ne k k o hich o ill have
24 e , b k if o co nk for efficiencie , o acco nk for
25 khi , o acco nk for kha k, kha k price increa e ill be

1 ob iated or i ch a mall price increa e, i i
 2 reall holdn m.

3 MR. LEONARD: I think o ha e o go in o i
 4 reali ing the model i going o predic a price
 5 increa e, nle ho e co and ela icie are ero,
 6 hich i nlikel in a lo of he e ca e . If o ge
 7 one percent or o percent, i i j n o gh o
 8 orr abo , e peciall beca e there are probabl
 9 off eking effect . If he are e en mall efficiencie ,
 10 i going o ipe o .

11 MR. KATTAN: There i hi lang age in the
 12 merger guideline , hich I can recie a ell a I
 13 hold be able o, de o the fact that the fi e percent
 14 ke i n o a tolerance le el for price increa e , and e
 15 ~~TD(6)Tj5.1097 -2 TDh Kione .~~

1 MR. LEONARD: If I go back to the guideline
 2 and overall, that sort of hold nothing. If
 3 I follow the guideline strictly, neither by
 4 or second, if it's the third one, I can
 5 still have a price increase there, too. This is the
 6 economic of it and I don't know how to get around that.
 7 I don't think following the guideline or merger
 8 implementation are from that. Again, you are making an
 9 assumption in there, that we don't care about it if it
 10 the third on the list. I don't know if that's right.

11 MR. FROEB: Tad?

12 MR. LIPSKY: I think part of the problem -- I
 13 think there are some respectable role for implementation,
 14 making explicit the hidden assumption is a good one. I
 15 feel that a lot of the evidence, that triggered the
 16 thought a mention of the five percent. Back then
 17 the 1982 guideline were written, one of the principal
 18 reason about increasing the five percent SSNIP was a
 19 that it would give an unobtainable degree of
 20 precision.

21 You know, this is going to become a standard
 22 and the latter are going to be on this, it's a
 23 specific number, set in a specific area, and re-
 24 enough, that we've had happened, to the point that
 25 I may recall that the major feature -- there a

1 all an 1984 of guideline issued by Paul
 2 McGrath -- one of the major features of the 1984
 3 guideline is a big increase in the aid,
 4 no, and a minimum, so that all have the wrong idea on
 5 the five percent. Some markets could be seen and
 6 some markets could be 1.5. This is just mean to suggest
 7 the right question and the magnitude. He has no idea
 8 about.

9 Similarly, I think, in the implementation area, if
 10 you can be confident about the sign of the first
 11 derivative for an of the major variable, whether it is
 12 price, or cost or whatever, someone is going to triumph
 13 from the fact that you can establish it from an modeling
 14 device at all, that would be real progress.

15 I really liked the analogy to the dipole over
 16 equilibrium. We know that even after pronounced
 17 equilibrium is a popularized as a theory, there are some
 18 modeling gradually to describe pronounced equilibrium
 19 in a manner intended to be pejorative as equilibrium
 20 jerk. Of course, there are pronounced equilibrium
 21 respond by calling the gradual equilibrium creep,
 22 which suggest something of the flavor of the debate over
 23 the general effect of theory in anti-inflation.

24 The question I am going to pose is this, and let me
 25 answer bluntly. Most is that most of the

1 MR. WERDEN: There are a million ob Kacle KhaK
 2 Kand in Khe a , noK Khe lea K of hich i o don K
 3 ha e Khe Kime. ThatK o ld Kake e Kra monK , I Kthink,
 4 and o don K e en ha e e Kra da in mo K of Khe e
 5 merger ca e .

6 IK o ld be fairl e pen i e, b K I m re o
 7 o ld campaign for e Kra f nd for Khe agencie Ko
 8 pporK KhaK.

9 I don K kno KhaK Khe deci ion maker ho Kkill
 10 remain la er are going Ko care abo K Khe independenK
 11 g . I don K kno KhaK Khe care abo K Khe in ide g .
 12 I don K kno KhaK ik o ld be gi en an eighK.

13 I can imagine doing omeKhing like KhaK, m ch
 14 more o K ide of Khe agenc Khan in ide. I ppo e if o
 15 hire Khe e people a Kemporar emplo ee , o co ld ol e
 16 Khe confidenKialik problem , b K Khen Khe e g o ld
 17 ne er be able Ko riK e abo K Khe e Khing and Khe ma
 18 noK anK Ko do KhaK.

19 GetKing people Ko make Khe commiKmenK Ko get p
 20 Ko peed on Khe e Khing i Ko gh. We find ik hard e en
 21 hen e are pa ing people \$800 an ho r Ko get KheM Ko p K
 22 Khe Kime commiKmenK in. IK noK going Ko be ea Ko get
 23 ol nKer for Khi orK of Khing, and ik create
 24 conflicK of inKere K. I don K Kthink Khere are going Ko
 25 be a loK of Kaker .

1 Co rnk appointe d e perK , I ha e ome haK more
 2 mpaK h for, b K I don K K hink iK ha e er been done
 3 c ce f ll . There ha en K been a loK in anK iK r K
 4 ca e , b K I K hink ne er c ce f ll . The K rack record
 5 i n K o good.

6 I K hink K haK mighK make ome en e,
 7 paK iK larl if haK K he co rnk appointe d e perK a a ked
 8 K o do i haK Tad gge K , hich i K o K ell K he j dge
 9 doe K hi K heor make en e, i K hi in K he main K ream,
 10 haK doe K hi K heor reall depend on, i K here ome
 11 faK al fla in K hi K haK an ne K ral per on o ld ee,
 12 K haK K he are K r ing K o paper o er, and K he e K o e K reme
 13 po iK ion I m geK K ing from K he K o ide , hich i
 14 clo e K K o K he K r K h.

15 There are a loK of K hing K haK a co rnk
 16 appointe d e perK mighK be able K o do c ce f ll ,
 17 alK ho gh if K he are appointe d K he a Fred Kahn a
 18 appointe d, like an arbiK raK or, b K riking people from a
 19 li K, o are going K o geK K he lea K common denomiK aK or
 20 e perK, noK K he be K e perK. I don K K hink K haK i going
 21 K o ork K oo ell.

22 MR. FROEB: I anK K o K rn from merger
 23 i m laK ion, hich nfoK naK el or noK, iK eemed K o ck
 24 p all K he debaK e on K he panel. There are a loK of oK her
 25 i e a oiaK ed iK h, nilaK eral effeoK . I anK ed K o

1 Ko Khem o Ko o r EC i i Kor, Ko Valerie.

2 I i po ible Ko allege both, nilaKeral and
3 coordinatKed effectK in a merger ca e? Ha e o e er
4 Kried Ko do KhaK?

5 MS. RABASSA: We ha e Kried Ko do KhaK.

6 MR. FROEB: We ha e 10 more minKe . I anK Ko
7 gi e each of Khe paneli K K o and a half minKe , and
8 I m going Ko be Krick here, Ko m p kind of a big
9 picK re K pe g e Kion. WhaK criKici m do o ha e of
10 Khe g ideline , Khe g e Kion of nilaKeral effectK , and
11 haK po iKi e gge Kion do o ha e for iK
12 impro emenK.

13 Greg, do o anK Ko KarK?

14 MR. WERDEN: I g e m main concl ion o ld
15 be iK o ld be ill Ko re- riKe Khe g ideline . The
16 o ld come o K or e. The al a do. The e commiKee
17 projectK are noK good idea . An one per on co ld
18 probabl do beKer Khan both of Khe agencie can do
19 KogeKher. M main advice al a i don K riKe
20 g ideline , and KhaK advice ha been Kaken on a n mber of
21 occa ion .

22 I don K Khink Khere i m ch in Khe a KhaK I
23 don K like in Khe nilaKeral effectK eKion of Khe
24 g ideline right no . I K arKic laKe in er general
25 Kerm Khe Kheorie . ThaK i haK g ideline are ppo ed

1 Ko do. I do n a er m ch abo the e idence.
2 That i ha g ideline don do er ell. I do n
a an i3n 7(That i ha g id9be .097 0 TD(2)Tj5.1323 -11.21.1 a

1 MR. FROEB: Joe?

2 MR. KATTAN: I ack all agree iKh m ch of haK
3 Greg aid, and in parkic lar, I m noK re Khak e co ld
4 do m ch beKer iKh Kh e c rrenK g ideline , hich do
5 addre Kh e i e aK a le el of generalik Khak I Khink
6 i appropriaKe.

7 Jim Rill ha oiced ome of Kh e imilar
8 criKici m Khak I ha e, o I don Kh Khink iK nece aril
9 Kr e Khak none of Kh e people in ol ed in Kh e 1992
10 g ideline ha e concern abo Kh modeling, b Kh iK
11 ab ol Khel correK Khak Kh e g ideline a ab ol Khel
12 noKhing abo Kh modeling, and I m noK a ing Kh e im laKion
13 approach i n Kh appropriaKe, b Kh I Khink iK i Kh e ca e
14 Khak iK nece aril a k a ome haK differenK g e Khion
15 Khan Kh e g ideline do, herea Kh e g ideline foc on
16 Kh e pacial eparatKion ba ed on g alikaKi e aKKhriK e ,
17 prod K aKKhriK e , marketK aKKhriK e . Man of Kh e
18 im laKion define differenKiaKion b nece iK ba ed on
19 marketK hare. ThatK i Kh e ignificance of firm i ba ed
20 on marketK hare.

21 The 35 percentK i e, Greg i right Khak if o
22 read Kh e lang age er clo el , and read like afe harbor
23 lang age, on Kh e oKher hand, ha Kh e been a ca e ince
24 1992 here, nilaKeral effectK ha e been alleged, nder 35
25 percentK?

1 The realiK ma be differenK. I Kthink iK i
2 the ca e KhaK mo K people do ie iK a a afe harbor.

3 MR. FROEB: Greg?

4 MR. LEONARD: I g e I o ldn K anK Ko K op
5 aK the 35 percentK, getK rid of KhaK, and getK rid
6 of hare alKogeKher iKh differenKiaKed prod cK , Khen
7 the reall j K are enKirel meaningle .

8 I Kthink Khe g ideline are Kring Ko e ome
9 Kerm KhaK a loK of differenK people can nder Kand, and
10 la er and Khe companie KhaK are Kthinking abo K merging
11 and o forK. A ide from Khe hare i e and Khe 35
12 percentK, I probabl o ldn K change an Kthing eikher.

13 MR. FROEB: Valerie, I am going Ko open iK Ko
14 o . Yo can Kalk abo K o r g ideline or Khe ne l
15 prom lgaKed EC g ideline . Feel free. Do o ha e an
16 gge Kion for change? Big pick re?

MS. RAE10M a4.097 0c8 onR4kK o ee Groa en

gge K ar e4.024Yfree. Do

1 This broader institutional problem, which I
 2 think allows the firm problem to arise, to continue,
 3 which is the decision maker, because they are larger,
 4 are essentially free to ignore how the economic are
 5 telling them. The solution, I think, are trying to
 6 get to a again analysis that are closer to the truth,
 7 and I think they are doing it to make it less easy in
 8 some way for decision maker to ignore how the
 9 economic are telling them, but, also, I think there is
 10 a degree of amount of a better term, no intended,
 11 the consideration between the competing economic theories
 12 need additional permission, both within the agencies and
 13 before work.

14 We have focused on some of the institutional
 15 that might be needed to accomplish that. That, I think, is
 16 the direction to look for, a discipline that will
 17 facilitate scientific progress.

18 MR. FROEB: I am going to give the last word to
 19 David Scheffman, who is sitting here.

20 MR. SCHEFFMAN: This is a very good panel, a
 21 lot of good discussion. I did focus too much on
 22 implementation. Very clearly, the implementation model really
 23 aren't so complicated. It is sometimes A and B and some
 24 equilibrium condition and stuff.

25 What do you don't think about the A/B model

1 doe n't necessarily mean there is going to be a price
 2 increase. In fact, I think one of the problems in the
 3 labor market in industrial markets here the labor will
 4 change, nilateral effects cause on seemingly a good
 5 adjustment, the economy will change them off,
 6 competition is much more complicated, you can look at
 7 it that a, but all of a sudden you have a brand, and all
 8 of a sudden you have a theoretical work.

9 I keep asking the economy -- I don't think
 10 it is free because more time economy and agencies are
 11 doing both in labor and you have some other economy
 12 actually getting into the detail of competition, you
 13 have to do that in either case. Simulation can be
 14 useful, but I caution you and I keep asking this, A and B
 15 analog is ever good and there is nothing wrong in the
 16 guideline. It is a remarkable prediction. It
 17 remarkable all the time in industrial product merger.
 18 Economy don't seem to forget that when the economic
 19 demand elasticity.

20 Let me give you one example. There are a lot
 21 of problems in retail and wholesale. I have been
 22 working in soft drink for over 20 years, and I am not
 23 convinced there is a substantial percentage of people who
 24 are in between Coke and Pepsi when prices are near a
 25 parity. That is the demand curve is ever flat. No one

1 e Kimake a demand cre like KhaK.

2 That i j K one of man rea on h o Kthink
3 abo K h Khi Kheor ma noK ork. A K all , Khe demand
4 cre ma be er flak, ma ha e kink , haK e er.

5 Tho e are Khe Kthing e orr abo K in
6 ind Krial prod oK merger , beca e e a k Khe c Komer
7 and Khe a , ell, I m a K all noK orried altho gh A
8 and B are m K o premier g alified pplier , beca e I
9 can geK iK ome here el e. We a , ell, KhaK doe n K
10 ork.

11 We need Ko Kthink ome more abo K Khe
12 f ndamenKal Kheor in Khe g ideline . There i noKthing
13 rong iKh KhaK, b K iK a reb Kable pre mpKion. We
14 need Ko Kthink abo K a Ko heKher iK i righK or noK.

15 MR. FROEB: On KhaK noK e, I anK Ko Kthank all
16 of Khe paneli K and Khe a dience.

17 (Appla e.)

18 (Where pon, atK 12:30 p.m., Khe ork hop
19 rece ed for l nch.)

20

21

22

23

24

25

A F T E R N O O N S E S S I O N

C O O R D I N A T E D E F F E C T S

MR. KNIGHT: Good afternoon and welcome to the panel on coordinated effects. Coordinated effects analysis might be better termed, perhaps, the observation that predictions are enough, especially about the future. Of course, Section 7 of the Clayton Act call for predictive analysis, and the Agencies have indeed made great efforts over the year in an attempt to answer the often difficult question of whether a particular merger is likely to enhance or diminish competition in the relevant market.

Historically, much of that focus has been on concentration. Indeed, concentration continues to serve as the threshold test for coordinated effects. However, as the 1982 Merger Guidelines recognize, and recent agency pronouncements confirm, a lot of the concentration data provided a starting point for analyzing the competitive impact of the merger.

What comes next in regard to coordinated effects analysis is the topic of this panel. The Merger Guidelines consider the theories of competitive harm, unilateral effects and coordinated interaction.

During the 1990 and continuing through today, much has been written and said about the coordinated

1 effect theories and various approaches to achieving
2 coordinated effects of merger.

3 Recently, both agencies have significantly
4 renewed their interest in the analysis of coordinated
5 effects.

6 This panel represents a continuation of that
7 effort. Today, we are delighted to have a full list of
8 esteemed guests.

9 Deborah Majoras is with the law firm of Jones,
10 Davidson, Rea & Pogue, here the practice in the area of
11 antitrust law, among other. From April 2001 to the end
12 of last year, Debbie served as Deputy Assistant
13 General of the Department of Justice Antitrust Division.
14 During her tenure at the Justice Department, Debbie
15 responsible for the civil, international and
16 foreign -- she oversaw a number of matters involving a
17 myriad of industries, from software to financial services
18 to defense, health care, media and entertainment, to
19 industrial equipment.

20 In addition, she served as the chair of the
21 International Competition Network Group and oversaw a
22 policy initiative which the DOJ review process
23 initiative, best practices project, the merger remedies
24 manual, and the data to the DOJ/FTC health care hearing.
25 She has often a frequent speaker on behalf of the DOJ.

1 In her current practice, Debbie also speaks
2 and writes on anti-trust issues.

3 Dr. David Scheffman has recently rejoined LECG
4 as a director, after a second stint with the Federal
5 Trade Commission as Director of the Bureau of Economic
6 Analysis. He is also a professor in business strategy and marketing
7 at the Undergraduate School of Vanderbilt University,
8 where he has chaired a professor in the 1990s.

9 Dr. Scheffman is a noted scholar in the area of
10 anti-trust economics, among other things, and has written
11 several important articles and books.

12 In his most recent role as Director of the
13 Bureau of Economic Analysis, David has instrumental in
14 implementing a wide range of analytical instruments
15 in evaluation, promoting best practices for
16 interaction between the Bureau of Economic Analysis and outside
17 parties, including economic and financial consultants.

18 Dr. Andre Dickstein with Charles River
19 Associates. Prior to joining CRA, he was the Acting
20 Chief of the Bureau of Economic Analysis.

in b m097eb between the Bureau and instrumental in

1 Andre has worked on a wide range of merger and
 2 non-merger projects on electronic networks, cable,
 3 broadcast and media, computer software and services,
 4 insurance and health care.

5 Dr. Steven Salop is a Professor of Economic at
 6 Georgetown University Law Center in Washington, D.C.,
 7 where he teaches economic and economic reasoning and the
 8 law. He is a contributor to the Charles River Associates,
 9 focusing on microeconomic and regulation. He has
 10 written numerous articles on various areas of economic
 11 and law, including antitrust, joint venture and
 12 coordination.

13 His research has focused, among other areas, on
 14 various aspects of merger and joint venture, including
 15 market definition, ownership issues, and efficiencies.
 16 It also includes telecommunication, electronic commerce,
 17 computer hardware and software, financial services and
 18 consumer products.

19 Dr. Jonathan Baker is a Professor of Law at
 20 American University College of Law, where he teaches
 21 courses in the area of antitrust and economic
 22 regulation. From 1995 to 1998, he served as the Director
 23 of the Bureau of Economic and the Federal Trade
 24 Commission. From 1993 to 1995, he was a Senior Economist
 25 at the Council of Economic Advisors in the Executive

1 Office of the President.

2 Dr. Baker has served as Special Assistant to
3 Deputy Assistant Attorney General for Economic and the
4 Antitrust Division of the Department of Justice, and as
5 Assistant Professor at Dartmouth's Tuck School of
6 Business Administration, a fellow at the American Bar
7 Association's Center for the Study of the Federal Trade Commission.

8 Professor Baker is currently involved with the
9 American Bar Association's Division for Antitrust Law,
10 and is a senior consultant with Charles River Associates.

11 Paul Yde is with Freehfield, a national
12 law firm in Washington, D.C. as of March
13 of 2002. He is currently chair of the Antitrust
14 practice group. He has served as advisor to the Federal
15 Trade Commission and as a litigator in the
16 FTC Bureau of Competition.

17 In addition to being recognized as a leader in
18 antitrust law, he has been active in the leadership of
19 the Antitrust Division of the American Bar Association,
20 he has been a speaker and a moderator at seminars, and
21 he has been on the editorial board of the Antitrust Law
22 Journal and Antitrust Magazine.

23 As the moderator of the panel, I will attempt
24 to lead the discussion through a number of relevant
25 issues. While more questions may all be addressed to

1 all panels , all panels are encouraged to jump in
 2 the discussion and participate in the discussion of their
 3 own.

4 With that, let's go ahead and get started.
 5 Perhaps a good place to begin is the discussion
 6 of the definition of coordinated effect. What do we
 7 mean? The Merger Guidelines focus on a number of
 8 whether a merger may lessen competition, and I am
 9 particularly interested in the appropriate
 10 definition?

11 MR. SCHEFFMAN: Thank you, Mike. Sorry for the
 12 long introduction. I hold the given an
 13 abbreviated bio. I am going to be a
 14 proponent. I am given a handout. I am not going to
 15 talk about all of this.

16 Let me step back to the beginning, to my
 17 beginning in antitrust. When I came to the Commission,
 18 and Steve Salop was here, too, when I came to the
 19 Commission, were litigating the Cereal case, and both
 20 of the antitrust agencies had enforcement
 21 efforts against oligopoly.

22 If you think about the Cereal
 23 case, which I am not a big fan of, but it is a
 24 interesting case. If you look at the Commission and
 25 the litigation about the Cereal case, and looking

1 aK ho e anal e merger in concentratKed ind Krie no ,
 2 where i a KKal di connectK. ThatK i partK haK I anK
 3 Ko Kalk abo K here.

4 I am going Ko j mp Ko lide Khree, and partK
 5 khi ha happened a a re, lK of Khe fog on nilaKeral
 6 effectK .

7 We a KhaK iK Kr e formall KhaK Khe model
 8 KhaK e, e in nilaKeral effectK are "oligopol " model .
 9 WhatK I learned back in Khe dark old age of economic , i
 10 Khe are Khe mo K primitiK e oligopol model . The e are
 11 model KhaK do not incl de e actl haK o Kthink mightK
 12 happen in ind Krie KhaK e Kpicall re ie Khe e da
 13 for merger . Specificall , in Co rnoK and BerKrand, Khe
 14 a mpKion, hich e er one reali ed m K not make an
 15 en e in a concentratKed marketK, i KhaK each competKor
 16 a me KhaK iK action do not Kimp lare reactKion b
 17 Khe oKher competKor .

18 Economi K ha e kno n for almo K 100 ear KhaK
 19 khi a mpKion probabl doe n K make en e a anal i
 20 of real beha ior in concentratKed marketK , b K KhaK i Khe
 21 orK of anal i e ha e in nilaKeral effectK incl ding
 22 in "oligopol " model like Co rnoK and BerKrand.

23 In factK, game Kheor i m ch richer Khan
 24 Co rnoK and BerKrand.

25 Some people ha e aid, nilaKeral effectK i all

1 o need beca e if o b ild coordinatKed inKerackion on
 2 Kop of KhatK, iK i e en or e, o if o ha e a ca e iK
 3 nilaKeral factK , Khen o ha e a coordinatKed inKerackion
 4 ca e, Koo. ThatK co ld be Kr e, nder ome partKic lar
 5 model . Ho e er, haK e ee in man concernKed
 6 marketK i m ch more competKive beha ior Khan haK e
 7 predicKed b Co rnoK or BerKrand, beca e a loK of Khe
 8 beha ior i noK abo K picking a price on a demand c re,
 9 b K Kr ing Ko hifK o r demand c re aK Khe e pen e of
 10 o r ri al .

11 WhatK happened in coordinatKed inKerackion, i.e.
 12 oligopoli Kic inKerdependence? In Khe 1980 , Khere ere
 13 a loK of coordinatKed effectK ca e , primaril beca e of
 14 Khe le el of concernKion. The ere, in factK,
 15 coll ion ca e . The anal i a Khe checkli K and
 16 arg ing abo K heKher or noK coll ion a po ible in a
 17 gi en ind Kr and in a more ca al manner, haK Khe
 18 merger mighK ha e Ko do iK KhatK.

19 The mo K completK record of KhatK i Khe ca e in
 20 hich Khe B rea of Economic memoranda ere ack all
 21 di co ered b Khe oKher ide, and o a Khe big Ken ion
 22 beK een Khe la er and Khe economi K abo K Khi .

23 WhatK ha happened ince? CoordinatKed
 24 inKerackion ha goKken ome rene ed empha i iK Khe ne
 25 Admini Kration, alKho gh iK reall had ne er gone a a .

1 What is it based on?

2 If we go back to the 1982 Guideline, the
3 theoretical foundation of the 1982 Guideline is a
4 Stigler theory of oligopoly. Stigler theory of
5 oligopoly is a brilliant paper, but it is a theory of
6 collusion. What occurred since the Stigler paper is the
7 development of dynamic game theory. There are a lot
8 of results in dynamic game theory. You can get almost
9 an result. So, it is not very helpful. But, the focus
10 of dynamic game theory, particularly a Cournot, is
11 on collusion game. But there are a lot of "things" in
12 between collusion and perfect competition.

13 What I am suggesting is that we need to go back
14 to something like oligopolistic interdependence, not
15 tacit collusion. Collusion theory does not all really
16 fix the merger issue, although there are few
17 issues here it does fix.

be the b

05.7leai in r... on... oi an... K... K... e... d... f... b... a... a... K... K... he... the

11

1 case, the type of case. One category which I would add is
 2 interaction here is the oligopolistic coordination,
 3 which seems to lead to have the ideal competitive
 4 circumstances which might be adversely impacted by a
 5 merger.

6 They are the things we should be concentrating
 7 on. I think that is what the agencies actually do. I
 8 think that is what the attorney actually focuses on. I
 9 think in coordinated interaction case, that the
 10 attorneys are focusing on in most cases is the evidence
 11 that is the actual nature of competition. They are
 12 trying to prove, for example, in a unilateral effect
 13 case, not that A and B are close buyers, which
 14 often is the evidence not the primary one, but that they
 15 are particularly close competitors.

16 In non-unilateral effect case, they are
 17 looking for evidence that the parties to the merger in
 18 some sense are behaving "cooperatively."

19 This is the area that I think the economist
 20 could have the most impact, in the theoretical prediction
 21 of theories, which don't really explain a lot of what
 22 we are actually trying to analyze.

23 MR. KNIGHT: Thank you. Jon?

24 MR. BAKER: Thank you.

25 Let me first respond by bringing you back to the in a

1 able to identify and reach the outcome .

2 That when we do coordinated effect
3 analysis, we are spending a lot of time thinking about
4 whether firm can reach a conclusion on coordinated
5 effect or come .

6 There are a bunch of examples of in the
7 Guideline, and when I am working on cases in the
8 Antitrust Division and working under the 1992 Merger
9 Guideline and other cases at the FTC.

10 MR. SALOP: You all might be surprised by I am
11 actually in my hands here, the actual
12 framed in Kodak. You have to understand, David and I are
13 both old guys. You have to go back in the context
14 of the work of model that we learned when we were in
15 graduate school, back before there were graduate school .

16 Basically, David is talking about it is
17 called to be called conjectural variation model. You
18 start off with a basic unilateral effect model and
19 expand by adding there is some conjectural variation,
20 that if firm one raises price, when firm two will react
21 by changing its price a particular amount, and firm one will
22 anticipate that reaction of firm two. There are more
23 complex work of Nash-Bertrand equilibrium model .

24 I think we need to think about the model. I
25 think a modeling strategy, the unilateral effect

1 to accommodate each other and it is already there. There is already
2 a natural for and looking elsewhere.

3 The second task that the have to accomplish
4 accomplish is monitoring whether there has been
5 compliance with that agreed upon accommodation. Again,
6 the notion is over time they are going to learn whether
7 they can work one another. Again, repeated interaction
8 is key.

9 The third task, of course, is in the event that
10 there is deviation from the agreement, they have to have
11 a fallback plan. Again, that is for and looking. If they
12 are in the latter period of competition, there is no scope
13 for punishment and everything is natural.

14 I would agree with Jon that there is a very
15 simple and elegant point made in the Guideline, which is
16 that all the profitability of the coordinated
17 strategy is contingent upon accommodation, and
18 economic, and game theory in particular, has repeated
19 interaction as being essential to that.

20 MR. KNIGHT: Let me go to the Guideline for a
21 moment. The focus of the analysis on looking at the
22 post-merger market, in particular, whether it is one that

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1 Stigler-Potter checklist of factors, to look at that
 2 post-merger market and to determine if one of those
 3 is conducive to coordination. Those factors include the
 4 availability of routine information concerning market
 5 conditions, transaction, and competitive, the
 6 characteristic of buyer and seller, characteristic of
 7 typical transaction, and whether there has been previous
 8 collusion.

9 Let me ask you, Steve. I think I'll ask an
 10 appropriate question about it?

11 MR. SALOP: Every factor gets one more
 12 brick, one more brick in the underpinning of the
 13 dynamic. I think this sort of simple checklist that we
 14 have has really a lot of shortcomings. There are several
 15 types of shortcomings.

16 First of all, the screens in the checklist are
 17 imperfect. For example, with respect to the HHI, we know
 18 that there is often substantial competition despite high
 19 HHI. The opposite is also true, there has been
 20 successful price fixing in markets even that have safe
 21 harbor HHI.

22 Take like the negotiated price. The
 23 checklist said like price and don't discuss, here
 24 there are competitive concerns. That's true. Price
 25 fixing conspiracies in many industries are in

1 negotiated pricing. Acidic acid, ~~in~~amin , and o on.

2 Even if ~~the~~ price are indi id all negotia~~ted~~,
3 a e learned from Mr. Wil on in ~~the~~ ADM mo ie and
4 Wei ing mo ie, e kno if ~~o~~ can moni~~tor~~ g ali~~k~~ , ~~then~~
5 ~~o~~ don~~t~~ ha e ~~to~~ look at price at all.

6 ~~The~~ ame ~~in~~ man of ~~the~~ ~~other~~ element~~s~~
7 in ~~the~~ checkli ~~k~~. E ce capaci~~k~~ . While on ~~the~~ one
8 hand e ce capaci~~k~~ can red ce ~~the~~ likelihood ~~of~~ cce ~~f~~ l
9 coordinat~~ion~~ b gi ing firm a great~~er~~ incen~~ti~~ e ~~to~~
10 chea~~k~~, b ~~ut~~ on ~~the~~ ~~other~~ hand, e ce capaci~~k~~ increa e
11 ~~the~~ likelihood of coordinat~~ion~~ b increa ing ~~the~~ abili~~k~~
12 of firm ~~to~~ p ni h.

13 Big b er . Big b er can keep ~~the~~ market~~s~~
14 compet~~itive~~, b ~~ut~~ big b er can al o ind ce ~~to~~ eller ~~to~~
15 rai e ~~the~~ co~~st~~ .

16 Even efficienc benefi~~k~~ in a coordinat~~ion~~
17 model, e ~~think~~ co~~st~~ a ing generall red ce ~~the~~
18 likelihood of coordinat~~ion~~ b gi ing ~~the~~ firm ho red ce
19 ~~to~~ co~~st~~ a great~~er~~ incen~~ti~~ e ~~to~~ chea~~k~~. On ~~the~~ ~~other~~
20 hand, ~~the~~ co~~st~~ a ing increa e ~~the~~ abili~~k~~ of ~~the~~ merged
21 firm ~~to~~ p ni h ~~in~~ ri al ho defect from ~~the~~ agreemen~~t~~.

22 Even ~~the~~ Depart~~ment~~ of J ~~stice~~ in 2001
23 recogni ed ~~that~~ co~~st~~ a ing can increa e co~~st~~ imilari~~k~~
24 acro ~~the~~ firm and ~~thereb~~ increa e ~~the~~ ri k of
25 coordinat~~ion~~.

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1 All the factor can go both a . There are
 2 erio interaction effect . I think everyone agree
 3 that the longer the detection lag, the less likely the
 4 coordination will succeed.

5 I think everyone would also agree that
 6 product homogeneity would facilitate coordination by
 7 ensuring a rapid response to the extent of cheating.

8 If long detection lag, then product
 9 homogeneity increases the extent of cheating because
 10 there is more to gain.

11 I think the checklist is just too simple to be
 12 relied on for more than just a guide, a basic guide to
 13 thinking about the industry . I would certainly have it
 14 if the agencies made a decision and said, well, we have
 15 five in this pile and three in this pile, so we are going
 16 to bring the case, and it would be even worse if the
 17 a, oh, I have a lead one in this pile, therefore, the
 18 policymaker might have a direction to come out in
 19 either direction, so I don't need to worry about the
 20 fact at all.

21 MR. KNIGHT: Debbie, are the checklist factor
 22 effective?

23 MS. MAJORAS: Yes, I think the checklist
 24 factors are effective. I know that David Scheffman has
 25 shared some ideas . I'm going to defend the Guideline a

1 little bit on a couple of fronts, not entirely, but a
2 little bit here.

3 First of all, the checklist is a minor. If
4 it is the agency here doing the Salop
5 aid, and sort of making a list on the side and
6 the side, and however the most, that the a it
7 come out, then, re, I would agree that would not be a
8 particularly responsible analysis.

9 Starting with the guideline a,
10 maybe I'm reading it differently from everyone else, but
11 the a "depending on the circumstance, the following
12 market factor among other maybe relevant." How many
13 things do you need? And when you go through
14 it, it's not a checklist of just very specific market
15 factors.

16 For example, it's a good idea to look at
17 marketing and pricing practices, characteristic of
18 buyer and seller, characteristic of typical
19 transaction.

20 The number of firms that I have seen, and there
21 are those of DOJ who have worked very closely with
22 Andre on working on some analysis on coordinated
23 effects, many of the things we are talking about that

1 about the cr i e line in e gigation and the anal i
 2 that a done where, he a in hi peeche , that a a
 3 er raighfor ard application of the fact to the
 4 Guideline , Guideline to the fact .

5 I don't mean to arg e about emantic , b I
 6 think e do ha e to be caref l hen people a thro o to
 7 the checkli t.

8 The other thing that e need to remember an
 9 time e talk about risk of common characteristic that
 10 might be red flagged for an agenc , red flagged for
 11 con eling client , i the follo ing. A lok of the
 12 anki work and anal i that i done, er important
 13 anki anal i , i done o time .

14 Fir st of all, i h con el con eling their
 15 client ell before the agencie ha e e er heard about
 16 it, ell before it ha hi the pre , hen there ha n to
 17 e been time for a cr l e ken i e market anal i . B t
 18 in fact, o ha e a client ho an to kno i i e en
 19 or h m cr ing hi thing. That the fir st place.

20 The second i i h in the fir st 30 da at the
 21 agencie . If the agencie can ha e ome factor that
 22 e can agree on that are at lea red flag , that if
 23 who e are no pre en, the agencie co ld then ha e ome
 24 comfor ba ed on other factor , inclding market hare
 25 and concentration and encr and the re g, gee, hi i n to

1 one here we need to keep going, it's a second reg we
 2 and go forward, when we may be in trouble because a lot
 3 of work is done in the first 30 days. I think the
 4 items depend on a lot of work being done in the first
 5 30 days.

6 MR. YDE: Let me just add to that. Debbie
 7 would move on to the next line. The question here is that our
 8 objective is. If we are talking about re-issuing the
 9 Guideline, changing the administrative organization,
 10 to move away from the checklist and design something
 11 else, that's one thing.

12 If we are talking about actually changing the
 13 economic theories we are all relying on in applying the
 14 Guideline, that's another thing.

15 Let's go to the first part, which is that
 16 Debbie is referring to. I certainly have never read the
 17 Guideline as a checklist. We look first at the
 18 underlying economic theories, that I think everybody agrees
 19 is the basis for the coordinated interaction.
 20 Then we look at the standard and the objective that are
 21 stated in that section as well as in the overall
 22 purpose of the Guideline in trying to interpret that
 23 the "checklist" as.

24 I think a long time ago we read the Guideline first
 25 of all with the objective in mind and understanding that

1 The underlying economic theory is, when you don't end up
 2 with the Salop range of factors that he gave.
 3 I guess there is a more fundamental question
 4 which is that I think I didn't fully appreciate from that
 5 date a long time when I first read his paper, which is the
 6 question that the theory of oligopoly, Stigler's theory
 7 of oligopoly is not an appropriate theory for predicting
 8 outcome for merger or for determining whether a merger
 9 should be analyzed in predicting there is a substantial
 10 lessening of competition.

11 This goes to Jon's point. That seems to me not
 12 to be just a technical point. There is a technical point
 13 about that kind of evidence is being used to predict
 14 anticompetitive effects, but if that is a long time
 15 shouldn't be using the likelihood or the possibility of
 16 collusion or at least the theory of oligopoly as a means
 17 of predicting whether a merger is anticompetitive, that I
 18 think make the guideline and through them and
 19 rather over.

20 MR. KNIGHT: I think that you are saying, that is?

21 MR. SCHEFFMAN: I'm glad to aid that. Let
 22 remember here the checklist came from. It came from
 23 somehere else. Poner a just brilliant about
 24 implementing it. It came from the theory of oligopoly.
 25 That's a brilliant paper. It's a set of conditions,

1 reall the 40,000 foot level of ork of er broad
2 ind Kr characteri ic , that o could ma be make ome
3 pronouncement abo in a er general model abo
4 whether or not the ere cond cie or not cond cie Ko
5 coll ion.

6 Again, that paper i the theor of coll ion.
7 ok of people ha e aid that. I not reall the
8 theor of oligopol . I the theor of coll ion.

9 I agree ith Debbie. The agencie are uch
10 more ophi cated in the e of thi . The paper Mar
11 and I did aid let reall get do n on the ground in
12 thinking abo a "checkli k" ork of anal i . If George
13 Skigler o ld ha e ack all applied hi theor Ko an
14 ack al ind Kr and had all the e idence and fact e

1 it only has power in one direction. Given certain facts,
 2 it can reject the liability of an act of coordinated
 3 behavior. In cr i e, which is an interesting example,
 4 we had a merger with something that would be bad to some
 5 people, which is field management, or that there may be
 6 a case here. The only reason there is a case is
 7 we got down in the fact and said, well, here is the
 8 evidence of coordination? If we could have found an
 9 act of coordination in there, we would have had five
 10 more again in the cr i e merger. We couldn't find it.
 11 However, if we found "it," that would not prove
 12 that the merger is anti-competitive.

13 The problem goes into the evidence in
 14 coordinated interaction case is the basis of the case?
 15 The problem is increasingly, that the antitrust
 16 principles turn his focus to that is the competition
 17 and to arguing that there is some oligopolistic
 18 coordination, there are some things that look suspicious,
 19 here if it for three, we have to block this
 20 merger. Sometimes they are right and sometimes they are
 21 wrong, from an economic perspective, and we have to
 22 provide more help on the economic side.

23 That is where the real gap is. Economic does
 24 not give much answer to that in this area
 25 there may be something that can happen, the checklist page in

1 a en e. There i ome ba i ma be ~~Khak ik~~ o ld be
 2 po ible ~~ko~~ coordinat~~ke~~ on ome~~khing~~. I m no~~k~~ a ing
 3 coll ion co ld ne er ari e from a merger, b ~~Khak~~ no~~k~~
 4 ~~the~~ primar problem, a I ee ~~ik~~.

5 In merger , e are orried abo ~~kh~~ ~~her~~ ~~ik~~
 6 going ~~ko~~ change ~~the~~ ~~na~~ re of compet~~ition~~ no~~k~~ in a
 7 coll i e a , and no~~k~~ in ~~the~~ ~~par~~tic lar d namic game
 8 model e are ~~talk~~ing abo ~~kh~~, hich e ne er ee. Think
 9 abo ~~kh~~ ~~who~~ e model . Look at ~~eg~~ ~~ilibri~~ m here ~~the~~
 10 coll i e ~~eg~~ ~~ilibri~~ m i ~~ained~~ beca e ~~there~~ are
 11 p ni hmen~~k~~ ~~kr~~ategie and o ee price ar and ~~khing~~
 12 like ~~khak~~. Yo hardl e er ee ~~khak~~ in an real orld
 13 ind ~~krie~~ e ee. Yo ee ~~ik~~ in a fe . Hardl an of
 14 ~~the~~ ind ~~krie~~ ~~khak~~ e ee do e ee ~~khak~~. None~~the~~le ,
 15 e ee ome "oligopolie ."

16 That i here e ha e ~~ko~~ de elop more anal i .
 17 Thi i here ~~the~~ ~~ak~~orne ~~r~~n ~~khing~~ , here ~~the~~
 18 economi ~~k~~ ha e ~~ko~~ ha e ome~~khing~~ more ~~ko~~ a . The
 19 can ~~k~~ a per ~~the~~ checkli ~~k~~, ~~ik~~ fail ~~the~~ checkli ~~k~~ in
 20 ~~the~~ large, o ~~there~~ i no ba i at~~k~~ all for coordinat~~ion~~,
 21 look at ~~the~~ ~~da~~ta. When o ha e ha~~k~~ look like
 22 coordinat~~ion~~ in ome en e, ~~khak~~ here e ha e ~~ko~~ ge~~k~~
 23 more economic anal i in~~ko~~ ~~the~~ deci ion making.

1 it not really analyzed the a the firm's ge- tion i ,
 2 whether after the merger, the firm can solve their
 3 cartel problem .

4 In order to analyze the ge- tion, we are
 5 looking at a lot of factors , in terms of dynamic
 6 oligopoly interaction . I agree with Paul and Debbie.
 7 It is an innovative analysis of evidence that focuses on
 8 the ge- tion of whether the firm can solve their cartel
 9 problem , and whether they can reach consensus .

10 MR. SALOP: I don't think an erio- economic
 11 would a what would like to get rid of the
 12 coordinated effect- tion of the Guideline . I believe
 13 the issue is whether there should be an ex- ception p-
 14 in, which is called -- I don't know what to call it --

15 MR. SCHEFFMAN: Non-negotiable.

16 MR. SALOP: Data, we will let you name the
 17 exception when you come back to being Bureau Director for
 18 the third time.

19 If the idea is that we are anticipating ri- al
 20 will follow the price increase. The firm may think
 21 about it in just what a , in which thinking about it in
 22 terms of consensus and punishment. If you have to have
 23 that sort of anticipation, that sort of strategic
 24 interaction into the context of consensus , decision, we
 25 are going to have trouble.

1 I would a typical non-natural effect
2 cause in the case I'm talking about. You have read a
3 manila envelope memo that I have, and they are not about
4 collusion analysis. They are about competition going
5 to be reduced somewhat as a result of this. It is focused
6 on the right question. I don't at all agree with the
7 conclusion because there is no anchor there. That is

1 of parallel cond ~~o~~K, and e ~~co~~ldn ~~K~~ find ~~i~~K.

2 MS. MAJORAS: Da id, j ~~K~~ ~~ko~~ ~~ro~~nd ~~K~~ha~~K~~ ~~o~~K. I
3 agree ~~i~~Kh ~~o~~. ~~I~~K ma be ~~K~~ha~~K~~ ~~K~~he ~~G~~ideline are
4 impreci e, no~~K~~ ~~K~~ha~~K~~ ~~o~~meho ~~K~~here i ~~o~~me~~K~~hing ~~o~~mi ing
5 from ~~i~~K ~~K~~ha~~K~~ ~~K~~he agencie ha en ~~K~~ been able ~~ko~~, e ~~K~~he
6 ~~G~~ideline anal i .

7 We ha e done ~~i~~K in ca e here e are looking
8 a~~K~~ pa ~~K~~ coll ion. The anal i ~~K~~here a a ~~li~~ttle
9 differen~~K~~.

10 MR. YDE: The fact~~K~~ ~~K~~ha~~K~~ ~~K~~he memo ~~K~~ha~~K~~ are
11 coming for ard and ~~K~~he anal i ~~K~~ha~~K~~ i being pre en~~K~~d
12 b ~~K~~he a~~tt~~orne -- and I m ~~re~~al o b a lo~~K~~ of ~~K~~he
13 economi ~~K~~ -- ~~K~~he fact~~K~~ ~~K~~ha~~K~~ ~~K~~ha~~K~~ anal i i no~~K~~ ell
14 gro~~u~~nded in ~~K~~he ~~K~~heor of oligopol and ~~K~~he coll ion
15 ~~K~~heorie ~~K~~ha~~K~~ are ~~K~~ak~~K~~d, or a~~K~~ lea ~~K~~ decribed, in ~~K~~he
16 ~~G~~ideline , ~~K~~ha~~K~~ doe n ~~K~~ nece aril commend ~~K~~ha~~K~~
17 anal i .

18 There ~~ho~~ld be ome rigoro economic anal i
19 applied, and if ~~i~~K a ~~K~~he anal i in ~~K~~he ~~S~~igler
20 ~~K~~heor , ~~K~~ha~~K~~ going ~~ko~~ be be~~tt~~er ~~K~~han j ~~K~~ork of a
21 ~~g~~ge ~~K~~ion ~~K~~ha~~K~~ e kno ~~i~~K an~~ti~~compe~~ti~~ti e beca e
22 ~~K~~here i going ~~ko~~ be a ~~re~~duction in compe~~ti~~ti~~o~~n .

23 MR. SCHEFFMAN: Ab ol ~~K~~el . The ~~S~~igler ~~K~~heor
24 onl ha po er ~~ko~~ reject~~K~~. Yo can pro e, a I ~~K~~hink e
25 did in ~~cr~~ie and ome of ~~K~~he ~~o~~ther e ample , ~~K~~ha~~K~~ ~~o~~r

1 Theor can possibly hold here, given all the
2 economic noise in the industry.

3 The Stigler theor doesn't tell us when
4 don't have -- a lot of industry activity all look like
5 it -- it doesn't tell us in the industry that don't
6 look like hard core oligopoly but look all more
7 oligopolistic in some of the outcome, have to hold
8 make the decision on. This is when the latter a
9 concentrated and look picture, one has a case.
10 That is not a proper basis, but I am saying the
11 economic have to get into the game here, and the model
12 that are being aren't the right tool.

13 I am going to be empirical analysis, but
14 we also need some theoretical development to shed better
15 light on whether we have a problem or not.

16 I think the DOJ folk have advanced the ball in
17 thinking about whether the merger --

18 MR. YDE: I have an empirical analysis that
19 regards that the issue of the Guideline or the Guideline
 a case has been established, the derivative of an

MR. SCHEFFMANN: I am saying that the approach

1 That number of competitors make a difference, you have
 2 a case. You don't need a theoretical or other than that.
 3 "Suppicio" oligopoly conduct, that the antitrust think
 4 are "suppicio" oligopoly conduct, that is a situation
 5 here the economic and the latter get into every
 6 argument, and here we need some more economic and
 7 theoretical analysis to do that.

8 Are there mistakes? In the enforcement
 9 decision? We know, because we see hardly any
 10 condemned merger that anyone is complaining about. We
 11 all know that the economic disagree, much less than
 12 the "ed" do, but the disagree on some significant
 13 percentage of the case. Probably some time they are
 14 right.

15 We don't all get it wrong on industrial
 16 merger and the relative small number of companies.
 17 I'm happy to rely on the companies' statements like the
 18 agencies do. We get who's right.

19 Branded products. We have middlemen.
 20 Supermarkets. It's not clear we are getting it right. I
 21 think we get it wrong enough of the time that we could do
 22 a better job.

23 MR. SALOP: That is, that's a call good
 24 labeling.

25 MR. KNIGHT: Andre?

1 MR. DICK: I m not re in li Kening Ko KHi
 2 di c ion for Khe la K liKle hile KhaK Khere i reall
 3 a m ch di agreemenK among Khe people, p here a ma be
 4 meek Khe e e. I Kthink almo K e er one o ld agree KhaK
 5 e don K anK Ko Khro o K Khe checkli K fact or
 6 haK e er e anK Ko call Khem. AK Khe ame Kime, e al o
 7 anK Ko be er caref l in ho e e Khem.

8 A SK e e pointed o K in hi opening remark on
 9 KHi Kopic, on KHi g e Kion, clearl Khe checkli K
 10 conditKion are not nece ar for coordinatKion beca e e
 11 can ob er e co nKer e ample , nor are Khe fficienK
 12 beca e e can ob er e ind Krie here e can co nK p
 13 on both hand Khe n mber of fa orable or allegedl
 14 fa orable checkli K conditKion and eK Khere doe n K eem
 15 Ko be an e idence of coordinatKion.

16 The ho ldn K be Kaken liKerall . I ha e
 17 al a Kho ghK of Khem a not Kelling, omeKhing abo K
 fact al concl ion o m ch a orK of g ide po K ,

1 The other point that I asked to mention is
2 that one of the deficiencies of course of the checklist
3 factor is that it can be pretty helpful in describing or
4 characterizing coordination or collision pre-merger, but
5 they are not by themselves all that helpful in terms of
6 telling about post-merger conditions for the implementation
7 reason that many of the conditions can be changed
8 directly through firm action, through the actions that
9 we take.

10 Sometimes they can be helpful in identifying
11 pre-merger conditions on coordination, but they may not
12 tell how the merger will relate or change those
13 conditions.

14 MR. KNIGHT: Jon Baker, will give you the
15 last word on this particular topic.

16 MR. BAKER: She may ask to come back after
17 this.

18 I understand here we differ, David, and I think

1 guidance. I think it's wrong.

2 I find the Guideline very helpful in
3 understanding competitive effects, including collusion
4 and competitive effects analysis, which I think is
5 important.

6 MR. SCHEFFMAN: A Greg Warden has indicated
7 and articulated, the Guideline by their nature are agree
8 enough to incorporate anything. I don't think it's so
9 much a problem with the Guideline. There can be
10 misleading as to what all has the practice is.

11 I don't have anything against unilateral. I
12 have a lot of problem with Bertrand, for a lot of
13 reasons, and in a lot of circumstances. I don't have a
14 problem with unilateral as a more general theory, a man
15 of might, etc.

16 I do have a problem in the gray area here. I
17 don't think we have unilateral, but we think we might
18 have a case because of coordinated interaction, and the
19 dynamic per game are not the answer, they are not
20 going to give an answer to whether we have a case or
21 not, but the problem is the answer doesn't seem
22 an answer. They will go ahead and they will generate a
23 case. We need to have a better answer. They will see
24 don't give much help to an answer who is difficult
25 in the four to three merger here is difficult and

1 it clearl not, nilaKeral.

2 MR. KNIGHT: We are going to get to ome of
3 the additional tools that e might e. Before e do
4 that, I am to take a light detour to talk abo
5 merger for a min e.

6 The guideline coordinated effect ection
7 does indicate that a merger can contribute to coordinated
8 interaction b making o a merger firm.

9 Jon Baker, does that anal i make sense, and
10 if so, hen hold it be applied?

11 MR. BAKER: I eem it hold al a be
12 applied.

13 When o think abo the ection of ho doe
14 the merger change the o come, ho i the con strain
15 being changed b the merger? It i all abo merger .
16 I make it ond like it i ome ork of pecial
17 anal i . I come right o of thinking abo the
18 dynamic oligopol theor , firm are going to differ in
19 all ork of dimension in the e ection .

20 If a merger in ol e non-merger firm , then
21 o need to anal e ho the merger i affecting the
22 merger.

23 MR. KNIGHT; One of the crici m that e ha e
24 heard at the agencie i that the in e igating aff
25 are all to quick to label the acq ired firm a a

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1 MR. SALOP: I like the ma erick theor , which i
2 not meant to be critical but rather to j emphasize
3 several points .

4 First, I think "ma erick" is an unfortunate
5 term, because ma erick gives the idea that there is
6 someone who is not going along with the other one else.

7 It is possible that the disruptive firm might
8 be the firm with the greatest incentive to cheat, and
9 that is what is found in the Guideline for the monop
10 park, but a disruptive firm could also alternatively be
11 the firm with the greatest -- the firm with 60 percent of
12 the market, and someone would cut price, he would
13 That firm would be the ma erick. He is the one who
14 determine the equilibrium.

15 I think the holdn impl think about the
16 ma erick as being the firm that is least likely to go
17 with the price increase.

18 We hold also a look for an alternative to
19 ma erick .

20 MR. SCHEFFMAN: I like the ma erick, but
21 probably not for reasons you would appreciate. I'm
22 all a hanging argument . I have big arguments with hard
23 core economists who think which ma erick is off it .

24 I, as a strategic professor, a firm choose
25 their competitive strategies . Most of which is about

hi.

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1 more. Did I a ~~Khak~~ back ard ? I ~~Khink~~ a ma erick i
2 here he doe ~~noK~~ an~~K~~ ~~Ko~~ p ni h a m ch a he ~~ho~~ ld.

3 I ~~Khink~~ in real orld ~~ik~~ ~~akion~~ here firm
4 differ and ~~the~~ firm can ~~find~~ a ~~Ko~~ p ni h or ~~Ko~~ make
5 ide pa men~~K~~ , ome firm are doing more of ~~the~~ ork in
6 con ~~Krainig~~ coordina~~Kion~~ ~~Khan~~ ~~oKher~~ .

7 I~~K~~ eem a perfect~~Kl~~ rea onable ~~Khing~~ for me ~~Ko~~
8 do ~~Ko~~ find ~~oK~~ ho ~~the~~ ma erick i in order ~~Ko~~ ,nder ~~Kand~~
9 he~~Kher~~ ~~the~~ merger --

10 MR. SALOP: I ~~o~~ ld ha~~K~~ ~~Ko~~ ee coordina~~Ked~~
11 effect~~K~~ anal i ~~Ko~~ be red ~~ced~~ ~~Ko~~ he~~Kher~~ a firm i a
12 ma erick.

13 MR. DICK: There a corel ~~Ko~~ ~~Khi~~ , ~~Koo~~ , in
14 ~~Kerm~~ ~~Ko~~ ~~the~~ re pon e ~~Ko~~ ~~the~~ econd ~~g~~ e ~~Kion~~ Pa l a ked,
15 hich i ~~where~~ i al a a firm on ~~the~~ c p, ~~where~~ i
16 al a a ma erick, more ~~Khan~~ one ma erick, and ~~the~~
17 ~~g~~ e ~~Kion~~ i if ~~the~~ merger elimina~~K~~ ~~Khak~~ ma erick, ho
18 i ne ~~K~~ in line, and if ~~the~~ are er imilar, clo e in
19 ~~Kerm~~ of ~~the~~ con ~~KrainK~~ ~~the~~ place on coordina~~Kion~~ , ~~Khen~~
20 ~~the~~ merger, e en ~~Khog~~ h ~~ik~~ elimina~~K~~ a ma erick, ~~o~~ ld
21 ~~noK~~ ha e a er ignifican~~K~~ effect~~K~~. Yo al a ha e ~~Ko~~
22 look at ~~the~~ ne ~~K~~ g and h he i going ~~Ko~~ replace ~~the~~
23 ~~g~~ ~~Khak~~ ~~gok~~ knocked ~~oK~~.

24 MR. SALOP: J ~~K~~ like ~~the~~ ne ~~K~~ be ~~K~~ b ~~Kik~~ ~~Ke~~.

25 MR. DICK: Right~~K~~.

1 market and I don't recall searching for a merger.

2 To the extent that these are really in

3 in the litigation, sometimes looking for one, I think the

4 reason for that come back to something that would have

5 been going here, David and others, which is if the

6 litigation would really need to answer it, does the

7 merger market, not just that is the structure and that

8 are the market characteristics, and that would be

9 be post-merger, but how is the actual merger going to

10 make an impact. That is a very hard litigation to answer.

11 That is one of the reasons that DOJ is trying to

12 reinstate looking at the theories and looking at that

13 evidence and looking at that evidence left to do. The

14 evidence are even doing a very good job of answering

15 that litigation.

16 When you have a merger to point to, that is a

17 specific -- the merger, the going, is having the impact on

18 the market and pre-merger conditions that impact on more.

19 It's not surprising that you would fall back on

20 that, that the enforcement agencies would.

21 MR. YDE: On the definition of a merger and how

22 you can define a merger, how is identified a merger,

23 in North Carolina, here I am on the other side,

24 North Carolina -- I'm sorry, Jon I have not read your paper, I

25 did read your deposition and your expert report -- North Carolina

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1 a not a company could have been identified, and
 2 least a far as I understand, there are no underlying
 3 structural factors which would be the
 4 market. Nevertheless, it did appear, at least argued
 5 that it may have been the case and it may be supportable in
 6 some cases, that the had a strategy that on a repeated basis
 7 the historical had not gone along with the generalized
 8 price increase which were proposed in the industry.

9 I guess when you go along for analysis, David.
 10 I think the efficiency which you find there is a
 11 historical record of market? I would think you would
 12 have to identify some underlying structural factors, either
 13 in cost or capacity or whatever else broadly
 14 defined, which would be after a merger it market
 15 being lost is important.

16 MR. BAKER: I think you are much happier if you
 17 can identify it. In the North example, you basically
 18 had a right. It is a hard to pinpoint it. The
 19 behavior had gone on for so long and so consistent that it
 20 is a hard to reach the conclusion that really a firm
 21 that for reasons that are clear based on market
 22 structure is a coordinating coordination.

23 I would have been happier to have understood it.
 24 It really takes a long history of years of multiple
 25 incidences of doing that before I am willing to come up

1 the conclusion in that case.

2 MR. YDE: Do you think it is important that
3 can explain the course --

4 MR. SCHEFFMAN: A a b line that a professor,
5 I draw on more basic than has been in simple economic
6 model. It is going to be obvious that you have a market.
7 It is going to be pretty obvious and you are going to have
8 natural experiments to be able to prove you had a situation
9 here where one firm never follows the price increase of the
10 competitor and price change are important, the hypothesis on
11 the whole. Then you are going to have a track record like
12 that or you are going to have in some cases a relatively
13 small share of firm that go around and are used to voice
14 the bigger firm in industrial markets.

15 A real market, you are not going to have to hang
16 for. You have to prove it actually affects the price.
17 They go around and knock on the door and try to get
18 a line. That's fine. Do the actual have an impact on
19 price? That's the critical point.

20 MR. KNIGHT: We have talked on a number of
21 occasions here about the additional approaches and would
22 that the agencies might begin to see to a more coordinated
23 effect. Andre Dick a sort of involved in the effort and
24 the agencies to reinstate the analysis. Can you tell
25 a little bit about that or see the agencies could be doing

1 or are beginning to do in killing coordinated effect ?

1 Another a that people have looked at that, or have marked
2 to look at it, whether a firm might be picked in a sense
3 that the removal of that firm is going to be significant

1 here the question is not whether the factors are present
 2 or not but could the merger in some significant a change
 3 the factors, change the conditions, relationships, b
 4 narrowing competition. That is one of the
 5 allegations, for example, in the Primdor Manonick case that
 6 the Division brought forward three years ago.

7 A third source of competition could be narrowing
 8 the opportunities for firms to deal from coordination,
 9 and under that category, I think people all think about
 10 the degree of transparency in the market, that firms observe
 11 each other strategies and can they observe each other
 12 payoff, which is market share and so forth.

13 Also, the pace of innovation. I think a market in
 14 which new products are coming all being introduced or com-
 15 changes are coming all occurring that may create
 16 opportunities or lend themselves to opportunities for
 17 market to take advantage of opening to disrupt
 18 coordination?

19 None of these concepts, I think, is particularly
 20 new. Probably that the Division did, which is, I think,
 21 none the less helpful, a to to to add a little more
 22 rigor and put them in a more structured framework.

23 I had one slide that is a sort of helpful to talk
 24 through one example. It relates to the point of how to
 25 interpret historical evidence, which is something that has

1 been talked about already.

2 Let me just work of all through in the
3 inkere of time. If we find the slide, we find it.

4 The question is, hold his market? We have a
5 his market of coordination, let's say, in the industry.
6 Should we market, and if so, how?

7 In practice, the company has placed a substantial
8 emphasis in management on his historical evidence. In the grain
9 case, a his market of price fixing is a through to be an
10 important. In Cardinal Health, the his market of capacity
11 coordination is a through to be important. Price leadership
12 in the Heinz case which Johnson worked on, and in Hospital Corp
13 of America, the notion there is a cooperation, not
14 necessarily anticompetitive, but cooperation in general in
15 the past is a through to be possibly relevant to analyzing a
16 current transaction.

17 His market has clearly shaped how the company has through
18 about which and has clearly shaped how agencies have heard
19 evidence and influenced work of here the have set the bar
20 for a pending merger effect going forward.

21 There is an empirical basis for thinking his market
22 market which is work of grounded in some empirical evidence.
23 At the base, it is really driven by correlation, rather than
24 sound microeconomic theory.

25 In management, we talk about his market as work of a

1 mmar ~~ka~~ ~~ki~~ ~~ic~~ for ~~no~~ ~~er~~ ~~able~~ ~~informa~~ ~~tion~~, ~~no~~ ~~er~~ ~~able~~
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22 That ~~i~~ ~~s~~ ~~a~~ ~~real~~ ~~it~~ ~~y~~ ~~check~~ ~~and~~ ~~i~~ ~~call~~ ~~it~~ ~~a~~ ~~lit~~ ~~t~~ ~~le~~ ~~bit~~
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1 le on of the Division in learning, which is also a
 2 have identified clearly the micro foundation for
 3 his work might make.

4 A Debbie mentioned a few minutes ago, the
 5 critical question is how will the merger effect competition
 6 or effect coordination in the market. In the context of
 7 looking at the historical evidence, we have to ask, will
 8 his work affect coordination after the specific proposed
 9 merger?

10 There are a number of good theoretical - grounded
 11 reasons his work might have had effect. His work can
 12 help build understanding among firms. It can help reveal
 13 the type of firm, their cost parameter, their discount
 14 rate -- information that the other will find relevant to
 15 whether coordination is sustainable.

16 His work can teach firms how to coordinate. That
 17 is the example that Jonathan did on his paper on the NRA
 18 code for fuel. His work can also sometimes improve the
 19 accuracy of current and future monitoring; a shorter
 20 time firm learn more about the underlying demand
 21 condition and seeing the are relatively able to help
 22 them in the future in terms of monitoring and planning.

23 The final point that has to be added to this,
 24 pointed out by the Division in approach, is there has to
 25 be a certain check. We also have to ask, has his work

1 changed significantly since the last time looked? Has there been
 2 significant entry? Has the geographic market broadened?
 3 Has the power barrier emerged? Has the capacity constraint been
 4 relaxed? Can the demonstration either in fact or through the change
 5 in the historical evidence have really led to important
 6 change, a pricing behavior?

7 I just took a look at the work that has been done in
 8 one example, but I think the new approaches are intended to
 9 build from the checklist approach and address something
 10 that might well be here. We should look for
 11 evidence, and work of course to be realistic about it, apply
 12 realistic check and evaluation check, and above all,
 13 develop a good firm microeconomic foundation for the
 14 market factor market.

15 MR. KNIGHT: Following on that, David, you talked
 16 earlier about the economic market has more to
 17 contribute, particularly in a changing current market
 18 pre-merger. Can you talk about some of the things that
 19 come about?

20 MR. SCHEFFMAN: I work of alluded to that. I've
 21 talked about it in a variety of places, which is, I think
 22 you need to look beyond the checklist and then aid the
 23 agencies clearly do that. I think it should be clear to
 24 everyone that we do, the agencies do.

25 Look at the details. We are talking about merger

1 affected price. That is, we are all concerned
 2 with. Where is price determined? In most of the market we
 3 look at, price is determined between the seller and the
 4 individual buyer. I don't like the heat market and hardly
 5 any of the market we look at are like that heat market.

6 You need to look at all the detail of who sets
 7 price and the determination of who sets price to get some
 8 idea whether or not to think there is coordination
 9 capability. That is the main point of Mar and my paper.
 10 Looking at the detailed transaction level data, looking at
 11 in detail has information firms have from one another.

12 Mar and I had a wonderful case once where we had
 13 a terrible document that our client, a price
 14 leader, all the competitors thought was a price leader.
 15 We turned out that we looked at all the data and it was
 16 pretty hard to see from the data that there was a
 17 leadership going on. As I tried to tell our client, it
 18 is hard to be a leader if you don't have any followers.

19 What looked like from the document a classic
 20 oligopoly, that they were cracking each other were
 21 doing, looking at how they were gaining sales from and
 22 losing sales to, and everything like that, and cracking that
 23 by looking again at the other company, there was no match in
 24 the data. Looking at how the crack capacity, high the
 25 cost to do it carefully, and when we could check that

1 again. The other companies all did, and of
 2 detailed analysis is clearly relevant and is spelled
 3 out in detail in the paper.

4 To get into the detail of whether or not there is
 5 an amount of coordination going on or not, there is a basis for
 6 it, again, I think it is a good effort, but it is not a one
 7 to one. You can actually do that. I worked on a lot
 8 of markets that might think are oligopolies, but the
 9 data is not, as in a chemical merger, it is hard to find
 10 real oligopolies. The evidence is pointing to the agencies.

11 When a large merger case DOJ had that
 12 generated a serious price fixing investigation? Not too
 13 many.

14 Antitrust attorneys are going to look at, talk to
 15 people and look at the documents and determine if there is a
 16 case going to do this merger. There is another reason
 17 that it is not a serious case. You are not going to
 18 see it hard, even here it does not.

19 I think we need to be looking at something else
 20 and here is the plan, given the pre-merger, which does
 21 the merger make a difference?

22 MS. MAJORAS: DOJ does have one no.

Malko

1 coordination model. You can only win, you can't lose.

2 What we need is that we can reject coordination

3 or we need that we can reject competition.

4 Other issues, these are really problematic.

5 The issues of whether we are going to grandfather

6 existing coordination or whether, in fact, we are going to

7 hold existing coordination again in the merger. The 1992

8 Guideline doesn't resolve this issue fully.

9 In my view, I don't think we should grandfather

10 pre-existing coordination, for the implementation of the

11 merger coordination might break down if and when market

12 conditions change, but if you permit the merger, it could

13 erode the coordination and prevent the breakdown in the

14 future if and when market conditions change.

15 The Merger Guideline really do focus on the

16 incremental effect of the merger, and the net effect is

17 a that we are worried about when enforcement factor.

18 There is this one place, in Section 1.11, in

19 market definition, here the Guideline says that the

20 agencies' prevailing price levels pre-merger

21 circumstances are wrongfully given effect of coordinated

22 interaction, in which case, the agency should use a price

23 more reflective of the competitive price.

24 To the extent there is an coordinated interaction

25 or a chance of it, that means you should apply this, and

1 that mean o can do the SSNIP e ba ed on the c rren
2 price, and mean critical lo , one more rea on h o
3 hold thro o imple critical lo anal i .

4 I don kno of an ca e in high the agencie
5 ha e e er applied hi pro i o. The a ma be the ill
6 e a differen price SSNIP e , b I e ne er een one.

7 MR. SCHEFFMAN: I g aran e o an ind r in
8 high the aff ha pre con incing rea on to belie e that
9 price look picio l high beca e of f nn ork of
10 beha ior, o are going to ge a merger blocked.

11 MR. BAKER: I ha e one point to add to e e
12 commen abo the pre ailing price, hich I ba icall agree
13 i h. The empha i that bo h of the agencie ha e been
14 making recen l , and e peciall the FTC, on ga hering
15 empirical e idence on i e a to he her the merger i
16 reall ef l.

17 There are in ere king idea abo the thing that
18 migh be e ked and o can look at on caci coordina ion.

19 The point I an to make abo all the e empirical
20 die i that the are ied to pecific theorie of ho

1 hi historical fact .

2 We can also see that the other , it is terrible that
3 we have to pay for them, but we are part of the process ,
4 and that is what we know. It is governed in
5 the end by what we do in court, and that is a good
6 discipline.

7 MR. YDE: We don't ask you to do the document
8 from the hearing . What you are doing essentially is
9 document the making admission in document and formulating
10 them in hearing , that is consistent with the document , and
11 particularly other evidence that may be taken the
12 transaction is not anticompetitive.

13 I think you ask to take the admission and
14 formulate a hearing that is consistent with the admission .

15 MS. MAJORAS: Yes , there is no question, and
16 be interested that you have to take the document and you have
17 to analyze the evidence in the context of all of the other
18 documents . You can just pick one of the file and
19 analyze the evidence.

20 MR. KNIGHT: Are there any more forward asking
21 the agencies , how do you see this affecting the area in
22 which you counsel clients ?

23 MR. YDE: There are three different things we do.
24 I think Debbie would agree. First, there is the counseling
25 on transaction , counseling , pre-filing, making prediction

1 about what is likely to happen on a transaction in front of
 2 the agency, the course of review at the agency, and related
 3 to what is the actual negotiation of the provision in the
 4 merger agreement.

5 The second is the representation before the
 6 agency, and the third is litigation. I'll go to the
 7 challenge on litigation. There is almost nothing that is going
 8 on in the agency that has an effect on the outcome of
 9 litigation. I'm sure the people in the agency right now
 10 would disagree with that, but if you look at the court
 11 decision in the UPM case, I think you recognize that the
 12 courts aren't paying an attention to the theories that the
 13 agency -- at least the more rigorous description of the
 14 theories that the agency -- are proposing.

15 On counseling, the most significant effect or the
 16 most significant element in all of this for counseling a
 17 client on merger is when the leadership of both agencies
 18 intend to reinstate the coordinated effect analysis.
 19 That's a pretty much the beginning and the end.

20 Once you are told that the agency intend to
 21 focus on coordinated effect theories, you need not to take
 22 that into account in the actual negotiations are making a
 23 prediction about the course of agency behavior and, also,
 24 about the actual negotiations of the risk allocation
 25 provision, especially if you are looking at a transaction

1 in which there is likely to be a small part of the overall
2 transaction that comprise the potential coordinated effect,

1 not presenting a critical lo anal i on e er ca e
 2 had before him, ere probabl making a mi ake. The
 3 ame hing i r e here. I ld j gge the man al
 4 ha been p Koger b the DepartmenK of J Kice
 5 ack all ho ld be generall di rib ed o the general
 6 p blic. I ha en een iK eK, b I ld gge haK
 7 o ld be helpf l o e er bod in predicKing ho the agenc
 8 i going o look atK o r deal and ho ho ld pre enK
 9 o r ca e.

10 IK o gi e g idance o the aff and managementK
 11 abo ho the leader hip anK the aff and managementK o
 12 look atK the ca e.

13 There i ome feedback. Yo anK o do ome of
 14 the anal e pfronK o ee haK e er iK happen o be haK
 15 i being gge ed b the agenc a being infl enKial. Yo
 16 anK o do ome of haK pfronK o ee ho iK i going o
 17 look hen o go in.

18 IK generall doe n ha e a big impactK on mo K of
 19 the orK of gro le el j dgmntK o are making abo K
 20 heKher o proceed.

21 MR. BAKER: Wh boKher o do iK if iK doe n K
 22 makKer for the o Kcome?

23 MS. MAJORAS: He i n a ing iK doe n K makKer
 24 for the o Kcome.

25 MR. YDE: IK i the g e Kion of heKher o are

1 going to proceed with the action or not.

2 MR. BAKER: I need to know the date in
3 advance?

4 MS. MAJORAS: The client doesn't often give
5 time to do a month or two of a pricing study to sell
6 that to do. The analyst knows tomorrow whether
7 the goods will be one a hot.

8 MR. YDE: Like most things, you can generalize too
9 much. What I said is a generalization.

10 MR. SCHEFFMAN: I am going to clarify something Debbie
11 said, because I'm sure he didn't mean it. Documents and
12 other qualitative information are not necessarily "fact."
13 And fact-based analysis, often not economic analysis, can
14 corroborate or disprove the "fact" appearing in documents
15 and deposition.

16 In my last talk with the FTC, we had a difficult
17 case and the attorney really had convincing evidence. But
18 it's a difficult thing to figure out with the market. The
19 market is a complex thing that has the characteristics, and it
20 seemed right. That's what the documents said. However, the
21 economic analysis of the competitive market of the company.
22 The market is an analysis like that.

23 MS. MAJORAS: I'm not saying that the analysis are
24 all going to come to documents. I thought I was being
25 asked a general question. You have to play them according

1 to have in front of . In addition, there are
 2 time here I might not all disagree with , here I
 3 might think the document, if it is registering has in fact
 4 a company think one of its competitors is doing and react
 5 accordingly and that may not be wrong once an economy
 6 comes in and does a job, so has. That firm is behaving
 7 because of has it though, it had imperfect information, so
 8 that is not all relevant, even though it is not to be
 9 not the actual fact .

10 One final thing, one thing that I think is
 11 interesting in consulting clients in merger, and talking
 12 about coordinated effects versus unilateral effects, I think
 13 I am some of it in the dynamic on the other side of the
 14 table when I talk DOJ, and that is it is also a
 15 psychological.

16 It is hard to get clients focused sometime on
 17 the right issue when you are talking to them about
 18 coordinated effects, because the stake is personal,
 19 because they become very angry. You can not all see it in
 20 meeting sometime on the other side, here we would spend
 21 45 minutes with member of a firm explaining to has
 22 great people they are and how they are very honest people,
 23 and they are never going to do bad thing that would put
 24 them in jail and that sort of thing.

25 I just mention that because it is sort of an

1 inKere King fact. I i Kr e, I Khink, hen o con el
 2 client , iK take a long Kime Ko get Khe client Ko onK of
 3 calm do n, noK j K be onK of Kicked off atK Khe agenc , and
 4 noK j K anK Ko keep proK King, b K Ko, nder Kand e are
 5 noK j K Kalking abo K e plicic coll ion. We are Kalking
 6 abo K oKher form of coordinatKion.

7 I noK going Ko be helpf l Ko go inKo Khe agenc
 8 and Kell Khem o ha e learned o r le on, o are er
 9 good no , Khi i ne er going Ko happen again. If Khe
 10 market ha n K changed, b KanKiall , KhaK j K i noK going
 11 Ko be per a i e.

12 The don K reall, nder Kand Khi . The anK Ko
 13 kno h did o make me p K in place all Khe e onderf l
 14 compliance program and no iK i n K going Ko do me an
 15 good. On Khe oKher hand, hen e are Kalking abo K
 16 nilaKeral effectK , nobod Kake iK per onall if o
 17 gge K Khe might ack like Khe are Khe king of Khe hill.

18 I i al a an inKere King factKor, I Khink, hen
 19 o are con eling.

20 MR. SALOP: I di agree iK h Da e KhaK imple
 21 correlatKion are going Ko carr Khe da in co rK. ThatK i
 22 haK economeKric i all abo K. One ide p K in a imple-
 23 minded correlatKion and Khen Khe oKher ide ho KhaK iK
 24 didn K conKrol for KhaK factKor, and hen o p K Khe
 25 conKrol in, iK K rn Khe re, lK arond.

1 The lesson in the U.S. Tobacco didn't present an
2 economic response to the household that's done. If
3 they had, they could have blamed the damage as a result of
4 direct costs.

5 I think every time and time again that people do
6 a poor correlation, when the other side does some
7 empirical economic, perhaps it's explained a
8 further variable, and the block is the initial data.

9 MR. SCHEFFMAN: I said you don't find a
10 correlation or a regression in there at all. It is just
11 simple fact. Yes, here the price. Take a look at them,
12 see how you think. I'm not saying that is the only thing.
13 Economic can do more than that. If you do something other
14 than that, which you sometimes need to do, when you need to
15 be empirically about it, of course.

16 I am just responding that sometimes economic
17 can do something and the sometimes forget that, let's just
18 develop the basic fact here and see whether the
19 labor are saying it's true, and sometimes it's not because
20 often the business people don't have it right. That is
21 often here where there is a big margin of opportunity. That is
22 not to say you can do an amount of modeling and correlation,
23 you better do it right.

24 MR. KNIGHT: In the minutes that we have left, I
25 want to give each of our panels a chance to answer that

1 lang age from the Guideline about the merger making
 2 coordination more perfect, more complete, and more durable.
 3 It does not indicate that perfect or complete
 4 complete or durable in all respects. It is a directional
 5 implication.

6 MS. MAJORAS: I agree with Andre. I think it is
 7 more important that the original piece that is in
 8 Section 7 analysis has some content to the standard
 7

1 Kandard Khat I don K think a inKended b Congre .

2 I agree in i an inKere K ing paper and K there are

3 Kime hen o are orking K thro gh a SeKtion 1 problem and

1 adding to the proof. This is not an attempt to replace what
2 we do now.

3 MR. SCHEFFMAN: I've done both Section 1 and
4 Section 7 cases. The present objective is have Section 1
5 standard for merger cases. I think the word
6 "collusion," but that is not really what we are doing at the
7 agencies. We are looking at the elimination of
8 competition, SLC, that the market is going to become less
9 competitive. Sometimes the approach is, in collusion,

1 anal frame work has, in fact, helped or hindered the
2 effective use of the Guidelines.

3 More fundamentally, given actual experience over
4 the past 12 years, we might ask whether it makes sense to
5 continue to require disclosure of this information.

6 From an economic standpoint, is it an artificial
7 distinction? Does it have a theoretical and/or practical
8 basis for its origin, maintaining and maintaining for the
9 future? How often is noncommittal a key factor in
10 merger analysis and in handling price and market movements
11 more people the concept of noncommittal to play a
12 significant role in merger analysis?

13 To address these and other issues related to the
14 concept of noncommittal, I am pleased to have a chance
15 to have a moderated panel of commentators.

16 Let me just make a couple of minutes briefly to
17 introduce you to the panelists. To my far left is Doug
18 Melamed, who is a partner at Wilmer, Cutler & Pickering,
19 where he co-chairs the firm's antitrust practice group,
20 and a member of our board, in between is Kirk in private
21 practice, Doug served as the principal Deputy Assistant
22 Attorney General at the Justice Department in the Antitrust
23 Division in the late 1990s, and culminated his tenure of
24 duty there as Acting Assistant Attorney General in charge of
25 the Antitrust Division.

1 Sitting next to Dog is Dr. Timothy Daniel, who is
2 an economist with NERA, here in Washington, D.C. Like Dog,
3 Tim also has a distinguished prior career in government
4 service, having served as an Assistant Director for
5 Antitrust here in the Bureau of Economic and the Federal
6 Trade Commission.

7 To my near right is Mark Whitten. Mark is
8 currently an Antitrust Counsel for the General Electric
9 Company, where he has been since 1997. Like the other, he
10 also has prior government experience, for several years
11 serving as the Deputy Director in the Bureau of Competition
12 here at the Federal Trade Commission. Mark is also
13 currently an Associate Editor of the ABA Antitrust
14 Section Antitrust Magazine.

15 Last, but certainly not least, Dr. Rick
16 Warren-Boulton, a principal with MICRA, an economist
17 consulting firm here in Washington. During his career,
18 like the others, he spent time with the government having served as
19 the Deputy Assistant Attorney General for Economic Analysis
20 at the Antitrust Division for several years in the 1980's.

21 With the brief introduction, let me ask Dog to
22 begin with some remarks on noncommitted.

23 MR. MELAMED: Thank you, Ted.

24 Obviously, the issue of public response and antitrust are
25 an important part of merger analysis, and indeed, look of

1 a part of an analysis. I take it that the topic
 2 that is not that broad one, but rather the narrower one of
 3 the efficiency and desirability of breaking that topic into
 4 two separate categories or dividing the number of
 5 potential entities into two categories, so-called committed
 6 and noncommitted entities.

7 Under the guideline, which do make each a
 8 distinction, noncommitted entities are defined as firms that
 9 are not presently selling in the market, but would enter
 10 within one year in response to a price increase and could
 11 enter without incurring significant costs.

12 Once found to be a noncommitted entity, the firm
 13 is included in the relevant market, and that, of course, has
 14 implications for HHI and other calculations. Potential
 15 entities that are noncommitted entities are taken into
 16 account, at least, much later in the analysis as
 17 described in the guideline.

18 In summary, the distinction does not enhance
 19 merger analysis. I make no sense for a number of reasons.
 20 First, let me touch upon one of the reasons that are easier
 21 to make.

22 There are practical problems with this kind of
 23 distinction. I create an additional issue in merger
 24 analysis that some people may all depend on, and
 25 that is worrying about that category does this potential

1 ppl response fall into. This is not an area that is
 2 likely to have or in my experience has had much payoff,
 3 because there are almost always some costs, especially if
 4 opportunistic costs are taken into account. I guess this is
 5 another aspect of a thing that the fact that the firm is not
 6 presently selling in the market is something. As I
 7 understand it, there have been several cases here
 8 uncommitted entrants have figured into the analysis.

9 Second, even here an uncommitted entrant is
 10 identified, in reading the guideline, you can determine
 11 that you have either creamlined or horkened the analysis in
 12 an abstract making the identification.

13 The guideline are explicit about a proposition
 14 that seem clearly correct. That is, even an uncommitted
 15 entrant can be deemed to be completely in the market.
 16 That is to say that not all of its capacity would be deemed
 17 to be in the market. The guideline state, for example,
 18 that capacity that is "committed or profitably employed
 19 outside the market," that it would not enter in response to
 20 a SSNIP, and that would not be included in the market.

21 Even if you identify an uncommitted entrant, you
 22 then have to ask the question, how much of this entrant's
 23 capacity would be in the market. And for that, you would

1 The particular fact, has the likelihood of the timing
2 and the magnitude of either one might predict from the
3 error.

4 Not surprisingly, experience does not suggest
5 there is an actual category creamline analysis, nor
6 does it affect the benchmark analysis of the merger. It
7 might affect the benchmark analysis if HHI calculation
8 were to be an end-all or even a highly important part of
9 merger analysis. But we all know that HHI are at best a
10 marking point.

11 The recent data released by the agencies suggest that they are
12 kind of like marking point, they don't tell you anything
13 about what is going to happen.

14 The uncommitted error exercise is only apparently
15 to enable refinement of the calculation of the initial HHI
16 and, in my opinion, that is not going to have much effect
17 on the outcome of the merger analysis.

18 In addition to the practical consideration, I
19 think there are theoretical problems with the
20 uncommitted/committed error dichotomy. First, there is
21 always in mathematics a problem when you create categories and
22 force labor and economic to focus on the categories and
23 argue about whether something does or does not belong in a
24 category. You then begin to get a lot of reasoning by
25 analogy, rather than benchmark analysis about what the

1 competitive effect of the merger. As best I know, there is a kind
2 of undue formalism here by creating two categories from which
3 are really implied different places on a continuum.

4 Second, there is a real problem with calculation
5 of share. If an uncommitted entrant is identified, how
6 have we figured out what that means. I am going to tell
7 one judge or many judges near you how to make a
8 judgment as to how much capacity should be put in the market.
9 Since the uncommitted entrant has no historicale, the
10 only a good candidate would be determining how
11 much of his capacity should go into the market.

12 We know from the Guideline and sound analysis
13 that it is often the case that there are superior measures
14 to use for calculating market share, such as dollar sales
15 and unit sales. If you put an uncommitted entrant into
16 a market in which the Guideline would ordinarily suggest
17 that the better measure to calculate share is unit or dollar
18 sales, you either are going to have apples and oranges in
19 your calculation of market share, or you are going to be
20 requiring all share to be calculated on the basis of
21 capacity, which will either be regarded as the absolute
22 measure of calculation here.

23 The most important problem I have with the
24 distinction between uncommitted and committed entrant is a
25 theoretical one. It does not, in my view, correlate

1 ell iKh iK p rporKed p rpo e. I Kake iK Khe p rpo e i
 2 Ko fig re o K haK i in Khe markeK. I Kake iK Khe p rpo e
 3 of fig ring o K haK i in Khe markeK i Ko be able Ko a
 4 iKh more or le preci ion and acc rac haK i Khe naK re
 5 of Khe compeKiKion in Khe markeK. WhaK are Khe real
 6 con KraiK on Khe compeKiKie cond oK in Khe pre-merger
 7 period.

8 The rea on o do KhaK i Ko deKermine heKher
 9 Khi markeK i cepKible Ko anKicompeKiKie re KricKion .
 10 If iK a heaK farmer , e o ld probabl Kthink noK. Or Ko
 11 idenKif heKher Khe merger eem Ko be eliminAKing haK a
 12 nder Khe KaK go anK an impoKant con KraiK on
 13 anKicompeKiKie beha ior b , for e ample, merging iKh a
 14 ma erick or merging iKh a compan iKh a large markeK
 15 hare.

16 The ncommiKed/commiKed enKr di Kion doe
 17 noK Kell o er preci el an Khing abo K Khe KaK go
 18 anK. The critiKal definikion of " ncommiKed enKr " i
 19 Khere are no nk co K . S nk co K are noK an e enKial
 20 condiKion for e erKing a pre enK compeKiKie re KraiK.
 21 EnKr KhaK Kake a great deal of nk co K co ld nder ome
 22 circ m Kance ind ce enormo compeKiKie con KraiK in Khe
 23 markeK.

24 One ind Kr , for e ample, i moKion picK re e hibikion,
 25 here a ne KaK-e-of-Khe-ark enKrank in Kheaker co ld

1 o ernight render ob ole the inc mbenk , beca e of a brand
 2 lo alk in thea ker e hibition. B the ame token, the
 3 ab ence of nk co doe n g arank ee that there ill be
 4 an effect on pre enk compe kition, beca e if limi pricing
 5 i no k reg ired beca e inc mbenk co ld in kan kaneo l
 6 re pond ko an kicipa ked ne enkr and re kain thei market
 7 hare , then o are no k going ko ha e an pre enk effect
 8 from an one ho i chara ker i ed a an ncommi ked enkr .

9 For who e pra cical and theore kical rea on , I
 10 don k think the di kincion make an en e.

11 I think if e are going ko ha e a di kincion, I
 12 o ld gge e go back ko ome old fa hioned nomencla re.
 13 I o ld gge k that e o gh ko a k o r el e in a e ing
 14 the k k g o: In addi tion ko the firm in the market, are
 15 there firm no k in the market ho are e erking a percei ed
 16 po ten kial enkr effect? Then o might be ad k all making
 17 the kake of compe kition in the market more compe kiki e khan
 18 the k k g o anke.

19 The econd ca tegor , the commi ked enkrank , who e
 20 ho e er no pre enk percei ed enkr or ill predi k ad k al
 21 enkrie , and o anal e thei impact on the merger, in the
 22 compe kiki e effect kage hen a king the g e kion, if there
 23 ere an kicompe kiki e effect from the merger, o ld the
 24 enkr ameliora ke them.

25 If o look at k in kerm of a ing effect

1 rather than, ncommitted either notion, I might ask to make
 2 some rough judgment. How much of his capacity do people
 3 think is likely to enter? What do they perceive to be his
 4 likely entry? And I could calculate some HHI in the
 5 process calculation.

6 I don't know what it would become in the HHI
 7 calculation, but it would be a data point that might give
 8 some idea of analyzing the magnitude of perceived potential
 9 entry effects.

10 Beyond that, I would depend on the kind of
 11 dichotomy that the present guideline has.

12 MR. GEBHARD: Thank you, Doug. Tim?

13 MR. DANIEL: Good afternoon. I think my comments
 14 are going to be largely complementary to Doug. I'd like
 15 to make a few additional points as we go. At the end, like
 16 Doug did, I will have a practical suggestion for a possible
 17 alternative to the current application of ncommitted entry
 18 concept in the merger review process.

19 I don't think there is an disagreement among the
 20 crowd that the Merger Guideline provide a pretty logical
 21 approach to the merger review, defining the market according
 22 to consumer behavior, identifying participants in that

22

22

16

1 anal i , o go in to the competitive effect and the enter
2 and the efficiency .

3 There is no disagreement that noncommitted enter a
4 defined in the Guideline and a defined by Ted at the
5 of which the decision deems a place at the table, and
6 need to be considered certainly a part of the merger
7 review, and a possible addition to an anticompetitive
8 effect.

9 The question is here, noncommitted enter hold be
10 analyzed. Ultimately, it really doesn't matter. I think
11 economic are all pretty much on the same page with regard
12 to that. You don't want to get hung up on here, do the
13 analysis, but certainly you do need to do it. The analysis
14 can be done in a conference and it can be done in an
15 efficient way, here it is done at the stage of identifying
16 market participants for purpose of calculating market
17 share for those participants and the HHI that follow.

18 What do I ask? For many of the same reasons
19 that Dog is articulated, as laid out in the Guideline.
20 It is relatively complicated. It not enough just to
21 identify, as Dog would do, a firm that might be acting in
22 the industry or a firm that might have capacity and enter a
23 particular market.

24 I think to do the analysis correctly, you need to
25 assess the profitability of that noncommitted enter

1 beginning sale in the market of concern. To do that, a
 2 the guideline point is, you need to consider the effect of
 3 the uncommitted entrant cost. I don't think there are
 4 any cases here a firm that not currently selling in a
 5 market that decided to move into that market in the
 6 increasing an entry cost, so the entry cost are relatively zero.
 7 You have to consider the effect of high fixed firm would
 8 increase the cost and the agencies have historically, and
 9 rightfully so, been ever concerned about creating a gap if
 10 the one and a half the one.

11 In a differentiated product market, you need to
 12 take whether or not the uncommitted entrant would capture
 13 sales. In other words, would it product be attractive
 14 enough to consumer to make that entry market to the
 15 competitive equilibrium. It's not a simple analysis at all,
 16 in my view.

17 Lastly, have economists like to do is take the
 18 profitability of entry to compare the margin that might be
 19 earned by the uncommitted entrant going forward against the
 20 entry cost of entry and the ongoing cost of operation, and
 21 see whether or not that uncommitted entrant make sense. In
 22 my view, in the case here the calculation of share and
 23 the calculation of HHI and the calculation of delta from
 24 a merger are intended to be in an initial screen
 25 -- it's time for you to go forward or not -- the kind of

1 calculations are out of order and could be
2 an inefficient a condition of the merger review.

3 This morning when I am here, I think it is a Joe

1 fall into the noncommitted entrant box, or whether it be in,
 2 12 or 19 months ago and may be in the committed entrant box.
 3 It really doesn't change the importance of the analysis or
 4 the nature of the analysis.

5 I don't think that distinction makes the merger
 6 process more meaningful.

7 To bring home the point, the Guideline does the
 8 analysis right in terms of direction. To do the analysis
 9 right, but that analysis is complete. As I said, economic
 10 like to do this stuff. This is not stuff that we propose
 11 not to do. Certainly, I am not saying that at all. We are
 12 proposed to do it at a different point in the merger review
 13 process.

14 The first point is that we need to check and
 15 see whether this noncommitted entrant will actually be able
 16 to make sale in the marketplace. If a firm has the
 17 technical capability to achieve such a noncommitted, it
 18 responds but likely would not, because of difficulties in
 19 achieving product acceptance or distribution or production
 20 would render such a response unprofitable, that firm will
 21 not be considered to be a market participant.

22 I think the recent FTC investigation of the ice
 23 cream case -- here the issue, as I understand it, is an
 24 outsider, a new entrant, a new firm, could get
 25 distribution of its ice cream product to consumers --

1 pro ed to be a er lengh , nderaking, a er complicat
 2 anal i in high the co of di Krib Kion and the abili
 3 to e, p the di Krib Kion ne ork ere at the cenKer of
 4 the in e KigaKion.

5 Again, the kind of ork economi lo e to do, b
 6 ik eemed to me to belong in the enr anal i a oppo ed
 7 to the pfronK anal i of a igning market hare and
 8 comp King HHI .

9 On the econd g oke, ik i to the opporK nIK
 10 co K point the Do g menKioned, hich i the in a e ing
 11 heKher or not a firm i an ncommiKed enrKank, nder the
 12 G ideline , one o ld look to ard the end of the g oke,
 13 heKher the firm capaci i el e here commiKed or
 14 el e here o profiKabl emplo ed the ch capaci likel
 15 o ld not be a ailable to re pond to an increa e in price in
 16 the market.

17 Again, hich i an anal i the ab ol Kel ha to
 18 be done, if o are propo ing the a partic lar firm i a
 19 poKential enrKank inK a market place. Yo ha e to a k haK
 20 ik i doing no and if the capaci i oKher i e being
 21 emplo ed to ere e anoKher market, either anoKher prod oK
 22 market or anoKher geographic market. Yo ab ol Kel need to
 23 a k heKher or not the profiK in who e market o ld be o
 24 high a to make enrK inK hich i partic lar market le
 25 profiKable and therefore not likel . Thi i ab ol Kel

1 The analysis to do in the economic section of a merger review .

2 Let me leave you with a few more recommendations, based on the evidence . I think on the
3
4 uncommitted economic analysis, a currently described in the
5 Guideline, in other words, for the purpose of figuring
6 out how it in the market, how the market participants are,
7 how their shares are, could well be used, but in some
8 fairly limited circumstances .

9 Both of the conditions hold firm if capacity is
10 the proper measure for calculating here . This could be in
11 a homogeneous product market or in a market where consumers
12 make relatively large purchase decisions and therefore
13 capacity is only the right way to think about the ability to
14 enter the economy .

15 Capacity is the proper measure, as I mentioned.

16 Secondly, the capacity for an uncommitted entrant
17 is capacity that is controlled by a firm that is already
18 selling in the market at issue . Suppose we are talking

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1 re ie proce , iK i m ch more a back and forth beK een Khe
2 pri aK e parkie and Khe go ernmentK official and Khe
3 in e Kigak i e Kaff. In a co rK, o reall need Ko orK of
4 la o K o r be K ca e aK Khe o K eK, and if o r be K ca e
5 in ol e incl ding Khe e ine prod cer ho o reall Kthink
6 can ing Kheir capaciK g ickl inK Khe direcKion of
7 pickle reli h conKainer , KhaK i e aKl haK o o ghK Ko
8 do, along iK h oKher ppl re pon e KhaK co ld be
9 a ailable.

10 MR. GEBHARD: Thank o , Tim. B m reckoning,
11 Khe oK e i no K o K o noKhing in fa or of Khe di Kion
12 beK een commiKed and ncommiKed enKr being largel
13 arKificial, iK h Khe po ible e cepKion of limiKed
14 circ m Kance KhaK Tim menKioned aK Khe end of hi remark .

15 I am ondering if Khere i an one ho ill defend
16 Khi bea K.

17 MR. WHITENER: S re, h noK. LeK me find m
18 eapon here. I g e iK fall Ko me Ko gi e Khe agencie
19 omKhing Ko go on, if Khe anK Ko keep Khi eKion in Khe
20 G ideline , hich I happen Ko Kthink i a preK good idea.

21 LeK me begin b a ing I didn K partic larl eek
22 Khi ork. I didn K ha e a partic lar a Ko grind on Khe
23 eKion. I Kend Ko agree iK h Khe oKher paneli K , and I
24 Kthink Khi i here Rick probabl come o K, Koo, KhaK iK
25 noK a park of Khe anal i KhaK geK ed an a f l loK, aK

1 lea n in the rigoro en e h i laid o in the
2 Guideline .

3 The ge ion a I ee i a a general ma er of
4 Guideline r i i f o ha e a good economic and
5 anal ytical frame ork, e en if the anal i i a rea onable
6 appro imation of ha the agencie do, at lea in
7 ome ca e , then o ha e a ba i o pre m ch lea e i
8 alone. I think in thi ca e the an er o both of the
9 ge ion i e , and therefore the an er o the l i ma e
10 ge ion i e .

11 There are a nber of o her a peck of the
12 Guideline h i I o ld probabl ha e at before I o ld
13 o ch thi one. I m re o her ha e kked abo
14 n i l aeral effect plen and ill o er the co r e of thi
15 er help l ork hop. A er en ible frame ork, n i l o
16 ge i n o thi enormo l conf ing mi ing and ma ching of
17 marke hare and marke hre hold in an anal i
18 f ndamen all no abo hare and no abo hre hold .

19 Let me ee ha I can do o pre en a fair and
20 balanced o her ide of thi di c ion.

21 Man people i i i g in thi room in ome capaci
22 ha e had ome role, in dra i g the Guideline . Ob i o l ,
23 all of r o ork i h h e m. I think there i a fir
24 principle, h i i don t me i p. A I aid, if o
25 ha e a frame ork h i i economicall o nd, o ho ld look

1 er clo el aK heKher Ko Kark Kinkering iK h iK.
2 Acl al enforcementK doe noK go back Ko Khe orK of
3 K li ed G ideline anal i . Arg abl no i a good Kime
4 Ko look aK Khe HHI pre mpKion and ee heKher Khe reall
5 are oK of nc iK h haK Khe agencie aK all do.

51

1 dorman~~K~~, n~~K~~il ome da omebod a , he , I ha e a ca e
2 here ing capaci~~K~~ or repo it~~K~~ioning or import~~K~~ man~~K~~er, and

1 rea on ~~that~~ Dog ~~that~~ . The ma ~~no~~ ha e ~~the~~ ~~c~~ ~~rren~~
 2 con ~~tr~~aining effect ~~that~~ a ~~c~~ ~~rren~~ market ~~part~~icipan ~~t~~ ha .

3 I ~~is~~ economicall ~~o~~nd? I ~~think~~ o. I ~~think~~
 4 ~~the~~ ~~cri~~g ~~e~~ ~~that~~ e ha e heard o far ~~fo~~ on ho of ~~en~~
 5 i ~~is~~ applied. I ~~the~~ ~~di~~ ~~vin~~cion be ~~en~~ committ ~~ed~~ and
 6 ~~un~~committ ~~ed~~ ~~en~~ ~~r~~ ~~er~~ of ~~en~~ or e ~~er~~ a ~~part~~ic ~~lar~~ ~~ef~~ l
 7 ~~di~~ ~~vin~~cion ~~to~~ make. Are e engaging in market ~~dra~~ing ~~that~~
 8 i ~~ar~~tificial.

9 I ~~think~~ ~~there~~ are ome legi ~~ma~~ ~~ke~~ ~~g~~ ~~e~~ ~~tion~~ and i ~~is~~
 10 might be in ~~ter~~ ~~ing~~ ~~to~~ look at e i ~~is~~ co ~~o~~ and a k ~~he~~ ~~r~~
 11 hi ~~k~~ and ~~r~~ ~~n~~ ~~en~~ ~~r~~ i reall ~~ha~~ e are af ~~ter~~ in ~~ter~~m of
 12 ~~the~~ price con ~~tr~~aining effect. M ~~en~~ e i ~~the~~ e are ~~no~~
 13 o ~~o~~ of ~~the~~ main ~~cre~~am of ~~the~~ ~~fundamen~~tal ~~g~~ ~~uide~~line
 14 economic , o I ~~think~~ ~~the~~ ~~pa~~ ~~that~~ fir ~~st~~ ~~ke~~ ~~ke~~ .

15 Are ~~the~~ e ~~er~~ ~~ef~~ l a a ~~pr~~actical ~~mar~~ket?
 16 Again, I agree i ~~th~~ ~~the~~ ~~en~~ ~~ti~~men ~~t~~ ~~that~~ ~~the~~ are ~~no~~ ~~ef~~ l
 17 reall ~~er~~ of ~~en~~. Mo ~~o~~ of ~~ho~~ ha e done a lo ~~o~~ of
 18 merger ha e ~~no~~ ~~er~~ of ~~en~~ at ~~do~~ n and creat ~~ed~~ a market
 19 ~~part~~icipan ~~t~~ and hare ~~ca~~ble ba ~~ed~~ in large ~~part~~ in
 20 an ~~ti~~cipat ~~ed~~ ~~ppl~~ re ~~po~~ n e ~~that~~ ha e ~~no~~ ~~ac~~ all been
 21 demon ~~str~~ated in ~~the~~ market.

22 There are a ~~nu~~mber of rea on ~~h~~ ~~the~~ impl
 23 don ~~t~~ come in ~~to~~ pla ~~er~~ ~~m~~ch. I don ~~t~~ an ~~t~~ ~~to~~ pend a lo ~~o~~
 24 of ~~ti~~me on ~~th~~i . In coordinat ~~ed~~ in ~~ter~~action ca e e are
 25 reall looking for ho are ~~the~~ ~~part~~icipan ~~t~~ , ho man are

1 there, has is the rough idea of their share and their
2 significance.

3 A Dog point out, the share are just a marking
4 point, so he goes and does all this somewhat complicated
5 analysis to bring into that market. Who else has perhaps
6 the potential to come in quickly.
7 That is a fair point. The coordinated effects analysis is
8 in the Guideline. It does look at a marking point at
9 share, and leads a number of firms. While I agree we are
10 not often going to come up with a more meaningful share
calculation for that, people respond, that, uncommitted

1 ba i for a problem. If o defer them to an analyst,
 2 and I will come back to this, I think o will return to
 3 order of an undifferentiated cell to do that. If e o ldn
 4 have a problem under the coordinated theory in the field, i,
 5 the enterprise comparable or decent sized firm, I don't
 6 think e have to look much further.

7 Winding down point, again, fair enough. The line
 8 are drawn through the guideline. I don't think the line
 9 drawing in this case is particularly here. I think the
 10 introduction of some cost in the analysis in the early
 11 1990 is a more appropriate analysis overall, especially
 12 addition to the guideline. What is significant in terms of
 13 bank cost? At least the guideline take a crack at
 14 defining that, and talking about recovery of the cost.

15 You are not going to get o of line drawing if
 16 o through the analysis. You are talking about o
 17 ear no, and indeed, I think o have some helpful
 18 guidance about that is sufficient under Section 3(b)
 19 o do under this section on how to evaluate the potential
 20 presence of a firm as a current market participant.

21 Having said that this section is an analysis
 22 probably correct and perhaps not especially, if it is
 23 rarely going to come into play, and it's making progress in
 24 the document, o can make a case for a single keep the
 25 document short and confined to the issue at hand really

1 come p in the real world.

2 I think there are some examples, but not too many
3 reported decisions that I think of really turned on an
4 uncommitted or anal i . But the time o ha e a full
5 litigation case and looked at the entire marketplace and
6 competitive effects , one hope , the role of the other
7 player has been fully analyzed. It almost doesn't matter
8 after a full litigation and litigation case has categor
9 o p them into.

10 We are talking here about enforcement decisions
11 and an analysis that later can do going in and that the
12 agencies do in making the decision that they make on a
13 weekly and monthly basis on which case to bring and h .
14 In that context , there are some actions here I have seen
15 which analysis come into play .

16 One example is important . Again, Dog and Tim would
17 probably agree that there are often going to be some costs
18 in in all an kind of enforcement or reporting. That is
19 obvious right. It doesn't mean they are significant.
20 The often will be some cost . When we think about
21 product reporting, that is, looking at the industry

1 coming in from outside the geographic market, I think it is
 2 a little easier to think of this as an efficient one.
 3 Importer may have relatively few costs of providing product.
 4 On the other hand, the manufacturer has significant costs and it
 5 may not apply. In some instances, the manufacturer already has the
 6 product. The manufacturer essentially has the feature. The manufacturer
 7 has the expertise. Transportation costs may not be significant.

8 What do we need this analysis to look at? It
 9 may be just a sell-in man case to allow look at
 10 them as an entity and we will come to the same conclusion.
 11 Again, I go back to the example. Suppose you have decided
 12 or you are considering a narrower geographic market. Say a
 13 U.S. market. You think there is some basis for that, you
 14 have to make it credible as an agency and ask yourself if
 15 there is a problem in that market, and you only have a very
 16 small number of local producers after the merger. If you
 17 have the ability to approximate which firm is roughly
 18 that kind of product capability, measured a capacity or
 19 likelihood, can be selling in that market in a reasonable
 20 amount of time, then not at least compare them in the order of
 21 estimation of current participants, and you might come to a
 22 judgment that this is not a three-to-one deal, this is a
 23 nine-to-eight deal, and therefore, we don't have to ask a
 24 hole lot more.

25 You could go back and look at import

1 find that pro imi ba ed on data, and to be er inkere ked
 2 in looking at a potentiall nilateral effect ca e ba ed on
 3 kind of that bidding data. Then to a ma be e ha e an
 4 i e here, and reall kip o er or perhap not gi e eno gh
 5 credence to the repo ioning point.

6 Go back to Joe Kakan point. If enkr i the
 7 la re ork, and I think, in fact, there i a lot of kr kh
 8 in that, the la khing I think e ho ld do i kind of
 9 commi to ncommi ed enkr fringe the enkr anal i ,
 10 beca e nder nilateral effect ma be in man of the e
 11 ca e ill go a a , e en tho gh the o merging firm are
 12 clo e in ome feat re or ome regard, beca e there are
 13 e eral oher pla er koda that ha e not cho en to ell in
 14 that niche b k co ld fairl readil do o.

15 We o ghk to look at them a ppl re ponder and
 16 not p h them off a kimmel , likel , and fficient enkr .
 17 To think of them a enkrank i reall kraining the logic,
 18 I think, at that point.

19 Don k me i kh Guideline if the are kind of
 20 rea onabl anal kicall correct and if the are ome kime
 21 ef l. I think the are rea onabl anal kicall correct,
 22 and I think the are ome kime ef l.

23 Thank o .

24 MR. GEBHARD: Thank o , Mark. E ik polling no
 25 well e ha e abo k a k o ko one oke. Let me kr rn the

1 podi m o er Ko Rick Warren-Bo lKon.

2 MR. WARREN-BOULTON: I d like Ko do khi Kanding
3 p. When e are cricki ing the G ideline , I anK Ko ee
4 if Werden i an here iKhin range. IK i ea ier Ko d ck if
5 o are Kanding, if o are going Ko cricki e Khem.

6 Since iK Ko one, I m going Ko change m
7 concl ion. I like the nderdog, and ma be Kr Ko defend
8 the bea K, perhap for all the rong rea on .

9 Going la K mean I am noK ppo ed Ko repeat.
10 That er diffic lK gi en KhaK e er bod el e ha done all
11 the good K ff. I ha e a friend KhaK e plain khi b
12 a ing if iK orKh p bli hing once, iK orKh p bli hing
13 Ko or Khree Kime . If iK orKh a ing once, iK
14 probabl orKh a ing iK Ko or Khree Kime .

15 I onl ha e Khree pointK . M r le i ne er ha e
16 Khree of an Khing beca e nobod can remember more Khan
17 Khree of an Khing. I can K.

18 The fir K pointK I d like Ko make i the Kr e
19 ncommiKed enKrank, noK nece aril the ncommiKed enKrank
20 of the G ideline , b K the Kr e ncommiKed enKrank i like
21 an nicorn. IK a Khing of bea K . IK ofKen ighKed.
22 IK hard Ko confirm. E er bod el e eem Ko ha e een
23 one. IK reall hard Ko bag.

24 IK er diffic lK Ko geK enKr iKho K ome nk
25 co K . The econd and Khird pointK , I Kthink, are more

1 inKere King. E en if o find Khe ill i e ncommiKed
 2 enKrank, KhaK noK likel Ko ha e m ch effect on Khe
 3 anal i of a merger. E en if o bagged Khe nicorn, iK
 4 noK a partic larl Ka K Khing.

5 The conKra K, of co r e, i iK Khe commiKed
 6 enKrank. The commiKed enKrank i a real find, beca e hen
 7 o ha e a commiKed enKrank, iK i Khree Ko K o, and no iK
 8 i K o Ko K o. We call Khi a K o-K o. Sorr . Took me a
 9 long Kime Ko Khink of KhaK.

10 SPEAKER: I can K aik for Khe Khird pointK.

11 (La ghKer.)

12 MR. WARREN-BOULTON: If o find o r elf one good
 13 commiKed enKrank, iK i orKh a er large mber of
 14 ncommiKed enKrank .

15 The Khird pointK i KhaK finding a commiKed
 16 enKrank i going Ko ha e a ignificanK effect on Khe
 17 anal i . The real problem KhaK I ee KhaK e are dealing
 18 iK here i Khe Kandard in Khe G ideline for commiKed
 19 enKrank i j K Koo high. I don K ank Ko, e Khe ord
 20 "real." The pointK KhaK I am going Ko make i in a orld
 21 iK a great deal of ncerKainK , e en a er lo
 22 probabiliK , e en a high nlikel probabiliK of ind cing
 23 commiKed enKrank , can re Krain price and pre enK haK o ld
 24 Kher i e be a price increa e afKer Khe merger. The pointK
 25 i KhaK Khe enKrank doe n K ha e Ko be partic larl likel if

1 inefficient dangers .

2 Let's start with thinking the ill effects. I
3 thank Tim Daniel for the nicorn analog . A number of
4 it, and I could be wrong, the defining characteristic of a
5 re-negotiated contract is that even though it does not
6 actually make the product, sell the product at the moment,
7 it merely exists or presence of it there, in the words of
8 the Guideline , likely will influence the market pre-merger
9 and would influence it post-merger.

10 There are two a characteristics might identify such a
11 creature. First, you can look for contractual
12 characteristics that would imply that it would be the case.
13 Then of course, although it is a little unfair, you could
14 actually look at the evidence and ask if it does behave that
15 way .

16 Let's look at the two of them. The first is the
17 one that later loses because you don't need an actual
18 it, so that they are going to do it they are going to look for
19 evidence that the presence of the renegotiated contract
20 actually affects price currently , and therefore would also
21 affect them afterward .

22 In theory , that the Guideline do, because the
23 Guideline are highly contractual in that sense, it is a
24 that it would affect the current pricing decision , if that
25 potential contract, let's call it a potential contract for the

moment~~ed~~ beca~~use~~ e~~ven~~ don~~t~~ kno~~w~~ he~~r~~ i~~f~~ a commi~~tt~~ed or227

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1 lo enough and adjust members in lo enough o
 2 that you can get something that you might call hit-and-run
 3 after-a-little-while. That could be profitable and that
 4 could constrain current price.

5 The most likely candidates for that are in bidding
 6 markets. The nice thing about bidding markets is an entrant
 7 may be able to make sure he has enough business at an agreed
 8 price to allow him to recover his sunk costs even before he
 9 has to incur any of the costs. In that situation, he is
 10 virtually uncommitted entrant.

11 Those are not the only situation. There are
 12 situations in which a potential entrant could enter into
 13 long-term contracts with competitors in the market. Airline
 14 are probably a good example. We all know that has been very
 15 difficult for small firms to enter into the airline market
 16 because of the price response of the incumbents. The
 17 natural idea of the bet is to do it, that before you
 18 enter, you go and you're to contract with competitors.
 19 Contracts with large companies like General Motors who
 20 promise to buy tickets on your airline if you enter, you can
 21 contract with representative of groups of competitors. What
 22 the bill aims to do is to contract with you at prices that
 23 are below current price but above potential price. We
 24 will make sure you will survive. In those situations that
 25 happen in the competitors can make a committed entrant into

1 an uncommitted entrepreneur and encourage them.

2 I think the 1992 Guideline, everyone agrees on
3 this, make a contribution by focusing attention on bank
4 costs, and I think that a preliminary purpose, but that
5 it doesn't do everything it doesn't answer the other half
6 of the question. The first half of the question is how
7 large the bank costs, but the second half of the question is
8 how long it is going to take the incumbent to reach.

9 The thing that is really arbitrary in the sense of
10 the Guideline is this one year recovery. If you are
11 going to ask this kind of question, how long would
12 you hold a company that are the bank costs, how long would
13 it take to recover those bank costs, and when compare that
14 with how long it is going to take the incumbent to adjust
15 his price.

16 In other words, if it takes much less than one
17 year for an incumbent to adjust his price, and in most
18 cases that is true, you can identify a whole bunch of people
19 uncommitted entrepreneur in the sense that you think they are
20 going to constrain current price, then in fact they are
21 not.

22 What else could you look at? You could look at
23 actual evidence of competitive effects. When you start
24 talking down this road, the unicorn begin to look pretty
25 ill, i.e. Think of the kind of empirical work that you

1 ould any one see if a firm announced
2 crank.

3 Remember, the goal is the current con-
4 price, even though he is not accounting the
5 product. You can find evidence that price or margin
6 are lower in market here there are announced crank.
7 You can find evidence that the margin fell when an
8 announced crank "entered a announced crank," in
9 other words, a not accounting in the market.

10 I know a kind of firm. Let me imagine we
11 have an airline that is flying between New York and L.A.
12 and between New York and San Francisco. What can we ask
13 it to do when the price between San Francisco and
14 L.A. does it fall? Does it fall as much as the price fell
15 between New York and San Francisco. You are clearly not an
16 announced crank between San Francisco and New York, once
17 you are flying -- I mean -- San Francisco and L.A., once
18 you are flying back and forth between San Francisco and New
19 York and New York and L.A.

20 A more interesting question is do you find
21 evidence of price increases when the announced crank
22 entered the market, that is, it is expected from being an announced
23 crank. One of my favorites is do you find evidence that
24 price didn't fall when the announced crank began
25 accounting the product. Shouldn't that be the case

1 if he a ~~cr~~ e ~~ncomm~~ ~~ed~~ ~~en~~ ~~rank~~.

2 When ~~o~~ look ~~at~~ price and margin , do ~~o~~ find
 3 ~~that~~ HHI ~~that~~ ~~o~~ ha e been calc lating ~~it~~ ~~h~~ a igning
 4 hare of ~~ncomm~~ ~~ed~~ ~~en~~ ~~rank~~ predick ~~be~~ ~~er~~ ~~han~~ model
 5 ~~that~~ don ~~t~~ a ign hare of ~~ncomm~~ ~~ed~~ ~~en~~ ~~rank~~ .

6 E en if ~~o~~ go ~~thro~~ ~~gh~~ ~~tho~~ e e erci e , ~~o~~ a ,
 7 oka , I fo nd m elf an ~~ncomm~~ ~~ed~~ ~~en~~ ~~rank~~ , ha ~~t~~ ~~o~~ are
 8 ~~ck~~ ~~it~~ ~~h~~ i ~~the~~ ~~g~~ ~~e~~ ~~k~~ion of ho large a hare hold ~~o~~
 9 gi e ~~to~~ an ~~ncomm~~ ~~ed~~ ~~en~~ ~~rank~~ . I ~~think~~ ~~the~~ an er i ~~the~~

1 That o are going from a small number to a small number
2 minimum 1, to from a large number to another large number.
3 That is not going to happen all the time.

4 I think Tim also commented, and I think correctly,
5 that has that mean is not committed either is likely to play
6 a larger role or be more influential in a Section 2 case than in
7 a merger case.

8 Finally, does all that mean that not committed either
9 is just a concept, and well, it is not likely to do much
10 harm, it is not likely to do much good, so we might as well
11 leave it in the Guideline.

12 I think the problem with not committed either is it
13 really focuses attention away from committed either. See
14 Smith in an article that came out right after the 1992
15 Guideline made that point, that the real car thing
16 about raising price after a merger is it might induce either
17 someone who cannot easily be let go. In other words, by a
18 committed either, somebody is going to be stuck with a
19 long time and so can't get rid of.

20 The contract with him and run either is that if
21 who is him and run either has no sunk costs, they are not
22 a threat to incumbents. If so make a mistake with an
23 not committed either, so can always go back to the way
24 go.

25 If there is a lack of uncertainty with respect to

1 The price will induce entry, when if you're not
 2 the perimeter and you get committed entry, there is a higher
 3 price to pay.

4 Sort of like you clear air here, the threat of entry
 5 can really be an effective deterrent to a price increase,
 6 even if the price increase would only slightly increase the
 7 probability of entry.

8 The odd thing is it is perfectly possible in a
 9 world of uncertainty, which I think is the world we live in,
 10 committed entry influence current price more than a
 11 noncommitted entry.

12 If the Merger Guidelines make a contribution here
 13 or if the concept make sense, I would like to see it
 14 because you want to do it and you want to make sure it
 15 is only a noncommitted entry. Where it separates the
 16 noncommitted and the committed entry, and I think the
 17 lesson we should learn from this is not that it is the
 18 noncommitted entry that are really more important, but it
 19 is the committed one.

20 The nice thing about the Guidelines procedure is
 21 it lets you separate the heat from the chaff to get to
 22 the groups who are really going to affect price if entry
 23 occurs, and those are the committed entry.

24 Thank.

25 MR. GEBHARD: Thank you, Rick. No, all the OK

1 are ca K, and b m reckoning, iK i abo K 2.5 Ko 1.5.

2 (La ghKer.)

3 MR. GEBHARD: I ha e j K a co ple of g e Kion I
4 o ld like Ko Khro o K Ko Khe panel atK large.

5 M en e i KhaK m ch if noK all of Khe di c ion
6 KhaK e ha e had Khi aKernoon -- behind KhaK di c ion i
7 KhaK e are orried abo K kind of an, nilaKeral effectK
8 anal i or Kor behind a propo ed merger. We are orried
9 abo K heKher Khe po K-merger enKik mightK be able Ko
10 e erci e markeK po er, nilaKerall .

11 I am ondering if Khe concePK of, ncommiKed enKer
12 inKrod ce an partic lar comple iKie , an addiKional
13 comple iKie , or an pec liar comple iKie , KhaK need Ko be

1 identify at least potentially, noncommitted entities, how
2 hold that entities? Does that add an
3 particular complication?

4 MR. WARREN-BOULTON: Are you asking if an
5 noncommitted entity could be more important than the current
6 entity? I think that is what you are implying.

7 In that case, it would be essentially a paper
8 off. Having an noncommitted entity would be more likely
9 than entering into one more firm agreement in the market.

10 MR. GEBHARD: I take it when that does not add an
11 particular complication, as opposed to calling an
12 unilateral effect for.

13 MR. MELAMED: To the extent that the notion of
14 noncommitted entities is used, I don't think there is a huge
15 difference between it and unilateral effect and
16 it is used in a unilateral effect case.

17 If there is a pricing-in-the-effect, which
18 is what I think might be useful in that kind of situation,
19 it certainly could contain an anticompetitive behavior,
20 precompetitive pricing theory.

21 In addition to that, one could imagine an
22 noncommitted entity is actually colluding, if you have
23 multiple markets and the collusion takes the form of market
24 allocation.

25 MR. WHITENER: It is a very good question, and

1 inKere King g e Kion. UnilaKeral effeK , here I Kthink Khe
 2 imporKance i Khe greaKe K, Khe rea on h Joe KaKKan made
 3 Khe commenK Khi morning, lo enKr i I Kthink Khe real
 4 nicorn here, e peciall if e are Kalking abo K
 5 differenKiaKed prod cK , hich i here nilaKeral effeK
 6 all ari e . The folk ho are poKential pplier are
 7 almo K al a in ome adjacenK prod cK area. IK i a
 8 g e Kion of repo iKioning, noK a g e Kion of b ilding a ne
 9 planK or coming p iKh ne Kechnolog or in e King 10 ear
 10 in intelleK al properK . I Kthink iK i certKainl rele anK
 11 in ome ca e in Kho e in Kance .

12 To o r g e Kion, Ted, iK eem Ko me KhaK
 13 idenKif ing Khe e in Khe ing or poKential ppl
 14 re ponder in a ca e here Khe poKential Kheor i
 15 coordinatKed inKerackion, iK co ld er ell be Khe are
 16 partic larl ignificanK. The ma be Khe lKimaK
 17 ma erick.

18 Ho doe Khe markeK participanK Kr ing Ko e al aK
 19 Khe pa off from coordinatKion e al aK Khe ppl
 20 re ponder ? The ma ha e a m ch diffic lK e al aKing Khe
 21 Kimeline , likelihood, degree of a poKential ncommiKed
 22 enKrank a Khe paneli K here are a ing Khe agencie o ld
 23 ha e.

24 IK eem Ko me iK i an inKere King g e Kion, and
 25 iK ma be, I ha en K Kho ghK abo K Khi a loK, KhaK if o

1 had a number of who e folk in the ing in the
2 capabilities to come in quickl , that ma be a er
3 de bility ing factor for a coordination ca e. Yo ld
4 need to look at that in a earl in the anal i a o can.

5 MR. DANIEL: I ld conc r in Mark ie on
6 that. I think I ld al o conc r in hi er point.

7 Commited er to me reall i the profiability
8 of the e ken ion of that prod ct line or e ken ion of that
geographic region of the prod ct.

1 he iKank Ko mo e for ard er aggre i el . I o ld Kthink
 2 abo K haK iK o ld Kake for him Ko begin doing haK he
 3 ha n K been doing before, hich i er ing U.S. c Komer .

4 MR. WARREN-BOULTON: One Kthing hich I Kthink i
 5 orKh noKng, hen people are looking for ho i mo K likel
 6 Ko be Khe enKrank, and omebod ho i making iK ome here
 7 el e, omeKng like KhaK, I Kthink in man of Khe reall
 8 inKere Kng ca e , iK noK omebod ho i making Khe ame
 9 Kthing or making omeKng imilar, or making omeKng in a
 10 differenK area. IK a erKicall relatKed firm. If o
 11 a ked ho a Khe mo K likel and Khe mo K Kthreakening
 12 enKrank Ko Micro ofK de kKop operakng Kem, Khe an er
 13 i InKel. The an er i if o ha e a monopol in a
 14 complemenKar prod oK, KhaK firm i noK orried abo K price
 15 red oKion KhaK happen afKer iK enKer beca e KhaK firm can
 16 pick iK p. If Khe price of MS DOS had fallen, InKel co ld
 17 pick iK p b increa ing Khe price of Khe chip.

18 There are Khe e orK of reall inKere Kng
 19 iK akion in hich erKicall relatKed firm can and are
 20 imm ne from Khe al problem iKh enKr , hich i
 21 po K-enKr price red oKion .

22 MR. DANIEL: Mo ing Ko Khe Kthird rail no , Rick.
 23 VerKical merger .

24 MR. WARREN-BOULTON: Ye , long o erd e.

25 MR. GEBHARD: Rick ma ha e alread addre ed Khi

1 g e Kion, aK lea K in park, b noKing KhaK commiKed enK
 2 i more imporkanK in Kerm of eight Khan, ncommiKed enK ,

1 under and that, you have to get beyond the category and
2 you have to really ask how likely it is when and how
3 likely it is perceived to be, how likely it will happen, and
4 over that time.

5 The category does not help the analysis. You have
6 to look at all the factors in the guideline, of which you
7 could choose one, and make an assessment.

8 I don't see how you go through the categorizing
9 exercise. I think you go through it as a question, is
10 there somebody that is not in the market that might
11 ameliorate things and if so, how and how often.

12 MR. WHITENER: A part of the probably 1.5 case
13 for keeping the case, I guess I would not point to the
14 difference in treatment of each case as the reason to keep
15 the analysis. I do think it is a relevant difference
16 between the analyses. I think the fact that the enrollment
17 costs, they are likely to be low cost of each. It is
18 going to be legitimate to look at that type of player a
19 having a high elasticity of people, someone you have to look

forecasts of health care costs, 7 -ITENE e into that case.

1 hea ind Kr . I am making idges b I co ld make
 2 gidge . That conceps doe n make a lo of en e ofKen Ko
 3 think abo lo nk co of enKr . There are going Ko be
 4 perhap g ike ignificanK co .

5 That i h I think the oher e ample that I
 6 pointed Ko are probabl more ofKen here khi i reall
 7 rele anK, and impork i a good e ample Ko Tim pointK. IK
 8 i noK a good commenKar on merger anal i if e are
 9 a Komakicall a ming that beca e the hip are ailing
 10 pa the pork , e are noK going Ko co nK them.

11 We are ppo ed Ko do a d namic anal i . We are
 12 ppo ed Ko po ik a change, eikher a price increa e or the
 13 enKr anal i no talk abo a ppl increa e or
 14 decrea e. There i an ind cemenK for that hip Ko rn and
 15 go inKo pork.

16 If i i reall that ea Ko rn and go Ko pork,
 17 anal icall , e holdn care if i ha ne er done that,
 18 beca e before the merger, e ha e a nice compeKi e markeK
 19 and afKer ard e don K, iK reall o ghK Ko be haK i the
 20 ack al d namic effeok, and if that i relaki el ea , then
 21 iK eem Ko me e ha e a role for gi ing who e folk ome
 22 degree of ome pre ence in the markeKplace, in o r inial
 23 cK of ho the pla er are and haK the anal i look like.

24 MR. WHITENER: If there are price fl oK akion
 25 that eem Ko be the K pe that hold dra the re pon e and

1 it has not occurred, I agree. Maybe it is often going to
 2 be the case. If I had a fairly capable emerging
 3 competitive market here the equilibrium does not give them
 4 an reason to turn and go to port, and a merger arguably
 5 change that, when I get it would be relevant to me
 6 whether it prevents me to make a left turn and go back
 7 to the dock and unloading.

8 MR. WARREN-BOULTON: My concern is how we respond
 9 to that. Even in this direction, it is quite clear that
 10 everybody is saying the merger is somehow likely to
 11 have a price impact if it never turned and entered the
 12 port, if it really is an uncommitted entrant. If it
 13 never turned and entered the port, there are some sunk
 14 costs of entering and going into the port. If the
 15 incumbent raises their price, when I am going to turn
 16 into the port, and once he gets into the port, I am not
 17 going to be able to get rid of him. The merger is likely to
 18 be the cause of a problem if the entrant never goes into the
 19 port than if I see him eventually coming into port, and
 20 the pre-merger position in the merger I have never dealt with
 21 in God, do everything I can to see if I can characterize
 22 that the entrant is an uncommitted entrant.

23 MR. WHITENER: It is the interpretation that I
 24 think I find really problematic, and I am not quite sure how
 25 that happened, except maybe it came earlier in the

1 Guideline , and like all proced re , o pend all o r time
2 orring abo ha come fir .

3 MR. MELAMED: Anal i a ide, if o are arg ing
4 the orld i going to hell b don orr , there i going
5 to be a a ior, o are in big tro ble, and o an to
6 a oid being in that it ation.

7 MR. GEBHARD: I ee e ha e e ha ed o r time.
8 In fact, e ha e gone o er for a fe min te .

9 Let me j clo e b noKing that for a topic that
10 iniKiall man people who ghK a noK partic larl the
11 e ie K on the ork hop agenda, I think e ha e had er
12 inKere King di c ion, and ome inKere King comment K hi
13 afKernoon.

14 For that, I anK to thank each of the paneli K
15 and thank the a dience ho K ck arond for the late, late
16 park of the da .

17 Thank o er m ch.

18 (Appla e.)

19 (Whereupon, at 5:20 p.m., the
20 workshop was concluded.)

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CERTIFICATE OF REPORTER

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I, RiKa M. Hemphill, CVR, do hereb certif ~~that~~
the foregoing proceeding ere recorded b me ia a diocape
and red ced ~~to~~ ~~pe~~ ~~riking~~, nder m ~~per~~ ~~i~~ ~~ion~~; ~~that~~ I am
neither co n el for, relat ed ~~to~~, nor emplo ed b an of the
partie ~~to~~ the ackion in hich the e proceeding ere
tran cribed; and f rther, ~~that~~ I am not a relat i e or
emplo ee of an attorne or co n el emplo ed b the partie
hereo, nor financiall or oher i e inkere ked in the
o kcome of the ackion.

1 come ofnn l 2ch ~~for~~ HEMPHILL,

RITA M. HEMPHILL,