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

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

Northwestern University School of Law  
Conference Center  
340 East Superior Street  
Chicago, Illinois

Matter No. P092900

Reported and Transcribed by:  
Janice M. Kocek, CSR, CLR

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APPEARANCES

WELCOME

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

PANEL 1: ENTRY

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

PANEL 2: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

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

PANEL 3: UNILATERAL EFFECTS

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

PANEL 4: EFFICIENCIES

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

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P R O C E E D I N G S

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INTRODUCTION AND WELCOMING REMARKS

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

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

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

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



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

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

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

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

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

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

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

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

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

1 of them.

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

10 MR. WEBER WALLER: This is fine.

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

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

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

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

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

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



1 analysis, indeed untraditional market analysis.

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

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

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

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

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

16 MS. BOAST: Thank you, Spencer.

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



1 industry-specific trades.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20                  But from this work we learned a  
21                  great deal about many things. But contestability  
22                  is not really an applied concept. It's really  
23                  theoretical benchmark, much linsray convexity.

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

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

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

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

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

25                  Bloomberg would need to develop



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

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

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

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

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

25 The agency, maybe outsiders and



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

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

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

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

1 the competitive effects analysis.

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

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

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

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

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

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

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

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

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

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

25                  One thing for you to think about,

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

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

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

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

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

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

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

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

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

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



1       confusing, perhaps contradictory distinctions.

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

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

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

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

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

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

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

25                   Enforcers and experienced



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

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

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

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

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

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

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

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

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

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

25                  I would be remiss if I didn't note

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

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

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

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

18              That concludes my comments.

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

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

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

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

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

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

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

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

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

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

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

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

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

25                  When I was the deputy at the

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

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

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

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

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

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







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

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

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

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

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

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

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



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

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

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

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

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

25 My main comment, if I had to give



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

5 I'll stop there.

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

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

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

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

25 And you know, the antitrust

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

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

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

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

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

1       about lifecycle management of the drug.

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

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

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

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

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

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

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

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

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

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

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



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

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

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

12                But it does actually happen

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

25                  If you look at it from today's

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

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

15 And that's why I think the

2herdary effective18.

15 effective19.

15

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1       need to take that into account.

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

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

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

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

9 MR. MURPHY: That's what I'm trying to  
10 say. I'm not trying to advocate for getting  
11 rid of market definition either, but I just  
12 think you have to realize that not all markets

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25 I'd be concerned that -- my main

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 manufacturers of value brands trade up.  
2 The brand literature says that's  
3 virtually impossible because of the successful  
4 associations of quality and other things that



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

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

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

15 MR. CARLTON: I have two responses.

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

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

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

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

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

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

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

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

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

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

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

12 MS. BOAST: Bob?

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

22 MR. CARLTON: I agree with that.

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

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

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

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

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

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

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

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

4 MR. CARLTON: Safe harbors.

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

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

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

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

1       agree.

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

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

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

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

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

15 Anybody have a view on burden?  
16 Rob?

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

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





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

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

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

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

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

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

1 don't want to.

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

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

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

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

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

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

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

3 MR. CARLTON: Why do you hate to?

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

7 MS. BOAST: Bob, what about you?

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

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

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

25 MS. BOAST: Spencer, what about you?





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

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

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

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

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

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

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

7                 Our first speaker is Debbie  
8       Majoras, who is immediately to my left, and  
9       probably well known to everybody in the room.  
10       She was previously a very distinguished Chair

1                           Following Debbie will be Michael  
2       Whinston, who is the Robert E. and Emily H.



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

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

8                MS. MAJORAS: Well, thanks very much,  
9       Rich. It's good to be back. I was thinking  
10       that I'm not used to being outnumbered by  
11       economists anymore. I'm sort of outnumbered by

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

14 MR. FEINSTEIN: Michael.

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

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

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



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

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

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

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



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

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

11 I completely agree with Debbie  
12 about the importance of having initial  
13 screening devices; and I.iu3rke t/GS1 D u im(8a3ce of havig device

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

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

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

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

25 Maybe we say that 5 percent on

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

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

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

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

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

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

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

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

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



1 to know anything about demand.

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

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

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

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

25 It turns out, however, that the

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

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

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

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

25 In that senselusst windo

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

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

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

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

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

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

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

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

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

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



1 important to frame my comments on this.

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

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

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

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

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

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

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

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

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

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



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

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

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

15 There are two approaches that are  
16 generally used. The so-called difference-in-  
17 difference approach, which is really looking at  
18 price changes. And in that situation, you need  
19 to find a control group that's identical in  
20 terms of all of the demand and cost pressures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 alternative explanations?

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

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

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

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

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



1 points out, anything other than structure.

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

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

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

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

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

25 Those are the goals. So I'm going

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

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

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

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

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

25 So we're already past that. Now,



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 used in scientific studies. What are they?

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

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

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

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

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

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

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

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

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

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

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

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

25 So, first of all, does the

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

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

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

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

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

1 just don't think it's appropriate.

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

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

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

12 MR. LANGENFELD: Makes me happier.

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

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

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

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



1 the enforcement agencies one way or the other.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20                   Finally, I think if people think

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 market definition.

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

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

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

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



1       there are potentially more other substitutes.

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

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

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

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

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

12                   When we're looking prospectively, and  
13 adopting my own term of all these being indirect  
14 market definition analyses that we're talking about  
15 here -1.825 Tt02o3ductural,nk in termve clneemmng ue82999.8(wouly]

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

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

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

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

23             MR. LANGENFELD: That is correct.

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

1 focused on the likely ability to increase  
2 price.

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

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

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

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

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

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

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

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

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

1 the effect of price.

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

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

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

18             MR. FEINSTEIN: Debbie?

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

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

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

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

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

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

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

25 MR. WHINSTON: Can I say just one other





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

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

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

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

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

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

25 So I guess I would ask each of

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

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

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

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

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

23               MS. NOETHER: Yes.

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

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

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

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

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

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

1 I would fix that.

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

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

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

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

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

10                  So I think I would spend some time  
11                  thinking about what these safe harbors are, whether  
12                  they're the berabostie harborswe can unse intermsr  
32                  oft the presumpticong. r Tat'sg whure themarkeat

MR. FEINSTEIN: Jim?.

MR. LANGENFELD:k Iguess - - elld, .

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thatwe shwoulddto or



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

6 Secondly, there's been a lot more





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

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

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

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

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

25                  MS. BOAST: So I knew she had

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

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

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

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

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

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



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

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



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

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

18 And the third area, and the one I

1 individual customer negotiations post-merger.

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

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

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

25 So in the first case with the too



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

6                    In the second case you want to

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

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

13 MS. BOAST: Thank you, Mary. That  
14 was -- I'll call it an overview, although it  
15 was obviously more complete than that, but  
16 a really helpful way of thinking ab tha2bha  
17 different kinds of caselterEla andperhapsha

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

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

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

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

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

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

1 posed by the Daubert standard.

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

10 I think the guidelines are very  
11 clear in sayied I into account.

1 the courts.

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

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

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

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

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



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

16 Finally, with respect to consummated  
17 mergers, there's really no suggestion of whether  
18 the analysis would be any different. And I think  
19 it's clear that the analysis could very well be

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

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

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

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

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

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

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

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

25               One of the things I like to think

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

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

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

1       what that case was about.

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

8                   And the useful way to think about  
9       that case was that Whole Foods and Wild Oats  
10      and maybe a few other people who were distinct  
11      from a whole group of other participants in the  
12      market, traditional supermarkets.

13                  Our whole question was would  
14      there be an anticompetitive effect here if  
15      there was a merger. That was the right lens to  
16      use for the analysis, and we shouldn't decide  
17      the case based on market definition. We should  
18      look at the competitive effect and then that will  
19      tell us at the end what was the right market  
20      definition. But the idea that we'd have a stage of  
21      market definition then and analyze the effects  
22      within the market was not very helpful in that  
23      case.

24                  And I get back to Rob gave you an  
25      example earlier today of Thomson Reuters. It

1       was the same issue. So the right lens for  
2       thinking about that was Bloomberg was  
3       different, Thomson and Reuters were more  
4       similar in what they did, and whether you  
5       called it a broad market that included all of  
6       them or a narrow market with repositioning or  
7       entry by Bloomberg really didn't matter. So  
8       you could do the analysis in either way.

9               Well, what's the burden in the  
10       current framework? Well, the problem is  
11       currently we have these sort of structural  
12       presumptions that are built into the guidelines  
13       which carry, like it or not, some weight to  
14       that second stage of the analysis.

15               You know, you're not free to say  
16       I'm going to choose the most effective lens for  
17       thinking about competition without getting some  
18       burden carried over from the presumption. So I  
19       think it's important that we try to reduce the  
20       presumptions, the structural presumptions in  
21       the guidelines.

22               If you think about it in terms of  
23       unilateral effects versus coordinated effects  
24       or structural versus direct effects -- if you think  
25       about those dichotomies, they're both useful

1 frameworks, but you don't want them getting in the  
2 way of each other. You don't want them sort of  
3 interfering with doing the best analysis you can.

4 So one answer to that is, well,  
5 let's just jump in and do a competitive effects  
6 analysis right from the beginning. The problem  
7 with that is there's just way too many mergers  
8 to do a competitive effects analysis in every  
9 merger that comes over the transom. So what you  
10 need to do is you still need to have a stage one  
11 where we can screen things out and a stage two  
12 where we actually do a competitive effects  
13 analysis.

14 When it comes to stage two, I'm  
15 very much on board with what I think most  
16 people said this morning and from what I read  
17 people said at other workshops, this  
18 distinction that somehow we're going to parcel  
19 out entry and put it over here, and we're going  
20 to put efficiencies over here, and then we're  
21 going to do the analysis if none of those  
22 things existed and then we're going to bring  
23 those in later. I don't find that very  
24 helpful.

25 I think in many cases that I've

1 worked on, competitive effects, for example,  
2 and efficiencies are just intimately tied  
3 together. They're kind of part and parcel  
4 often in the same events. The same thing that  
5 generated efficiencies generates potential for  
6 competitive effects. I don't see any real  
7 reason to separate them out in a particular  
8 format.

9 As was said earlier today, same is  
10 true with entry. Entry is part of the market  
11 equilibrium that exists today. You think about  
12 direct evidence. Well, any direct evidence you put  
13 forward about pricing effects of market  
14 structure or pricing effects of market events.  
15 If entry is important, it's already influenced  
16 those numbers. You can't say entry's not part of  
17 my analysis. The data you have, you might wish  
18 you had data that didn't reflect the impact of  
19 potential entry, but the data you have does.  
20 You can't divorce it out of the data, so it has  
21 to be by definition part of your analysis.

22 So how do we do stage one, stage  
23 two? I think we should be able to do stage one  
24 and stage two where you have to decide which  
25 mergers are no problem and which mergers warrant



1 further study.

2           It seems to me a structural market  
3 definition/Herfindahl approach isn't the only  
4 way to either push things forward or say we  
5 don't need any further analysis. So for example,  
6 if somebody comes in and says I have good evidence  
7 of direct effects or unilateral effects, that's  
8 probably enough to push this to stage two even if  
9 we can't jump through all the other  
10 hurdles.

11           Similarly, if somebody comes in  
12 and says, well, there's no overlap in what I  
13 sell and what he sells, so however you define the  
14 market, the diversion ratio is so low here, it's  
15 not going to cause a problem, that should get you  
16 through the review. If somebody says we have a  
17 well-defined marketplace and our shares are both  
18 small, then off to the side unless somebody  
19 came back and said either that market's wrong,  
20 or number two, I have evidence of direct  
21 effects, which, again, would presumably trump  
22 your market definition as being appropriate in  
23 that case.

24           So I guess the way I see it is the  
25 current guidelines are a little too focused on



1 good idea. At a minimum, they need to be  
2 adjusted to reflect current practice.

3 Finally, I think probably if  
4 they're going to be used at all, they should be  
5 used more in the safe harbor direction,  
6 although that safe harbor should be able to be  
7 defeated by evidence of direct or unilateral  
8 effects.

9 MS. BOAST: Kevin, if I heard you  
10 correctly, you said that the structural  
11 presumption could be used to -- if you had a  
12 well-defined market and low shares to make a  
13 decision that you didn't need to go to phase  
14 two.

15 I'm not sure I heard you say the  
16 other way around, and maybe you did by  
17 implication, that if you have a well-defined  
18 market and high market shares, you go to stage  
19 two?

20 MR. MURPHY: I think you probably would  
21 end up going to stage two unless someone could  
22 demonstrate the absence of effects in spite of  
23 those shares.

24 You're talking about a merger in  
25 Boston and I have market outcomes in forty

1 other cities that have the market structure  
2 you're looking at and prices are no higher  
3 there than they are elsewhere, I think you're  
4 ready to go. You don't need to go to stage  
5 two. Maybe that is stage two.

6 MS. BOAST: I understand. I felt like  
7 you were using the screen one way, and I just  
8 wanted to raise the question about whether  
9 reducing reliance on the structural, quote,  
10 "presumptions," closed quote, meant -- and that  
11 would be a fair position to say you used the  
12 structural presumption to screen things out and  
13 otherwise you look at effects and start there.

14 I don't have a conceptual problem  
15 with that. I might have a practice problem  
16 with it. One comment, since I can't seem to  
17 resist commenting during the middle of these  
18 presentations, about structural presumptions in  
19 the guidelines.

20 The way I've always thought about  
21 it, and the way it certainly works in practice,  
22 is that I think of litigation as a burden-shifting  
23 exercise in the sense that burdens shift  
24 because courts want the burden on the party  
25 most in control of the relevant information at

1 any given point in the process.

2 Internally, and I think Roxane is  
3 right, maybe the label is wrong. It's more a  
4 question of telling you that if this following  
5 set of conditions is satisfied, we will be  
6 operating from this premise. That's not to say  
7 that we're done and you do the rest of the work.  
8 But one of the internal discussions is, we  
9 periodically meet with staff to review the various  
10 matters. They'll say you've got X, Y and Z,  
11 bearing in mind they're mostly starting with what  
12 is a version of competitive effects analysis  
13 anyway. It's a way of guiding, you  
14 know, how far do we want to go and what is the  
15 next piece of evidence we should be looking at,  
16 and so sometimes setting priorities.

17 But it's also a way of saying you  
18 should know that as a general proposition when  
19 we reach this set of conditions, we will be  
20 thinking that there might be something to  
21 pursue further, which is essentially what you  
22 were saying.

23 Paul, please pick up with whatever  
24 you want to say.

25 MR. DENIS: Thank you, Molly, and thank



1 right questions.

2 That sounds a little bit trite to  
3 say in a setting like this. You can say, well,  
4 what are the right questions. Well, the right  
5 questions I think revolve around identifying  
6 the conditions that are necessary to establish  
7 that a merger is likely to have adverse  
8 competitive effects. They're categorizable under  
9 Section 7. That's what we ought to be focused  
10 on. Those are the right questions. And that  
11 necessarily implies a fairly high level of  
12 generality.

13 Roxane referred to this in her  
14 remarks, that merger guidelines are unlike some  
15 of the other federal enforcement guidelines,  
16 they don't go into a lot of examples, a lot of  
17 discussion of evidence. That was by design, and I  
18 think it actually was the right way to go. Because  
19 by sticking with the right questions approach and  
20 staying away from evidence, not entirely away from  
21 evidence, but largely we stayed away from evidence,  
22 created a document that had a great deal of  
23 credibility with people.

24 It's lasted far longer than any of  
25 us expected. No one would have predicted that

1 the guidelines would have been around for  
2 seventeen years before encountering substantial  
3 revision. And I think it's because the  
4 guidelines achieved a level of credibility by  
5 focusing on the right questions, not getting  
6 into the nitty-gritty of the evidence.

7 The commentary is a far better  
8 document for that; and I certainly subscribe to  
9 the notion that we should have a regular updating  
10 of the commentary to go into more of those issues.

11 What's happened with the  
12 guidelines because of the approach they've taken,  
13 they've gotten widespread adoption. Not just by  
14 practitioners within the agencies and outside the  
15 agencies, but also by the courts and globally. I  
16 mean, it has become the template for merger  
17 analysis around the world, and it's because of the  
18 approach that we took. It had a fairly high level  
19 of generality and, therefore, was able to be  
20 applied in a wide variety of complex.

21 So we've got a durable document  
22 that I think has been largely successful. I  
23 certainly won't say it's perfect. As wedded as  
24 I am to what we did, I'd have to agree that it  
25 is time to change, and particularly in the area



1 of unilateral effects that we're talking about  
2 here.

3 When we introduced the unilateral  
4 effects section to the guidelines in '92, it  
5 was definitely the single biggest innovation in  
6 the document. There had never been a  
7 unilateral effects section. There was a leading  
8 firm proviso in the '84 guidelines, but people  
9 really didn't talk about unilateral effects. So  
10 this was a big change at the time.

11 We're now all quite familiar with  
12 it; but when we rolled it out, it was pretty  
13 unfamiliar. It's turned out to be the most  
14 influential change, I think. If you look at  
15 government complaints, this is not a rigorous  
16 analysis. But having eyeballed a lot of them, they  
17 are largely dependent on the unilateral effects  
18 theories in this case. There are very few cases  
19 that are based entirely on coordinated effects  
20 theories, and I would suggest that the coordinated  
21 theory is usually subsidiary to the unilateral  
22 theory these days.

23 But ironically, despite being the  
24 most influence change, unilateral section is  
25 probably the least understood. And I think

1       it's on just about everybody's short list of  
2       things that need to be revised.

3               So what went wrong? Where did we  
4       fall off the rails here and what can we learn  
5       from the history as we embark on a process of  
6       considering revisions to these guidelines?

7               At a high level, I see two things  
8       that went wrong. One, in some respects we  
9       adopted too high a level of generality. And in  
10      other respects, we got away from the central  
11      tenet of asking the right questions.

12              On the point of generality, we had  
13      a basic notion of unilateral effects that I  
14      think was well-articulated in the guidelines.  
15      By unilateral we meant, you know, without  
16      concurrence of rivals, without the need for  
17      coordination. It's a different mode of  
18      competitive analysis. I think it is different  
19      than coordinated, and Dennis Carlton and I have  
20      had this discussion a few times and I guess  
21      we'll have it again.

22              We stress in the guidelines that  
23      unilateral effects can arise in a number of  
24      different settings. We spent a fair amount of  
25      time on a couple of those settings in the



1       certainly something I would urge in this  
2       process, is we not get too far ahead of the  
3       economics.

4               We probably could have done a  
5       better job even with the state of economics at  
6       the time. So that's one source of our problem  
7       here. And we tried to put too much, I think,  
8       on the template of differentiated product site.

9               In terms of the right questions,  
10       we did fall off the rails on that one. We  
11       threw in a presumption in the middle of the  
12       unilateral effects section. The reason we did that  
13       was twofold. First, there were significant  
14       concerns about unilateral effects leading to a  
15       bunch of small effects cases, that resources  
16       would be wasted chasing small effects cases. So we  
17       started out by trying to put in a safe harbor to  
18       avoid that problem. We ended up with a  
19       presumption, sort of ended up with a camel, I  
20       think, because of the committee process.

21               Others were concerned the  
22       government would never be able to prove a  
23       unilateral effects case. I think, you know,  
24       we've seen the government can certainly prove a  
25       unilateral effects case. So the presumption that

1 we ended up with practically defies application.  
2 The conditions that have to be met to apply it are  
3 so cumbersome as to be almost impossible in  
4 differentiated products.

5 So those two things, I think, have  
6 created a lot of confusion in unilateral; but  
7 they also point in the direction of things that  
8 can be done to fix the problem.

9 I think if the drafters can break  
10 out these different settings in more detail and  
11 set out the necessary conditions for  
12 establishing a problematic transaction, that will

1 corollaries to that. One is I would not put  
2 tools into the guidelines. I would not put in  
3 UPP or GUPP or GUPPI or any of these other  
4 tools. These are useful things to do.  
5 They inform us in certain settings about the  
6 right questions, but they're just tools. I  
7 would explore them in the commentary, but I  
8 wouldn't put them in the guidelines.

9 I would certainly drop the  
10 presumption that's in the unilateral effects  
11 section right now. In fact, I would drop all  
12 the presumptions. Others have made that point  
13 as well. When you think about Baker Hughes  
14 and presumptions, as Molly was getting into  
15 earlier, it's about burdens shifting in terms  
16 of coming forward with evidence.

17 Guidelines ought to be burden-  
18 neutral. They actually profess to be burden-  
19 neutral, but I think this is one area where  
20 they're not. The presumption has to go.

21 In its place the agencies are  
22 going to have to deal directly with the issue  
23 of substantiality. That's the elephant in the  
24 room, I think, and it's the hardest one to deal  
25 with. Nobody wants to say that we're

1 willing to tolerate certain adverse effects  
2 that hurt certain people. But I think that is  
3 the thing that you're going to have to wrestle  
4 with the most.

5 I'm just about out of time  
6 here. I guess I will leave it at that. If the  
7 drafters can pull off that much, I think they  
8 may end up with a document that's going to  
9 outlive its predecessor.

10 MS. BOAST: Paul, do you mean  
11 substantiality throughout the entire merger  
12 analysis, or did you mean to be specifically  
13 referencing the concern that led to the safe  
14 harbor, and that is, you know, tiny effects  
15 cases?

16 MR. DENIS: I think it's a broader term  
17 than just the tiny, little unilateral effects  
18 cases. It was most pronounced there because we  
19 were making a change, but it comes up in other  
20 contexts as well.

21 If you have a statute that says  
22 there has to be a substantial lessening of  
23 competition, we never spent much time talking  
24 about the substantial part. We talked a lot  
25 about the lessening of competition part and how

1 to make that operational. But we routinely  
2 duck the substantial one because that's a hard  
3 question.

4 MS. BOAST: Because I think it also  
5 says in a relevant market; and therefore, we  
6 spend all our time trying to figure that out  
7 before we figure out whether it's substantial.

8 MR. DENIS: Markets are one way of  
9 ensuring that we get substantiality. If you  
10 force yourself to define a market, you have a  
11 dimension over which to measure this effect.



1 heard thus far or expand upon it?

2 MR. MURPHY: I would just reiterate a  
3 little bit what you just said, which is if you  
4 go straight to the unilateral effects or direct  
5 effects kind of analysis, you always do have to  
6 circle back in some sense to market definition  
7 to get that substantiality component.

8 It's another place where market  
9 definition shows up in the guidelines, because  
10 we sort of say implicitly within a market if  
11 some people gain and some people lose, we look  
12 at the net and see who gains, but we don't do  
13 that across markets. And market definition,  
14 therefore, has yet another place that it shows up  
15 in the analysis. I think in some sense if you take  
16 a deemphasis on market definition, you then have to  
17 have a substitute way of talking about  
18 substantiality.

19 MR. DENIS: Molly, if I could, one  
20 other point. I think each of the panelists, I  
21 think it's fair to say each of the panelists  
22 all day have noted the interconnection between  
23 the various elements of the guidelines  
24 analysis. And Kevin really pushed on this in  
25 his remarks about how the various pieces keep

1 feeding back into each other.

2 That's a really important  
3 observation, I think, in thinking about the  
4 drafting and this issue that's on the table  
5 about how did the pieces fit together and how  
6 should the guidelines be applied.

7 I'm a strong booster of keeping  
8 the framework and making people work through  
9 the framework in an orderly way. I mean, I  
10 agree that you can skip steps. Those of you, and  
11 this room is full of experienced practitioners, you  
12 can skip steps, right, because you're making  
13 assumptions about the steps you're skipping and you  
14 know what you're skipping. And you know how they  
15 fit together.

16 That is an important point I think  
17 people are forgetting. When they say I don't  
18 need this framework, they're ignoring how  
19 dependent they've become on the framework.  
20 They've completely internalized it. People have  
21 gotten very good at applying the framework. But I  
22 think to ensure that the next generation of  
23 practitioners will do as well, I think we need to  
24 keep the framework and keep the emphasis on the  
25 working through the framework in a fairly linear

1 way.

2 MS. BOAST: Although we've heard a lot  
3 about making sure we recognize these are just  
4 tools, they're all leading to the same end, the  
5 process should be flexible, I think there's  
6 also a theme that some version of a framework  
7 is a helpful way of corroborating the results.

8 But this is one of the reasons  
9 that the very beginning, before we even began,  
10 opened our first panel, I said now that we're  
11 about halfway through the workshop process, I'm  
12 beginning to wonder whether our modest goals  
13 were too modest.

14 I think Steve Calkins has his hand  
15 up.

16 MR. CALKINS: All right, Kevin. I had  
17 careful notes during your remarks that you  
18 specifically were saying you ought to put a lot  
19 less weight on market definition. I've got you  
20 down as saying don't do market definition very  
21 much. Then in the comment just now you  
22 emphatically came out and said it's important  
23 to do market definition. And if you could  
24 reconcile those two, and indeed you might even  
25 reference back to your wonderful product example

1       that you were discussing with Dennis Carlton and me  
2       during the break before, and think through exactly  
3       what would you do with market definition and how  
4       would you use it.

5               MR. MURPHY: I guess I would say the two  
6       shouldn't get in the way of each other, I guess is  
7       what my key emphasis was.

8               Ultimately we have to establish  
9       how things change and how competition is  
10       affected. And to do that, you can start with  
11       kind of a market definition because that kind  
12       of identifies the players and helps you  
13       understand how competition occurs today and  
14       then gives you a lens on how it's going to  
15       change when you introduce more people or reduce  
16       the number of competitors in that case.

17               The other is to start with  
18       competitive effects and say, look, if I can  
19       establish competitive effects, then I've  
20       learned a lot about how I should be defining  
21       the market and then come back to market  
22       definition later.

23               And either one can allow you to  
24       get to either stage one or stage two, but I  
25       don't see how you could jettison entirely the



1 threshold. You can have a case where the best  
2 market definition is a narrow one and do a  
3 whole analysis realizing it's very narrow. In  
4 another case where it's very broad, and do the  
5 whole analysis realizing it's very broad. And  
6 those are fine. Do the market definition that



1 presumption. I think if you just put that aside  
2 and talk about do you really need to know who  
3 competes in this market, can you approximate a  
4 market. That's informative. The market  
5 analysis, I think, is informative to some  
6 extent.

7 MR. MURPHY: I agree. I agree. You've  
8 got to understand the players and how  
9 competition occurs; but to think that that  
10 definition of a market, think of it in terms of  
11 the overall elasticity of demand for that  
12 market, you're going to have cases where that  
13 market is really, really broad and the  
14 elasticity of demand might be one and another  
15 case where it might be five. And you can't  
16 have a fixed set of presumptions to apply to  
17 both of those markets because those markets are  
18 incredibly difficult.

19 I don't care whether it's Bertrand  
20 competition or Cournot competition or anything  
21 else. Those markets are really different, and you  
22 can't have a fixed set of standards. You want to  
23 be able to choose the one that works the best for  
24 the case you have, and the presumptions stand in  
25 the way of that, the way I see it.



1 MS. BOAST: Jeff?

2 MR. GROSS: This last point that was  
3 made about confusing the market definition for  
4 purposes of the concentration analysis and  
5 market definition that you would handle  
6 unilateral effects, competitive effects, I  
7 think is an important one.

8 I think what happened is that  
9 historically we had the old structure  
10 performance paradigm of Philadelphia National  
11 Bank and Von's and some of those other cases;  
12 and I'd be interested, maybe in a private  
13 conversation, from Paul's reflection as to the  
14 extent that they were fearful of getting away  
15 from that old paradigm.

16 We sometimes let that in the  
17 HHI analysis overshadow what is going on in  
18 terms of competitive effects because you're  
19 really, if you're calculating the elasticities  
20 with what's going to happen in terms of market  
21 power as a result of a merger in the  
22 competitive effects, you are defining a market.

1 push that structure paradigm, which is a nice  
2 way to start, particularly for safe harbors. You  
3 know, if you can get into the HHI and say, hey,  
4 we've got a safe harbor here, and we can move on.  
5 But once you get past that safe harbor, then I  
6 think you need to set that aside and start focusing  
7 on the competitive effects.

8 MS. BUSEY: I'd also like to state what  
9 I think is the obvious, which is no one pays  
10 any attention to the HHI's really.

11 MR. GROSS: Unless you're in a safe  
12 harbor.

13 MS. BUSEY: Well, yeah. Even then it's  
14 an embarrassment when you have to explain them.

15 MS. BOAST: Well, of course, the safe  
16 harbors from a strict enforcement point of  
17 view, a strict legal point of view, there is no  
18 safe harbor. So you could have a safe harbor  
19 for purposes of an HSR review; but if it turns  
20 out in a consummated transaction that there  
21 were competitive effects, there's no safe  
22 harbor, to make the point clear.

23 MS. BUSEY: To state it a different  
24 way, in the healthcare guidelines they  
25 don't have exactly safe harbors; but they state







1 think in some cases there are significant  
2 differences between looking at a unilateral  
3 effects case and a coordinated effects case,  
4 depending upon the nature of what you're  
5 looking at and the types of models you're  
6 looking at.

7 So in, say, a more homogenous  
8 products type of industry or, actually,  
9 probably better to Paul's point, capacity-type  
10 industry, there may really be a question of a  
11 dominant-firm-type model where it really is a  
12 true unilateral effects type of analysis, where  
13 the merged firm will restrict output and  
14 how the other guys may react by expanding output,  
15 but they have limits on that. But I think that  
16 sort of fits better into that type of analysis.

17 When you're talking about a lot of  
18 the ways that people are pricing, say,  
19 differentiated products in a Bertrand-type setting,  
20 you can call that unilateral, but then you are  
21 really trying to take into account, at least to  
22 some extent, the reactions of others. Is that  
23 unilateral or coordinated? It's a little hard to  
24 tell.

25 I particularly always have

1 difficulty figuring out in the number of  
2 bidders models where when you reduce the number  
3 of bidders by one, you reduce the sum that were  
4 bidding and so everyone will raise their bids. Is  
5 that coordination or is that unilateral? It's kind  
6 of hard to pigeonhole that in one setting. It's  
7 sort of doing things in your own interest, so  
8 usually call it unilateral, not coordinated. But  
9 it's also clearly very much taking into account the  
10 reactions of others. While I think there's some  
11 reasons to think about the distinction of looking  
12 at whether the firm on their own, no matter how the  
13 other players react, would find something  
14 profitable. In some cases I think the distinctions  
15 aren't all that helpful.

16 MR. MURPHY: I guess I would come down  
17 in the same area. I think in many cases  
18 they're not very helpful because while you can  
19 come up with stories. For example, take the  
20 homogeneous products. You can say, well, I've got  
21 the dominant firm. Well, that's unilateral. Well,  
22 then you can just have some simple kind of  
23 coordination-type world. And suddenly that same  
24 market looks like a very coordinated effects world.

25 I've got Bertrand pricing for some

1       guys that take other prices given. Now, I've got  
2       two gas stations across the street from each  
3       other. I take into account the fact if I cut  
4       my price, he's going to cut his price in  
5       response.

6                   Is that coordinated? Is that  
7       unilateral? I don't know. It's a bit of both. I  
8       guess I find most cases have evidence of both. And  
9       the models we put on may be unilateral models and  
10      coordinated effects models, but I don't think  
11      that's as good a description of reality as it is of  
12      the description of the models we throw at it.

13                   MR. DENIS: Let me try to defend the  
14      distinction or draw it in a different way that  
15      maybe will make it more clear. I take the point  
16      that both Dennis and Kevin have made that all of  
17      what we're calling collateral and unilateral  
18      derives from noncooperative oligopoly theory. No  
19      dispute about that.

20                   Where the difference lies is  
21      whether the reactions of rivals have any impact  
22      on the merged firm or not, whether they have to  
23      take that into account. Of course, everybody  
24      always thinks about what their rivals are doing.  
25      The distinction we tried to draw between



1 coordinated and unilateral was whether the  
2 rivals' reactions mattered.

3 So if you want to take the case  
4 where firms are differentiated by their  
5 capacities. Essentially what the guidelines  
6 are saying is that there's a circumstance in  
7 which rival firms can't do anything about the  
8 merged firm's restriction of output. Why? Because  
9 they don't have the capacity to do it. That's the  
10 answer. That, we're saying, is unilateral because  
11 you can look at it as the rivals' reaction can't do  
12 anything or that the merged firm doesn't have to  
13 take it into account.

14 It gets a little squishy, I'll  
15 admit, on firms that are differentiated by  
16 their products when you take repositioning into  
17 account. We bifurcated repositioning away from  
18 sort of the initial inquiry. The initial inquiry  
19 is strictly unilateral. We're saying we're  
20 essentially assuming that the world's not changing.  
21 And we're saying if we assume the world's not  
22 changing, can you raise your price? All right.

23 So by defining away reactions, we've made  
24 it unilateral. That may seem like a bit of a  
25 trick. Maybe it is. But it was a way of



1       they are strategic substitutes or strategic  
2       complements in some sense, is kind of what you  
3       were saying is which way people respond.

4               The other thing I would say on the  
5       repositioning point, is you say, okay, I'm  
6       going to do market definition without people  
7       repositioning. But ultimately market  
8       definition has to rely on data. And if the data  
9       was generated in a world where the potential to  
10      reposition was important, that's all part of what  
11      we're going to then use to define a market.

12              It's, like, I don't know how to  
13      pull that out of the data and then do the  
14      market definition analysis that wasn't there.  
15      Nor do I know why because I want to put it back  
16      in later anyway. I would just keep it in there  
17      and live with it.

18              MR. DENIS: If anybody could pull it  
19      out of the data, he could.

20              MS. BOAST: Actually, Paul's  
21      explanation is quite interesting to me because  
22      if you go back, even the drug wholesalers case  
23      where Judge Sporkin kind of got confused  
24      between coordination and the unilateral  
25      analysis in some points. The case law, the judge's

1 early introduction to merger analysis was  
2 simple. If you take one rival in a defined  
3 market out, will it make it easier to collude.  
4 That's all they were really thinking about.

5 Now Paul is telling us we really  
6 never meant that -- not in those terms, in the  
7 coordinated effects discussion of the  
8 guidelines. So I feel like not only do we have  
9 a convergence issue in what that whole  
10 discussion was intended to do in the  
11 guidelines, but something not responsive to the  
12 case law because of the opportunity to collude  
13 piece.

14 MR. LANGENFELD: Actually, my  
15 recollection is consistent with yours, Molly. This  
16 is sort of an incipency, arguably, type of  
17 statute. We want to prevent the facilitation of  
18 collusion; and even though the original Stigler  
19 models, your professor, chair, talked about it, I  
20 think it was based on, you know, a game

1 agreement, the aspects of whether you could  
2 punish someone if they deviate from the  
3 agreement. That's why you count the number of  
4 competitors. Right? So that's really where  
5 it's focused now, and that was my understanding  
6 back why it was in there.

7 But in the accommodation the way  
8 Paul puts it is at the center of that, too.  
9 And if you look right now at where a lot of the  
10 antitrust action is, it's suing every industry  
11 that you could possibly imagine for price  
12 fixing or customer allocation.

13 Look at the Europeans -- look here.  
14 That's where a lot of the non-merger action is  
15 right now. So think that there is a concern, a  
16 legitimate concern, about conspiracy or  
17 coordination that is not just unilateral.

18 I attended a session in part  
19 of the D.C. workshop in this, and Professor  
20 Marx, interesting name, had a very good insight  
21 that I thought that we had missed in '92.

22 MR. DENIS: We missed something?

23 MR. LANGENFELD: And that's the way the  
24 guidelines are currently written, it's a set of  
25 three negatives basically. You got to get over

1       this hump, you got to get over this hump, you got  
2       to get over this hump. Well, if you're bringing a  
3       case based on coordinated effects and all you have  
4       to do is knock down one of those three humps,  
5       well, it gives the defensive side, that gives  
6       the merging parties a lot of ammunition.  
7       There's no positive there.

8                   And Professor Marx made the point,  
9       which I think is very valid, that the guidelines  
10      need some balance here. She's done a bunch of  
11      analysis of coordinated effects and pricing,  
12      most of which I have seen. But her key point is,  
13      look, there should be something to weigh on the  
14      other side. In other words, shouldn't we have an  
15      element of the guidelines that says what is the  
16      gain to coordinateme167187

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20      but if the gains of the coordinateme are very, very  
21      big, like, say, ie ae industry with low  
22      marginal costs, high priced fixed costs, then  
23      shouldn't that be a positive thing to show, to  
24      say, look, they've got all of this to gain and  
25      maybe they have these impediments to being able

1       to coordinate. But the gain is awfully big, so  
2       we shouldn't be surprised that they are making





1       very specific set of models in mind.  
2                   And so the only way dynamics show  
3       up in the guidelines is really through some  
4       notion of punishment dynamics through  
5       punishments and cooperation.

1 workshop or more.

2 Let me ask one other question of  
3 the panelists, and we have only a couple of  
4 minutes left, so just some quick reactions.

5 One thing we hear routinely from  
6 the parties and quite frankly routinely from  
7 staff is these firms or these products, rather,  
8 are or are not the closest substitute.

9 I think Dr. Shapiro, were he here, would  
10 pound the table and say that's not really the test.  
11 I suspect every economist in this room would agree  
12 that while the closeness of substitution matters,  
13 that closest substitute or next best substitute  
14 isn't the proper test.

15 We are thinking about how we give  
16 guidance in this area without creating a  
17 standard in the world.

18 Any ideas?

19 MR. MURPHY: First of all, I will say  
20 that closest isn't the right test. That's the most  
21 obvious one. Whether you're the number one or  
22 number two depends on how close number one and  
23 number two are. But not only that, depends on how

1 discussion of that.

2 In a differentiated products  
3 world, you can be on the other side and still  
4 matter a lot. In a bidding auction market, maybe  
5 it doesn't matter that much where you are in terms  
6 of on the other side. It depends on where the  
7 fourth guy is because you're eliminating the third  
8 guy in line. Well, how close is the fourth guy to  
9 the second guy. So I don't think it's going to be  
10 easy to have a uniform standard there. I think  
11 it should be made clear that it's not always  
12 closest.

13 MS. BUSEY: I agree with that, although  
14 I wouldn't give up the closest. If you happen  
15 to have a closest that's merging, that's the  
16 problem. So I wouldn't abandon that  
17 altogether.

18 MS. BOAST: And that's helpful in  
19 explaining to clients especially.

20 MS. BUSEY: Helpful to explaining to  
21 clients, but seems to me it's also relevant.

22 MR. MURPHY: Showing you're not the  
23 closest isn't sufficient to say there's not a  
24 problem. I think that's really what we're  
25 trying to say here.

1                   MR. DENIS: I think, Molly, if you  
2           adopt the approach that I was envisioning of  
3           breaking down your different modes of  
4           competitive interaction, laying them out in  
5           more detail in the competitive effects section,

1 and everything. So having some clarification of  
2 that would be very helpful to giving guidance  
3 to practitioners, to business; and actually,  
4 you know, stepping back, we often talk about  
5 practitioners.

6 Giving guidance to staff is  
7 actually important. You get a lot of new staff  
8 in all the time, so actually having some  
9 guidance about what they should be looking for  
10 and not always be asking their colleagues, but  
11 having something they can look at to help them  
12 understand how they should be approaching cases is  
13 also really very important.

14 MS. BOAST: Well, we are officially out  
15 of time. It's been really my privilege to  
16 share this session with an incredibly  
17 illustrious panel, to whom I hope we will all  
18 give our thanks.

19 (Applause.)

20 MS. BOAST: We reconvene at 3:00  
21 o'clock for efficiencies.

22 (Brief recess.)

23

24

25

1                                   PANEL 4: EFFICIENCIES  
2                                   MR. FEINSTEIN: I guess I should  
3                                   disclose, actually, this is sort of an  
4                                   exquisite irony, on a panel that's supposed to  
5                                   address efficiencies, one of our panel members  
6                                   is trapped on an Amtrak train that is stuck  
7                                   somewhere between Detroit and Chicago. That's

1 writing some of what he was going to be  
2 presenting today, so they will still become  
3 part of the record.

4 Our first speaker today to my  
5 immediate left is Mike Baye, who is the Burt  
6 Elwert Professor of Business at the University,  
7 Kelley School of Business, and also served as  
8 the Director of the Bureau of Economics at the  
9 FTC during 2007 and 2008. He is a well-regarded  
10 expert on the issues that we'll be addressing today  
11 and a very thoughtful commentator.

12 After Mike, we will have John  
13 Treece, who is a very experienced trial lawyer  
14 at Sidley & Austin here in Chicago with a  
15 variety of experience on a lot of cutting-edge  
16 antitrust issues, both as a trial lawyer and  
17 also as a counselor.

18 Following John we'll hear from  
19 Professor Sam Thomson, who is currently at Penn  
20 State where he is the Arthur Weiss Distinguished  
21 Faculty Scholar and director of Penn State  
22 Center for the Study of Mergers and  
23 Acquisitions. He's also been a professor of law  
24 at UCLA, Director of UCLA Law Center for Study  
25 of Mergers and Acquisitions, and at one time

1 was the head of the tax department at Schiff,  
2 Hardin & Waite here in Chicago in addition to a  
3 number of other positions. We're very pleased  
4 to have him with us.

5 And our final speaker is Stephen  
6 Calkins, who is currently the Associate Vice  
7 President for Academic Personnel and a  
8 professor of Law at Wayne State University. His  
9 teaching focuses extensively on antitrust and trade  
10 regulation. And Steve also served in the  
11 mid-'90s as the general counsel of the FTC  
12 during the time that Bob Pitofsky was the  
13 Chairman. He is a much sought-after speaker on  
14 antitrust issues of all stripes.

15 So with that, let's get started  
16 and I'll turn it over to Mike Baye.

17 MR. BAYE: Thank you, Rich. It's a  
18 real pleasure to be here, and I'm grateful to  
19 have an opportunity to help with your discussions.  
20 I agree with much of what was said this morning.

21 Certainly economics is a dynamic  
22 science. Things have changed since the  
23 guidelines and the revisions which dealt  
24 explicitly with efficiencies were put in place.  
25 I'm happy to contribute to that dialogue



1 and wish you the best as you sort through the  
2 process of trying to deal with that.

3 Since this panel is on  
4 efficiencies and since I think I'm the sole  
5 economist on the panel, I thought it might be  
6 useful just to begin with just a discussion of  
7 what efficiencies are in the first place. I think  
8 we can all define things to mean whatever we want  
9 them to mean, but clearly there's a difference  
10 between the way economists view efficiencies and  
11 the way many attorneys, and, in fact, the law views  
12 efficiencies.

13 I think if you poll a hundred  
14 economists, a hundred an economists will say  
15 the appropriate measure of efficiencies would  
16 center on total welfare. When you look at the law,  
17 the law really deals with the issue of consumer  
18 welfare and the competitive effects on consumers.

19 I think it's useful just to  
20 kind of keep in mind what the economic  
21 arguments are for the total welfare standard as  
22 opposed to the computer welfare standard. This is  
23 not because I'm of the opinion that somehow in  
24 revising the guidelines that standard is going  
25 to be changed; but because I think it helps kind of

1 cast a way for one to think about presumptions  
2 and burdens as one is thinking about some of  
3 the impacts of mergers that might not be  
4 counted formally in the courts as they're  
5 contemplating the impact of efficiencies on  
6 consumers, rather than the overall economy.

7 The reason economists favor  
8 total welfare over consumer welfare is that in  
9 the long run it's total welfare that's going to  
10 affect the health of the economy, total welfare  
11 being defined as the sum of consumer surplus and  
12 producer surplus. And, obviously, in the long run  
13 if the U.S. economy doesn't economize on the use  
14 of all resources, we're going to be producing  
15 goods and services at a cost that's more expensive  
16 relative to what we could be producing those goods  
17 and services for. I think that's especially  
18 important in an area where the buzzword certainly  
19 in business schools and around the globe is the  
20 term sustainability, okay.

21 So if you think of a merger, for  
22 example, a hypothetical merger that was going  
23 to save lots and lots of resources, say less  
24 money spent on electricity, for example. If those  
25 savings were in the form of fixed cost savings and,

1       therefore, not passed on to consumers, should they  
2       count?

3                   From an economist's viewpoint,  
4       to the extent they improve the overall  
5       efficiency of the allocation and resources,  
6       they might be relevant for considering to  
7       offset price increases.  However, if you look at  
8       the law, maybe those efficiencies wouldn't be  
9       included.  And indeed, a lot of the issues that  
10      we've dealt with earlier today and this morning  
11      really stem from issues that center around  
12      differences between total welfare and consumer  
13      welfare.  For example, when Kevin Murphy  
14      talked about defining a market sufficiently  
15      small that some consumers are harmed from  
16      repositioning, that's because that just seems  
17      like a silly notion of welfare to focus on that  
18      one small group of consumers.

19                  Lots of the issues that really  
20      center around the discussions for debate I  
21      would argue center around this dichotomy that  
22      we have between a focus on total welfare and  
23      consumer welfare.

24                  Why might we care about total  
25      welfare over consumer welfare?  Well,

1 ultimately to the extent that one thinks that  
2 those savings on energy that accrued to a firm  
3 that contemplates a merger in this hypothetical  
4 that I proposed, if you imagine that those  
5 gains, those savings are going to accrue to  
6 shareholders, those shareholders are themselves  
7 ultimately consumers and one might argue should  
8 be counted in that.

9 But I'd make a broader point, to  
10 the extent that those savings accrue in the  
11 profits of firms, those profits are taxed at  
12 the corporate level and then again at the  
13 shareholder level so that well over half of  
14 those efficiency gains are going to be tax  
15 revenues to the federal government that could  
16 then use those revenues to redistribute incomes  
17 among disadvantaged parties.

18 I guess the big point I'd like  
19 to make is that total welfare is certainly an  
20 important issue to take into account as one is  
21 evaluating antitrust policy.

22 I'm no fool. I recognize the  
23 law focuses on a consumer welfare standard.  
24 But it's important to keep those things in mind  
25 as one is trying to calibrate the competitive

1 effects of a merger. It's useful to keep in the  
2 back of your mind that there may be social benefits  
3 that are accruing to the economy as a whole that  
4 aren't being manifested or accounted  
5 for in the analysis of the merger.

6 That said, let's talk a little bit  
7 about the nature of efficiencies. If you take a  
8 close look at the guidelines, it's pretty clear  
9 that the nature of efficiencies that are  
10 contemplated in the guidelines are things like  
11 production costs, transportation costs and the  
12 like. The obvious question that arises then is  
13 whether one wants to make a distinction between  
14 efficiencies that save fixed costs versus  
15 efficiencies that save marginal costs.

16 The traditional story from an economic  
17 viewpoint is if you're focusing on total economic  
18 welfare, certainly reductions in fixed costs count.  
19 But if one is looking at a measure  
20 of consumer welfare, using traditional models,  
21 it's kind of hard to understand how reductions  
22 in fixed costs might ultimately impact consumer  
23 welfare.

24 If you look at the way the economy has  
25 evolved over the course of the

1 past decade-and-a-half, there have been  
2 tremendous changes in the nature of the  
3 economy that blurs the impact of fixed  
4 costs and marginal costs on the overall  
5 efficiency of the market.

6 I would argue in addition to  
7 production costs and transportation costs,  
8 there are a number of synergies that might  
9 arise through merger that are quite difficult  
10 to quantify, but nonetheless, I would argue,  
11 should be counted as efficiencies in any event.

12 Just to give you a couple of  
13 examples, one can imagine a merger that might  
14 hike the informational advantages and the IT  
15 capabilities of firms in a manner that allows  
16 them to procure cheaper inputs. Whether or  
17 not those cheaper inputs, ultimately are passed  
18 on to consumers in terms of lower prices,  
19 they represent savings. The point is that many  
20 of the costs to achieve those savings might  
21 accrue through forms of various fixed costs.  
22 It's very difficult to associate those particular  
23 fixed costs and those synergies with the actual  
24 reductions that might occur in the procurement  
25 of input prices.

1                   Another example would be in the  
2                   area of coordination of R & D efforts. It  
3                   might well be that a synergy that arises as a  
4                   result of a merger might allow firms to more  
5                   effectively engage in research and development.  
6                   Again, that's not something that's going to be  
7                   directly related to marginal costs. It might be  
8                   related to fixed cost efforts of the firms and,  
9                   therefore, difficult to actually account for in  
10                  formal efficiencies analysis the way it's  
11                  traditionally done.

12                  Another example is in the online  
13                  area, the impact of reputation and service  
14                  quality, for example. One can imagine where  
15                  one firm has a comparative advantage in  
16                  production or distribution. Another firm has a  
17                  comparative advantage in advertising or  
18                  reputation. And it may well be the merger of  
19                  those two firms creates value in the form of  
20                  better information transmitted to consumers and  
21                  ultimately better service quality. Again, those  
22                  types of efficiencies are things that are not  
23                  typically accounted for if you're using the  
24                  standard fixed cost versus marginal cost analysis  
25                  based on income statements, yet, these efficiencies

1       stemming from those synergies can be very, very  
2       important.

3               I have a number of other examples that  
4       I'll talk about if we have time later; but the key  
5       point of all this that I'd like to make is that I  
6       think looking at the current state of the economy,  
7       it's very difficult for individuals to actually  
8       link underlying merger activity or the prospects of  
9       a merger, the impact of that on the ultimate  
10       synergies that will be realized from the merger.  
11       It's very difficult to quantify.

12               The typical story is that the  
13       parties have better information about the  
14       efficiencies that would stem from a merger than  
15       the government and, therefore, it makes  
16       sense to have the burden of demonstrating those  
17       efficiencies on the parties rather than the  
18       government. While I am somewhat sympathetic to  
19       the fact that firms often have better  
20       information than does the government about  
21       traditional types of efficiencies, like unit  
22       costs and production and so forth, I think in  
23       terms of the ability to actually quantify many  
24       of the synergies that arise through mergers,  
25       particularly in the new digital age, I think



1       it's very difficult for firms to formally  
2       quantify the benefit of those synergies.

3               The big picture that I'd like to leave  
4       with you as you are contemplating revising the  
5       merger guidelines, I'd like to see a little bit  
6       more discussion about the nature of the  
7       efficiencies, recognizing that efficiencies don't  
8       only manifest themselves in shifting production  
9       from a high-cost firm to a low-cost firm, but can  
10      also manifest themselves in various synergies  
11      really on the demand side that improve the  
12      quality of the product that consumers receive,  
13      as well as the nature of services that they  
14      receive. Those things are incredibly hard to  
15      quantify; and it would be very useful, I  
16      believe, for the guidelines to provide some  
17      guidance about how parties might realistically  
18      attempt to make those efficiency gains cognizable.

19              MR. FEINSTEIN: Thank you, Mike. I  
20      should mention before John begins, there's a  
21      handout so people have the ability to  
22      take a look while John is offering his remarks.

23              MR. TREECE: Thanks, Rich. Yeah, I  
24      think you'll find it helpful. It's very, very,  
25      very simple, but I'm going to be referring to

1       them.

2                   I want to start by thanking the  
3       Department of Justice and FTC, specifically  
4       Molly Boast and Rich Feinsein for arranging  
5       this workshop and inviting me to participate.  
6       It's an honor. I also want to thank Henry Butler  
7       of the Searle Center for hosting. This is the  
8       second conference in as many months I've  
9       attended here recently. I received an excellent  
10      research paper from the Center on Consumer  
11      Litigation. And Henry's done a terrific job in a  
12      very short period of time to establish the Center  
13      as a place where important work is done well, and  
14      all of us Chicagoans look forward to seeing the  
15      Center assume an ever-important role in our  
16      community.

17                   Efficiencies and mergers  
18      analysis. Well, some of my defense bar  
19      colleagues might say the empirical evidence  
20      would suggest that if we're talking about the  
21      role of efficiencies, this must be the last  
22      panel of the day. So here we are.

23                   I think I have a very common  
24      perspective on the overall enterprise. I agree  
25      that it is time to revise the guidelines; but

1       like many people, I think it should be done  
2       with a relatively light touch.

3               The guidelines have served us well  
4       by providing broad principles that have  
5       permitted our understandings evolve, to the  
6       point, in fact, where it's now appropriate to  
7       capture the evolution in a revised set. But I also  
8       believe that the revision process should be limited  
9       and have very well-defined objectives.

10              The most important objective in my view,  
11       is to reflect the reality of how the Agencies do  
12       their work. That is important not only because  
13       the guidelines should provide the bar and their  
14       clients with an ability to predict the  
15       government's treatment of the transactions, but  
16       also because they are relied upon by the courts  
17       to identify the right questions they should be  
18       trying to answer.

19              In that respect, I'd echo what  
20       Paul Denis said, the point is the guidelines  
21       should highlight the questions, not the  
22       answers. That means the guidelines should  
23       not be so detailed as to lay down prescriptive  
24       rules that try to answer all possible questions  
25       in all possible factual circumstances.

1                   Although a couple of the comments that  
2           I've read seem to rehash significant arguments that  
3           perhaps have been lost at the agency level, I think  
4           there's relatively widespread agreement that the  
5           guidelines should not be too detailed.

6                   But the other side of the no-  
7           prescriptive-rules coin is that the guidelines  
8           should not, without very good reason, foreclose  
9           or appear to foreclose particular types of  
10          analyses that in a way could hinder further  
11          evolution of our thinking. Just as the agencies  
12          should not insert new rules into the guidelines  
13          that are overly prescriptive, they should also  
14          consider deleting overly descriptive language  
15          that's currently in the guidelines.

16                   If we look at the efficiency  
17          section, let's begin by acknowledging, I think  
18          it's fair to say, that the general perception  
19          among defense lawyers is that the agencies are  
20          too skeptical, perhaps too dismissive of  
21          efficiency claims. I think that perception is  
22          probably overblown. After all, I assume that the  
23          agency attorneys and staff ask themselves the same  
24          initial question that we ask our clients, why do  
25          you want this deal. The answer almost always

1 evokes a host of consumer benefits. I agree  
2 with Roxane Busey that we ask our clients a whole  
3 set, a panoply of questions, but almost always we  
4 start with that. Certainly, efficiencies  
5 asserted with the transaction are acknowledged  
6 in consideration of the competitive effects.  
7 The two concepts are completely intertwined.

8 But there's nonetheless a view  
9 that the agencies are too slow to acknowledge  
10 the efficiencies that are usually the very core  
11 reasons for the deal. That reluctance has  
12 been reflected in the existing guidelines.

13 On the one hand, for the existing  
14 guidelines there seems to be an almost universal  
15 agreement that the core notion of cognizable  
16 efficiencies asks exactly the right questions. Are  
17 the asserted efficiencies merger-specific? Are  
18 they verifiable? And by the way, that does not say  
19 quantifiable, but verifiable. And do they arise  
20 from anticompetitive output restrictions?

21 But then the existing guidelines  
22 seem to me to proceed to undercut that  
23 simplicity by suggesting that efficiencies, and  
24 I'll quote here, "relating to research  
25 development, procurement, management, or



1 efficiencies not strictly in the relevant market,  
2 but so inextricably linked with it that a partial  
3 divestiture or other remedy could not feasibly  
4 eliminate the anticompetitive effect,"  
5 et cetera.

6 Now, I want to discuss Footnote 36  
7 for three reasons. First, if one purpose of  
8 revising the guidelines is to clarify them, the  
9 question of cross-market efficiencies deserves  
10 some attention because it's not immediately  
11 obvious what it means. For one market to be  
12 inextricably linked with another, to me the term  
13 has a mysteriously talismanic ring to it, which  
14 suggests that the exercise of prosecutorial  
15 discretion may prove to be more arbitrary and  
16 less transparent than we would like.

17 Second, the inextricably linked  
18 language seems to establish a threshold  
19 question designed principally to foreclose  
20 consideration of legitimate efficiencies. That  
21 is, the footnote acknowledges that a merger may  
22 create substantial and legitimate efficiencies  
23 in markets other than the market under  
24 consideration, but nonetheless suggests that  
25 for largely unexplained reasons they won't be

1 seriously considered.

2 Third, my experience is that  
3 when antitrust rules don't accurately reflect  
4 how businesses actually strategize about their  
5 competitive responses, and more often than not  
6 we need to rethink our rules and our language  
7 rather than condemn the strategy. In this regard,  
8 I think antitrust lawyers and economists sometimes  
9 tend to think narrowly in terms of relevant  
10 markets, I think that was Kevin's point, but  
11 businesses certainly don't. When they formulate  
12 competitive responses, they look at all the tools  
13 they have, including their entire arsenal of  
14 products, business methods, distribution  
15 channels and R & D.

16 The footnote fails to acknowledge  
17 this reality by continuing to limit the  
18 consideration of efficiencies within single  
19 relevant markets that more often than not  
20 because of the unilateral effects analysis have  
21 been narrowly defined by the agencies.



1 products in a single facility can reduce the cost  
2 of producing products other than the product that  
3 is in the relevant market under scrutiny. In fact,  
4 depending on the relative size of the markets or  
5 sales volumes of the products, it may be the case  
6 that most of the efficiencies accrue to products  
7 that fall outside the market that's under  
8 consideration. Furthermore, there are efficiencies  
9 which seem in many cases to satisfy easily the  
10 guidelines test for cognizable efficiencies.

11 A second example is research in  
12 basic science or common research and  
13 development that may support multiple products,  
14 product lines that are properly deemed to be in  
15 separate markets. Spreading the fixed cost of that  
16 research across multiple products, some of  
17 which are acquired in the merger, may not only  
18 lower the cost for all products, it may very  
19 well incentivize R & D investment that might  
20 not otherwise occur. So while there may be a  
21 debate about how to allocate those savings across  
22 the product lines, they don't seem to inherently  
23 fail the cognizable efficiency test.

24 Finally, joint sales and  
25 promotions, of course, of multiple products

1        have the same effect. Significant savings are  
2        realized when a sales force is able to present  
3        multiple products as they knock on doors. And the  
4        same comment about cognizable efficiencies applies  
5        there well. These are all legitimate and  
6        potentially significant efficiencies, but it's very  
7        hard to see why they should not be routinely  
8        recognized in merger analysis.

9                    Now, in addition to cross-market  
10        efficiencies associated with economies of

1 draw some experience from a case we tried a  
2 couple of summers ago in which the evidence  
3 provided some useful examples. The core fact in  
4 the case, illustrated on Page 4 of the handout, was  
5 a significant procompetitive price effect of  
6 competition between symmetrical bundles.

7 Very briefly Johnson & Johnson and  
8 its rival, U.S. Surgical, together sold more  
9 than 90 percent of sutures and/or 90 percent of  
10 medical devices called endo-mechanical products  
11 or endos. Beginning in the 1990's, both  
12 companies marketed their sutures and endos  
13 to hospitals through group purchasing organizations  
14 in bundles. In J & J's case,  
15 the hospital got the lowest price if it  
16 purchased both 90 percent of its sutures  
17 and 80 percent of its endos from J & J. Our  
18 expert, who was Kevin, showed that as a result  
19 of this bundled competition, prices for sutures  
20 remained flat for eight years, and this is shown on  
21 the page of the handout, and prices of endos  
22 declined about 20 percent.

23 So for fun I've illustrated on the  
24 next three pages one way, and there are  
25 several, one way in which we explained to the





1        endos to satisfy its doctors demands, and yet  
2        constrain its endo price increases by  
3        threatening not to buy U.S. Surgical's sutures,  
4        a business that it had just invested in heavily.

5                So in short what the agencies  
6        might see as a suspect 3-to-2 merger of the  
7        sutures market clearly empowered the hospitals  
8        to pit two more relatively symmetrical bundles  
9        against each other, countering each company's  
10       strength.

11                Now, I submit that if a hospital  
12       purchasing department knows enough to dance in  
13       the halls to celebrate this glorious  
14       development, the agency should be keen on  
15       noting the effects of this merger, the suture  
16       merger to the endo market, even when the suture  
17       market might be asserted to be the relevant  
18       market for the analysis.

19                I tell this story not to suggest  
20       that any revised guidelines should frame rules  
21       about how to consider price lowering effects in  
22       one market that are occasioned by a merging in  
23       the second. I think that would be a serious  
24       mistake. Rather, the story illustrates the  
25       fact that our thinking about markets evolve,



1 here in the Midwest. I think exposing a  
2 draft revision to public comment would help  
3 ameliorate that perception.

4 MR. FEINSTEIN: Thank you, John.

5 MR. Thomson: Rich, I want to thank you  
6 for inviting me to participate today. This is  
7 a particularly enjoyable time for me to be here  
8 because I started my academic career here at  
9 Northwestern Law School back in January  
10 of 1973. So it's great to return to this great  
11 law school.

12 What I'm going to do I have seven  
13 slides that I want to go through. Let me simply  
14 outline for you first the position I'm going to be  
15 taking here. In a 1968 article that many of you  
16 are familiar with in the American Economic Review,  
17 Professor Williamson, who won the Nobel  
18 prize in economics this year, and who is now at  
19 Cal-Berkeley, provided a theoretical  
20 justification for the efficiencies defense.

21 As we know, the DOJ/FTC merger  
22 guidelines and court cases take a cautious  
23 approach in dealing with efficiencies. Former FTC  
24 Chairman Muris and others have argued that  
25 efficiencies should in many cases trump the



1        anticompetitive effect. That is, with significant  
2        efficiencies, the authorities should be less  
3        concerned about the anticompetitive effect.

4                Now, on the basis of the analysis  
5        in my paper entitled "A Critique of  
6        Williamson's Case for an Efficiencies Defense  
7        The Rectangles Are Rarely Larger than the  
8        Triangles." I argue for a continuation of the  
9        cautious approach that is currently in the  
10       regulations. Now, I do not address other  
11       objections to an efficiency defense, such as  
12       Posner's view that all the costs are not  
13       reflected in Williamson's approach. So I'm  
14       focusing simply on the theoretical  
15       justification.

16                Let's start with the traditional  
17        presentation of the Williamson justification.  
18        This is a graph based on his 1968 article in  
19        the American Economic Review, his 1997 article in  
20        the Penn Law Review, and the presentation of this  
21        issue in the ABA's third edition of its  
22        antitrust book, the 6th chapter dealing with  
23        efficiencies.

24                So this graph, which started in  
25        '68, has life today as reflected in this ABA



1                   And Williamson's insight is that  
2           if the cost savings here, which are reflected  
3           by A2 and A1, are greater than the dead-  
4           weight loss to consumers, which is reflected in  
5           B1, then this merger increases total welfare  
6           and arguably should be permitted even though  
7           there's a huge wealth transfer from consumers  
8           to producers, and the wealth transfer is in  
9           B2.

10                   So that's his insight. His  
11           insight is that A2 plus A1 exceeds B1 so  
12           that in many cases the efficiencies resulting  
13           from a merger will overcome or swamp the dead  
14           weight loss.

15                   All economists agree that B1 is a  
16           detriment to society. But if there's an A2  
17           and an A1 and an efficiency associated with  
18           the merger and that efficiency overpowers the  
19           dead-weight loss, then under a total welfare  
20           approach, which is what Mike just talked about,  
21           arguably this merger would be permissible, even  
22           though consumers are harmed because consumer  
23           welfare is reduced by B2.

24                   Now, notice a couple things about  
25           this graph. One, it has a concave demand

1 curve. Not a linear demand curve, but a  
2 concave demand curve.

3 Now what I have done here is taken  
4 this basic Williamson graph, and made the demand  
5 curve linear. And I asked the question what  
6 happens to the triangle and what happens to the  
7 rectangle.

8 I also assume that as a result of  
9 the merger there is monopoly pricing, so I draw  
10 a marginal revenue curve. And the marginal  
11 revenue curve is the second slanted curve.  
12 It's the red curve in the middle. It's a  
13 marginal revenue curve.

14 I made the demand curve in the  
15 Williamson analysis linear, and I've added a  
16 marginal revenue curve. I needed a marginal  
17 revenue curve in order to determine the actual  
18 monopoly quantity and monopoly price.

19 Okay. Now, how do I determine a monopoly  
20 quantity and monopoly price? I determine it by the  
21 intersection of the marginal revenue curve and the  
22 average cost curve. So we see then that initially  
23 as a result of the merger when we move from  
24 competition to monopoly, the price jumps from  $P_1$  not  
25 to  $P_2$ , but to  $P_m$ . So it jumps quite high. Huge, a

1 huge jump.

2 But we also have efficiencies, the  
3 same efficiencies we had in the first graph.  
4 The efficiencies here are represented by the  
5 yellow rectangle.

6 The efficiencies cause the  
7 quantity to go up from  $Q_m$  to  $Q_{me}$ , that is  
8 quantity with monopoly but efficiencies, and  
9 the price to drop from  $P_m$  to  $P_{me}$ , that is  
10 price under monopoly with efficiencies.

11 So some you might say that some of the  
12 benefit of the efficiencies is being passed on to  
13 consumers in the form of a lower price, a price  
14 that is lower than the monopoly price would be if  
15 there were no efficiencies.

16 Then I asked the question, well,  
17 what happens to the triangle, the dead-weight  
18 loss. That's the red area in this graph. And  
19 how does it compare to the efficiencies gains,  
20 the yellow area. And in this case the triangle  
21 exceeds the rectangle. Even though in this  
22 particular situation, even though in the  
23 Williamson presentation of the efficiency gains,  
24 the efficiencies are about 18 to 19 percent of  
25 costs. So there are cost savings of about 18 or to











1 Bureau of Competition and the Bureau of  
2 Economics are as likely to accept fixed cost  
3 savings as variable cost savings at about the  
4 same rate. Variable cost savings impact  
5 price, but fixed cost savings generally do not,  
6 at least in the short run. Unless the parties  
7 can establish that fixed cost savings will be  
8 reflected in price in the reasonable future,  
9 they should be rejected.

10 Thank you very much.

11 MR. FEINSTEIN: Thank you, Sam. I'm  
12 sure we'll have a lively discussion about what  
13 we just heard, and that will probably begin  
14 with what we're about to hear from Steve  
15 Calkins.

16 MR. CALKINS: Thank you. A pleasure to  
17 be here. All the same thanks as everybody  
18 else. Henry Butler throws a great party and a  
19 lovely event, and so we appreciate that.  
20 Hopefully we'll get invited back regularly.

21 It has been a privilege to be here  
22 listening to so many really distinguished  
23 people, people who have played important  
24 roles in leading cases, and especially the  
25 people who played leading roles in the writing

1 of the big guideline revisions. I want to make  
2 very clear that I had no role in that process.  
3 I had a role only in that I was the general counsel  
4 of the FTC back when the efficiencies section was  
5 revised. So I did live through  
6 that.

7 I want to assure you that it would  
8 have been bad public policy to share all of  
9 those drafts with the public for many reasons.  
10 We can go into that later.

11 I emerged from that process with  
12 mixed feelings about the efficiency section as  
13 revised. It's not elegant and you can take  
14 potshots at it. Indeed, I for a long time  
15 reveled in taking pot-shots at it. For instance, I  
16 have an antitrust case book out there, but at the  
17 time I did not and I was using somebody else's case  
18 book. And they reprinted the guidelines, including  
19 the efficiencies section, without the footnotes.  
20 And of course, it's in the footnotes that you get a  
21 little bit of the tension with what's in the text.  
22 You can see that the Federal Trade Commission is  
23 made up of lawyers and economists. Sometimes they  
24 get more their way in the text, sometimes more in  
25 the footnotes. And if you read the efficiencies

1 section without the footnotes, you're really  
2 missing much of what's going on.

3 So I made fun of the editor of  
4 that case book and gave my students the real  
5 efficiencies language and went through, and  
6 there's some tensions here and I've made fun of  
7 them in my classrooms many times.

8 I now had to think about these in  
9 connection with this presentation. And I went  
10 back and I looked at them; and I have come to  
11 the conclusion that the efficiencies section of  
12 the guidelines is, I think it is fair to say, a  
13 work of pure genius. It really strikes precisely  
14 the right note. It gets it about as perfectly as  
15 can be done. My advice to be to leave it  
16 entirely alone; do not touch a single word.

17 Efficiencies is a subject about  
18 which there's some ambiguity, there's some  
19 tension, there's some uncertainties. You want  
20 to proceed a little differently in this case  
21 than you might in that case, and you can do all

1       been learned people, the Antitrust Modernization  
2       Commission Report being the most prominently  
3       known. We heard it in previous sessions  
4       today who said, by God, the guidelines are  
5       terrible because they say look at marginal  
6       cost, do not look at total cost.

7                But of course, they don't say  
8       that. What do they say? If you happen to have  
9       copies of them, you could pull them out. They  
10      never say look only at marginal cost, ignore  
11      fixed cost. We were too clever for that. What do  
12      they say? They say, "The Agency will not challenge  
13      of merger if cognizable efficiencies are of a  
14      character and magnitude such that the merger is not  
15      likely to be anticompetitive in any relevant  
16      market." Is not likely to be anticompetitive.  
17      That's the test. Not anticompetitive.

18               Does that say you have to look  
19      only at price effects and you ignore quality?  
20      No. It says not likely to be anticompetitive.  
21      Does it say you have to look only at marginal  
22      cost and not total cost? No. It says not  
23      likely to be anticompetitive.

24               But then you say, keep reading, so  
25      I do. "...the agency considers whether cognizable

1 efficiencies likely would be sufficient to  
2 reverse the merger's potential to harm  
3 consumers in the relevant market, e.g., by  
4 preventing price increases in that market."

5 And I would like to remind the  
6 lawyers and inform the economists that there's  
7 a difference between i.e. and e.g. I.e., had  
8 we used i.e., it would have meant reverse the  
9 merger's potential to harm consumers, in  
10 orders, by preventing price increases. But we  
11 didn't say i.e.; we said e.g. And e.g. means for  
12 instance. So one way you can show that  
13 efficiencies should prevail is by saying that they  
14 prevent price increases. But that's only one way.

15 Nothing in here requires someone  
16 to come along and look only at marginal cost or  
17 look only at price increases. This is an  
18 invitation to be thoughtful.

19 And in case there's any question  
20 about that, you then go down to the footnotes.  
21 And in the footnotes, Footnote 37, a beautiful  
22 footnote, talks specifically about how, yes,  
23 "the result of this analysis over the short term  
24 will determine the Agency's enforcement decision in  
25 most cases," but, "the Agency also will consider

1 the effects of cognizable efficiencies with no  
2 short-term, direct effect on prices in the relevant  
3 market."

4 What could be more clear?  
5 Sometimes the agencies will look at effects,  
6 not only prices. Delayed benefits from  
7 efficiencies will be given less weight, and  
8 they probably should be. In short, the  
9 efficiency section gets the tension and the  
10 balance precisely right and ought to be left  
11 alone.

12 People talk about pass-on and,  
13 when that can be shown, that is a virtue if you're  
14 a defense lawyer. But it's not absolutely  
15 necessary under the guidelines as written.

16 Some people have complained that,  
17 and indeed our missing colleague in his written  
18 remarks did complain that the guidelines are  
19 tougher on efficiencies than on competitive  
20 effects, if you will.

21 And I frankly don't go as far as  
22 Sam Thomson does; but in general, I think that  
23 it makes sense to have a little bit more  
24 skepticism about efficiencies than about  
25 competitive effects.

1                   Bob Pitofsky wrote an article  
2                   shortly before I went to the FTC in which he  
3                   came out squarely in favor of having a broader  
4                   efficiencies defense while at the same time  
5                   having a much more aggressive approach in  
6                   terms of competitive effects.     I'm simplifying  
7                   this, but basically he said, you know, be worried  
8                   about more mergers but then look seriously at  
9                   efficiencies. And of course, it's all a  
10                  tradeoff.

11                  If you're going to look at mergers  
12                  to monopoly, then there ought to be pretty darn  
13                  huge efficiencies that are going to overcome  
14                  that, indeed, that level of nervousness was  
15                  sufficiently great that there's that sentence  
16                  stuck in the middle of the guidelines saying  
17                  that efficiencies almost never justify a merger  
18                  to monopoly or near monopoly because of  
19                  nervousness about that. So if that's the kind of  
20                  mergers you're challenging, well, then you ought to  
21                  be pretty skeptical about efficiencies.

22                  On the other hand, if we get back  
23                  in the world of challenging mergers going from  
24                  seven to six, or six to five, or something like  
25                  that, well, then it's more important to let



1 more mergers off the hook, if you will, because  
2 of efficiencies. There's a tradeoff.

3 But in the world in which we are  
4 living today with the kind of standards that  
5 are actually applied by the agencies,  
6 efficiencies aren't going to make a difference  
7 except in mergers that raise all sorts of  
8 questions that you ought to be thinking about.  
9 And I think that it is appropriate then to  
10 proceed with a certain level the skepticism.

11 Anybody who has practiced law or  
12 worked with business persons has run across the  
13 phenomenon of business leaders deciding to make  
14 a transaction for reasons having nothing to do  
15 with efficiencies and everything to do with  
16 something else. You can list your different things  
17 they might have something to do with. They  
18 hire a consulting firm and suggest to the  
19 consulting firm that it would be good for the  
20 consulting firm to come up with a thick, glossy  
21 document that shows this is a very pro-efficiency,  
22 wonderful merger. And consulting firms are masters  
23 at coming up with those sorts of studies.

24 In that kind of world, when we  
25 know that business leaders are not always

1 motivated by reasons of efficiency, if we're  
2 looking at mergers from 3 to 2, and 2 to 1, and  
3 such, I think that it's appropriate to proceed  
4 cautiously when it comes to efficiencies. But  
5 that's all these say, is just be a little bit  
6 cautious.

7 So where are we? That's sort of  
8 my bottom line. Why then is there all of this  
9 concern? Why all the upset?

10 I had a conversation with a leading  
11 economist in the last week who said, by  
12 God, the problem is not the guidelines, the  
13 problem is with how they are being enforced. Why,  
14 I went in to Carl Shapiro just very recently and I  
15 said look at all these cost savings; and Carl said  
16 to me, are they marginal cost or are they fixed  
17 cost. And I said, Carl, give me a break.

18 There are two possible take-aways  
19 from that. One is that the people who are  
20 upset about the efficiency guidelines are  
21 driven by individual experiences. We all  
22 take the two experiences we've had and  
23 generalize. The other possibility is that, in  
24 fact, there are times when the agencies  
25 mindlessly say I'm going to totally ignore

1 fixed costs no matter what.

2 I don't think the latter is true.

3 As was just referenced earlier, I think Sam  
4 did, there was an article that came out of the  
5 FTC the only this year that showed that fixed  
6 costs are given serious considerations.

7 We know that fixed costs played a  
8 part at least in the published comments about a  
9 number of mergers, Jensen, XM Sirius, a number  
10 of others; so it appears to me that the  
11 agencies take fixed costs into account, and so  
12 I don't think there's the problem that some  
13 people think out there.

14 If you really insist on doing  
15 something to this part of the guidelines, even  
16 though it is about the most perfect part of the  
17 guidelines, you could, without doing harm,  
18 trying to be practical in my advice, do a  
19 little search for the word marginal. And you  
20 could simply delete the word marginal without  
21 actually causing great harm. So that you can see  
22 that there's an example in a coordinated  
23 interaction context, marginal cost reductions  
24 made coordination less likely or effective.  
25 You could probably delete the word marginal

1 and not cause a lot of time. And if you  
2 were to remove one or two or three of the  
3 word marginals, you probably wouldn't  
4 really change much of anything. I mean,  
5 it really is true that, you know, marginal  
6 or fixed depends on the time horizon that  
7 we're talking about. So I think you could,  
8 if you had to do something, you could remove  
9 a marginal or two and not do any great harm.

10 If you insisted on doing more  
11 serious surgery, you could delete some of the  
12 last paragraph without causing a lot of harm.  
13 When that was written, there was no commentary.

14 That sort of stuff is now in the  
15 commentary, and so you can say we don't  
16 need that kind of practical example kind of  
17 thing because it's in the commentary.

18 If you have to do something,  
19 those are the two things to do; but I really  
20 don't think that you need to do something  
21 because I don't think that the criticisms are  
22 well- founded in how the guidelines are written  
23 and how they at least ought to be applied.

24 MR. FEINSTEIN: Thank you.

25 What I'd like to do first before I

1       pose any questions is give each of the  
2       panelists an opportunity to react to what  
3       they've heard from any of the other panelists.  
4       And why don't we do it in the order in which  
5       they spoke, so we'll start with Mike.

6               MR. BAYE: Thanks. There's a lot to, a  
7       lot to respond to, I guess.

8               Let me just first say that I agree with  
9       some of what I heard. In particular, John  
10       mentioned that there's an important difference  
11       between verifiable versus quantifiable.

12              I guess part of my concern stems from the  
13       fact that in many merger analyses, we're actually  
14       able to do a fairly good job of quantifying price  
15       effects. Increasingly over  
16       the past decade-and-a-half we've had econometric  
17       tools and the data and so forth to do so.  
18       Staples/Office Depot is always kind of held up as a  
19       poster child. But those types of analyses are  
20       readily available now and guide analysis.

21              My concern is that within an agency, one  
22       might expect the same level of rigor when it comes  
23       to evaluating efficiency claims.

24              I guess the point I would like  
25       to emphasize is that efficiency claims are

1 extremely difficult to quantify. If the government  
2 had the burden to prove that  
3 there were not efficiencies, there's no data to  
4 prove that. Okay. And conversely. So the burden  
5 matters there a lot. I can see that oftentimes  
6 parties are in a better position to muster the  
7 argument, and I think it's incentive-compatible  
8 for parties to have to do that.

9 So I think in that sense we're  
10 agreeable. I think where there's some  
11 disagreement is between the asymmetry with which  
12 economists view efficiencies and the way attorneys  
13 typically have your efficiencies. I think  
14 attorneys generically think of efficiencies in  
15 terms of things like reductions in marginal costs,  
16 reductions in fixed costs, economy of scope,  
17 economy of scale. In my experience,  
18 oftentimes when economists are talking about  
19 efficiencies, they're talking about things  
20 other than the traditional cost-based  
21 efficiencies. Things that improve product  
22 quality or network effects and things like  
23 that, which are equally hard to quantify if  
24 you're imagining what a merger might look like.

25 And I think there is some

1 evidence. Two of my colleagues mentioned this  
2 study by Malcolm Coate and by Andrew Heimert,  
3 both in the Federal Trade Commission. Malcolm  
4 is an economist. He's in the Bureau of  
5 Economics. Andrew is an attorney in BC. So  
6 I think it's an interesting study. They looked  
7 at memos that were written by the Bureau  
8 of Economics and the Bureau of Competition in  
9 the recent past. And it is true that -- I think  
10 this is very, very important. I think the agency  
11 does a very good job of evaluating efficiencies  
12 claims. The memos clearly demonstrate that both  
13 economists and attorneys are giving serious  
14 considerations to efficiency claims.

15 One thing that strikes me as  
16 interesting from that study is it turns out,  
17 and there are many ways you can slice this, but  
18 it turns out that BC memos, Bureau of  
19 Competition memos, generally accept efficiency  
20 claims about 8 percent of the time, whereas the  
21 economics memos accept efficiency claims about  
22 27 percent of the time.

23 There's a huge asymmetry  
24 between the way economists interpret the term  
25 what is a "cognizable" efficiency. Should we





1 Master Card lurking in the background. My guess is  
2 that the benefits, the reductions in fraud and the  
3 increased convenience on consumers would not have  
4 been quantifiable and, therefore, interpreted by  
5 some not to be verifiable. And therefore, the  
6 merger might have been blocked.

7 I'm not making any statement on  
8 whether the Justice Department made the right  
9 or wrong decision, but somehow one has to be  
10 able to balance off those potential benefits of  
11 cost.

12 MR. FEINSTEIN: Just before we get to  
13 the others, Steve, when you were using the  
14 example of merger to monopoly, or a three to  
15 two on the one hand versus a seven to six, or a  
16 six-to-five on the other hand, it seems to me  
17 just sort of intuitively that one of the  
18 reasons that the agencies may traditionally be more  
19 comfortable relying on the efficiency arguments in  
20 the less concentrated markets, I'll say, is because  
21 I think it's easier to assume that because of the  
22 competition that will remain, the benefits of those  
23 efficiencies will likely be passed through to  
24 consumers. Is that a fair statement?

25 In other words, if in the six to five

1 situation, wouldn't the merged party that is  
2 capturing some efficiencies have a greater need to  
3 make sure that its prices reflect the benefits  
4 of those efficiencies?

5 MR. CALKINS: I think it really  
6 depends. You could be in a situation where the  
7 price isn't really controlled by those folks. For  
8 example, it's a pricing situation that is  
9 controlled by other people in the industry, and so  
10 it's not really going to be passed on.

11 MR. FEINSTEIN: But wouldn't you expect  
12 if there are five or six remaining competitors  
13 that you're more likely to have a competitive  
14 price at the end of the day.

15 MR. CALKINS: I guess in general I am  
16 sympathetic to the idea that if we really are  
17 saving a lot of money, that ought to count for  
18 something.

19 And so in that sense, I'm with  
20 Mike in saying that if I really am believing  
21 that we're having substantial savings, that's a  
22 good thing. And my guess is that it's going to  
23 end up, to some extent, being passed on.

24 It's not going to be a usual  
25 situation where no cost savings would be passed

1 on at all. That would be an unusual kind of  
2 market. And so to that extent, I don't  
3 personally think that one has to think only  
4 about passing on savings in terms of money to  
5 consumers.

6 It's a little bit more that my  
7 guess is that in the six to five there's a  
8 sort of unstated, unfashionable sort of  
9 deep-seated belief that rivalry is a good thing,  
10 it matters, and that the spur to competition  
11 from having a couple of people out there is a  
12 good thing and that bad things may well happen  
13 if you simply get too concentrated.

14 I mean, I'm from Detroit. And  
15 I've said this before, but it really is true.  
16 When there was a Big Three and that's all  
17 there was as a practical matter and they were  
18 bargaining with the same union and facing the  
19 same kind of costs and not feeling serious,  
20 vigorous pressure and rivalry the way that,  
21 say, the firms in Japan were feeling in  
22 competing with each other, you had the classic  
23 kind of, you know, quality slipped and costs  
24 went up and contracts were entered into that  
25 just made no sense in the long run, and feather

1 bedding went in, and poor management went in.  
2 And having three firms was not enough of a spur  
3 to competition. And you know, it was only once  
4 that model was broken that the whole thing blew  
5 up; but frankly the city of Detroit and the state  
6 of Michigan have been paying a long, long, steep  
7 price for having gone through a period of very  
8 relaxed competition.

9 So I'm guessing the six to five is  
10 less about the precise assurance that this will  
11 be passed on right away and more about saying  
12 that, gosh, if we're saving some resources and  
13 we still got five firms left, we don't have to  
14 worry so much.

15 MR. FEINSTEIN: That may well be correct,  
16 and I guess the other way of  
17 thinking about it is even if it isn't obviously  
18 passed on, there's less concern about a price  
19 effect in a six to five market because of the  
20 remaining competition.

21 MR. CALKINS: Well, the price effect or  
22 quality effect.

23 MR. FEINSTEIN: John, do you have  
24 anything you want to say?

25 MR. TREECE: First of all, Steve, I

1 suggested we circulate a draft, not all your  
2 drafts, back and forth. That was my  
3 suggestion, and I stand by it because I do  
4 think if we had a draft for public comment  
5 we'd get a little more focused responses, and I  
6 think would be helpful.

7 Really, based on what you said. I don't  
8 think you and I are terribly far apart because  
9 I just meant to be fairly complimentary on the  
10 guidelines efficiencies.

11 I was really focusing on those  
12 few instances, being the last paragraph of 36,  
13 and my view that that deviated from the general  
14 tenor of the drafting of that section. Generally  
15 it was open-ended and said, yes, we're not saying  
16 it should be only variable costs, we're not making  
17 this prescriptive rules. But I did think that in  
18 the last paragraph, and again, as I've said in my  
19 remarks, Footnote 36 crossed the line.

20 Now, having said we don't disagree  
21 very much, let me disagree. My clients aren't  
22 the scoundrels that you make them out to be.  
23 You know, my experience, at least recently, has  
24 been when people come in with a merger, often the  
25 justification is some kind of technology synergy,

1       that they're looking for some type of intellectual  
2       property, but not in the sense I want this patent,  
3       but rather, an expertise. This gets to what Mike  
4       said. The problem is it's not quantifiable, and I  
5       acknowledge that the long run for business people  
6       is not the long run for economists.

7                What they're doing is they're  
8       betting their business, their careers, or  
9       whatever, and hoping that in the next five to seven  
10      years, if I go through with this  
11      merger I'm going to pick up some technology,  
12      some know-how, some expertise, and I don't  
13      really know that it's going to work out. I'm  
14      hoping it works out. I'm making a bet. You can't  
15      quantify it, but certainly it's real and it drives  
16      the transaction.

17               And the problem is that it is  
18      speculative, so does that mean we ignore it?  
19      I don't think so because you are at the  
20      same time rebutting a speculative anticompetitive  
21      effect oftentimes.

22               In that respect, I mean, Sam, I  
23      acknowledge your graph, but it assumes that the  
24      conclusion of the merger is a pure monopoly.  
25      A lot of times we don't know what the

1        anticompetitive effect is of the merger. We're  
2        speculating, often I'm just speculating that no one  
3        else is going to change, that we're facing a static  
4        market. And yet, we've had lots of  
5        discussion today about repositioning and other  
6        competitive responses to that merger. So  
7        nothing is going to stay the same. And you are  
8        speculating about the anti-competitive effect.

9                There's a real tension, I think, among  
10       practitioners, or sense among the defense bar that,  
11       wait a second, your anticompetitive effect that  
12       you're speculating about is being honored while my  
13       pro-competitive justification or efficiency, which  
14       we admit has some speculation to it, is not being  
15       honored.

16                I will say also that -- I do a  
17       lot work in pharmaceuticals, and that's an area  
18       where I'm a little mystified with what the  
19       agencies do. At one time I thought where they were  
20       heading was that if a product was in a phase  
21       three clinical trials, okay, that's not  
22       speculative, we'll consider that and look at the  
23       effects of the merger. Now you look at the cases  
24       and they reach back farther and farther into the  
25       pipeline. I also do some patent litigation, I have

1       some pharmaceutical patent litigations, I have  
2       spoken to people who do medical development; and



1 disagree with, and that is searching for the word  
2 marginal and deleting it, I would keep marginal in  
3 there.

4 MR. CALKINS: That was only if they  
5 insist on making a change. I recommend no  
6 change as my opening position.

7 MR. Thomson: Efficiencies were one of  
8 the factors that the DOJ considered in the XM  
9 Sirius deal. I was listening to one  
10 of the business shows about three weeks ago.  
11 And the Chairman of Sirius was on talking about  
12 their very good third-quarter report. And he said,  
13 well, you know, one of the things is, if somebody  
14 wants to be in satellite radio, they can only deal  
15 with us. What he was saying is that we have  
16 pricing power. You know, I think it was a huge  
17 mistake for the DOJ to have credited those  
18 efficiencies in that particular transaction.

19 Also, as I point out that in the  
20 Williamson analysis, it is only a small price  
21 increase that would be swamped by efficiencies  
22 in general. We're talking about predictions about  
23 what's going to happen on the price side. If the  
24 merger goes through, the parties have every  
25 incentive if they got any market power to raise the

1 price as high as possible. So we may be predicting  
2 a low price effect when in fact there is a high  
3 price effect, which, again, makes me skeptical of  
4 accepting an efficiencies defense.

5 Finally, one of the  
6 things I've sort of taken a look at is bank  
7 mergers. I noticed in bank mergers, every one  
8 that I've looked at, the DOJ and the Federal  
9 Reserve Board, the Federal Reserve Board has an  
10 antitrust screen for bank mergers, mergers  
11 involved with bank holding companies. Every one of  
12 those uses a concentration standard for determining  
13 whether there's going to be an approval. It's an  
14 HHI with a post-merger HHI of 2,000 with a delta of  
15 200. If any of those  
16 banking markets have a higher post-merger HHI  
17 than 2,000 or a higher delta than 200, there's  
18 an automatic divestiture in those markets. So it's  
19 a pure Philadelphia National Bank approach in the  
20 bank area. There's no discussion of efficiencies;  
21 and indeed, in the commentary, the DOJ and the FTC  
22 commentary, you go through, there's a beautiful  
23 discussion of the efficiencies and the various  
24 cases in which efficiencies they've been applied.

25 There's no discussion of applying

1 efficiencies in bank merger cases. So bank  
2 mergers, to my knowledge, are an illustration of  
3 where the authorities are taking a Philadelphia  
4 National Bank basic concentration analysis; and  
5 it seems to me that that is appropriate in  
6 other markets as well.

7 That is, forget about  
8 efficiencies, except in those rare cases where  
9 the agencies themselves are afraid that they  
10 may be making a mistake and prohibiting a  
11 merger that's not likely to be anticompetitive.

12 MR. FEINSTEIN: Steve, did you want  
13 to --

14 MR. CALKINS: I've jumped in. We've  
15 only got ten minutes. I'll let you move on.

16 MR. FEINSTEIN: This isn't so much a  
17 guidelines question, but it sort of illustrates  
18 a practical challenge that I think the agencies  
19 face on a fairly regular basis with respect to  
20 efficiencies. So maybe it implicates the  
21 guidelines.

22 In the interest of full disclosure,icienciesi13

1 talking about is what's quantifiable; what's  
2 verifiable and what's speculative; and what's  
3 credible at the end of the day because ultimately  
4 we're trying to make as well-informed a prediction  
5 as we can.

6 Steve, you alluded to the situation where  
7 parties come in with studies at varying points in  
8 the process, and sometimes there are studies that  
9 can demonstrate -- and sometimes there are  
10 contemporaneous documents that can demonstrate --  
11 that efficiencies really were driving the deal from  
12 the very beginning, or one of the things that was  
13 driving the deal.

14 Sometimes that happens later in  
15 the process and it can be characterized as sort  
16 of a little bit of a post hoc effort. Doesn't  
17 mean it may not be correct, but it's also not  
18 uncommon for there to be situations where you have  
19 a respectable efficiencies presentation, and you  
20 also have business documents from senior people

1 or words to that effect.

2 MR. THOMSON: Whole Foods.

3 MR. FEINSTEIN: Well, for example. I'd  
4 be interested in hearing your thoughts about that:  
5 that could be viewed as uninformed, it could be  
6 viewed as speculative, it could be viewed as  
7 something that isn't necessarily credible. But it  
8 sort of gets right to the ultimate trade-off where  
9 there's some risk of reduced competition. But  
10 there are also some potential for efficiency  
11 gains.

12 I mean, does it make a difference  
13 if we have that situation where, in fact, there  
14 is some unvarnished intent evidence in terms of  
15 how the agency should view efficiency claims?

16 What do you think?

17 MR. CALKINS: The intent evidence tells  
18 you that the people whose words you're reading,  
19 to the extent you're interpreting them  
20 correctly, believe that the merger will result  
21 in less vigorous competition, higher prices or  
22 less direct rivalry from this firm, or  
23 something whereby they're viewing it as their  
24 lives will be better because this important  
25 competitor is gone.

1           In general, business people know a  
2           great deal about their business. They're not  
3           always right; but you know, that's pretty good  
4           evidence of what's going to happen. It's  
5           not proof, but it's pretty good evidence.

6           So it tells you, it gets you along  
7           the road of saying there may be a serious  
8           competitive problem here. On the other hand,  
9           it's possible as a matter of theory that a  
10          merger that is motivated by take out this  
11          important competitor might also be one that is  
12          going to yield some very, very substantial  
13          efficiencies and cost savings.

14          So at least in theory, even if you  
15          prove the lessening of competition on the one  
16          hand, that doesn't mean that there cannot be a  
17          very great savings in terms of efficiency.

18          The fact that they're going the  
19          route that they're going for reasons that are  
20          anticompetitive makes one less likely to believe  
21          the efficiency story; but you still have to take a  
22          look at it. And even though that may not have been  
23          how they stumbled across the idea, it might still  
24          be correct. You still have to take a serious look  
25          at it, I think.

1 MR. FEINSTEIN: Others reactions?

2 MR. TREECE: I agree with Steve that  
3 intent evidence isn't really about intent, it's  
4 about an understanding of how the market works.

5 But I think that in the example  
6 you gave, the question is how, how does  
7 competition actually work. In the example I gave  
8 of my bundling case, obviously we had a plaintiff.  
9 The plaintiff was a small company that made one of  
10 type of endo-mechanical product. This was a  
11 defense that we did not have the guts to raise in  
12 front of the jury; behind the scenes we called it  
13 the roadkill defense. And that is that all  
14 economists said, yeah, the pro-competitive benefits  
15 of the bundle-to-bundle competition the between  
16 U.S. Surgical and J & J were enormous. Was there  
17 some foreclosure of a small competitor? Of course.  
18 Was that small competitor so fringe that the  
19 pro-competitive benefits of allowing to say, well,  
20 you can't bundle because we want the  
21 small guy to be able to thrive? Every economist  
22 who looked at this issue said, no, obviously the  
23 pro-competitive benefits of the bundle-to-bundle  
24 competition outweighed the anticompetitive effects  
25 of whatever the foreclosure effect was.

1                   That goes to the question which I  
2           think Paul mentioned earlier, and that's  
3           substantiality. You have to measure  
4           substantiality within some market.

5                   But there is a tradeoff, and I  
6           would not be surprised at all to see the case  
7           that you've described where, you know, the  
8           merger has both components.

9                   In addition to substantiality, I  
10          think you have the difficult question,  
11          well, what happens, going back to my  
12          theme about cross-markets, what happens  
13          when you have an anticompetitive effect  
14          in one market and pro-competitive effect  
15          in the other.

16                   The example I gave from this case  
17          was easy in the sense that you have the same  
18          consumer. That's not always the case, of  
19          course; and I think it's a very uncomfortable  
20          position for the agencies to think about  
21          favoring one group of consumers over another in  
22          the context of a merger.

23                   I don't have an answer, but I  
24          certainly recognize the problem.

25                   MR. FEINSTEIN: Sam?



1                   MR. Thomson: I don't have anything  
2           else.

3                   MR. FEINSTEIN: Mike?

4                   MR. BAYE: I would agree. I think  
5           documents are useful pieces of information; but  
6           as far as intent, I mean, if you look at the  
7           academic literature on the value of mergers,  
8           for example, McKenzie's study suggests that  
9           over half of mergers lose value for the  
10          acquiring firm's shareholders. Okay.

11                  Y, iaskan, rself, well, west9is Okay.

1 alone may point you in a direction.

2 But without additional evidence, I  
3 think that the documents are not particularly --

4 MR. Thomson: Can I ask Mike a question  
5 on a point you just made?

6 MR. BAYE: Sure.

7 MR. Thomson: You indicated that this  
8 study showed that, and I assume that you were  
9 talking about the acquiring company's shareholders  
10 lose in 58 percent of the transactions. But  
11 the target company shareholders win virtually  
12 in all.

13 MR. BAYE: Well, that's because --  
14 again, the reason is because people are paying  
15 more than something's worth for the assets.

16 MR. Thomson: They're paying more than  
17 the trading value of the stock. But there  
18 still could be -- even though the acquiring  
19 company shareholder's lose, there could still  
20 be significant efficiencies in that merger. It's  
21 just that the acquiring company has, in essence,  
22 paid the cost of those efficiencies to the target  
23 company's shareholders.

24 MR. BAYE: Exactly. There may be well  
25 be efficiencies to the merger; but I guess the

1 point I'm really trying to make is if you see  
2 the document that says we think we're going to  
3 be able to raise price 20 percent post-merger,  
4 maybe 5 percent.

5 We're going to save a gazillion  
6 dollars in cost as a result of a merger. Ah,  
7 maybe a half a gazillion.

8 I'm just pointing out that you  
9 have to be cautious when you look at documents.  
10 I think especially when you look at the type of  
11 strategy, the type of MBA's that I teach,  
12 they're good salesmen.

13 MR. FEINSTEIN: We have a question. Go  
14 ahead, Jim.

15 MR. LANGENFELD: Just two quick  
16 comments. One, in terms of how you weight this  
17 stuff, a lot of times I've found that it's been  
18 particularly useful to see if the company has a  
19 track record in acquisitions, because that  
20 gives you, and perhaps it's not a natural  
21 experiment to see what type of credibility whatever  
22 they're doing now.

2t I teach,



1 Rich?

2 MR. FEINSTEIN: Sure.

3 MR. Thomson: Am I correct that in bank  
4 mergers the DOJ does not generally, or it maybe  
5 never takes into account efficiency?

6 MR. FEINSTEIN: Well, I wish you had  
7 asked that question while Molly was here.

8 MR. CALKINS: The FTC doesn't do bank  
9 mergers.

10 MR. FEINSTEIN: We don't do banks. I  
11 think it would be ill-advised for me to answer  
12 that question definitively because I can't  
13 really answer it.

14 MR. Thomson: Does anyone in the  
15 audience know the answer to that question?

16 (No response.)

17 MR. FEINSTEIN: But it's a good  
18 question.

19 MR. Thomson: Maybe I'll send her a  
20 note and ask her.

21 MR. FEINSTEIN: By the way, if you  
22 could, if you have a hard copy of your handout  
23 if you could send it to me, just e-mail me, and we  
24 can make sure it gets into  
25 the record along with the transcript.

1                   Any final thoughts in  
2                   thirty seconds or so from anybody on the panel?

3                   MR. CALKINS: I would just observe that  
4                   I do think that it would be better if we developed  
5                   a little better shared understanding of what counts  
6                   as an efficiency.

7                   MR. FEINSTEIN: Yeah.

8                   MR. CALKINS: I remember -- and here I  
9                   may disagree with one of my colleagues here,  
10                  but I remember reading the reported opinion in  
11                  the Heinz baby food where apparently there  
12                  was a massive amount of litigation over whether  
13                  or not access to the better recipes of one  
14                  major baby food company by another baby food  
15                  company was a social benefit efficiency that  
16                  ought to justify a merger that was otherwise  
17                  anticompetitive. And I guess I just thought, my  
18                  God, if we can't expect baby food companies to  
19                  make a decent product without having an  
20                  anticompetitive merger, you know, we really  
21                  ought to send everybody back to business school  
22                  to try again. I thought that wouldn't  
23                  count.

24                  I have seen debates about whether it is a  
25                  pro-competitive efficiency to let one firm buy

1      another firm in order to use tax breaks.      And I





1 here and beyond that we'll look at a bunch of  
2 factors, including where you are or something.

3 But if you just go forth and inflate  
4 the numbers to try to comport with reality,  
5 that's a fine thing to do in terms of guidance;  
6 but immediately that will become the minimum  
7 threshold for any case you want to bring.

8 So yes, one of the problems of the  
9 guidelines is they're addressing all these  
10 different audiences: government officials  
11 and business persons and academics and people  
12 around the world and judges.

13 But as a government officials, you  
14 can't afford to write a document that's going  
15 to prevent you from winning an important case  
16 in that last arena.

17 MR. FEINSTEIN: I don't disagree with  
18 any of that.

19 MR. TREECE: As a litigator, let me  
20 respond briefly, I agree entirely. If you  
21 think of the guidelines as jury instructions,  
22 my gosh, the incentives for the person with the  
23 burden of proof to give expansive sway to his  
24 burden and to crimp the affirmative defenses are  
25 enormous.

1           I think that's part of the reason  
2           the defense bar is skeptical of the treatment  
3           of efficiencies. There seems to be a  
4           reluctance to acknowledge the efficiencies in  
5           the guidelines for exactly the purpose that  
6           Steve has suggested. When you go the to court,  
7           they don't want to see that.

8           MR. FEINSTEIN: Well, I guess the last  
9           thing I would offer to say as evidence that  
10          mergers don't always work out quite the way  
11          people expect them to, as I was riding in here  
12          this morning I heard on the news that today is  
13          the day that AOL was moving forward on a stand-  
14          alone basis. And I suspected that the  
15          shareholders of AOL and Time Warner probably  
16          don't look back fondly on the last ten years.

17          Let me, let me do two things.  
18          First of all, I want to thank Henry Butler and  
19          his crew here at Northwestern for being  
20          wonderful hosts. This has really been  
21          terrific. We appreciate it.

22          MR. BUTLER: My pleasure.

23          MR. FEINSTEIN: And then secondly, I  
24          think this has been a really lively,  
25          informative way to end the day, and I want to

1 salute the panel. So thank you very much.

2 (Applause.)

3 (Whereupon, at 4:37 p.m., the  
4 hearing was adjourned.)

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1       STATE OF ILLINOIS     )  
2                                     )     SS:  
3       COUNTY OF COOK       )

4  
5                     JANICE M. KOCEK, being first duly sworn,  
6       on oath, says that she is a court reporter doing  
7       business in the City of Chicago; and that she  
8       reported in shorthand the proceedings of said  
9       hearing, and that the foregoing is a true and  
10      correct transcript of her shorthand notes so taken  
11      as aforesaid, and contains the proceedings given  
12      at said hearing.

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Janice M. Koczek, CSR, CLR