UNITED STATES FEDERAL TRADE COMMISSION

UNILATERAL EFFECTS ANALYSIS AND LITIGATION WORKSHOP

U.S. Federal Trade Commission
601 New Jersey Avenue, N.W.
Conference Center
Washington, D.C. 20001

Tuesday, February 12, 2008
9:00 a.m. to 5:00 p.m.

Reported by: Susanne Bergling, RMR-CLR

PARTICIPANTS

Introductory Remarks:

Deborah Platt Majoras

Panel 1:

Andrew I. Gavil
Janet L. McDavid
Robert Willig
David P. Wales, Moderator

Panel 2:

Jonathan B. Baker
Kathryn M. Fenton
Richard G. Parker
Daniel M. Wall
Jeffrey Schmidt, Moderator

Panel 3:

Hon. Douglas Ginsburg
Hon. Diane Wood
Michael J. Bloom
Richard Liebeskind
William E. Kovacic, Moderator

Panel 4:

William Baer
Susan Creighton
Richard Rapp
Constance Robinson
J. Thomas Rosch, Moderator

Panel 5:

Orley Ashenfelter
Dennis Carlton
Carl Shapiro
Joseph Simons
Michael R. Baye, Moderator

CONTENTS

Introductory Remarks............................. 5
Deborah Platt Majoras............................ 7

Panel 1.. 19
Andrew I. Gavil.................................. 22
Janet L. McDavid................................. 39
Robert Willig.................................... 29
Discussion....................................... 46

Panel 2.. 66
Jonathan B. Baker................................ 69
Kathryn M. Fenton................................ 76
Richard G. Parker................................ 84
Daniel M. Wall................................... 91
Discussion....................................... 107

Panel 3.. 129
Michael J. Bloom................................130/157
Richard Liebeskind............................... 143
Discussion....................................... 167

Panel 4.. 178
Discussion....................................... 181

Panel 5.................................... 227
Orley Ashenfelter.......................... 244
Dennis Carlton............................. 231
Carl Shapiro............................... 237
Joseph Simons.............................. 254
Discussion................................. 258

Conclusion................................. 284

P R O C E E D I N G S

\- - - - -

INTRODUCTION

MR. SCHMIDT: Good morning. I think we are going to try to start the program. Welcome to the FTC's Workshop on Unilateral Effects. I am Jeff Schmidt, the Director of the Bureau of Competition, and we are very glad to have you here today. We are really excited about this program. As some of you may know, this workshop is the brainchild of Chairman Majoras, and it represents the best of the FTC in trying to better understand some of the important competition policy issues that we face.

I have the chore of doing a couple housekeeping tasks here, so if you will indulge me as I go through this to make sure that I have covered the requirements. I think the -- let's see, the first thing is I have been asked to remind you that the agenda today is a full one, so that if you can try to be back in your seats by the time lunch is over with and breaks are over with, we can hopefully stay on schedule.

And I have also been asked to ask you to use the side doors instead of the center doors, for reasons that are not particularly clear to me.

Secondly, if you will turn off the ringers on your cell phones, BlackBerries, pagers, and the like, and I will do likewise when I get down from here.

And third, the restrooms are out the glass doors, past the security desk, and then behind the elevator bank to the left. Both the men's and women's restrooms are located there.

And then fourth, if you do leave the building during the day, unfortunately, for those of you who are not FTC employees, you will need to go through security again. So, if you can be sure to give yourselves a couple extra minutes to do that.

And then finally, as a federal government agency, we do practice certain safety measures. Probably the most important thing for you to know is -- obviously you know the one exit that you came in through -- if you need to leave the building in the event of an emergency. There is also an exit immediately behind us. There will be FTC people who will also be obviously here and are on site in the event that we have any problems, but, of course, we are not anticipating that.

So, with that, I'd like to welcome the Chairman of the Federal Trade Commission, Deborah Platt Majoras, to open our workshop.

(Applause.)

OPENING REMARKS

CHAIRMAN MAJORAS: Well, thank you very much, everyone. It is always good to see a robust crowd in the morning in Washington, especially on election day.

I welcome you to this workshop at the FTC. As many of you know, the FTC has found that when we are working through particular policy issues, we often find it very valuable to bring in experts from the outside who can then, in a public forum, communicate their views and help us think through the issue. Our public discussions can take whatever form or length is required for the issue.

Just last week, for example, we held a one-day round table with DOJ to explore our Joint Technical Assistance Program in the international arena. Just about a year ago this week, we had a two-day forum on the broadband access issue, which has been dubbed Net Neutrality. And then, as many of you know, over the past 18 months, we and DOJ have hosted 29 sessions of experts discussing the appropriate application of Section 2 of the Sherman Act to business conduct.

So, today, you have been good enough to join us as we gather to discuss unilateral effects analysis in merger review and in the litigation context, and I am pleased to say that we have gathered really a highly knowledgeable and thoughtful group of panelists, and I am very grateful to all of you for agreeing to lend your views.

Back in February of 2004, the FTC and DOJ held a merger enforcement workshop, which focused on whether the analytical framework set forth in the 1992 Guidelines, which, of course, had its roots in the 1982 Guidelines, was adequately serving the dual purposes of leading to the correct decisions in horizontal merger review and providing reasonably clear guidance to businesses and their counselors.

The workshop participants generally agreed that, in fact, the Guidelines framework was serving those purposes. So, borne out of that workshop, then, was not a reworking of the Guidelines, but rather, the agencies' commentary on the Horizontal Merger Guidelines, through which we explained, by reference to specific cases, including cases where we had closed the investigation, how we have applied the Guidelines to actual mergers.

If you reviewed the section on unilateral effects, it shows a large number of enforcement actions, most of which resulted in consent decrees. There can be little doubt, I think, among antitrust practitioners that unilateral effects is recognized as a central antitrust concern, and that the Government has a record of success in obtaining relief in these cases.

Of course, the record is not perfect. In litigated matters, both the FTC and DOJ have suffered some losses in differentiated products cases under a unilateral effects theory. Most recently, for the FTC, in the *Whole Foods* case, the district court did not grant the preliminary injunction that the FTC sought, and before that, DOJ lost the *SunGard* and *Oracle* challenges. Even when the Government has prevailed in cases in which a unilateral effects theory of harm has been alleged, as in *Staples*, *Swedish Match*, and *Libbey*, the courts' decisions have really not expressly discussed the application of unilateral effects theory.

Now, there may, of course, be no meaningful pattern in these losses. If we are doing our jobs, we likely will lose some cases over time, as only the toughest cases result in litigation; and try as we do, we cannot determine with absolute precision on which side of the line a close case will fall according to a court. Still, we cannot shy away from the tough cases if we believe that we have the evidence to support our position that a merger is likely to be anticompetitive.

Clearly, though, if you look at the cases and particularly the losses, they do show, I think, what we experience, which is that there are challenges in proving a relevant market in which we allege that the likely harm will arise out of the loss of competition between two competitors that have served as next-best substitutes to one another for a significant number of customers.

Recall that, for example, in the *Oracle* case, the Justice Department sought to bar Oracle's acquisition of PeopleSoft. These were two of the three incumbent manufacturers in a market defined as enterprise resource planning system software that handles human resources management and financial management systems for customers that made minimum purchases of $500,000. By comparison, the defendants, of course, argued for a much broader market that included not just those programs, but also other forms of ERP programs, as well as non-ERP software solutions, and would not have limited the market by size of customer sales. So, not surprisingly, defendants' proposed market expanded the number of market participants.

I am obviously simplifying in the interest of time here, but there, the court found that DOJ failed to prove its alleged product market, at least in part because it was not consistent with business delineations recognized within the industry. The Government had presented testimony from numerous customers that they might prefer defendants' products over some of the alternatives, but, said the court, none testified about how they would respond in actual purchases to a post-merger SSNIP. Lack of hard, quantitative data led the Government to rely principally on qualitative materials like market research reports and declarations from customers and industry consultants.

The defendants countered with examples of users that had implemented alternatives to the defendants' products. Ultimately, the court found that the Government had failed to define the alleged, narrow, relevant market, which meant that the shares that you then calculate to show concentration levels weren't correct and that ultimately, the Government's estimates of competitive effects, based on that market definition, also had to be disregarded.

Then you go to the *SunGard* case. The district court there rejected DOJ's market definition in refusing to bar SunGard from acquiring the assets of Comdisco. These companies, as well as IBM, were in the business of providing shared hot-site services which are backup computer centers that you use in the event of a disaster. The Government alleged a market that was shared hot-site services for customers with mainframe and midrange computer processing centers. Defendants contended that there were a lot of alternatives to these that customers could and did turn to to safeguard themselves in the event of disasters.

Both sides offered customer testimony to support their contentions, but there the court rejected the customer testimony, finding that both sides were engaging in cherry-picking sampling and that neither side's witnesses were representative of all existing and future customers. Ultimately, the court found a relevant market that was neither the narrow market that DOJ had alleged or the broader market that the defendants had alleged. In fact, the court found a market somewhere in between.

And finally, if you look at the Commission's challenge to Whole Foods' acquisition of Wild Oats, the court there rejected the contention that the relevant market was the premium natural and organic supermarket. There, the Government presented not only economic evidence but evidence that was taken from the parties themselves that, in fact, showed that the two were uniquely close competitors. There was no doubt that Whole Foods and Wild Oats competed at a certain level with other supermarkets, and we never denied that, but staff presented evidence that the companies believed that the other was a uniquely close competitor, and thus, made decisions on that basis; and as the Whole Foods CEO told his board in justifying the transaction, that the acquisition would eliminate Wild Oats as a platform for conventional supermarkets to get into the organic market segment, and the entry through that avenue would be only a threat to his market position. And in addition, after paying a premium for stores, Whole Foods made clear it had the intention to close dozens of stores and to scrap plans to build new stores.

Of course, the district court did not see the evidence there as we did and concluded that we were wrong about what constituted the relevant market, and that case is now on appeal.

Don't get me wrong. The courts play an absolutely critical role in U.S. merger enforcement. Indeed, almost uniquely so if you look at our courts' role in comparison with many courts around the world. And after every litigated case, it is very important that we carefully evaluate the courts' decisions, our own analysis, and our evidentiary presentations.

You know, the fact that litigated cases happen so infrequently -- indeed, the three cases litigated by the FTC over the past year were virtually unprecedented over the past couple of decades. The agencies just haven't litigated so many cases in a year. So, that makes it all the more important that we learn from each and every court decision.

In addition, because most merger decisions are not litigated, we have a great responsibility to ensure that we are basing those decisions, most of which result in consent decrees, on solid analysis which would be supportable in the courts if litigation were necessary. And if we lose, it is essential that we take a critical look at our legal analysis and presentation to determine, to the extent we can, how and why we were unable to convince the court of our position.

In this regard, I am very proud of the debriefing efforts that are being undertaken and have been for the last six months within our agency among the economists and the lawyers to think these things through, and today's workshop is another step in our process. We can identify ways to improve internally, but given the human limitations on objectivity, we may be so close to a case or an approach or a set of strategies that our own introspective evaluation is just simply not enough.

The workshop combines a lot of our thinking, covering many of the areas that we and others outside have identified as worthy of discussion. For example, has market definition, which has been such an important tool in analysis, become an end in unilateral effects cases rather than a means to determine if the merged entity will have the ability to exercise power? If so, is it because, as Professors Farrell and Shapiro argue and probably will talk about today in a preliminary draft paper, the Guidelines have shoehorned unilateral effects analysis into the traditional market definition concentration framework that has its roots in coordinated effects analysis?

We will define markets in unilateral effects cases in problematical ways in litigation, because given the nature of the analysis of closeness of substitution, they appear to judges to have been gerrymandered and not always consistent with our views as consumers; and, of course, we are all consumers, including judges. Are we ready to touch the third rail and discuss whether market definition is necessary in a case in which we can present direct evidence of competitive effects? In that regard, are we just getting tripped up over our own terminology and our step-by-step analysis, and should we do a better job of explaining, as I tried in the *Evanston* opinion, that in differentiated product unilateral effects cases, market definition and competitive effects are simply two sides of the same coin no matter how we label? Or should we, as some might argue, stick to traditional market definition and concentration calculations because, while sometimes imperfect, they provide important disciplines on legal analysis? Should our thoughts on this be influenced by the fact that a huge percentage of mergers we review have to be analyzed within only 30 days or less, necessitating that we have to have some tools to be able to find the right answer quickly? What about our evidence and how we present it? We have had judges reject customer declarations, customer testimony, parties' unvarnished statements about competition and mergers in favor of litigation declarations and economic evidence at different times, all of which, some of us believe, at least at some points, to be very important evidence in these cases.

Are we moving toward a system where fancy econometrics will win the day, much like we hear about jurors who have seen so much *CSI* and *Law & Order* on TV that they insist on fancy DNA or fingerprint evidence in order to find guilt in a case? What types of noneconomic and economic evidence are most probative in these cases, and how does our answer vary by factual conditions, where we have dynamic versus static markets; if we have industrial products cases versus retail cases, direct to consumer?

How do we handle new economic learning when we go in to court? This is very important, because ours is not a static discipline, and we want to learn as the economics develop. So, how do we handle that from a litigation standpoint? How important are industry experts? And how can we best tell the story to a judge, especially if the market definition -- and you heard some of the ones that I mentioned in some of these cases -- are just simply not intuitive to us as consumers?

Now, later today, I am very excited that we are going to have a mock closing argument over a hypothetical ice cream merger, and as you will see from the facts there, the Government in that hypothetical case alleged that superpremium ice cream is a separate market from other types, with the defense taking the position that ice cream is ice cream. As we will see, the economics and facts are not necessarily completely in alignment with what our intuition might be. So, this panel will provide us with really an exceptional opportunity to hear how two experienced judges go about weighing the often complex and contradictory testimony in economics, which is typically presented in an antitrust merger case.

So, with that, I would like to thank you all for being here to discuss with us this important topic, and, again, many thanks to our panelists who have agreed to be here with us. I will stop now, and I would like to introduce to you, to begin the first panel, David Wales, who's the Deputy Director of the Bureau of Competition.

(Applause.)

PANEL 1:

FOUNDATIONS OF UNILATERAL EFFECTS THEORIES:

CORE FEATURES, ECONOMIC BASES,

AND POTENTIAL GROUNDS FOR ATTACK

MR. WALES: Great. Thanks a lot, Debbie.

We are, to reiterate, very excited today about our various panels, and I personally am very excited about this panel. I think we have some great participants and hopefully we will have some great dialogue.

The way we would like to kick it off is just to talk about some of the foundations of unilateral effects, some of its core features, economic bases, and potential grounds for attack, and other general topics to set up some of the additional discussions that we will have.

The format is going to work this way: Each of the three -- now three -- panelists will have brief presentations to talk about some of the issues they think are important, that they want to convey, and then what we would like to do is open it up to discussion, hopefully get an active discussion as to some of these issues and drill down a bit further on some of the key points.

So, with that I am going to go ahead and give a brief introduction of the panelists, and then I am going to ask them to go ahead and start their presentations.

First off, we have, all the way down at the end, Andrew Gavil. Professor Gavil teaches law at Howard University School of Law. He has been a member of the Howard faculty since 1989. Prior to joining the faculty, he practiced antitrust law and commercial litigation with law firms in Chicago and Denver. He is the lead author of *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy*, and is currently at work with the co-author, Professor Harry First, on *Microsoft and the Globalization of Competition Policy: A Study in Antitrust Institutions.* In 2004, he received the Warren Rosmarin Award for Excellence in Teaching and Service at the Law School and serves as a faculty advisor to the *Howard Law Journal*.

Next up we have Robert Willig. Professor Willig teaches economics at Princeton University. He's a former supervisor of economics research at Bell Laboratories. He is the co-author of *Welfare Analysis of Policies Affecting Prices and Products,* and *Contestable Markets and the Theory of Industry Structure,* and co-editor of *The Handbook of Industrial Organization and Can Privatization Deliver?*

Infrastructure for Latin America, and numerous articles. A fellow of the Econometric Society, he has served on the editorial boards of the *American Economic Review* and the *Journal of Industrial Economics*. He served in the Antitrust Division in the U.S. Department of Justice as Deputy Assistant Attorney General for Economics.

Finally we have Jan McDavid. She is a partner at Hogan & Hartson here in D.C. She focuses primarily on antitrust and trade regulation litigation and counseling. She has served in multiple positions of the Antitrust Section of the American Bar Association, including Chair. She also is a member of the Antitrust Council of the U.S. Chamber of Commerce, and has served on antitrust task forces with the U.S. Department of Defense. She is the author or co-author of many books and articles involving antitrust, including the *Antitrust Evidence Handbook, Mergers & Acquisitions, and Antitrust & Trade Associations Practice Guide*. Ms. McDavid's recognition includes *The Best of the Best* Competition and Antitrust Section; *Legal Times of Washington* Top Antitrust Lawyers; *The International Who's Who of Business Lawyers;* and *Guide to the World's Leading Competition Lawyers*.

We are thrilled to have each of you here today.

With that I think what we would like to do is start off, Professor Gavil, with your presentation. So, take it away.

PROFESSOR GAVIL: The slides?

MR. WALES: Yes.

PROFESSOR GAVIL: Good morning, everyone. I am delighted to be here, and I thank Chairman Majoras and Andrew for inviting me to join you.

To start off our first panel, I was asked to see if in about five or seven minutes I could sum up the history of unilateral effects. So, I will try and do that.

I thought that in just a few slides I would talk a little bit about the roots of unilateral effects doctrine, both legal and economic, and how it fits into the larger picture of merger analysis. That got me thinking about various phases we have gone through in terms of merger enforcement analysis.

I start with a hypothesis, and it was really late last night when I typed this, so maybe it should have a question mark at the end. I am not sure this is my hypothesis, so I will pose it more so as a question -- a possible hypothesis.

In a sense, unilateral effects is both the oldest and the newest theory of anticompetitive harm for mergers. The underlying legal and economic theories are neither novel, nor new. What is newer? Well, the theory has certainly been refined; it has been elaborated. There are new empirical techniques, and we will talk a little bit about that, which have clearly been aided by technology and there is increased access to data, which also, aided by technology, has been very significant. But the question, of course, on everyone's mind, and as Chairman Majoras already put it for us, is why has the contemporary theory of unilateral effects proven to be such a difficult sell in the courts?

The basic larger idea of merger to monopoly, of course, is original to the Sherman Act. Here is a quotation from Hans B. Thorelli, *Federal Antitrust Policy*:

That "Sherman" -- talking here about John Sherman -- "wanted the bill to cover the great industrial trusts proper as well as mergers and other tight combinations when of a monopolistic nature there can be no doubt."

So the idea that we should prohibit mergers to monopoly is a very old idea in antitrust. It was supposed to be covered by the Sherman Act. In many of the early merger cases that came out of the great merger wave, *Northern Securities*, *U.S. Steel*, although of varying success in terms of enforcement, the basic theory was merger to monopoly, and the trusts themselves were combines. They were viewed as mergers to monopoly.

The 1950 amendments ushered in the non-monopolistic merger period, somewhat in response to the *Columbia Steel* case of 1948, although there are other factors as well. The Government was losing a number of these merger challenges from the twenties to the forties. Congress decided to step in. They clearly had a different set of concerns. They broadened out and altered the focus from a focus on merger to monopoly to what we might call nonmonopolistic mergers.

We might also call these the wilderness years, as the anchor, even in early thinking about merger to monopoly, was a little bit more clear than what happened in this period. There was an evolution from emphasis on "trend towards concentration," a concept which is typified by cases like *Brown Shoe*, *Von's*, and *Pabst*, and which we now teach against in casebooks, toward the structural approach, and the general concerns it raised about market shares that were obviously elevating. Here was the idea of making predictions from market structure that took form in the *Philadelphia National Bank* presumption, and, of course, was reflected in the first Merger Guidelines in 1968.

From 1968 to 1992, there was an effort to better define what the true anticompetitive theory was, and in a sense this period led to a commingling and a fusion of two competing traditions. One was the oligolopy tradition going back to the 19th Century in economics, and the other was the structural presumption, which had developed in some of the writings on industrial organization economics in the 1950s.

If you go back, as I did, looking at Stigler and Posner and Bork and contrast them with Kaysen and Turner (1959), you really see these two very different sets of ideas competing for influence in terms of merger policy. Their first offspring was the coordinated effects theory in the 1982 Guidelines and the way the Guidelines are structured. This is a point that Joe Farrell and Carl Shapiro explore in their paper, I will mention that a little later on. The attempt to structure Guidelines that combine pieces of different theories I think is one of the issues that is going to emerge today as important. We have different intellectual thoughts that are reflected in different pieces of the Guidelines, and like a puzzle where the lines between the pieces are still very defined, they do not always quite fit together very well, and sometimes they can even work at cross-purposes.

From the mid-1980s to the present, there was something of a reintegration of the pre-1950 and post-1950 models. Monopolistic and nonmonopolistic mergers are reintegrated in the Guidelines. Coordinated and unilateral effects are both introduced. Both, of course, have roots in oligopoly theory, but both are still tethered to the structural concepts in the Guidelines.

For more sources on this history of unilateral effects and its roots, I just cited a few of the articles here on the slides, all of the authors being in the room, Baker, Willig, and Denis, all go through some of these issues of the intellectual roots of modern unilateral theory.

Well, where do we go from here and what is the discussion about today? I think one issue that I wanted to put out is, how do we relate developments in unilateral effects to the larger context of modern antitrust? And this I am not quite sure I believe, but I wanted to put the idea out there. Coordinated versus unilateral effects parallels, in a sense, the tension that now exists in Section 1 between actual effects and the quick-look doctrine on the one hand and circumstantial effects under the Sherman Act. Coordinated cases tend still to be structural in some sense, economic, and more sophisticated in others. But to the degree they are relying on creating a circumstantial, predictive case for coordinated effects, they are more like the circumstantial approach to merger analysis.

I tried to give a new name -- I don't know if it will work or stick -- but unilateral effects is more akin to "predicting actual effects" based on empirical evidence, and in that sense, it really can be located in the circle with cases like *NCAA* and *Indiana Federation* and *California Dental* and *Polygram*, cases that try to, as the Chairman was talking about earlier, try to look at actual effects and market definition, market power, as flip sides of an issue.

As the court said in *NCAA* and again in *Indiana Federation*, traditional market power analysis involved defining a relevant market, calculating market shares, and predicting market power and consequence anticompetitive effects from large and durable shares. The Court has held, however, that doing so was just a surrogate for actual anticompetitive effects. When you have the actual anticompetitive effects, you shouldn't need to do those things.

The tension about that has arisen with respect to such actual effects cases is similar to the tension that exists now around unilateral effects. Concerns about the reliability of actual effects evidence have also caused some push-back in non-merger areas. So, one productive step we could take would be to get merger analysis, instead of in its own pigeonhole, relocated in the larger picture of what is happening in antitrust.

The irony of precision -- last slide here -- why are unilateral effects cases a tough sell in court? For economists, there is the appeal of empiricism. They are very appealing. They -- based on data -- I pulled this quotation out of one of Jon Baker's articles:

"[i]f the facts support a unilateral theory, it is clear as a matter of economic logic why the particular merger would likely lead to higher prices."

This reminded me a little bit of the language in *Polygram* where the FTC talked about anticompetitive effects being "intuitively obvious" based on economic analysis. But what is the challenge for decision-makers? Why the resistance?

Well, in a sense, the models can be more complex than the traditional *PNB* presumption. This is somewhat ironic since the models were designed to yield a greater degree of precision, a greater degree of understanding, yet the models themselves are more complex. The *PNB* presumption was by comparison easy, like per se rules, like other burden-shifting devices. It did not require a lot of understanding to say: "40 plus 20 is 60. Ooh, that's a lot!"

Empirical evidence also may be confusing when combined with traditional structural evidence. It can appear highly dependent on assumptions, and, therefore, subject to manipulation if the assumptions change. It can be a little bit more rigorous in theory than practice. Sometimes the data do not match the theory. And I think there is a larger issue, one that David Meyer talked about in a speech last fall. We are, whether we like it or not, at something of a historical moment in antitrust, where courts are proving very skeptical about antitrust cases, and unilateral effects has run into that skepticism as it tries to develop and evolve in the courts.

Those are my opening comments, and I will turn it back over to the panel.

MR. WALES: Great. Thanks, Professor Gavil.

Next we have Professor Willig with some brief remarks.

PROFESSOR WILLIG: Brief?

I face an interesting challenge. I was asked to cover the Merger Guidelines, a short overview to be sure, unilateral effects therein, the history of antitrust, and the economics of unilateral effects, and

I wasn't given five to seven; I was given three to five.

MR. WALES: I lied.

PROFESSOR WILLIG: With another cup of coffee, I can talk really fast. So, who's got the coffee for me?

Elements of the Guidelines in an historical context: First and foremost, relevant market. What is a relevant market? I know we talk about all the algorithms, those of us who love that kind of thing, but the idea of a relevant market is so simple that I think we should remember its basic concept all day long throughout the discussions. A relevant market is a collection of the principal sources of competitive discipline on the products of the merging firms, especially the overlapping products of the merging firms.

If you collect all the sources of competitive discipline and you put them all under a single source of control, then you should be seeing some elevation of monopoly power, and hence, the hypothetical monopoly test as the way to make sure that you have got all of the principal sources of competitive discipline identified and collected in the relevant market. The idea of it is simple. The hypothetical monopoly test is just the way to make sure that you have actually got market power there collected in these various sources of competitive discipline.

This was the idea of the 1982 Guidelines, along with a way of counting concentration within a relevant market. The concentration question, again, taking it away from the technocratics, the Herfindahls and the like -- remember when that was a bizarre thing? I remember that. I mean, I hate to be an historian and feel like it was yesterday and I was already old when these things happened. That is sort of a dangerous dream of mine. Never mind how Jon looks. He looks great, exactly the way he looked -- God knows when. No improvement, but no change.

(Laughter.)

PROFESSOR WILLIG: So, why do we count concentration and change in concentration? Well, a relevant market is a place where a hypothetical monopolist could or would exercise monopoly power. The change in concentration and the level asks, well, what does the merger do to bring us to the status of that hypothetical monopolist? How close will the merger actually bring us to that hypothetical monopoly? It goes hand in glove with the idea of the relevant market. The Herfindahl is a very clever way to measure concentration. It is nothing but an arithmetic way to collect share data and see how concentrated they are.

Now, everybody keeps saying today -- and I have heard this before as well -- that the 1982 Guidelines are all about collusion, coordinated effects, as we would call it today. Hey, I was there; Larry White was there. It turns out that the Herfindahl Index, by 1982, was being published as coming right out of a Cournot model. You all remember this, economists Cowling and Waterson, and, in fact, Ordover and I were asked to write a review of those '82 Guidelines. I had done some consulting on the Division on them when they were being written with Larry White, and in '83, Ordover and I wrote, "Why do they keep using the word collusion in the Guidelines? They are actually talking about oligopoly models like Cournot with what we would call today unilateral effects." I think it was more a mislabeling, a lack of language, than a distortion of the ideas. We obviously did better a decade later by looking it in the face, but to say that the '82 Guidelines were really about collusion I think is a grave intellectual error if we are doing history, and that was my assignment.

Now we move on to the current Guidelines -- hopefully still current -- and we have coordinated effects, which we are not talking about today, and we have unilateral effects, and I'd like to highlight three different cases of unilateral effects that are squarely in the Guidelines, and here, too, I am worried that we are losing track about which one it is that we are speaking of.

First of all, unilateral effects apply in the Guidelines to the case of "homogeneous products," commodities in the common parlance. The Guidelines call this a market in which firms are distinguished by their capacities rather than by the characteristics of their products, because they are all basically the same; hence, homogeneous products. Unilateral effects make totally good sense in a market of homogeneous products. The economics of it are very simple.

The idea is that if a firm gets bigger in a space of homogeneous products, then it has got a bigger base of capacity on which to enjoy a price rise, and so a big merger tends to enhance the incentives of the newly merged firm to cut back on output so as to push the price up, because now, it has got more capacity on which to enjoy the positive profit effects of that price rise.

Not elaborate, not fancy, not about merger simulation models, although we have lots of analytics to handle that if we want to, but it is not what we are usually talking about on a day like today, but it is still unilateral effects. So, I think we need to sharpen our language away from just unilateral effects to unilateral effects in markets where the products are importantly differentiated to separate out the case of the commodities.

Second of all, within the category of differentiated products, there is a main case really in the Guidelines where the differentiated products are -- I am calling it today generally differentiated. Jon Baker and I and Paul Denis debated this stuff for much of two years together. Generally differentiated products are ones that compete with others in the relevant market, but kind of generally, without any specific product-to-product relationships.

Think about cold remedies. I mean, does anybody really know what the subcategories are of cold remedies? Everybody's got their favorites, and yet each cold remedy basically competes with all the other ones. Maybe a pharmacologist would know the difference, but we consumers sure don't. Or midsize cars, you know, they are all kind of mushed together in one big pot, no specific competitive relationships.

Well, in a market like that, it makes sense to think that the share of a product is indicative of its competitive significance as an alternative to whatever your favorite product is; that shares really connote competitive significance, because the competitive relationships are general throughout the marketplace. That is the lead case of differentiated products under the Guidelines, and there, relevant market makes just as good sense as it does for a homogeneous product industry that collects all these products that interact importantly; concentration makes sense as a measure of significance, and off we go.

There is a lot of economics lying behind this. The Logit model of demand handles this. We all grew up on the *CES Utility* model of monopolistic competition, and in markets like that, this is exactly the kind of interaction among the products. This is really classic differentiated products stuff.

What we are all getting confused about is the third case where the competition among differentiated products is not general; instead, it is local, and where differentiation is local, market share is not indicative of competitive significance as a matter of substitution for any other product. Some products yes; other products, no.

Think about Toyota Camrys. They are very successful cars, and yet they are in no way interesting substitutes for the BMW drivers in the crowd. Instead, maybe an Audi with a low market share is a much closer source of substitution for the BMW than would be the best-selling Camry. So, here, product characteristics are discernible; they are different; people recognize them as such; and they drive the importance of different substitution relationships. So, three different kinds of unilateral effects. Today, we are really only talking about the third one, and I think it would really help to clarify that in our discussions.

When we have localized effects, we are going to have small, narrow relevant markets. You know, Bimmer-oriented relevant markets instead of all cars or all midsize cars, and what we are hearing is all judges who I guess do not drive Bimmers find it a little bit harder to understand.

A proposal I would make today -- and I am not going to wait for the question, I just want to slip it in -- the proposal is that we accept the idea that markets can be narrow where competition is localized -- bite that bullet -- and accept the idea that sometimes the best evidence for what constitutes the true, narrow relevant market is not our normal kind of intuition about, "Oh, a car is a car; a grocery store is a grocery store; a stationery story is a stationery store," but we allow ourselves, where appropriate and where the evidence is there, to deduce market definition from evidence about competitive effects; that after we look at the *Staples/Office Depot* evidence, that where there are only two superstores instead of three, prices are higher, that teaches us that the office superstores are not in the same relevant market as your corner drugstore, which I would have thought intuitively, but the evidence proves that is not true. The evidence proves that, indeed, the relevant market is office superstores. I wouldn't have known that through other sources of evidence, but the statistics that show that are our best evidence for market definition.

Why shouldn't we allow markets to be defined using best evidence? And in cases where we have those kinds of data, that would be our best evidence. It is not that markets are irrelevant. It is just that we should be willing to test them and to prove them, sometimes using the same kind of information that we use for competitive effects, where we have such solid evidence.

It is not wrong in *Whole Foods* for the judge to be debating what the relevant market is -- all supermarkets or just organically oriented ones. That is very much the right question, and I think the judge was on the right beam in trying to figure out what the best source of persuasive evidence was. I don't know what the right answer is either. So, if I were the judge, I would have been all over the lot just like the judge was. I don't know if it was a wrong process. It is a hard question. Maybe the FTC knows better. I am not aware of those data, but, I mean, maybe you are right. But I think the judge was grappling with the right question, and why not allow competitive effects and natural experiments to be part of the evidence that does drive a determination of the relevant market, along with competitive effects? I think there is nothing wrong with that.

I think there is a danger in eliminating the idea of a relevant market, because not forcing ourselves to actually enumerate, out loud, all the sources of important competitive discipline creates the danger that in our weaker moments, when we are not absolutely on our game -- and I know mostly we are in this room, but sometimes we are off our game -- when you are on the other side of me, for example -- that under those circumstances, you should be impelled by the process to enumerate all of what you think are the important sources of competitive discipline, and the process of relevant market is the force that makes us do that. Just saying, "Oh, it is obvious that these two products are the closest substitutes, end of story," is a dangerous way to lead our process as far as the law is concerned.

Thank you.

MR. WALES: Thank you, Professor.

We are now going to turn to Jan McDavid with her opening statement.

Jan?

MS. McDAVID: Thanks, David.

In recent years, as we have been talking about, the agencies have increasingly relied on unilateral effects theories. Other panelists, and especially the economists in the room, can tell us whether the techniques underlying these theories are appropriate and debate which theory is appropriate in a particular case. I am not an economist; I don't play one on television. I hire people like Bobby for that.

Instead, I'd like to discuss these issues from the perspective of an antitrust practitioner who has to explain them to business people who are making decisions about potential transactions and who interact with the staff of the agency about particular transactions.

Now, it has always seemed logical to me to consider whether a merger that eliminates direct competition between the merging parties substantially reduces overall competition within the meaning of

Section 7. Unilateral effects analysis is based on the very common sense notion that a merger is likely to have more a harmful competitive effect if the merging parties are particularly close competitors.

The most obvious example, of course, is a merger to monopoly in which there is no competition remaining following a transaction. But it also seems logical that transactions in which some rivals remain could produce those competitive effects. In other circumstances, they won't. The question before us, before the agencies and before the courts, is how do you distinguish between all of these different formulations?

I have always found that the easiest way to explain these concepts to business people is the next best substitutes formulation, and so that is basically what I have done.

Now, as a Colorado skier, I often use the *Vail* case as the paradigm that I walk my clients through in trying to have them understand competitive effects. About ten years ago, Vail resorts, which operates both Vail and Beaver Creek, proposed to acquire the Ralston resort ski properties in Colorado. Those of you who thought Ralston only made dog food will be surprised to know that they actually operated Breckinridge, Arapahoe Basin, and Keystone, and did not do so especially well.

The Division concluded that there were two kinds of skiers: There were destination skiers, like me, who get on an airplane and fly somewhere to ski, and if prices go up for us, we could go somewhere else. I could get on an airplane to Salt Lake rather than to Denver if I wanted to go skiing. And then there were what they called the front-range skiers, the folks who get in their cars somewhere in the Denver metropolitan area and drive about two-and-a-half hours to a ski area, and they concluded that that was the market in which they needed to analyze the effects of the proposed Vail-Ralston transaction.

The competitive impact statement made it clear that the Division was applying a unilateral effects theory to the case. Before the merger, Vail was deterred from increasing its prices at Vail and Beaver Creek by the fact that skiers could go to Keystone instead, if prices were to be increased at Vail and Beaver Creek, or Breckinridge or Arapahoe Basin. But if Vail also owned Keystone, Breckinridge, and A-Basin, they would also pick up the revenues on the sales of those tickets, and therefore, a price increase might become profitable.

Based on an econometric analysis, using largely survey data -- and that is a point I really do want to come back to -- and data on margins, the Division concluded that a price increase of a dollar per ticket was likely in the event that Vail owned Vail, Beaver Creek, and Keystone, because Keystone was the next best substitute. They also concluded that divesting A-Basin would fix this problem.

Now, the antitrust agencies' ability to engage in the type of analysis that they used in the *Vail* case or in the other cases we have been talking about has been made possible by the kinds of rich data sources that are available, as well as computers. In cases involving branded food products, for example, IRI and Nielsen data permit very elaborate econometric models in which we can actually use transaction data to test these propositions. But the retail scanner data that we have in branded food products are not available most of the time, and even in branded food product transactions, they actually focus on competition at the wrong level, because they are focusing on the prices set by retailers, not the prices set by the manufacturers of the food products who are actually engaged in the merger.

So, what substitutes for these kind of data are available and how does the quality of the data affect the quality of the analysis in which we are engaging?

It seems logical to me that differences in the quality of the data are very likely to lead to differences in the quality of the economic analysis that is being done and that use of data that is not reliable may lead to skewed and unreliable results.

An awful lot of the debate is also about the kinds of assumptions that are being used, and if you vary the assumptions, you vary the outcome. It is very possible, under the Guidelines and under the Commentary, to find unilateral effects at even low market shares. Many of us believed there was a 35 percent safe harbor in the Guidelines, but the Commentary says there isn't. Where is the right line? Every model of unilateral effects predicts some kind of a price increase absent some significant efficiencies. We all know how reliable the efficiency estimates are. All of this can skew the outcome in ways that may render the results at least suspicious and make people skeptical.

Now, I bring to this process the skepticism that I also bring to the HHI analysis. The HHIs lead to a mathematical result which looks precise on its face, but we all know that it varies entirely based on market definition and market shares, neither of which are very reliable, and then you just square it and add it up. So, it all depends on where you start as to where you end up.

For that reason, I rarely try to define markets in the transactions I am working on. I always zero in, almost immediately, on competitive effects analysis, because that is where I have always thought the game was going to be played. I have always thought that the HHIs are a very useful first screen for thinking about the transactions into which we should start conducting that kind of elaborate analysis, but they create an artificial sense of precision where no real precision is possible, and I am concerned that some of the same things happen with respect to the kinds of unilateral effects analyses that we have been undertaking.

Let's go back to the *Vail* case as an example. People who ski in Colorado who probably agree that Keystone was the most likely next best substitute for Vail and Beaver Creek, with Breckinridge being a close second. I think we would have been very skeptical that survey data would allow you to conclude that prices would go up one dollar or we would be especially skeptical that divesting Arapahoe Basin was going to fix that problem.

I have never skied at Arapahoe Basin. It is way too hard for me. There are people there who sleep with their dogs in their Volkswagen buses in the parking lot.

It is not a substitute for Vail. So why should we trust an economic model that suggests that it is.

So, I think where all of this takes me is that we have to bring some common sense to these kinds of analyses, and that is where I am concerned that the agencies are running into resistance. Some of what they've been doing appears to be gerrymandered or jury-rigged and doesn't pass the common sense test. When your judge is someone who's been sentencing drug offenders in the morning and is handling unilateral effects analysis in the afternoon, you have to be conscious of the limitations of your audience. They don't do the math either.

Judge Wood, who handled the cereals transaction, brought Fred Kahn in to advise her as effectively her law clerk when she tried that case, even though she was a very experienced antitrust lawyer and very good at the economics. And that is, I think, an illustration of the sorts of problems that we have to be conscious of.

So, I would like to use the unilateral effects analysis as part of a holistic analysis of all of the evidence. I have always thought we get to pretty good results with the more traditional models, considering the company's strategic planning documents; who do they think are their most significant rivals; what do the customers say; what is the evidence about entry; is one of the companies failing; is one of the company's ability to compete on an ongoing basis impaired in the future. Does this tell us an overall story? Is all of the evidence consistent? Does it take you to the same place?

If that is the case, I think you can be reasonably confident about the kind of decision you are reaching. If it does not, then the agencies should be skeptical, and the agencies will encounter a skeptical audience in a federal judge. I think those kinds of lessons are things we have to keep in mind as we do these sorts of analyses.

MR. WALES: Thanks, Jan.

We will kick things off a little bit. I thought I would ask some questions and hopefully get the dialogue going.

It seems that there is not a lot of dispute that unilateral effects is a valid theory and one that we think should be applied in the appropriate cases, especially in differentiated product merger cases, but the reality is it has been a tough sell to judges, and I guess the question is, what do we take from that? What are the reasons why we think that judges are having a hard time? Is it the fact that perhaps unilateral effects is not a sound theory? Is it more practical in the sense that there are assumptions, intuitive problems? Are the Guidelines to blame? What do you think the problems are?

PROFESSOR GAVIL: Well, the Guidelines are a product of a long history and tradition, and again, I would say that you need to look at it in the larger context of antitrust. We have been thinking about relevant markets and market definition and market shares and assumptions that you draw from that, connections between that and the possibilities of anticompetitive effects, for a long time. So, shaking that loose is not going to be an easy process, and the evidence is going to have to be especially compelling.

I think if something does differentiate *Staples*, it is that the evidence was especially compelling. It is difficult from the outside to evaluate how compelling the evidence is in cases still pending, like *Whole Foods*, where we just don't know all of the evidence that was introduced.

And I think a second part of it is Bobby's comment that maybe we shouldn't be trying to persuade anyone to totally let go of that structural tradition. I combine that with Jan's comment -- this has been true in nonmerger cases -- when the two kinds of evidence are pointing in the same direction, you are going to have the strongest case.

Now, that means a lot of work maybe, but when the direct and circumstantial evidence in non- merger cases is pointing towards market power, those cases are pretty hard to rebut. So, maybe there is this sort of combination of thoughts here that lead to that conclusion.

MS. McDAVID: I think one of the things about *Staples* we should remember is that although we had very complicated economic analysis by Professor Ashenfelter, there was also some really simple stuff. Prices were higher where there was one firm and prices were higher where there were two firms than they were when there were three. That was a pretty simple paradigm for even people who don't do the math.

PROFESSOR WILLIG: It seems to me that the basic thought behind differentiated products or local competitive effects, the basic thought is totally intuitive. I mean, it passes my dinner table, even my breakfast table test at home, which is to say that, look, it turns out that when my favorite car is being priced by the marketing people, the first thing they look to is this closely competing car, and maybe we actually have evidence from the companies of that or maybe we can readily deduce that, but as an expert, that would be my opening line if I am talking to my family or to a common lay judge, is to say, look, what is keeping prices where they are today is largely and importantly competition with this other product, and guess what, after the merger, that product will be in the same executive suite, the margin will be just going into the same pocket as the margin on the BMW, my favorite car, and so that source of price competition will be gone.

Now, Your Honor, believe me, I have looked at other possible sources of competition, and there are other ones, but they are just nowhere near as important to the pricing of the BMW as that Audi car, and now Audi and BMW are threatening to merge. So, I have looked at a broader relevant market, I have tabulated all the other possible sources of competition, and they do have some effect, but not nearly as important as the effect that would be lost because of this merger. What is hard about that?

Jan?

MS. McDAVID: No, I think that is pretty simple, Bobby. By the way, I have always thought that the Division's case in *Oracle* made a great deal of sense. The problem was that the market, as defined, was not really a product the company sold. It, therefore, looked jury-rigged, and I think that is just part of the problem. It failed the common sense test.

MR. WALES: What about one of the -- I guess in the merger commentaries it talks about the fact that you can have both quantitative and qualitative evidence that may be probative of the closeness of substitution of the various products and, of course, the potential competitive effect.

Is it the case now that you must have quantitative evidence, despite the fact that the commentaries talk about how you can have either quantitative or qualitative information, like business documents? Obviously in *Whole Foods*, it seemed like the judge was more focused on the quantitative as opposed to the qualitative evidence, where there was some pretty good qualitative evidence in the business documents.

MS. McDAVID: We have to do both. The reality is when we are proposing a transaction, we have to do both. There is no alternative, and, you know, in all of the matters that I handle before the agencies, I encourage my economists to share all of their data, all of their analyses, almost sit in a room with the agency economist and be as cooperative as possible. We will get to the right kinds of outcomes. That is absolutely what we did in the cruise lines case, and many people hold that out as the model. We have to do it. The agency's going to do it. It is a mutually assured destruction circumstance.

PROFESSOR WILLIG: I mean, to me, the quantification, aside from our satisfaction in using professional standards as economists, but the substantive question that has to be addressed -- and this brings us back to relevant market, I think -- is suppose that we can all agree, intuitively, that B is the closest substitute for A, and A would be the sellers are threatening to merge, but that really is not the end of the story, nor is it even the end of the story to say how closely substitutable A and B are, because in many, many local or bigger markets, there is a C, D, and E lurking behind A and B.

Those of you who know Princeton, if you get off Route 1 to make a right turn to come to the campus down Washington Road, there is a little traffic circle, and on that traffic circle there is two gas stations, and they are head-to-head competitors. I mean, they are literally head to head on the traffic circle. So, I always use this in class. What if those two gas stations merge? What do you say, class? You can see they are close substitutes, so wouldn't you bust the merger right away?

So, anybody who says yes never makes it to the midterm as far as I am concerned. But you know what? Half a mile down Route 1, there are five other gas stations. Now, it is true if those two gas stations merge, we would lose that head-to-head competition, but it would not be a substantial or it might not be a substantial change in the state of competition, because there is all these other gas stations just a half a mile down the road.

This is what scares me about getting rid of relevant market when it comes to localized competition among differentiated products. Half of my class will say, right away, "No, no, we have got to stop that merger," without asking what else is there right behind that pair of closest substitutes? And that is the question that the relevant market forces us to answer, to pick it up, saying, "Well, yeah, there are other sources of competition, but you know what, they are not nearly as important."

But we need some quantification to get us to the ability to conclude whether or not those other gas stations are closely enough competitive to these two that are head-on to see whether their merger will significantly tend to raise price, or whether, instead, C, D, and E will provide ample competitive discipline to stop there from being a significant price increase because of the merger. That means some kind of quantification is necessary.

When I tell you half a mile, you know the answer, but when we are talking about cold remedies or supermarkets of different kinds, we have no ready such quantification, and now we are into a real debate that is frustrating a lot of people.

MS. McDAVID: I do not think it matters what you call it -- or whether you focus on relevant market or market shares, what you have to determine are what are the -- as Bobby put it -- the sources of competitive discipline post-transaction on the merging parties? And you are going to have to identify them and talk about how significant they are.

MR. WALES: It seems that judges have had a hard time, though, in terms of applying the Guidelines and understanding the difference between identifying that localized competition that we think matters in terms of the unique constraint on the merging, differentiated products, and defining a broader market that might contain more distant competitive constraints. Do we need to rethink how the Guidelines work in differentiated product cases?

MS. McDAVID: Well, the Commentary made an effort to do that, but we are regularly reminded that the Guidelines are not law. I think Judge Friedman reminded us of that in his *Whole Foods* opinion. So, the Guidelines are sources of explanation and an extraordinarily useful framework for us to use before the agencies, but fundamentally, they are not going to bind a court. Some explanation, in whatever format, I think is what you really need.

MR. WALES: Would anyone support amending the Guidelines?

PROFESSOR GAVIL: The Guidelines have become kind of a two-edged sword I think for the agencies. Yes, formally, they are not law. Yes, formally, they all state -- not only the Merger Guidelines, but all of the enforcement agency guidelines -- that they are not intended to establish a litigation format; they do not specify burdens of proof. But the degree to which the agencies use them in courts, the degree to which parties use them and hold the agencies to them, means that they have become very influential documents in court. They are looked to as demarking lines for burden-shifting when you look at the steps of the Guidelines. And the Guidelines, on their face, would seem to suggest that you always start by defining a relevant market and calculating market shares.

So, when you say change the Guidelines, ask should we change the Guidelines, well, to what end and with what consequences? I think it has become a difficult challenge for the agencies to articulate enforcement standards to two communities. They are articulating to the business community their intentions with respect to enforcement efforts, but then when they go to court, in part, given the Supreme Court's absence from mergers for so long, when they go to court, they are kind of trying to use the cases that are available, that are the best cases. Yet they have to live with the Guidelines as if it were law, as if it were their own law.

So, it is a challenging question, what to do with the Guidelines, and can you fix the problem in court by changing the Guidelines, by further developing the theories? Maybe. Coming back to something Bobby said, when those first '82 Guidelines came out with HHIs and SSNIP, you know, there was giggling in the room at the ABA meeting -- "what could this be and what court would ever do this?" And with time, that has clearly changed.

So, maybe part of the answer is that changing the Guidelines could change things, but it may not change things in the next case or it may take some time until those ideas filter through and gain the confidence of lawyers and judges as well.

PROFESSOR WILLIG: Well, let me ask, just to pose my own question, if you were to think with me that the best way to go is to deliver the message that the way to determine relevant market is through best evidence, which sometimes may be consumer survey -- God help us -- sometimes through your own stomach as a consumer, but sometimes through real consideration of marketing data or natural experiments, like in office products case, get the message out that we do need to determine relevant markets, but we can sometimes do it backwards. Sometimes we can do the same analysis that we would do for competitive effects but use that as the source of best evidence for relevant market.

What is the best way to get that message out? Is it a revision of the Guidelines? Is it a speech? Is it next time there is a document that talks about best practices, that that becomes a prominent example? Do it in court explicitly that way? Those of you who know courts better than I, what is the best way to deliver a message of that kind?

MR. WALES: One additional point, is the 35 percent threshold in the Guidelines. We have seen some courts reject that, actually in *Oracle*, there were some pretty negative comments on it; other courts were willing to accept it as another proxy in the attempt to measure the closeness of substitution between the merging products.

The Merger Commentaries talk about it as merely a screen and not a safe harbor. Does it still have a place in antitrust cases? Should we be using it? Is that something we should consider changing?

MS. McDAVID: Well, if you go back to my common sense notion, when the agencies challenge a transaction where the market shares are below 35 percent, it suggests that there are a number of rivals that really matter out there. I think that you are going to find a lot of skepticism about a challenge under those circumstances. You are going to have to have a pretty compelling case about why the other 65 percent is not sufficient to constrain the exercise of market power in that circumstance.

PROFESSOR WILLIG: I think it is a form of prosecutorial discipline, because it does force the agency to articulate a narrow enough relevant market to get past the 35 percent threshold and to confess that, indeed, we are talking about localized competition, that is the theory of the case. No matter how explicitly it is articulated, that is what is driving the bringing of the case -- maybe appropriately, there is no doubt about it -- but then the relevant market has to be articulated as a narrow one, and then the 35 percent threshold will be met easily.

The question is, will the court find that narrow market to be credible? And if not, maybe it shouldn't be credible. It really is a matter of judgment, and the court is weighing in from a lay point of view.

MS. McDAVID: Think back to the *Grinnell* case where the Court talked about the market definition as a red-haired, green-eyed man with the limp. I mean, is that the kind of thing you want to argue to a judge who is going to be viewing this through his or her prism, which may or may not include an economics background?

PROFESSOR WILLIG: Or maybe the judge will like to sleep in a van with the dogs and go skiing.

MS. McDAVID: Exactly.

PROFESSOR GAVIL: One thought just to add here is I think safe harbors are important. And I think that not all market definition is going to be rocket science. And the challenge is, if you have got a market definition that does require more data, that is one that is a little bit more complex, stating safe harbors can suggest a false level of certainty -- using a safe harbor that is based on a numerical threshold suggests a degree of precision that may not be there with more ambiguous markets. But it does give some guidance in terms of the less rocket science market definition, so transactions can be identified that just are not going to be on the table. Whether that is the right number, I do not know, but the concept of having some easily discernible area of safe behavior is an important one in enforcement. We talk about it again in all other areas of antitrust enforcement.

MS. McDAVID: The cruise lines case is an interesting example of market definition, because the Commission's statement defined a market limited to cruise lines, but then it became really clear that in a competitive effects analysis, the exercise of market power would be constrained by other vacation choices. Therefore, we focused on competitive effects, which is where I think the game really needs to be played.

MR. WALES: Okay, put your agency hats on. You are back at the agencies. What types of matters should the agency be looking for in terms of good unilateral effects cases? What are the specific factual circumstances you think necessary, perhaps even including some of the most recent cases -- were they ones we should have brought? Which ones should the agency be focusing on? Obviously merger to monopoly is the easiest, but I do not think anyone's going to say that is all we should be looking at.

MS. McDAVID: I would go back to circumstances in which the evidence aligns, where the economic evidence is consistent with the parties' internal strategic planning documents. You can almost use their strategic planning documents as a first screen. If they particularly focus on one another, that may be an indication of next best substitutes, and, therefore, a transaction should be subject to additional analysis. But I'd use a combination of all of the evidence and be sure it points in the same direction.

PROFESSOR WILLIG: Yeah, Jan, we have both seen an awful lot of collections of business documents where a company is very fond of naming one competitor over and over again strategically and where the sum total of the competitive forces from all the others, on analysis, turns out to be every bit as important.

MS. McDAVID: I said first screen.

PROFESSOR WILLIG: Yeah.

MS. McDAVID: First screen.

PROFESSOR WILLIG: But caution to that.

MS. McDAVID: Of course. It has got to be the whole collection of all evidence, not just the strategic planning documents, but including the views of the customers, evidence of recent entry, the competitive problems the particular firms face, the whole array of evidence.

PROFESSOR GAVIL: I think we have come to a point where there is something of a paradox that makes the question hard to answer. It is easy to say they need to bring the best case; the Government needs a win. It is easy to say that. And it is relatively easy, too, to say that, well, all the evidence ought to be pointing in the same direction.

Here is the reason I think it is somewhat paradoxical. The blatant merger to monopoly, like the blatant cartel, is not going to happen, presumably, very often. The cases that are going to be presented are going to be harder cases. The merging firms are going to be represented by people like Jan, who are making the best possible arguments with the best possible economists about why a particular transaction should be permitted. So, I think, in a sense, that, combined with the general skepticism of the courts about antitrust now, means there are not going to be any easy cases. It is going to be hard to choose the best case.

It's not to say that people do not still propose extreme things and that that may come along and you may get lucky and have a fish in the barrel to shoot, but I think that we are more likely to be facing complex fact patterns, complex economics, and close calls, and it may have more to do, in terms of winning, with the luck of the draw in which judge you get and how that judge reacts to the package of evidence than all that much that the agency can do or the parties can do. Those are going to be tough cases. That is where we are in a lot of areas of antitrust.

PROFESSOR WILLIG: And, of course, don't forget that how tough the cases are is, in a way, a testament to the remaining credibility of the agencies, because the cases that would be easy do not get to court. So, the ones that are left to go to court are the really hard ones, inevitably, and that is still true, despite the somewhat checkered record of the agencies in courts lately, and that is a testament to the lasting view of this marketplace of the skills and the abilities of the agencies. So, look on the bright side.

MR. WALES: I think there has been a lot of talk lately about the general skepticism about antitrust. That skepticism is something that we feel more generally in terms of talking to judges and others.

How do we deal with that? How do we reduce that skepticism and somehow renew the interest in strong antitrust enforcement?

MS. McDAVID: It is a forensic exercise. It's got to be. And I think the bench is becoming better educated about the concepts that underlie some of this. The Antitrust Bar tries to do a good bit of that, and we do supply copies of Antitrust Law Developments.

PROFESSOR GAVIL: The only thing I would add here is, again, I think context is important. We tend to get narrowly focused on our little corner of the world in antitrust. Judges are not skeptical just about antitrust cases. Litigation has become a costly and expensive process. *Twombly*, which we think of as our antitrust case -- I am working on a symposium at Howard on the history of *Conley* and *Twombly* -- and *Conley*, in 1957, 50 years ago, was a civil rights case. The five lawyers working on the case were all African-American. They were basically trying to crack the nut of getting at intent to discriminate by a union that was complicit in employer discrimination, and in that context, at that moment in time, the court said, "lower the pleading barrier, these cases have to go forward." That became the standard that we used in all civil litigation for 50 years.

And then if you had to imagine what would be the antithesis of that case, *Twombly* was potentially the antithesis of that case -- a nationwide class action involving potentially hundreds of millions of consumers against all of the leading telecommunications companies, and the court recoiled from *Conley* in that case.

Now, partly, that is a challenge of using the same procedural standards in every kind of case that we do, but what does that mean? It means that we have a litigation system today with over a quarter of a million cases filed each year in the federal courts. It's a lot of cases; a lot of them are complex; habeus can be just as complex for a judge as antitrust; and there is generally resistance to litigation. So, again, I think looking outside antitrust is helpful in locating ourselves in the larger world of federal court litigation.

PROFESSOR WILLIG: Do you think the public who forms these troubling views, including the judges, distinguishes adequately enough between cases brought by the United States, by the FTC, and cases brought by the adventuresome private bar?

I mean, maybe some of the bad rap that antitrust has is because of the activist plaintiff's bar. It could be. I think on average those cases are far more variable in their superficial and end validity than are the cases brought by the agencies.

PROFESSOR GAVIL: Bobby, I think it is a good point. One of the ironies, though, is that to the extent the agencies have fed the fires of hostility to private actions, the courts' hostility to antitrust is coming back and constraining the agencies as well.

But yes, clearly, if you look at the Supreme Court decisions of the last two terms, there is a lot of anti-private action rhetoric going on, and some of it was coming from the government agencies that were encouraging that view, and it came back to bite them in a case like *Credit Suisse*, for example.

MS. McDAVID: I think there is a good bit of truth in that. Certainly it was driving *Twombly* and *Trinko*.

MR. WALES: Okay, I'd like to thank our panel today. We had an excellent discussion.

(Applause.)

MR. WALES: The plan is to take a 15-minute break. So, let's be back at 10:35, if we could. Thanks very much.

(A brief recess was taken.)

PANEL 2:

THE ROLE OF MARKET DEFINITION IN

UNILATERAL EFFECTS ANALYSIS AND

IN THE LITIGATION OF UNILATERAL EFFECTS CASES

MR. SCHMIDT: The next panel is going to focus on the role of market definition in unilateral effects analysis. I think you have already seen from the first panel that it is difficult to separate these panel discussions so that they do not overlap at all, but our focus is going to be on the requirement or the lack of requirement to prove a relevant product market and the various implications of that.

We have a terrific panel to focus on that issue with us today, and let me just take a minute to go through the introductions, and then we will start right in.

To my far left, Jon Baker. Jon is a Professor of Law at American University's Washington College of Law, where he teaches courses primarily in the areas of antitrust and economic regulation. Professor Baker is a senior consultant with CRA International. His previous experience includes being the Director of the Bureau of Economics -- we won't hold that against him -- at the Federal Trade Commission, Senior Economist -- sorry, Mike, wherever Mike is -- Senior Economist at the President's Council of Economic Advisors, Special Assistant to the Deputy Assistant Attorney General in the Antitrust Division, and Assistant Professor at Dartmouth's School of Business Administration. As I am sure you know, Jon is co-author of an antitrust case book and past editorial chair of the *Antitrust Law Journal* and a past member of the Council of the ABA Antitrust Section, and in 2004, he received American University's Faculty Award for Outstanding Scholarship, Research, and Other Professional Accomplishments, and in 1998, he received the FTC's Award for Distinguished Service.

To my immediate left is Kathy Fenton. Kathy is a partner at Jones Day. She's practiced antitrust law for more than 25 years. She is currently the Chair of the Antitrust Section of the ABA and has served in numerous positions, including editorial chair, of the *Antitrust Law Journal*. She is a member of Jones Day's professional service committee and served as chair of the ethics subcommittee. She has written and lectured on issues of professional responsibility, conflicts of interest, and legal ethics, including serving as an instructor on legal ethics for the D.C. Bar's new admittees course. Her recognitions include *Who's Who in*

American Law, *The Best Lawyers in America, 2007*. She previously served as an Attorney Advisor to the Chairman of the FTC and was a law clerk here in the District of Columbia, the District Court.

To my far right is Dan Wall, partner at Latham & Watkins. Dan is Chair of Latham's Global Antitrust and Competition Practice Group. Throughout his career, Dan has been active in the Antitrust Section of the ABA, also. Dan was a founder and served four years as editor of the *Antitrust* magazine; was chair of both the Computer Industry Committee and Sports and Entertainment Industry Committee; organized and chaired The Stanford Conference on Antitrust in the Technology Economy. He has also authored numerous articles on application of economic theory to antitrust issues and on high technology antitrust. He began his career as a trial lawyer in the Antitrust Division of the U.S. Department of Justice, and his recognitions include *Chambers USA*, America's Leading Business Lawyers, *The Best Lawyers in America*, Legal Media Group's *Expert Guide to Competition and Antitrust Lawyers*, and *Global Competition Review's* GCR 100.

Then to my immediate right is Rich Parker, a partner at O'Melveny & Myers. Rich is Co-Chair of that firm's Antitrust/Competition Practice. He returned to

O'Melveny in February 2001 after serving three years at the FTC, as first Senior Deputy Director and then Director of the Bureau of Competition. Rich has been recognized as a Leading Lawyer in Antitrust by the *Legal Times*; named by the *Global Competition Review* as one of the best antitrust defense lawyers in the United States; and recognized as a leading antitrust practitioner by *Global Competition Review, Chambers Global, Chambers USA*, and *Super Lawyers Magazine*, and probably others. He received the Distinguished Service Award also from the FTC.

So, with that, I think we are going to try to follow the same format that the first panel used, which is to ask each of the panelists to give a short presentation, and then we will go right into questions and hopefully have a lively discussion. I think we are going to start with Jon.

PROFESSOR BAKER: Good morning, everyone. I am delighted to have been asked to be here, and I see some old friends. It is also very nice to be discussed, but for future reference, Bobby and Andy, I prefer to be discussed for my ideas, not for how I look, okay?

My assignment is to talk about -- is to be a law professor and to talk about the -- I can't help it, I will be an economist, too -- talk about the pros and cons of using market definition in unilateral effects cases to set up the panel. The arguments neatly divide into three categories, so I am going to talk about legal arguments, economic arguments, and litigation tactic pros and cons.

So, on the legal side, we have to start with the words of the statute, of Clayton Act Section 7, which objects to acquisitions that substantially lessen competition, and now I will quote, "in any line of commerce or in any activity affecting commerce in any section of the country," and that language, that statutory language, arguably, makes proof of a market an element of the offense.

On the other hand, if the Government can prove harm to competition directly, there has to be some market within which competition takes place, and, why isn't that inference good enough to satisfy the statute? I once wrote an article where I called that kind of approach a *res ipsa loquitur* market definition. So words of the statute is one legal issue.

Another legal issue is the *Oracle* decision. Judge Walker held that the Government must prove that the merger must -- in a unilateral effects case, that the merger must -- would create a monopoly or near monopoly. Monopoly is almost always demonstrated by high market share, so the Government essentially has to define a market to satisfy this element of what Judge Walker sees as part of the offense. The con here is that Judge Walker's holding in that decision is based on a clear error in economic reasoning. So, I don't believe that other courts will follow it. Even in the commonly used horizontal differentiation model that Judge Walker seems to have in mind, unilateral effects can arise in mergers that involve firms that are not the largest in the market and that do not create a dominant firm, just as a matter of economics. So, that is the legal pros and cons.

Now, economic pros and cons of defining a market. I think here I am going to start with the cons and not the pros. The economics of unilateral effects among sellers of differentiated products does not turn on market shares. You can think of unilateral effects as arising because the merger lets the firm recapture profits that previously it would have lost were it to have raised price, and so it now has, after the merger, an incentive to raise price. That is one intuition.

Another way of thinking about unilateral effects is that they arise because the merger allows the firm to remove the competitive response of an important rival, and that makes the initial firm's residual demand less elastic. Again, you can see how that would give it an incentive to raise its price. Either way you think about unilateral effects among sellers of differentiated products, the market shares do not directly matter to the economic analysis.

Now the other side of the story. The market shares would be a good indicator of pressure to raise price if the diversion ratios or the demand elasticities are related to them. That could occur if the customer's second choices are distributed similarly to customer first choices, which is what Bobby was getting at this morning when he talked about generally differentiated products.

Also, high market shares likely indicate that the diversion ratios are so high or that they are high enough that they will generate some sort of unilateral effects, unless the merging firms' products appeal to very different groups of customers. So, if a firm with a 50 percent market share merges with a firm with a 20 percent market share, the two would have to be in very different niches in order to not have a unilateral effects problem. The high shares almost shift the burden.

Also on the pro side of using market definition in the economics category, if the way you collect the evidence relies on econometric evidence of diversion ratios or demand elasticities, then, some sort of an at least informal market definition is required to specify the list of potential rivals that you have to include in order to avoid bias in your analysis.

So, if you leave out an important rival when you conduct the estimation, then the elasticity estimates are most likely biased in the direction of overstating the unilateral effects. This is something that I think Bobby was also getting at this morning when he talked about collecting the important sources of competitive discipline. The gas station example could be understood in this context, as biasing the estimate of unilateral effects because you left out the others down the road, in Bobby's theory.

The third area where I want to talk about pros and cons of defining markets and proving unilateral effects cases has to do with litigation tactics. Here, the pros and cons depend on whether the Government would define a narrow market or a broad market or not one at all. Let's suppose the Government defines a narrow market. Here we have in mind, office supplies sold through superstores rather than all office supplies, or superpremium ice cream rather than ice cream, the kind of things that we talk about in our professional world.

The pro of defining a narrow market is that it allows the Government to portray the case as a merger to monopoly or near monopoly, and it also creates a causal inference of unilateral effects when the market shares are high, as with the 50 percent firm merging with a 20 percent firm, as we said before.

On the other hand, a narrow market may not be persuasive if it looks gerrymandered. That could be a particular problem if some of Bobby's Audi drivers would go to BMW and some would go to Lexus. It may be that it is harder for him to sell his Audi/BMW market to a court, particularly if more of the Audi customers would go to Lexus than to BMW.

Also, this approach potentially focuses attention on the wrong issue. That is, it directs your primary attention to the extent of buyer substitution to the third firms, the rivals outside the market, rather than to the extent of the buyer substitution between the merging firms, which is the source of the unilateral effects. The first thing you want to know is the substitution between the merging firms, but you are busy worrying about, in market definition, the substitution to the third firms.

Now, let's suppose the Government defines a broad market. The pro here is that the market may seem more intuitive, like Jan suggested this morning, unless gerrymandered in its appearance. The broad market allows the competitive effects case to take primary place in telling the competitive effects story in litigation for the Government and focus attention on the way that the merger lets the firm recapture lost profits or alter the competitive response of an important rival, consistent with the economic theory. You are focusing on the theory, the economic theory.

On the other hand, if you define a broad market, you may essentially admit that a large number of firms are rivals to the merging firms, that merging firms' shares are small and that competitive effects are not uniform, because they are concentrated in a small part of the market. All those things are bad optics for trying the case, and they make the competitive effects look small. And there is also the danger of getting the Government embroiled in this question of whether there is a 35 percent safe harbor for unilateral effects or not in the Merger Guidelines that was alluded to in the last panel.

The final litigation choice would be not to define a market at all. Again, the benefit of that is it focuses the case on the way the merger lets the firm recapture the lost profits or removes the competitive response of an important rival, consistent with the economic theory. It would seem the Government could avoid litigation problems with defining a broad market when market shares are low, but the con is that may be illusory, because the defendant would presumably define a broad market, and so the Government may not actually avoid the problems arising from defining a broad market.

So, there you have it, an even-handed view of pros and cons of proving markets in unilateral effects cases.

MR. SCHMIDT: Thanks, Jon.

Kathy?

MS. FENTON: Thank you, Jeff.

I was asked to share some thoughts on the legal need to prove market definition in unilateral effects cases, and as Jon Baker already indicated, the reason we are having this discussion goes back to the basic language of Section 7, the requirement to show effects "in any line of commerce in any section of the country," a mandate that some -- you may call them a strict constructionist -- have identified as being the source for any obligation to prove markets as part of your affirmative showing of a Section 7 violation.

But I think the more interesting issue to focus on in this area is the fact that much of the current debate can be directly traced to the lack of recent and/or relevant Supreme Court opinions on this subject. I am sure there is a great analogy to children's literature that is possible here, whether it is Rip Van Winkle or The Sleeping Princesses, but your last substantive merger case goes back to 1975, and the last time the court spoke on this issue was a year earlier, in 1974, in the *Marine Bancorp* case, where it set forth a fairly traditional three-part analysis that says:

"The analysis of likely competitive effects from a merger requires determinations of, one, a line of commerce, a product market in which to assess the transaction; two, the section of the country or geographic market in which to assess the transaction; and three, the transaction's probable effects on competition in the relevant product and geographic market."

Now, judges, tending to be relatively conventional creatures, look at that language and see, not surprisingly, a mandate to define a relevant market. The silence on the subject for the ensuing years from the Supreme Court has simply added to the proliferation of approaches we see at the district court. Some of those approaches have been responding to other developments occurring at the Supreme Court level outside of Section 7, outside of the merger context, in areas involving either collusion or monopoly claims, because you have a whole series of cases, some of which were briefly touched on by the opening panel, *NCAA*, *Cal. Dental*, *Polygram*, and perhaps, most dramatically, *Indiana Federation of Dentists*, that seem to eliminate the need for formal market definition if there is actual proof of anticompetitive effects.

And I think the quote from *Indiana Dentists* probably captures this line of development outside the merger area most dramatically, because there the Supreme Court said:

"Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects, such as a reduction of output,' can obviate the need for inquiry into market power, which is but a 'surrogate for detrimental effects.'"

Needless to say, that precedent from the Supreme Court has surfaced in numerous briefs, often by the private plaintiffs or government agencies prosecuting a unilateral effects merger, seeking to argue that the formalities of market definition are not essential as an element of proof, and the argument in that regard, I think, is perhaps very nicely captured in a recent article by Katz & Shelanski in the *Antitrust Law Journal,* called "Mergers and Innovation," that takes a slight detour through unilateral effects analysis and says:

"If the formalities of market definition can be skipped in favor of direct analysis of harm in monopolization and collusion cases, there is no reason why the same should not hold true for merger analysis where the issue, likely competitive harm, is similar."

They go on to recognize that merger analysis has some limitations. They say it is "more often prospective and predictive than other kinds of antitrust cases where the conduct at issue frequently has been ongoing for some time," but this simply means that direct effects may be easier to show in nonmerger cases and not that direct evidence of market power should not have the same priority in merger cases where such evidence is available.

I would suggest that economists probably have more flexibility than district court judges in offering that alternative as a way of resolving these cases, but the debate continues, and as you look at the recent district court opinions involving unilateral effects, you know, *Oracle*, *Whole Foods*, *Arch Coal*, you really could go down the litany, you see judges struggling with this question of what is their obligation to formally make findings of fact and conclusions of law on the relevant market question, and they tend to engage in activities that could be characterized as a market definition exercise without necessarily acknowledging their obligation to do so. And I think the only hope I can identify for resolving this question is the possibility of further Supreme Court statements on this question.

Now, in the world post Hart-Scott-Rodino notification, that is going to be a difficult proposition, just because most mergers that are challenged by a government enforcement agency do not hold together long enough to ever reach the point of Supreme Court review, but I think there is one possible candidate on the horizon that I offer for your consideration. It poses the question of role of market definition not with respect to a product market but a geographic market, and the case, of course, is the Commission decision in *Evanston*, which is still awaiting, as far as I know -- and I will bow to more superior information sources -- a determination by the parties to file an appeal with one of the U.S. circuit courts.

But in that case, the Commission opinion dealing with a post-closing challenge to a hospital merger concluded:

"It is not necessary to define the relevant geographic market, because it is possible to show, through direct evidence, that the merger enabled the merged parties to exercise market power unilaterally." Thus, the Commission concluded, because the merger enabled the parties to raise prices by a substantial amount, at least equal to a SSNIP, through a unilateral exercise of market power, the geographic area alleged by the FTC to constitute a relevant market constituted a well-defined antitrust geographic market under Section 7.

Now, if that issue were preserved through the appellate process, we certainly have the prospect of a court of appeals chiming in on the need for relevant market definition and, as I said, a possibility for Supreme Court review since a concluded merger, a divestiture challenge essentially, is sufficiently high stakes that the parties might be incented to take that step.

But in the absence of that, I think we are going to continue to see a struggle at the district court level as they look back to precedents, and it is not just *Marine Bancorp*. It is *Philadelphia National Bank*, it is *DuPont*, that all contain the language about defining relevant markets, as well as what I would suggest are some practical limitations imposed by the Merger Guidelines themselves and the Merger Guidelines structure, because there, the five-part organization embodied in the Guidelines has, in a sense, provided a road map for a lot of subsequent district court analysis.

You start with market definition and concentration; you consider potential adverse effects; you do an entry analysis; you consider efficiencies; you deal with failing or exiting assets. That, again, sounds like a mandate for relevant market definition, and as a result, to borrow Andy's phrase from the initial panel, it is probably a very hard sell for the courts to try and avoid or escape that exercise, and in particular, this combines with a number of other practical aspects, including judicial skepticism of economic analysis.

And I was reminded in preparing for this exercise of a fascinating quote from Ken Auletta's book, *World War 3.0*, which, of course, is on the *Microsoft* case, but he had, you might recall, conducted fairly extensive interviews as part of the process for that book. One of the people he interviewed was Judge Hogan of the district court here in the District of Columbia, who some might view as one of the godfathers or patron saints of unilateral effects analysis since he is the author of the opinion not just in *Staples*, but also *Swedish Match* a few years earlier.

They somehow got off the topic of Microsoft in the discussion for Auletta's book and started talking about the *Staples/Office Depot* case, and Auletta reports in his book:

"When Judge Hogan presided over the Government's antitrust action to block the proposed merger of Staples and Office Depot, Hogan reported, 'We had a lot of economic evidence, we had a lot of documentary evidence, although in that case, the economic evidence that the Government had was not at all convincing to me. I think the internal company documents were more convincing. That is why I stopped the merger.'"

And that reality, I think, is something that you are going to see reflected in perhaps less overt fashion in many of the judicial decisions dealing with that question.

MR. SCHMIDT: Thanks, Kathy.

Rich?

MR. PARKER: I am supposed to give the

government perspective on trying these cases, and as you know, I am now playing on the other team, so it would really be unfair if you quote this stuff back to me when I am sitting next to a client. When I'm down here trying to convince you to go away. So, let's get that down as a rule.

What I want to talk about is how to put a case like this together. We have people who understand the law and economics better than I do. You do not need to hear that from me. So, here is my own personal view, and trying cases is an art, and everybody has a different style, but here is the way I think about it.

I was privileged, my first job out of law school, to clerk for Judge William Matthew Byrne, Junior, in Los Angeles, who passed away a year ago, who was one of the best trial lawyers in Southern California before he went on the bench. He won a lot of big cases. And was a great trial judge and was a great teacher. And I remember, when I was down there, we had this really boring patent case. I would rather watch paint dry than listen to this testimony in this chemical patent case, but that was my job and my co-clerk's.

And the trial ended, and we went back to chambers, and the judge said, "Well, "Justice West of the Pecos" says that the plaintiffs ought to win here."

I said just looked at him. He said, "By that I mean, common sense, logic, my gut sense of what is fair and reasonable," and then he went through and told a story about what happened here, which is exactly the way counsel probably should have tried the case, and said, "Now, that is what my opinion ought to say, and you tell me if we can get to a plaintiff victory under the case law, and if we cannot, then we better have a meeting and, figure something else out." "Justice West of the Pecos" has always been in the back of my mind. He never stopped being a mentor to me, and that is the way I view these cases.

In my opinion, the Government ought to try these cases with effects, and I do not think what I am saying is anything inconsistent with what was said in the first panel. You start with effects. Remember this. You have an advantage in being the Government, and the advantage is inherent judicial conservatism. You have a market that is working. And now you have these guys coming in with their fancy economists saying, "Well, we are going to change this structure radically, but don't worry, our efficiencies are going to do this, that, and the other thing." And so I think you have an inherent skepticism with a judge or with most judges about radical changes in a functioning market, and you are trying to stop that from happening. That is an advantage.

So, you play on that, and you build it by showing what is going to happen that is bad here. How are people going to get hurt? And as Dr. Willig said and others said this morning, there is an inherent dinner table logic to unilateral effects. Judges may not care about Bimmers and Audis, but Whoppers and Big Macs or something like that they do. Sure there is competition from other burgers and maybe from Taco Bell, but those two are unique competitors, and they look at each other when they price their products, and if one buys the other, that constraint is gone. That is a logic that makes a lot of "Justice West of the Pecos" sense.

In my opinion, the most important support for that case is the company's business documents. What do they look at? What do they look at when they go to the board? Do they look at this fringe or do they look at tacos? Do they look at whatever? Or do they look at each other? That is the number one point. And you build on that.

And the second thing you build on are customers. Customers. The Government cannot try, effectively, a case without strong customer support, and by "customer support," I don't mean just, "I hate the merger." I mean, "I have dealt with these people day-in and day-out, for year after year, and I play them off each other, and this, that, and the other thing, and I have detailed knowledge, and in my opinion, I have benefited from that competition, and let's not let it go away."

You cannot put on the stand a lot of people who simply don't like the merger because they don't like the merger but do not have any real experience in dealing with the entity being purchased. I am going back to *Arch Coal*, where at least -- and this is Monday morning quarterbacking -- but at least some of the witnesses in that case had that problem.

Now, relevant market. You have to prove a relevant market. Every case says that. You can't pretend like they do not say that, including your favorite cases, starting with *Chicago Bridge*, your latest victory, *Swedish Match*, every one of them, *Baker Hughes*, *Staples*, *Drug Wholesalers*, you name it, they all say it. You have to do that.

But I suggest that the first tactic is to back into the market from the effects. At least in Judge Hogan's court, you can do that. It is plain as plain could be that that is where the market came from in *Staples*. It is equally plain that that is where the market came from in *Swedish Match*. And generals always fight the last war, and this is a long time ago, and Rick Liebeskind and I and Jon Baker were heavily involved in *Drug Wholesalers*, and Judge Sporkin believed, at the end of the day, that hospitals and independent pharmacies could not protect themselves against the merging parties, and that is how we ended up both with effects and with the market. You back into it from effects.

You try effects -- remember, things are working great. They want to change it. Here is what is going to happen if you change it. This is what the customers say. This is what the documents say. This is what the economists say. What are you going to trust, existing competition or their efficiencies? Don't bet the consumers' money on their efficiency study or whatever other study they may have.

All right, the government has run into some trouble in some cases, and I wasn't in these cases, in, say, *Oracle* and in *Whole Foods*, so I don't know every -- you know, Dan will talk about *Oracle*, and we are lucky to have him here to talk about that perspective, but I suspect that what happened in both cases is that the government didn't prove effects, and everything got bollixed up on market, but frankly, at the end of the day, I will bet if you psychoanalyze the judge, you did not prove effects in *Whole Foods* and that is how the market ended up so broad.

And by the way, I want to compliment Paul Denis, who I see back here, on that case, because my litigation instinct on *Whole Foods* is that it looks like the evidence was very strong in that case, and I am not sure what happened. I was not in the courtroom.

In *Oracle*, and Dan will go into this more, it looks like the judge didn't believe the customers. The customers have to have real knowledge about the market, and I think, by the way, that is what happened in *Arch Coal* as well. I do not think the judge thought that some of the customers really knew what they were talking about, and it is clear in *Oracle* that that is what happened. So, those are the -- my best projection as to what happened in those cases, is that you didn't prove effects.

Now, let's assume you are in the next case, and you have a situation where you have a unilateral effect, where you have something like the *Whole Foods* case, where you have a problem in that intuitive logic may suggest that Safeway ought to be in the market, and I was driving in the car with my wife, who said, "How can they bring that case, because Safeway has organic food?"

That was a problem that you faced in that case.

Here is what I do: My colleague, Tim Muris, who is an antitrust purist, would probably throw something at me if I said this, but how about a submarket? It is not analytically the greatest concept in the world, but after all, this is about winning and you are a law enforcement agency. Law enforcement agencies have to win, and submarkets are all over the case law, undeniable. It is not just *Brown Shoe*, but submarkets are in all these cases, including the cases I just cited to. It is there.

Number two, credibility is the key. That is what you have got in front of a judge, is credibility. So, another alternative is to say, "You know, I will tell you -- I will give them their supermarket market" -- and again, I am doing Monday morning quarterbacking here, but I am speaking hypothetically. "I will give them their market. I will give them Safeway, Giant, Food Lion, and everything else, and, Your Honor, in most cases, we rely on the *Philadelphia National Bank* presumption, but, you know, I do not need any presumption. I don't want a presumption. I don't need it, because I have got hard and fast evidence that will show you that in 22 markets, 15 markets, or whatever it is, what drives price are these two, and if you let this merger go through, those prices are going up. I will give them their market. I will give them that, but I am also going to prove effects to you and I do not need *Philadelphia*." And I would -- in the right case, I would take that -- I would take that step.

Those are my thoughts, and I hope these most certainly have been helpful to you, and I know it is tough to lose these cases, it is very tough, because anybody who tries cases who loses them, it is not a good thing. The key point here is that I think it is very admirable for this agency to get all these people in here and to look at what they've done and to be self-critical and try to come up with some new concepts and some ideas, and I really commend you for doing that.

I will turn it over to you, Dan.

MR. SCHMIDT: Thanks, Rich.

Dan?

MR. WALL: Good morning. Let me pull something up here.

So, thank you for the introduction, but we all really know why I am here, and it is because of *Oracle*, which Rich did mention, and that is okay, you know, he got --

MR. PARKER: I mentioned it, Dan.

MR. WALL: Yeah. You know, you have got to have the villain in order to have an interesting plot, and I will gladly be the villain here and give you some defense perspectives.

In keeping with Commission policy, I will have to ask all of my competitors to leave the room at this point, just because I am going to be talking about some strategy points in here, but I think that the issues that are raised by this really are profound in the arena that is much more my home than the law and economics as well, which is the arena of trial, and it is a different environment than any FTC or ABA Antitrust Section conference.

It is a trial that is conducted before someone who rarely is particularly expert. In the *Oracle* case, we actually had someone who had practiced antitrust law professionally. That is definitely the exception rather than the rule. And it is an arena in which somebody is used to resolving contested facts in a wide variety of cases based upon that kind of "West of the Pecos" intuition that Rich was talking about, and if you do not try your case, if you do not build your case with that always in mind and with a firm understanding of what people like me are going to do to try to deconstruct your case and to break it down in the particular dynamic of a trial, then I think that the odds of winning in these cases go way down.

I am going to draw a lot on the *Oracle* experience here, you know, because I had a lot of trial materials that I could pull into my presentation and demonstrate some of these things, but it is just -- you know, it is just one case. This will always be true. But I will say this, that even though I know very well that the agencies all say that they'd bring the *Oracle* case again if they had a chance, and if I were the head of the Antitrust Division, I'd say that probably about any case I lost, so I respect that.

I will tell you that I felt very strongly, and Commissioner Tom Rosch, who was my partner at the time and tried that case with me, felt very strongly, before that trial began, that we were going to win that case, because the case that the Department of Justice had put together was not sustainable in the arena of trial. It was going to get cut down by trial dynamics. If your case is not resilient in the arena of trial, through trial -- the dynamics, it doesn't matter how good it is, because that is the arena that counts at the end of the day.

So, a few observations, and this is all about the idea of do you use market definition or not or do you put on a case without it. The first one, don't --

don't think about it. Under current case law and the Guidelines, which we will use viciously against you, this is a recipe for disaster, okay? And you have already heard some of the reasons, but it comes from the fact that, as Kathy discussed, this just -- market definition as an essential element of the analysis just couldn't be more entrenched in the case law.

I bet you that on a dare for a beer, I could cite you a hundred cases that in mergers and monopolization and other market power kinds of offenses say that this is a threshold requirement, and yes, there is this little thread out there that talks about the ability to prove effects, and I fear that as a defense lawyer in a monopolization case in which the conduct has occurred and the effects might be presently observable, and I might fear that in a post-merger challenge, like *Evanston*, where you have some ability to look at what's happened.

But honestly, I don't fear that very much -- I don't fear it very much at all in a typical merger case where the analysis is prospective, because I know that, by definition, the plaintiff, the Government, is not going to have tangible prove of adverse effects. They are only going to have some documents that maybe they can make a prediction from, and I can fight the prediction game based upon market structure and market definition arguments, and I will probably win that most times.

The second point, you know, the Merger Guidelines are your own worst enemy about this. If you want to pursue cases in which the unilateral effects market definition is not part of the equation, amend the Guidelines. Not a suggestion. I am telling you it is an imperative, because what we do is we use the Guidelines against you to impeach you, to say to the judge, "Look, they are not even following their own Guidelines." You would do it, too, if you were in our position, and some of you will someday when you are in our position. It is a natural argument; it is a great argument; it is a "gotcha." You know, you are never going to be able to run from the Merger Guidelines. So, you know, it is been a long time since the Merger Guidelines came out. Maybe it is time to revise them. I think that would be an essential step for you to have any credible program of trying to bring unilateral effects cases without market definition.

You know, the third point, there is this -- it is not just that you have all this case law that says that you have to have a defined relevant market. There is another body of case law that questions whether you can show the substantial adverse effect on competition if it is only on just some piece of the relevant market, and we thought we were going to get into this in *Oracle*, and then there was some change in DOJ strategy, and so we didn't really have to do it as much, but having looked into this, we were in a position to make a pretty good argument that the effect had to be generalized or that it at least had to -- you know, that there was some quantitative sort of threshold that the percentage of the consumers in the relevant market that would be affected, and so that you couldn't just make an argument that was about a very, very small group of consumers.

You know, I think that unilateral effects has a tremendous danger of taking the economics too far. You know, in *Oracle*, which was based largely on this sort of auction bidding theory, the Department of Justice's position, taking it from its expert reports, at face value, was that the adverse competitive effect would only -- that only about 20 percent of the customers were vulnerable to suffering this effect. Now, 20 percent is a big number in absolute terms, but query whether an adverse effect that only hits one in five customers in the market would survive as a matter of law.

But that's not really as far as this goes. You know, Carl Shapiro and Joe Farrell just published a very provocative new article on this in which they have an analysis that is basically -- that is driven by diversion ratios and gross margins, and they have a statement in there that you could show a unilateral price elevation in an industry with high gross margins where the diversion ratio between the firms is as low as 5 or 10 percent, and, you know, I have no doubt that Carl's math is right, but I have got to tell you, bring it on.

I mean, if you are going to bring a case and you are going to try to say that this merger should be stopped essentially because there are high gross margins and one in ten losses of the merging parties are to each other, I am going to come back with a very powerful argument that that is just too *de minimis*, insubstantial an effect to meet the substantiality requirements of Section 7. So, I think you have got to be very careful about doing this, and I think that that market definition is what judges find as an intuitive governor on this thing, on this whole process, of saying, "Show me an effect that is substantial in a market."

I want to -- this is a slide -- this was actually from my opening statement in the *Oracle* case, and it -- I bring this up just to -- just to show you how cynical and mean we really are on the defense side, because this is a -- I mean, this is what we do if a plaintiff has a flakey market definition or if they are running from market definition. There was actually a pretty credible theory that DOJ had developed during the Hart-Scott-Rodino process, which was actually before I got involved, that said that in these procurements for these software systems, that essentially every bid was akin to a relevant market, and then the Government decided not to bring that case, to make that their argument, when they filed it, saying that actually they were bringing a "traditional case."

And I have no doubt that the reason was is because they knew that they were going to get attacked by us for having come in with a novel theory that nullified the importance of market definition. So, we brought it up to make that point, you know, we brought it up, and it is because there is nothing more valuable to us than trying to convince the court that the Government is cheating, because the Government comes in with a tremendous reputation and sort of a presumption of being right, and we have got to crack that. So, in this instance, you know, we will bring it up.

So, what I am telling you is there is no running from market definition. You are going to have to build your cases around traditional markets, and you are not going to -- you can't leave us any room to argue that you are doing something else.

My second point about the approach of not having market definition is to say good-bye to *Philadelphia National Bank*, okay? Now, this may sound a little bit sharp and a little bit critical of the Government, but the fact of the matter is that one of the reasons you get yourselves into this mess on market definition is you want your *Philadelphia National Bank* presumption, and you are willing to do whatever it takes to get it, okay?

Well, I would tell you that I do not actually believe that the *Philadelphia National Bank* presumption should apply to a unilateral effects case, because it actually came out of the structure-conduct paradigm for coordinated effects, and the Supreme Court has really never addressed it in a unilateral effects context. But the thing is, what the Government is doing is they want to make this estimate up here, which is from the Government's brief in *Oracle*, where they say:

"Plaintiffs establish a *prima facie* case of a Section 7 violation by demonstrating 'that the merger would produce 'a firm controlling an undue percentage share of the relevant market,'" et cetera, all very familiar, tactically I get it, I understand it, but you are actually taking a big risk if you gerrymander the market in some way to get that when, if your economics effect -- proof is very strong, you probably do not need it to begin with.

So, what is the alternative? Well, you actually end up with the *Whole Foods* briefs that the Commission has just filed, which contain exactly one reference to *Philadelphia National Bank* and do not try to win the case and leave the defendant in an essentially unwinnable position through the presumption, but rather, cut to the effects. This is the world that you would have to live in if you eschewed market definition.

Now, my third point is don't kid yourself that the alternatives to market definition are practical or persuasive, because they usually aren't, and this goes to the point that a couple others have already made about just the relative persuasiveness of different kinds of proof. And remember, you know, in district court, rather than in university seminars, persuasiveness is about intuition to the layperson, to common sense, to very simple things like that.

And the thing that you have got to understand is that the intuition that we rely on is the intuition that mergers of firms that face a lot of competition won't harm anybody. That is a strong intuition, okay? That is a very simple intuition. That is Bobby's intuition of drive the half mile, fool, you know, get the gas down the street. Everything will be fine. And if we show, in any merger case, regardless of the theory, that the merging parties have a lot of competition, I am feeling pretty good about it. You can come in with your economists, but if I have shown that we have got a lot of competition, we are feeling pretty good about it.

Now, in contrast, I mean, the economics of unilateral effects are really, really complicated and difficult to understand. Carl has already reacted to this, I see visually, because he recognizes that what I have done is I have put up here on the slide what he calls a simple, practical test for identifying unilateral effects in his recent article, and, you know, I won't go into it, because I am sure he'll be discussing it, but, you know, it is got math, it has got those things where you have to use the different font to bring it down below the line, and it has got Greek in it, you know, and my point is that regardless of how good that is, I can do a pretty good job of making the judge not think about it, okay?

Carl may remember this story from a case we worked on together, and everybody has heard of this case, it is the trial of the *Eastman Kodak and Image*

Technical Services case, where we were up against Max Blecher, one of the best plaintiff's lawyers in the United States, and his expert, the plaintiff's expert, is Jeffrey MacKie-Mason, and he's being put on the stand, and the first question that the plaintiff's lawyer asks his own expert is, "Dr. MacKie-Mason, isn't it true that if you ask two economists the same question, you get three answers?" He started nullifying the economic testimony, because we were coming on with Carl Shapiro and Janusz Ordover, and we had a lot to say, and he didn't want the jury to care about it, and so with his own expert, his first question is nullifying the value of the economic testimony. Well, this unilateral effects stuff is very, very complicated, and it is something that you take a great risk as to whether you are ever going to be able to get the judge to understand and want to apply this.

Now, there is other cases. I mean, I mentioned *Staples*, and this is actually an exhibit from *Staples*, which Jan McDavid was essentially referring to earlier, and this -- you know, this was the evidence that they had, and in -- and, you know, this is the mother lode here. This was realtime proof that the Staples prices were substantially higher in markets in which there was Staples only and that the only real significant thing that brought their prices down was competition from their merger partner. I mean, that was really good stuff. If you have that, you are going to make an intuitive unilateral effects case.

Let me contrast that with the merger simulation in *Oracle*. The merger simulation in *Oracle* was essentially an auction model that Preston McAfee came up with. It had no real world data on it. It was one of these Logit models, which ironically demands market shares in order to run the model. It implies a demand function from market share. So, first of all, you can't use it as an alternative to market shares, but it was a model in which assumptions about market shares were then coupled with an assumption about how much surplus sellers were currently capturing from their customers. You know, that was so ivory tower-ish and so unreal and so untethered to actual data that I don't think it ever had a chance, but because it was also grounded in market shares, it was DOA as soon as the market definition shifted at all.

You know, Jonathan and Carl wrote an article criticizing Judge Walker's decision in which they make the point that he was unfair to this model in demanding more real world data, because they say that in their experience, that real world data on prices, costs, and output are invariably imperfect for a variety of reasons. You know, I can't help but offer a couple responses.

First of all, it is not actually a valid criticism of Judge Walker in *Oracle*, because Professor McAfee had no data. It was not an imperfect data. He was running a market share-driven model, not a data-driven model.

But second, I'm sorry, but pervasive data problems are a reason not to rely on merger simulations. They don't -- they don't excuse it. If it's bad data, you are actually adding risk to your case, not cutting it back.

So, fourth and finally, and I really -- I say this with great sincerity, is that you have got to stop taking the amount of trial risk that you are by arguing for markets that are narrower than they have to be. If you believe in your competitive effects case, argue it within a defensible market, and by that I mean a market that is not going to get cut to ribbons.

Look, we know it is not working, okay? We all know it is not working, and that is having a market definition that allows people like me to just gather up the evidence that inevitably will be there of competition from the firms that you have eliminated from the market.

These were just a couple of slides, I could have done a zillion of these, and I could take them from any other case, but they were just some of the slides that we used to identify firms that in *Oracle* the Government said were not in the relevant market, and then we just went to call reports and invoices and discovery documents and all sorts of stuff, and we created long, long, long lists of procurements in which these customers who were not in the relevant market were, in fact, competing with the merging firms or SAP, the third firm, in the market.

And when we do that, there is nothing you can do to stop us from having great days in court. You can't, because we have that evidence, and we can walk up to a witness and say, "Are you saying that you don't compete with Lawson? Are you?"

And first the guy looks like a deer in the headlights for a minute, and then he says something like, "Well, we don't see them very often."

Then I will say, "Isn't it a fact you saw them at Safeway?"

"I don't remember."

"Let me show you the document. Isn't it a fact you saw them at Food Lion?"

"I don't remember."

"Let me show you the document."

This is shooting fish in a barrel. This is so easy. Honestly, it really is. It takes very little talent to do that, because you have got the documents right in front of you, you know? I shouldn't say that, it will probably, you know, reduce the -- change the slope of my demand curve by saying that, but it is not that difficult to gather that stuff up, and you have got to anticipate that. You have got to anticipate that and plan for it and don't let me do it. And if you can bring your case by conceding me those people, do it. You take away all my good stuff. I mean, that's really what you want to do.

And that leads kind of to my sort of final point here, which is, you know, if you believe in the unilateral effects model, do it. I mean -- now, this is -- you know, this is -- this is another quote -- sorry to keep picking on Jon and Carl, but this is a positive one here. They make the point here that, "As an economic matter, unilateral effects don't turn on market definition. The economic analysis is the same regardless of whether the case is framed as a merger generating high concentration within a narrow market or is the loss of direct competition between the merging firms within a broader market."

Okay, do you believe it? If you believe it, do the latter. Don't let me make market definition the linchpin of the case. Take it away from me. You might lose that case in the district court, you might have to appeal it, and you might have to establish good law, but that's how you are going to get to a place where this unilateral effects theory is more powerful, and it has the foundation that you are going to need to go forward and win your cases.

Thanks.

MR. SCHMIDT: Thanks, Dan.

Jon, do you have any response to any of that? I assume you are in almost complete agreement.

PROFESSOR BAKER: That was terrific, Dan and Rich. I think I have to switch now from being the even-handed law professor to actually take a point of view here.

Dan wants to put the agency in a box. He says, "If you define a narrow market, I am going to say it's gerrymandered to evade market definition and avoid recognizing the plain fact of competition from Lawson and whoever all these other guys are, so you are going to lose." Then he says, "If you define a broad market, I am going to explain to the court that you are talking about effects that are only in 20 percent of this broad market. They're too small, they're *de minimis*, they don't meet the substantiality test of Section 7." Therefore, Dan says, "I am going to win either way. Don't bring these cases." He didn't quite say that, but that was the implication --

MR. WALL: Clearly I would never say that. Give me a break.

PROFESSOR BAKER: Only against Dan's clients.

That is not a happy box to be in, so let's see what we can do to kind of get ourselves out of it.

Now, Rich says, you basically have two choices. You take the broad market or the narrow market, and work with it. But the important question isn't what market you define. That it is really what both Dan and Rich were getting at -- and Bobby, too, earlier in the conversation. It is what is intuitive in explaining unilateral effects to the judge?

What Dan wants to do, either way, in the box that he puts you in, is to be able to say, "There are lots of rivals, so the merger partner can't be an important competitive constraint." That is the point of the box for Dan. And the answer to that for the Government is that your eye isn't on the ball. You have to say, "Wait a minute, the key issue here is that the merging firm didn't price higher before because of competition from the merger partner."

Sure, there was some competitive constraint from all the other rivals, but what you are losing with the merger is an important competitive constraint that will make a difference. Yes, I concede that, what, Audi customers also, like Mercedes-Benz and Lexus, but look at their documents. When they are pricing, they also -- they care about, BMW, and when you look at the diversion ratios and the margins that our expert, Dr. Shapiro, has computed, they show you the same thing. It's a matter of getting out of the box by changing the focus from who all these other rivals are to the fact that there is a competitive constraint from the merger partner, which is the essence of the unilateral effects case in the first place.

Whether you articulate it as a submarket or, in the economic analysis in the broader market, that's the story that the Government needs to tell.

MR. WALL: Look, the box exists. I didn't create it. This is the problem. The box exists. What you have now is choices for what is the optimal strategy in a world of boxes. You know, I don't think that it is -- in a trial dynamic, that it is a good idea to fight any issue, any issue at all, where there is going to be a lot of evidence on the other person's side, and they are going to be able to marshal it up and bash you with it day after day. And we make strategic retreats all the time in trials. We make strategic retreats.

And, you know, I do think that there are going to be cases in which the -- while the box is there, there is a very credible way of going, of saying, "Sure" -- I mean, just take *Oracle*. "Sure, these companies compete, no doubt about it. We don't -- we would never -- far be it from us, for the Government, to suggest that they don't compete, but we still believe that we can establish that the rivalry between the merging firms has substantial effects that are distinct from the rest of the rivalry in the market." And that's the approach that I am saying that I think would probably be more effective.

MR. PARKER: I think Dan and I are in total agreement on that, and as I have said, to go into a case and simply say I am not relying on *Philly Bank*, I don't need it, don't need a presumption, because I have got the goods on these folks, I don't need it, I think that can be extremely effective and would certainly mesh well within the current case law.

MS. FENTON: Yes, but, Dan and Rich, doesn't that necessarily get you pretty close to an analysis that will focus on, because of the uniqueness you just emphasized, the disturber in the marketplace, the maverick, that you sort of go down that line of analysis as a necessary consequence of the approach you're advocating?

MR. WALL: Well, I mean, it doesn't have to necessarily be a maverick. It could be, I guess that's one possibility here, that the merger is taking on a maverick or something like that, but, you know, just in the standard differentiated product model, you know, spatial competition or something like that, there's nothing -- it's completely coherent to say that I am going to draw the big circle around a bunch of competitors, but that in this particular, you know, sector of that circle, by the way, which is $100 million of commerce a year, so it's a lot that you -- you know, you shouldn't just be indifferent to it, that most of the competitive interaction is between these two brands. To me, that is a perfectly coherent case that I personally would not muck up by trying to say that they didn't have competition from the rest of the people in the box.

MS. FENTON: But you almost seem to be suggesting that the district court judge will know it when he sees it. I'm wondering what's the criteria that you would offer him for identifying that particular unique competition.

MR. WALL: Oh, I offer nothing special other than the unilateral effects analysis as it is articulated in the Guidelines. I just would not -- I mean, from everything I have heard and read, there appears to be no one who can actually explain where the 35 percent threshold comes from in the Guidelines. It got put in there somewhere along the way and without a specific economic rationale.

The real intuition is that if a large group of customers find the merging firms to be their next best substitutes, that you could have a problem that won't be addressed by other firms. I don't have a problem with that theoretically. It makes perfect sense to me, and I'd have no problem putting on a case under that theory.

MR. PARKER: And it turns on what the company's documents say, as I said, and it turns on what the customers say, importantly.

I think the 35 percent threshold, by the way, is a lose-lose situation for the Government. If you do find effects below 35 percent, then, you know, Dan quotes the 35 percent against you, and if you are in 55 or 60 percent, which the Government usually is, it doesn't matter. So, I don't see -- I think the

Guidelines' 35 percent not only has a -- has no real rationale that I've ever seen, but more importantly, from your point of view, and since I am taking the government position, I think it's bad for the Government.

MR. WALL: Again, there is a comment I want to make about Judge Walker's opinion in *Oracle* and what he was saying about this notion that you have to have a monopoly or something like that. This is actually the line that people are talking about. He says:

"In a unilateral effects case, a plaintiff is attempting to prove that the merging parties could unilaterally increase prices. Accordingly, a plaintiff must demonstrate that the merging parties would enjoy a post-merger monopoly or dominant position at least in a localized competition space."

As a participant in that battle, I would urge you to consider that the emphasis is on the last clause, the "at least in a localized competition space." We certainly weren't arguing that a unilateral effects case required a merger to monopoly, never made that argument; never said anything close to that argument. What we said is that the concept required that there be some identifiable space -- you know, group of customers -- in which there were not good substitutes to the merging parties. That's not terribly far off than what the Guidelines say themselves.

We were contesting factually whether that existed in the case, not to get too much into the details. The Government was saying that there was an identifiable space like that in which SAP, which is far and away the largest business applications provider, was not a good substitute for Oracle or PeopleSoft. We were contesting that. We said that that didn't exist. We were saying that factually.

And I believe that what Judge Walker was saying there -- and I know, you know, it has been interpreted -- and frankly, not unreasonably given the language he used -- to say something grander -- but what I think what he was saying is that you at least have got to demonstrate that there is that space where there is this -- some kind of dominance by the merging parties. I wouldn't -- you know, I wouldn't read it as being a whole lot more than that.

He does go on to worry about whether this is a backdoor way of creating submarkets, and that's a legitimate worry. He's not the first to raise that. A lot of people have raised that, whether unilateral effects is a backdoor way of getting into submarkets, but rather than decrying this as setting up a standard which is impossible to meet, if I were litigating on behalf of the Government, I would argue to reconcile it with the Guidelines rather than create a conflict.

PROFESSOR BAKER: May I add something on that?

MR. SCHMIDT: Sure.

PROFESSOR BAKER: Which is -- I don't have the *Oracle* opinion in front of me. My recollection is there is another place -- a second place in the opinion where he doesn't use that localized competition language, where he says something that sounds a lot stronger about the merger to monopoly. But I have a related comment -- maybe it's a different point, but on the same general issue -- that comes up when I hear, you know, "throw out the Merger Guidelines" or "revise them dramatically" kind of questions, which is I think it would be easy to overreact here to some merger decisions that are probably, in large measure, just bad luck.

If you sort of throw out the hospital mergers, which seem to be on a different planet than the rest of the merger decisions, and you throw out *Oracle*, because that is, you know, a judge who, unlike most, was an antitrust expert who had a strong point of view before he took the case, and you think about the other cases, there really aren't that many, and they are all tough.

You know, when we took -- when I was at the FTC and the FTC challenged Staples, I was always 100 percent sure that there was -- that the merger was going to harm competition, but I never thought it was anything but a close case in going to court, that -- you know, and had that -- many people thought it should have been an easy case for the defense. I mean, there was a strong, intuitive, broad market definition in which the merging firms had tiny shares, and if the judge saw the case that way, you know -- and he could easily have -- and if the judge had liked the efficiencies story, which was, you know, quite plausible sounding on the part of the merging firms, about the virtuous circle that they were getting into, that could easily have been a defense victory.

And the *Cardinal Health*, the drug wholesaling case that Rich talked about, which was -- you could argue about whether that was a unilateral or coordinated case. Our expert, Professor Shapiro, treated it as a unilateral case. I am not clear on what the judge thought it was, but, you know, that was a really hard case, too. You know, the FTC, when I was there, could easily have been 0 and 2 instead of 2 and 0.

And you come to *Whole Foods*, and it seems like, you know, that one just -- you know, just listening to the -- you know, seeing it from the outside, although I guess I did work 1.8 hours on that case, I guess, for the defense, so technically, I had a client, but, you know, I was essentially not really involved in that case at all. Looking at it from the outside, you know, it should have been a hard case, too, for both sides, it would seem to me, and it is easy to take one or two losses and read too much into them. So, I am going to just caution against overreaction.

MR. SCHMIDT: Dan, I wanted to ask you a question. In light of -- from your perspective, in light of the complexity that's involved in some of the economics relating to unilateral effects, is the logical conclusion of that that from the agency's perspective, as a policy matter, that we are relying too much on an economic analysis?

That's sort of what I heard you saying, and if that's the case, what is more realistic to rely on from a policy perspective, perhaps putting, as a secondary matter, whether we can win in litigation? And I am particularly thinking of the situation, as is the case I think in most of the markets we look at, there isn't a great deal of pricing data available.

MR. WALL: Right.

MR. SCHMIDT: So, in that circumstance, ought we just to look at the way the company executives, for example, the internal documents describe the -- you know, their market?

And then, just as a final thought on that, I can tell you that in many instances, part of the difficulty for us of doing that is we have some pretty stark comments from executives that we ultimately conclude are puffing --

MR. WALL: Sure.

MR. SCHMIDT: -- and we don't challenge transactions as a result of what we think is a much more thorough economic analysis. So, I am curious what your thought is on that rambling question.

MR. WALL: Okay. Well, you know, in my -- what is the antitrust equivalent of a fantasy baseball league where I run the Antitrust Division or the FTC? What I do is I make policy decisions based upon my Guidelines. That is what they are there for. And, again, I will consider the -- I would have no compunction whatsoever of walking into a room with a bunch of people like -- well, now, Rich Parker and Dan Wall, and saying, "I am going to sue you because of my conclusion that under the Guidelines and under the unilateral effects analysis, there is a valid case here."

But when they were out of the room and I was just talking to staff, I would say, "How are we going to win this case, guys?" And I would apply a fundamentally different analysis at that point, which is a very practical analysis, and it is one about saying what are the defense arguments and how are we going to negate them? And I am sure that this is done, but I've got to say, in all candor, that I think that some of the market definitions that have been proposed took on too much trial risk to think that it was done very vigorously.

There is just too much trial risk in the kind of market that we had in *Oracle*. I mean, it seems to me -- I was not involved at all, but it seems to me that in *Whole Foods*, you just had to have a very powerful argument in the can about how you were going to say that it doesn't matter that Safeway sells organic tomatoes and things like that, because you can see that one coming so clearly.

I think we have the same wife. My wife said the same thing when she heard about that case. I think, everybody did --

MR. PARKER: We'll have to talk about that.

MR. WALL: -- everybody did, had the same kind of feeling, that there was something screwy about the notion that Safeway, you know, which at least where I live is really dominant, wouldn't be competitive with Whole Foods.

MR. PARKER: Jeff, I think you have got to look at both the documents and the economics, I think both from a policy point of view and from a litigation point of view. I think you have to have both -- I mean, I think there is a lot of people who try antitrust cases who say, "Well, look, you know, all I have to do is have my Ph.D." -- I am talking about trial now, not policy -- "my Ph.D. has to cancel out their Ph.D., and then we will win it on the documents and the customers," and I think that in some cases, there is something to that.

But from a policy point of view, I think -- I think you definitely -- I don't think it's responsible to, you know, bring a case just on documents, and I also wouldn't bring a case just on economics without some support from what the parties say.

MR. WALL: Let me -- can I make a comment, and I would love to get your reaction to this, Rich, about what makes a good document, okay? This is a -- maybe a smallish issue, but it's an important issue. We deal with it all the time in antitrust litigation.

There is a tendency for people to think that -- so, a company has a selling aid that is directed -- Oracle had selling aids against PeopleSoft and SAP and a bunch of other people, but people -- you know, there was a tendency to think those were good documents, because it shows that there is sort of head-to-head competition going on there.

I have a pet saying that you shouldn't let ubiquitous phenomenon prove rare facts, and if you are trying to prove market power, you shouldn't be able to rely on evidence that would be found with or without market power, and the existence of selling aids like that is so common that it doesn't really shock you at all, that, "A-ha, Oracle is looking at PeopleSoft." Okay, great, wonderful. They do.

A great document is something that actually proves one of the particular facts that drives your antitrust analysis, your competitive effect analysis, or something like that. A great document is a document that says, "We don't have to meet that discount, because I don't really fear competition from this firm." You know, a great document is, "We're going to have to give the usual ridiculous PeopleSoft discount," you know, something like that.

You have to be very detailed and very critical about what those documents prove, because you will be met with the defense argument of, "Oh, this is just so much noise, you would find this in any company, and you can't make anything of it."

MR. PARKER: To me, the best documents -- and like I said, generals like the last word. In *Cardinal Health*, I thought the best documents were the documents where plaintiffs were saying -- I mean, the defense was saying we compete with everybody, all these little fringe, and we compete with direct delivery, all this other stuff, but every time they went to the board, so the board would understand the competitive situation and how they were doing, all they looked at was each other, and when people had to make serious business decisions as managers and as board members representing the shareholders, that's all they looked at.

That is a serious document, and you have to be careful of the marketing aids, because salespeople tend to -- that's why they can sell things. They say all kinds of stuff that's probably not analytically true at the end of the day.

MR. WALL: Yeah. A classic one is the DOJ used in *Oracle* a lot of documents that we had that actually were selling aids against the people who were excluded from the market in which we trash them, right? We say all these terrible things. Well, my response was, "Why do we have to go to the trouble of trashing them? It's because they are competing with us. That's -- you know, you do not trash people who aren't competing with you." So, it's at least ambiguous to rely on that kind of evidence.

MR. SCHMIDT: Kathy, let me throw one to you. Should the standard be any different in what we are talking about for a preliminary injunction versus a permanent injunction?

MS. FENTON: Well, I think this is another area where the existing cases are not particularly helpful, because the issue tends to be litigated in the PI context, and one of the questions that I struggled with in thinking about this is what would you do with the traditional assignments of burden of proof, burden of persuasion, in a full-blown trial on the merits if you were doing a true effects analysis and not starting with market definition as your starting point, what would be the trigger for shifting the burden of proof?

And I will confess, my own thinking broke down fairly rapidly there, because I don't know, if you're doing the back-end analysis, what do you do in terms of those assignments of burden of proof and burden of persuasion? It's too bad we don't have Andy Gavil, who is much more of a civil procedurist, up here to help us, but I think that is the real practical difficulty you are going to encounter in the area, Jeff.

PROFESSOR BAKER: Well, I can add that Carl and I proposed that you could essentially -- effectively get the equivalent of the -- the plaintiff could meet its initial burden, instead of by showing high, increasing market shares, with some evidence of -- based on diversion issues and margins or some evidence to show that these are -- there is a -- the merging partner -- one of the merging firms would lose sales to the -- a significant amount of sales to the other one now and that -- after the merger that that constraint would be lost, that kind of thing.

The essence of the unilateral effects theory gives you a simple showing that you could use to create the same presumption, although I guess you would need the FTC to hold this in a case in order to get it into the case law.

MS. FENTON: I was going to say, isn't that part of your problem, particularly in the PI context, is that you are making inherently predictive judgments without any kind of actual data?

PROFESSOR BAKER: Well, yeah, but it's the same formal structure as what we do now with the market shares.

MR. PARKER: Jeff, I have a view on 13(b), and that is you ought to put it in all your briefs but don't ever really think that's what's going on. The parties go in and say, "Judge, if you enjoin this, this deal is over."

This is important. You can't run the economy without really -- you know, by coming in and talking about whether there's issues going to the merits or whatever. The parties come in and say, "You are going to end a multibillion transaction if you do this." And Judge Bates didn't need 90 pages to do a 13(b) analysis, and all these other -- *Staples* and all these other opinions, when you read them, they are deciding the case, period, no matter what the standard they say they are applying, and you ought to assume you are trying the case when you go in for a preliminary injunction no matter what the law is, because I think that's what somebody in black robes is going to do.

MR. WALL: I also -- I always wondered myself about whether -- what the actual value of burdens of proof are after the third day of trial, something like that, you know? Burdens of proof are important in things like summary judgment motions. They are - they are definitely important in, I think, criminal cases where you have the beyond a reasonable doubt kind of standard.

When you get into a two-week/three-week kind of trial, the judge has been so immersed with the argument at this point that what happens is what Rich described in his talk when he was talking about Judge Byrne, who came back there and just told the clerks, "I think the plaintiffs should win." That's what happens. And so I wouldn't get too hung up on how you get there.

MS. FENTON: Yes, though Dan, isn't the flip side of that the concern where you don't have the two-week trial? I think in *Whole Foods*, you essentially had a day of live testimony.

MR. WALL: Okay, so one other practical point that I will give you-all, don't do that.

MR. PARKER: Never.

MR. WALL: Don't do that. Don't ever, ever, ever agree to have a merger try to get enjoined based upon a one-day or two-day hearing. You just have got to convince the judge. I really don't agree with one thing Rich said about how the status quo is the market with these people competing. The status quo -- this is -- you know, we do not have a merger clearance regime in this country. We have a merger notification regime, and the only advantage that the Government has at trial is you don't have to pay the filing fee like private parties do, okay? You have got to convince them to stop the merger. You can't do it in a day. That will almost never work. You've got to build your case up.

MR. PARKER: I am not backing off my previous statement, but I will tell you, you have got to take -- you know, these judges, judges are basically -- and I am not being critical -- they are basically clueless about antitrust. They know it's an important case, and so you have got to take them through it, and you have got to bring in customers, and you have got to bring in a -- I mean, I remember one time during *Drug Wholesalers*, there was an hour in which we never asked Carl Shapiro a question. Why? Because the judge was asking the questions. And we had the same situation with customer after customer after customer. And that's what you've got to do.

Now, sometimes, you know, if the judge wants to do it that way and that's the ruling, then there is nothing you can do about it, but I would sure never agree to it. And by the way, for the defense, I wouldn't agree to it either, the reason being I want to bring in my CEO. I want to bring in my CEO and bring this person in and talk about how the company was built and this, that, and the other thing.

MR. WALL: Well, I might -- you know, I might want to do it if I could say, "Excuse me, they forgot Safeway." If that were my argument, I might want to make that a one-day, one-sound-bite trial.

MR. SCHMIDT: All right. Well, I'd like to thank the panel for a terrific discussion.

(Applause.)

MR. SCHMIDT: We are going to take a lunch break until 1:15, and then we have another great panel on judicial perspectives scheduled for that time.

(Whereupon, at 12:05 p.m., a lunch recess was taken.)

AFTERNOON SESSION

(1:17 p.m.)

PANEL 3:

JUDICIAL PERSPECTIVES ON UNILATERAL EFFECTS

COMMISSIONER KOVACIC: We'd like to welcome everyone back to the afternoon of our program on unilateral effects analysis. For the next hour, we are going to have a moot court exercise in which Judges Diane Wood and Douglas Ginsburg query two advocates who will be working with a set of stylized facts, based loosely on an ice cream merger of the relatively recent past, and some somewhat stylized arguments to sharpen and focus our attention on some of the underlying issues.

First, our advocates. Speaking for the Government will be Michael Bloom who's our very capable Director of Litigation within the Bureau of Competition. He'll be joined on the other side by Rick Liebeskind from Pillsbury Winthrop. We proudly claim Rick as one of our alumni. Welcome home, Rick.

By way of a joint introduction, Judges Wood and Ginsburg share some striking and impressive credentials. Not only are they former enforcement officials, both at the Department of Justice, not only have they written a number of influential antitrust opinions as members of their courts, they are also teachers, they are scholars, and influential in that role in the competition policy area. Most striking to those of us who have done some work in the international field, they are seen by their judicial colleagues and former enforcement colleagues in the international community as being exemplars of the way in which one goes about thinking about and judging antitrust matters. We are delighted to have them serving as trial judges for our panel today.

Our format will be for Michael and Rick to offer their arguments with questioning by the members of the trial court, and then we'll have some time for discussion at the close of the presentations.

Michael, would you like to begin for us?

MR. BLOOM: Thank you.

Good afternoon, Your Honors.

Three companies produce superpremium ice cream for sale to retail outlets throughout the country. Unless this court decides otherwise, there soon will be just two. Incline Corp. and Tressel Company pioneered the superpremium ice cream market. Incline Corp. now enjoys an approximately 45 percent market share based on dollar sales. Tressel Company now holds some 39 percent of the market.

JUDGE WOOD: Mr. Bloom, aren't you assuming the answer to the most important question before us, which is whether there really is a superpremium ice cream market in an antitrust sense?

MR. BLOOM: I am, from the moment that I began calculating shares, Your Honor. And I will spend a good deal of time in my presentation explaining why superpremium ice cream is the correct relevant market based both on documents and testimony of industry participants and empirical evidence. I just wanted, at the moment, to set up the context as to how to view the proposed acquisition.

JUDGE WOOD: So, you do concede that there is no case if there is no superpremium market.

MR. BLOOM: Your Honor, in fact, the market definition exercise is a surrogate for a direct determination of whether competitive effects are likely in a nontrivial portion of the economy. We will demonstrate, by empirical evidence, that that is the case here. That makes out the relevant market, but at the same time, makes the formal market definition exercise of lesser importance than it might be had we not the ability to do the kind of empirical work that we had the ability to do here.

Tressel wants to eliminate an independent Higbee through acquisition. This would result in a two-firm market in which the combined Tressel/Higbee would have a 55 percent share.

JUDGE GINSBURG: Higbee is a relatively new entrant, is it?

MR. BLOOM: Yes, it is, Your Honor. It entered approximately four years ago, and in that four-year period, it has been able to garner a roughly 16 percent share of a superpremium ice cream market.

JUDGE GINSBURG: And it stepped up from the next tier, the premium ice cream tier?

MR. BLOOM: It did. It had some advantages that others may not have. The point that I'd like to make with respect to that, Your Honor, is that there was a duopoly prior to the entry of Higbee that functioned here for a number of years. In response to that duopoly and the superb margins earned there relative to the premium ice cream segment -- superpremium ice cream sells for three times the price of ice cream in the premium market segment, there was no sufficient entry in fact, there was no material entry at all that succeeded prior to the advent of Higbee's.

JUDGE GINSBURG: And do you have information on the effect of that entry on prices in the superpremium market?

MR. BLOOM: Yes. I can tell you that Higbee Corporation itself came in at a price 5 percent below the other firms in the superpremium market, and consumers benefited directly and immediately from the availability of that price.

JUDGE GINSBURG: And it is your contention that if they were to leave, that 5 percent would re-appear?

MR. BLOOM: Certainly, Your Honor. That 5 percent, perhaps a little more or less depending on the combined firm's assessment of what its profit-maximizing price is, but assuredly, an appreciable portion, if not all of that.

JUDGE WOOD: You know, along a related line, the 2007 Ice Cream Institute *Fact Book* outlines the difference among these three levels, if you will, of ice cream: value, premium, and superpremium.

MR. BLOOM: Yes.

JUDGE WOOD: And as I look at these differences, they don't seem to be all that huge, and that's what makes me wonder what you have in the record to show that even if Higbee were acquired, you know, a new Higbee might come along and challenge the superpremium sector of this market.

MR. BLOOM: Your Honor, the question of product differentiation is one that economists tell us is properly viewed from the point of view of consumers, not producers. I would submit to you that the relevant question in this case is, therefore, are these differences material to consumers and ought we expect some entry or repositioning that would take up the space of the lost Higbee from the point of view, again, of consumers?

Notwithstanding your assessment that the *Fact Book* doesn't suggest dramatic differences, consumers of superpremium ice cream are paying three times the price that they would pay for premium ice cream for the advantage of significantly higher butterfat content, significantly lesser injected air content, and the variety of imaginative flavors and combinations and inclusions of fruits and nuts and things that are offered in superpremium products. The difference matters greatly as measured by the relative prices consumers are willing to.

As I said, again, those prices of three times premium ice cream prevailed for several years prior to the advent of Higbee's. It seems to me to stretch credulity to suggest that if that 5 percent premium disappeared because Higbee's disappeared as an independent entity, all of a sudden, the gates would be opened, and premium forces would march in and rapidly take up Higbee's 16 percent share.

Now, I happily acknowledge that it may be that over time, firms will fill in from the premium space up to the superpremium space. There is, for example, in the record evidence about a firm that, at a slight premium to other premium vendors is offering an, arguably, higher quality product, some improvement in the inclusions, in butterfat content, and such.

JUDGE WOOD: You are speaking of Alfred's Coffee Beans?

MR. BLOOM: I am, Your Honor, I am.

JUDGE WOOD: Okay. I wanted to ask you, since you're talking about that, you're making an assumption here that when the -- post-merger, in fact, it would be profitable for the post-merger firm to raise prices, and, of course, the expert testimony from Dr. Pangloss is to the contrary. He thinks that either a 3 percent increase or a 5 percent increase would be unprofitable if unit sales were to drop by these various amounts.

I am concerned about that, since if you don't want us to worry about market definition, you want us to look at more direct measures of competitive effects, this critical loss analysis is one way that economists are trying to do that now.

MR. BLOOM: Let me address the critical loss analysis, as such, that was performed by Dr. Pangloss, and let me observe that it seems to be offered as a rebuttal to the empirical econometric work done by the Government's testifying expert, to which I will turn after discussing Dr. Pangloss' critical loss analysis.

I would suggest that this critical loss analysis is offered to show that the combined Tressel/Higbee would not be able to raise prices, but it shows no such thing. Dr. Pangloss states that, given the prevailing operating margin of superpremium ice cream manufacturers, a 3 percent price increase for Higbee superpremium ice cream would be defeated if Higbee's unit sales dropped 5.7 percent -- and he makes a similar finding for a different scenario, for a 5 percent scenario -- but that is correct if and only if none of the customers that switch ice creams to avoid the price increase switch to other products controlled by the combined Tressel/Higbee.

It is, as this court said in *Swedish Match*, if one is to correctly apply critical loss analysis, two factors are of particular concern: The price-cost margin and the diversion ratio, meaning the percentage of switched sales that are captured somewhere else, anywhere else, within the combined firm.

JUDGE GINSBURG: Mr. Bloom, the account you are giving, Pangloss points out, was derived from retail scanner data, correct?

MR. BLOOM: Dr. Cassandra's data was derived from retail scanner sales.

JUDGE GINSBURG: Right. And then Dr. Pangloss points that out and says that's not the market in which this transaction was taking place, that you should have been looking at sales to the retail channel.

MR. BLOOM: Had there been an equivalent data source available for sales to the retail channel, that undoubtedly would have been the starting point of the analysis.

JUDGE GINSBURG: So, are you like the drunk who's looking for his keys under the light because that's where the light is?

MR. BLOOM: Absolutely not, Your Honor. This is a situation in which we have a near-perfect proxy for the cross-elasticity of demand at the retail channel level. The reason for that is retailers' demand for ice cream products in every single category is derived from consumer demand for ice cream in those categories.

JUDGE GINSBURG: Well, I understand that, but you are making pretty fine calculations, so that if there is any difference between the consumer and retail demand at all, it could, seemingly, overcome the fine discriminations that you are making.

MR. BLOOM: I would suggest that the discriminations, while --

JUDGE GINSBURG: For instance, not every price change to the retailer is flowed through to the consumer.

MR. BLOOM: That is correct, Your Honor.

JUDGE GINSBURG: So, therein lies the problem.

MR. BLOOM: And that is why I did not say they are perfect proxies.

JUDGE GINSBURG: Would you have any data on how imperfect they are?

MR. BLOOM: I do not, Your Honor, but I can tell Your Honor that the data is consistent with the testimony of people who strive for profit within the retail trade and strive for profit within the producer of ice cream trade.

JUDGE GINSBURG: You mean competitors of these firms?

MR. BLOOM: The competitors and purchasers.

JUDGE GINSBURG: Well, they are not disinterested parties either.

MR. BLOOM: They are not disinterested parties. In fact, they are interested in the competitive mechanism producing a price in the case of the supermarkets that gives them an advantage, and the --

JUDGE GINSBURG: In the case of the competitors, though, they would just as soon see a price umbrella over their heads, wouldn't they?

MR. BLOOM: I think that is generally true of competitors, that they would prefer to see a price umbrella over their heads. But when we look not only at testimony in this trial, but at other pronouncements in documents of the parties, it seems pretty clear that the principal competitive interactions are within superpremium, if they are superpremium producers --

JUDGE GINSBURG: Right, but not without some effect on the next tier, on premium.

JUDGE WOOD: And I just wanted to say, I am not clear which competitors you're talking about, because you have told us that Incline Corporation is the only other seller of superpremium. Then there are these various companies at the premium level and presumably others at the value level. So, who are the competitors you're talking about?

MR. BLOOM: In this instance, the record that I have before me does not identify the specific firms; however, it is clear that they include customers who are looking for the best prices and who are making estimates of their ability to purchase --

JUDGE GINSBURG: Customers at which level?

MR. BLOOM: At the supermarket level.

JUDGE GINSBURG: Consumers or supermarkets?

MR. BLOOM: Retailers of products. And these are people whose interest is in the competitive market producing the lowest price for them. They have, I think, for that reason some special credibility when they say that they don't think that the price to them is sensitive to changes in price across segments.

JUDGE GINSBURG: On the contrary. They don't have a special credibility. That's a self-interested statement.

MR. BLOOM: Well, their self-interest is consistent with that of consumers and presumably with that of the market.

JUDGE GINSBURG: Perhaps, but there is no special credibility there. They would clearly like to have you do exactly what you are doing.

MR. BLOOM: Well, the reason I say that, Your Honor, is Your Honor correctly observes that competitors have an interest in a price umbrella being over their head, but --

JUDGE GINSBURG: But you are talking about supermarkets now, right?

MR. BLOOM: Yes, I am. Yes, I am.

JUDGE GINSBURG: And they want the lowest price possible.

MR. BLOOM: They want the lowest price, and I believe that the market, unfettered by an anticompetitive acquisition, has produced the lowest prices.

JUDGE GINSBURG: So, even if they don't know anything, they're inclined to say it's different from the premium market, right, that this merger will be three to two and disastrous.

MR. BLOOM: Well, I think if their statements were solely those prepared for litigation -- and they are not, they are supported by documents and other materials -- and if there were not empirical evidence that is consistent with those statements -- and I want to talk a moment about what Dr. Pangloss did -- you might raise that point, but I think the consistency of a variety of sorts of evidence about relevant market, ranging from a look at the practical indicia suggested by the Supreme Court and regularly applied since *Brown Shoe*, through the testimony of others and into the empirical work, all tells a consistent story.

JUDGE WOOD: Another thing that Dr. Pangloss challenged, though, was your assumption that the market is differentiated along these very clean lines. He notes this Alfred's Coffee-Beans-in-Cream is a premium brand, and the premiums are edging up toward the superpremiums with their inclusions, and maybe the Higbee superpremium had been 5 percent lower, and he, I think, has offered evidence that there is, in fact, more pricing and consumption interdependance among these levels than you have asserted.

MR. BLOOM: If you take a look at the spread between a 5 percent upcharge over premium, as being captured by Alfred's, and a 5 percent reduction in price in the market leaders in the superpremium segment, you are left still with about three times the price of one for the other. You know, there may be some progressive filling-in. You may -- you know, now you have a "better and beanier," and at some point down the road, you may have an "even better and still beanier," and so on. But I am reminded of the statement of John Maynard Keynes: "In the long term, we are all dead." How long will it take before consumers are rescued from the loss of that price increase that we believe inevitably will follow the acquisition, pushing Higbee's prices back up to the prevailing price, and I think that is the question for this court ultimately.

Unless there are further questions, Your Honors?

JUDGE GINSBURG: Thank you, Mr. Bloom. We may want to hear from you again, though, after we have heard from other counsel.

COMMISSIONER KOVACIC: If I could invite Rick to speak for the merging parties.

MR. LIEBESKIND: Thank you, Your Honors, and good afternoon. I'd like to make -- tick off five points that I'll come back and cover so that I can give you a preview a little bit of where I'd like to go.

First of all, I would like to talk a little bit about precedent, which except for one cite to *Brown Shoe* we didn't hear from Mr. Bloom on. I would like to talk a little bit about the fact that we are talking about a manufacturer merger, not a retailer merger, as Judge Ginsburg mentioned.

I'd like to talk a little bit about the theory of differentiated products mergers so that we understand why it does not meet the requirement that a merger may substantially lessen competition, which is the statutory standard.

I'd like to talk about the evidence of constraint from other people. And I'd like to talk a little bit, very little bit, about critical loss. So, those are the --

JUDGE WOOD: And I do think, Mr. Liebeskind, the elephant in the room for you is this enormous price difference between the superpremium level and even the premium level, as shown by the record.

MR. LIEBESKIND: There is certainly a large price difference between them, but the question, of course, Your Honor, is whether as a result of this merger somebody will be able to exercise market power and raise price and widen that gap.

JUDGE WOOD: I understand that, and it seems to me that Higbee was almost what we maybe once had thought of as a maverick. There it was, you know, pricing 5 percent below the other premium people --

MR. LIEBESKIND: And still is.

JUDGE WOOD: -- in the post -- in the post-merger world; though with Tressel and Higbee combined into one company, that gives you a certain amount of room to get rid of that 5 percent distinction.

MR. LIEBESKIND: Well, what we know, Your Honor, from the actual documents and the actual evidence in this case is that Incline, the market leader in Mr. Bloom's purported superpremium market, prices itself at roughly 3 percent -- three times that of premiums; that Tressel prices itself at parity; and that Higbee prices itself at 5 percent below Tressel and Incline. And therefore, the question is, will the constraint on Tressel go away or be loosened as a result of this merger?

Today -- this is not the *Staples* case. This is not a matter of Staples and Office Depot looking at each other and looking at the third player. We have one player who looks at the other two, but we have the two larger players in the market not looking at the other two, according to the evidence in this record, but looking at the premium competitors.

JUDGE WOOD: Well, they are looking -- I am not sure that the record shows that, because the record suggests that Tressel feels comfortable pricing at parity with Incline; Higbee, the newcomer, comes in at 5 percent lower. We are talking here about whether this transaction will lead to anticompetitive unilateral effects, and with Tressel and Higbee becoming one company, why do we think that Higbee's strategy of pricing below Incline will survive and not Tressel's of matching?

MR. LIEBESKIND: But presumably Higbee has to price below Tressel to survive at all.

JUDGE WOOD: But not -- but why are you making that assumption post-merger? They are all one company post-merger.

MR. LIEBESKIND: Your assumption post-merger, Your Honor, I suppose would be that once Tressel owns

Higbee, Tressel can raise the price of Higbee, but not of its own -- not its own price.

JUDGE WOOD: Well, because its own price is already up at parity, and so it brings Higbee's up.

MR. LIEBESKIND: And is constrained. And is constrained. Tressel's price is constrained.

JUDGE WOOD: Well --

MR. LIEBESKIND: If Higbee can raise -- If Tressel acquires Higbee and raises the price of Tressel, that is the unilateral --

JUDGE GINSBURG: That was not the Judge's question. It raises the price of Higbee.

MR. LIEBESKIND: I misspoke, Your Honor. I beg your pardon. If Tressel acquires Higbee and raises the price of Higbee's, will the price of Higbee's goes up? That is obviously implicit in the question. I cannot deny that that is going to happen.

JUDGE WOOD: Right, and why is not that an anticompetitive unilateral effect? With Higbee as an independent company, there is at least one participant in the superpremium market that is trying to compete to a certain degree on the basis of price.

MR. LIEBESKIND: Well, as Mr. Bloom noted in response to your questioning, Your Honor, Higbee is itself a recent entrant into this market. Higbee moved from the premium to the superpremium level. Alfred's is trying to do so as well. The fact that Higbee itself made that leap from premium, as outside of Mr. Bloom's market to inside of Mr. Bloom's market, suggests to me that others could also do so.

This, you may remember, Your Honor, was exactly the facts of *Baker Hughes*, that Secoma, in *Baker Hughes*, had made that leap, and what the court pointed to in *Baker Hughes* was that Secoma itself had entered and demonstrated that entry was possible into this market. Here we are not even talking about entry. We are just talking about --

JUDGE GINSBURG: Well, even courts learn, too, you know.

MR. LIEBESKIND: Beg your pardon?

JUDGE GINSBURG: Courts learn, too.

MR. LIEBESKIND: I hope they have -- I hope they have not forgotten the lesson of the *Baker Hughes* case, Your Honor.

JUDGE GINSBURG: Counsel, is it correct, as Mr. Bloom said, that your critical loss analysis depends on the assumption that none of the parties switching away from your higher-priced brand switch within the family of brands?

MR. LIEBESKIND: This is -- I am glad you asked that question, Your Honor, and this is a quibble. This is -- what Mr. Bloom's analysis --

JUDGE GINSBURG: In other words, it is true, yes.

MR. LIEBESKIND: It is true, and it is worth less than 1 percent, because what Mr. Bloom's analysis and what Dr. Cassandra's analysis shows is that the diversion effect is basically 9 percent of the diversion sales, and if you multiply the critical loss times the diversion, that is 0.81 percent. So, all we are really saying --

JUDGE GINSBURG: You are already doing more math than the court can do.

MR. LIEBESKIND: I assure you, it's taxing my own limits, but the basic point, and I hope -- in round numbers -- as we move the critical loss from 9 percent to 10 percent, and I am glad you asked me that question, Your Honor --

JUDGE GINSBURG: Did I ask a question?

MR. LIEBESKIND: You did, but I am using it as a segue.

I want to speak a little bit about critical loss, because that has been asked, what the role of critical loss is in this analysis. Critical loss simply is a benchmark for telling us what is the amount of lost sales that a hypothetical monopolist or two merged firms or whatever you are looking at needs to lose for a price increase to be unprofitable. It is not itself -- as Dr. Scheffman and Mr. Simons have said in their papers, it is mere arithmetic. It is not itself an econometric analysis; it is not a statistical analysis. It is merely a benchmark.

JUDGE WOOD: I am not sure I would phrase it that way, though. I think it really is more -- it is not like somebody sits down and plans, "I am going to lose so many sales. You know, I am still going to be making money." It is a way of capturing, from another end of the telescope maybe, you know, at what point does this effort to exercise unilateral market power after a merger become unprofitable, so people are going to experiment? They'll nudge, you know, maybe up to that point. But it doesn't mean, I think, that this is a freebie somehow, all within that critical loss range.

MR. LIEBESKIND: I completely agree with you, Your Honor. This is a methodological estimate of markets at equilibrium, and, in fact, what goes on all the time is people are, as you say, testing how much they can raise price. It is worth mentioning here, again, that the supermarket's testing of how much it can raise price is different from the wholesaler's testing of how much it can raise price. To the retailer, there is not a one-to-one correspondence. As is indicated in the record, these people have to compete for shelf space or facings in the supermarket. They have to give money for those facings.

JUDGE GINSBURG: Do the retail -- well, this goes back to the question of the adequacy of the proxy that is being used here by the Government, right?

MR. LIEBESKIND: Yes.

JUDGE GINSBURG: So, I gather from what you were just saying that even if the retail sales data -- pardon me, the sales -- yes, the retail sales data were a perfect proxy for the sales to retailers, all right, for the market that you have said they should have been looking at, even that would not adequately capture the fact that you have to pay for shelf space.

MR. LIEBESKIND: I think that is the same thing as saying it's not a perfect proxy, Your Honor.

JUDGE GINSBURG: Well, it could be simply that those prices per unit don't flow through exactly. That is what I had in mind earlier.

MR. LIEBESKIND: Well, that's correct.

JUDGE GINSBURG: But no, I am not talking about marginal price. I am saying you have got to pay for shelf space. That is not a marginal price, all right, but it is part of whether a price is sustainable for you.

MR. LIEBESKIND: It surely is, and we can debate whether or not it is marginal pricing. Your accounting is better than mine if my math is better than yours.

JUDGE WOOD: And also, that payment for shelf space has a lot to do with the quantity that you expect you are going to be distributing.

MR. LIEBESKIND: Absolutely.

JUDGE WOOD: If you would rather take your profits in high prices and lower quantities, you might not need to get very much extra shelf space.

MR. LIEBESKIND: Well, if you are in a market where there are large and powerful supermarkets and the only way you can get to consumers is by getting in there, you may not have that option. You may just need to get in there.

JUDGE GINSBURG: Counsel, I think you said among your five points was that the -- if I got it correctly -- that the whole unilateral effects approach does not meet the statutory standard, or maybe it's as applied here.

MR. LIEBESKIND: Well, I think it's as applied not only here but to differentiated products in the retail space, and the point there, as I am sure Your

Honors are familiar with, is that this analysis that's being applied here, this unilateral effects diversion analysis, to yield a post-merger price increase as a result of a merger simulation exercise, that predicts a price increase in any merger of any two people in a differentiated product space -- now, it might be bigger, it might be smaller -- but in any given merger, it is going to predict a price increase if you ignore or don't have efficiencies, repositioning, entry, all the other things that the Merger Guidelines put out by the Government tell us we should look at.

JUDGE WOOD: So, am I understanding you correctly that you can never, in your view, use unilateral effects analysis if it is a differentiated consumer products market?

MR. LIEBESKIND: Use it -- use it to prove a market, if I may finish your question, Your Honor, and that is the point I want to use.

JUDGE WOOD: Well, are they using it to prove a market or are they trying more directly, which the case law has certainly been moving toward in recent years -- actually, for some time now -- are they trying just to prove anticompetitive effects? Who cares about the market if you have shown anticompetitive effects?

JUDGE GINSBURG: There must be a market out there somewhere.

MR. LIEBESKIND: There surely is a market for ice cream, and perhaps --

JUDGE GINSBURG: But if there are these effects, then there must be a market out there.

MR. LIEBESKIND: Well, that gets back to the question of whether the effects are substantial and whether the effects are large enough to really be worthy of noticing whether you are noticing anything worth noticing, because when you have a -- when you start with a model that -- we don't have actual evidence of effects in the sense that it historically happened here, if we are talking about the econometrics. What we are talking about is a prediction, based on a mathematical formula, that says every merger will lead to an effect --

JUDGE GINSBURG: The effects are --

MR. LIEBESKIND: -- no matter how small.

JUDGE GINSBURG: -- historically the effect we have is that Higbee enters at a lower price than the two incumbents, and then the predictive question is what happens if Higbee essentially exits by becoming a part of one of them.

MR. LIEBESKIND: Right. And if you say we are going to put on blinders and we are going to assume that there will be no entry, there will be no repositioning despite the evidence of repositioning that we have seen, there will be no entry despite the fact -- despite what Higbee, in fact, did, and there will be no efficiencies, then the theory -- I am not disputing the theory of the mathematical calculation. What I am saying -- I am not disputing that you are going to have a price increase -- if you use this model, if you ignore everything else, you will have a price increase in any merger of any two companies. That is exactly my point.

JUDGE WOOD: But it all gets back to the record, though --

MR. LIEBESKIND: That can't be the law.

JUDGE WOOD: Well, these are very fact-specific situations. Obviously there are some cases in which courts have found anticompetitive problems, and I am thinking of the *Staples* case, for example, based on similar kinds of data; others not.

I don't see Dr. Pangloss, your expert, emphasizing, "Here are the companies that are poised to enter to defeat the market power." I realize that's not quite a unilateral effects argument, but nonetheless, you have, I think, strayed a bit beyond that, so I was going to, also.

MR. LIEBESKIND: Well, Your Honor, I think whether or not Dr. Pangloss said it, it's in the evidence before you, and my suggestion to Your Honors is that it is your right to look at the entire record and see that evidence, see the evidence of what Higbee actually did, see the evidence of what Alfred's actually did, and draw your own conclusions for it. You don't need an expert to get there.

JUDGE WOOD: What about Mr. Bloom's response on Alfred's, that their price is still so far below -- maybe it is 2.6 times -- yes.

MR. LIEBESKIND: So, consumers were getting a bargain.

JUDGE WOOD: Maybe.

MR. LIEBESKIND: I mean, in fact, Higbee's responded. They put in more beans or they chocolate-covered their beans or they added another flavor. They did what they did. They responded to Alfred's. So, there was a competitive response to this firm that is purportedly not in the market. That tells you --

JUDGE GINSBURG: Well, it was tiptoeing into the market with that product.

MR. LIEBESKIND: And my point exactly, Your Honor. There's room to enter this market. The market's been defined as butterfat above 14 percent, whereas butterfat of 13 percent is in the other market. So, you have to increase your butterfat by 1 percent and increase your price by 300 percent, and you are in the market. It can't be an entry barrier that you have to keep your -- that you can't raise your price.

JUDGE WOOD: Well, apparently there is much more to it than that. That's why I commented to your opponent that in some ways these facts indicate to me that there aren't huge differences, and yet I could say the same thing about all sorts of consumer markets. You know, what is the difference between a Calvin Klein polo shirt and the sort of thing I'd go buy at Target? They are both made of cloth; somebody sewed them. I mean, they are -- maybe they are all in the same market; maybe they are not. There is the same kind of price difference, I assure you.

MR. LIEBESKIND: If I could invent that -- if I could invent facts, I will invent a true fact, which is across the street from a supermarket in my neighborhood, there is a place where a guy makes his own ice cream, and that is not in this market either. It is a matter of whether or not you have access to the shelf space, which brings us back to that point.

JUDGE GINSBURG: Counsel, on repositioning, is the experience of Alfred's the only record evidence?

MR. LIEBESKIND: Other than Higbee itself.

JUDGE GINSBURG: Other than Higbee itself.

MR. LIEBESKIND: So, I've got two.

JUDGE GINSBURG: And that's your burden, isn't it?

MR. LIEBESKIND: My burden to show entry? I don't think so, Your Honor.

JUDGE GINSBURG: No, to show that repositioning mitigates any concern that the Government's raised.

MR. LIEBESKIND: Not under the *Baker Hughes* framework, not as I understand it, Your Honor. My understanding is it is the defense's burden to come forward with evidence. The burden of persuasion remains on the Government in all time frames. That is the statement in *Baker Hughes*. So, I would say that is not my burden other than to come forward with the evidence.

JUDGE GINSBURG: Anything else?

COMMISSIONER KOVACIC: Would the Court like to hear from Mr. Bloom again?

JUDGE GINSBURG: Sure, yes, please.

MR. BLOOM: Sure.

JUDGE GINSBURG: This is too much fun.

Mr. Bloom, could you pick up where your brother left off with respect to the burden on repositioning?

MR. BLOOM: Yes. The issue is one in which I believe the burden of coming forward has switched to the defendants in this action. They need to come forward with enough evidence to put that issue fairly back in play. I suggest to you that they --

JUDGE WOOD: I notice you're saying very carefully to come forward. You concede that you have the burden of persuasion throughout, as he said.

MR. BLOOM: Ultimately, on the question of competitive harm, the Government has the burden of proof throughout this matter, yes, Your Honor.

But let's, again, go back to this question of entry. What has the defendant produced? The only fact that the defendant has produced is the fact that Higbee's was the sole firm -- despite the existence of a highly profitable duopoly -- to successfully invade this market space over a protracted period of time.

JUDGE GINSBURG: Well, it's the only one that tried, isn't it?

MR. BLOOM: No. There are other efforts suggested in the record of failure, I believe.

JUDGE GINSBURG: I didn't pick that up. Where is that?

MR. BLOOM: But if I may, Your Honor, even if I am wrong on that, the fact of the matter is the contention of the defendant is that if Higbee's prices go up 5 percent, this is going to invite entry. That begs the question of why, then, there were not other entry attempts in the prior -- in the period prior to Higbee's entry where the market presented precisely the same situation as it will with a post-acquisition price increase.

JUDGE WOOD: So, we have evidence for about a five-year period in this particular record? I am just trying to think how far back it goes, because it is a little truncated.

JUDGE GINSBURG: I think we have three years since Higbee entered.

MR. BLOOM: Yes, and, Your Honor, I believe the record is not perfectly clear on the time at which Tressel and Incline themselves became the pioneers in this market. It seems to be at least a few years prior to the --

JUDGE GINSBURG: Well, it says that they introduced superpremiums --

JUDGE WOOD: 2003.

JUDGE GINSBURG: -- in 2003, yes.

MR. BLOOM: 2003.

The number -- what -- it's important to understand that the standard for repositioning is not could someone. It's not an abstract question. It's a "would someone". And we have empirical evidence in the absence of entry prior to Higbee, the absence of perhaps entry efforts.

JUDGE GINSBURG: Well, the superpremiums come along in late 2003 and 2004. Higbee entered three years ago. So, that's, when this record was compiled, 2004 or maybe early 2005. So, there was an opportunity there, and they took it, and I am not sure why you are saying that if the opportunity is restored, in the event the merger goes through and the price goes up, someone else couldn't take that opportunity.

MR. BLOOM: Well, Your Honor, let's take a look at what has to happen. First of all, the repositioning has to be sufficient to replace the loss of Higbee. Higbee is, as are the other superpremium firms, a national operator. It's been stipulated in this matter that the relevant geographic market is national.

A firm, in order to enter that market from the premium space, would have to establish a collection of recipes; would have to develop facilities to produce those tasty and exciting arrays of superpremium ice creams. They would have to build a direct-to-retailer distribution system --

JUDGE WOOD: Could I just maybe, since I think our time is getting short, summarize this? If I understand your position, it's really just that if there's this gigantic price gap between the premiums and the superpremiums, and since 2003, when Higbee starts introducing its brand, to the present, nobody else has tried to come in, the question is, why should we think there are people out there who are walking away from these profits?

MR. BLOOM: That, Your Honor, and the utter absence in the record of any evidence that any person is planning entry, is contemplating entry, is putting together the distribution system necessary to effectuate that entry.

JUDGE GINSBURG: The last question I have on the critical loss analysis is this: I think this is your expert's position, that if more than 5.7 percent of the unit sales lost as a result of a 3 percent price increase for Higbee's superpremium were captured as Tressel's superpremium sales, then the price increase would be profitable, right?

MR. BLOOM: That's correct, Your Honor.

JUDGE GINSBURG: Okay. And is there more to tell us that that would, in fact, happen, more than 5 percent -- 5.7 percent of the unit sales would be captured by Tressel's?

MR. BLOOM: I think there is, and it rests in human experience. The group that we are focused --

JUDGE GINSBURG: Is that part of this econometric analysis?

MR. BLOOM: It is not part of the econometric analysis except insofar as this chart's cross-elasticity of demands and explains the lack of price sensitivity --

JUDGE GINSBURG: Okay, now, if Higbee's price gets to where it's the same as Tressel's, why would anyone switch from Higbee's to Tressel's? If they are being priced out by the increase, they can go to premium. Why would they go to Tressel's superpremium?

MR. BLOOM: Let's address that question in this way: The consumers about whom we are concerned in a differentiated products market unilateral action case are those consumers here who have a preference for superpremium ice cream. That is what they are purchasing notwithstanding the great price disparity.

JUDGE WOOD: That's these young, trendy people who don't care about their weight?

MR. BLOOM: And apparently a few others, Your Honor. The question that I would pose to Your Honor is, if those consumers are willing to pay three times premium prices, and some of them have to sustain a 5 percent price increase to remain in the premium -- in the superpremium segment. Is it reasonable to expect, notwithstanding their willingness to pay three times premium prices, that they will not choose, in large part -- and we only need, I think we said, 5.7 percent --

JUDGE GINSBURG: Yes.

MR. BLOOM: -- that a significant number of them, far more than that, will choose to remain in the superpremium segment? There are --

JUDGE GINSBURG: Okay, first of all, they are not paying the same three times because of the 5 percent price differential, right? They are paying --

MR. BLOOM: Correct.

JUDGE GINSBURG: -- less than the two market leaders' prices.

MR. BLOOM: That's correct.

JUDGE GINSBURG: So, their willingness to buy superpremium is fragile. Now, the price goes up to where it's the same for all three. Why would someone now say, "I am not only willing to pay the higher price, but I am willing to pay it for a different product that I wasn't willing to pay it for yesterday?"

MR. BLOOM: There is no question but that the revealed preference of those who purchase Higbee's today, the superpremium, at 5 percent less than the market leaders, have a preference for that product at that price. But it seems to me that when you are asking about a 5 percent price change, it is highly implausible to think that fewer than 5.7 percent will divert to Tressel in the event of the loss of an independent competitor.

JUDGE GINSBURG: But that is just intuitive, correct?

MR. BLOOM: I would say that it --

JUDGE GINSBURG: So, if we don't share your intuition, we have a problem.

MR. BLOOM: I am sorry, Your Honor?

JUDGE GINSBURG: If the court does not share your intuition, then what?

MR. BLOOM: I think if the court doesn't share my intuition, the court ought to look at the empirical evidence of Dr. Pangloss, which -- excuse me, of Dr. Cassandra, which looks at thousands upon thousands of transactions and calculates cross-elasticities to determine that there is a relevant market here and that consumers will be injured in that relevant market. Consistency of that information and the testimony of --

JUDGE GINSBURG: The sustainability of a price increase and of re-entry depends upon something for which there are no data.

MR. BLOOM: If you are referring to --

JUDGE GINSBURG: Namely, what will happen -- no, what will happen to the customers who now find a 5 percent increase for Higbee?

MR. BLOOM: I beg to differ, Your Honor. The analysis of cross-elasticity of demand conducted by Dr. Cassandra empirically answers the question of whether critical loss will or will not be exceeded by actual loss. It does the thing that the defendants' testifying expert did not do, finding --

JUDGE GINSBURG: Well, both of the critical sentences begin with the word "if."

MR. BLOOM: Well, that's the calculation of the diversion ratio.

JUDGE GINSBURG: Okay.

MR. BLOOM: But if you look at the initial empirical work, the econometric survey, that study tells you that a price increase will be profitable, and absolutely --

JUDGE GINSBURG: Well, that work is, I guess, summed up in the sentence that says, from your expert, "that the analysis of retail scanner data implicitly indicates that the combined firm would employ pricing strategies under which actual loss would not exceed critical loss."

MR. BLOOM: That is correct.

JUDGE GINSBURG: But that is also a tautology, is not it? In other words, no firm would pursue a pricing strategy in which actual loss exceeded critical loss.

MR. BLOOM: It is certainly not intended as a tautology, and the testimony is clear on this point. What Dr. Cassandra is saying is that her econometric study says that there will be a post-acquisition price increase in a superpremium ice cream market. That means that the actual loss will be less than the critical loss. She has answered the unanswered question in the critical loss analysis done by defendants' economist through the econometric study involving testing of supply -- excuse me, of price-demand elasticities over thousands and thousands of products, looking each transaction against each other.

JUDGE GINSBURG: Thousands of products?

MR. BLOOM: Thousands of transactions. I misspoke. Forgive me.

JUDGE GINSBURG: Thank you.

COMMISSIONER KOVACIC: Would the panel like to hear at all further from Mr. Liebeskind?

JUDGE GINSBURG: I don't think he wants to take that chance.

MR. LIEBESKIND: No.

COMMISSIONER KOVACIC: Thank you, Counsel.

Thanks to Michael and Rick for very helpfully going through the hypothetical with the panel. I'd like to spend the few minutes we have left posing a couple of questions about the methodological issues that lie behind the exercise.

I suspect at the time that all of us, and certainly our two judges, began teaching competition law and teaching the evaluation and assessment of market power, the starting point in the traditional framework was to use the circumstantial approach of defining a relevant market and using market shares as a basis for inferring market power. From the '92 Guidelines onward, but perhaps even earlier from *Indiana Federation of Dentists,* comes the suggestion that that is, perhaps, a second-best approach to dealing with the underlying question of market power.

I was wondering if you were going back to the classroom and teaching again, how would you reconcile or at least think about these two streams of analysis; that is, the traditional approach that relied on market shares, and to what extent has the alternative, direct approach come to complement or perhaps even would it displace in some instance the traditional framework?

JUDGE WOOD: Well, I will say a word about that. Maybe it's because I taught too long at the University of Chicago, but it seems to me that it has been recognized for a very long time that the market share approach was a means to an end and not something that was independently interesting, and people would wring their hands about different ways in which you might get it wrong with markets; you might define the market too broadly and miss a transaction that was going to create market power or vice versa.

And there was a thought abroad, for a long time, that it was really just too hard to ask the question that you really wanted the answer to, the direct economic question, whether it is about own elasticities of demand or whether it is about actual anticompetitive effects in the market, and as you say, beginning with the dentists case, the Supreme Court and, of course, the agencies, that was an FTC case, and others began to say, "Well, maybe it is not impossible to do this. Maybe we can think better about how to do this."

Then if you fast-forward to the FTC's *Staples* case, which, of course, was one where, again, the challenge to the transaction prevailed, there is a lot of data out there these days that was not around when, you know, the decade of -- or the century, really, the 20th Century was unfolding when the old approach was developed.

So, I think today, if you were teaching it, you would say, "Here is the ultimate question: There are a number of different means to that end. One of them is probably still going to be defining a market, but there are others that are probably better."

COMMISSIONER KOVACIC: Doug?

JUDGE GINSBURG: Well, I haven't gone back and looked at it with this question in mind for today, but it seems to me that we kind of got over it in *Polygram*. That was -- for the D.C. Circuit, anyway, that was a pretty big step in the direction that we are talking about today.

COMMISSIONER KOVACIC: Yes. Yes, indeed.

In the discussion that you had with Michael and Rick about the use of quantitative methods, am I right in sensing that a fundamental question for advocates for agencies is -- and maybe it goes to the questions that both of you posed -- is, in using these techniques to have in mind the sensitivity of the analysis to small adjustments in assumptions; that is, that a panel will want to know how rugged the technique is in the face of possible adjustments about data or assumptions.

When you look at quantitative data of this kind, am I right to think that that's a question that you or your colleagues, the typical trial judge, might want to be attentive to?

JUDGE GINSBURG: Well, yes, but it has to be made accessible. I thought Professor Willig gave a good example of making it accessible when he used the car models. I think you would want to scale it down, as he suggested, to the kind of cars judges are familiar with, Camrys and Kias and things like that.

COMMISSIONER KOVACIC: TR4s, Porsche 918s, little cars, yes, yes.

JUDGE GINSBURG: Right. So, I think that was very useful.

Similarly, I think that presenting -- this whole metaphor of space can be usefully presented graphically. It's easier to grasp if it's literally portrayed.

COMMISSIONER KOVACIC: Yes.

JUDGE GINSBURG: I am sure if you think back, no one in this room took an antitrust course in which transactions and relationships were not diagrammed in virtually every case on the blackboard, and yet it never appears in the brief and rarely in expert testimony, and yet it was the obvious way, at least for some people a more efficient way, of absorbing material.

COMMISSIONER KOVACIC: Yes.

JUDGE GINSBURG: And as well as the homey example that Professor Willig gave.

JUDGE WOOD: Yes, I think that the first thing Doug said is really important. It's got to be accessible, and I know, for myself, when I am looking at these kinds of things and when I read opinions from other judges who we would all agree are excellent in this area, making clear the chain of reasoning and making clear what set of assumptions are being made to begin with and then what tests were run, what studies were done to test those assumptions, is absolutely vital, because the judge has a responsibility under Evidence Rule 702, under *Daubert*, if you want to think of it that way, although purists will say this is a 702 question at this point.

You have to evaluate the soundness of that methodology, and you will see a judge saying, "Well, you have made an assumption here," just as Judge Ginsburg was saying during our argument, "and it's too big. It puts too much of what we really need to pull out and test into that assumption." But if that's not put on paper for the judge, that won't come out, and obviously one side or the other is going to have an incentive to do that vis-a-vis the kinds of studies that have been made.

COMMISSIONER KOVACIC: I am thinking of the use of graphical presentations. I am thinking about a case that features prominently in one of Judge Wood's opinions, known well to this audience, *Toys "R" Us*. I am wondering if anyone has ever taught *Interstate Circuit* without attempting to construct the hub and spoke on the blackboard with the relevant parties and how that presentation of evidence might be a useful guide for how to make the presentation accessible.

As one of the comments on the earlier panels mentioned, Judge Hogan's subsequent reflections on *Staples* said that what really caught his attention were the documentary records. The econometrics were interesting, but that did not really cause him to turn his head.

JUDGE GINSBURG: But you have to prepare for the case where you do not have the documents, where what you have got is the econometric evidence. That is the one that -- that is the challenge, to present that case without taking things out of the mouths of the parties.

COMMISSIONER KOVACIC: Is there a methodology, just in general terms, that is likely to be more effective; that is, in thinking how to frame and present the case where that's what you have?

JUDGE WOOD: Well, it always seems to me that a person ought to be able to explain why these were the right questions to ask. Why should I think this econometric test is going to tell me anything about that? I envision, you know, maybe somewhere, even in the company, concern. There is somebody who's not a Ph.D. economist. Maybe it's the CEO. I mean, you have got to be able to say to people, "This is what we are grappling with," and if you can say it to the CEO, you ought to be able to say it to a judge as well.

JUDGE GINSBURG: Ronald Coase, with whom I studied, was then editor of the *Journal of Law and Economics*, and he said he wouldn't publish an article that had any nontrivial econometrics in it, because it was his view that if the author couldn't explain himself in English, he probably didn't know what he was talking about.

COMMISSIONER KOVACIC: Yes.

JUDGE GINSBURG: That's a useful guide, because your audience of a judge, of three judges, may not be able to follow that as readily. So, you want to present it in English; you want to -- the underlying econometric evidence, and you want to have a homey example.

If I can get 40 seconds to illustrate the last point?

COMMISSIONER KOVACIC: Absolutely, yes.

JUDGE GINSBURG: What was it -- was it *Monsanto* in which the Government or the Department, were going to file a brief on our PI and the Congress stopped us?

JUDGE WOOD: Yes, an appropriations rider.

JUDGE GINSBURG: It was an appropriations rider. Before the argument in which -- remember, Bill Baxter, Professor Baxter, couldn't answer one of the questions because of the appropriations rider. Before we filed that brief, he was called to the White House, to the Oval Office, to answer the President's question of why are we doing this? What is -- somebody had gotten to the President, maybe it was Charlton Heston or something, and said, "This is a bad idea," and the President didn't say, "I will stop it." He said, "I will look into it." So, he called up and said, "Tell me what you are up to." So, Bill went over there, and this is what he did. This is 1983, maybe '82?

COMMISSIONER KOVACIC: Yes, 1983.

JUDGE GINSBURG: He said, "Mr. President, imagine that you have a record store across the street from K-Mart." Now, you all remember K-Mart, and you remember record stores? He said, "And customers come in to your record store and listen to records in the listening booths, and if they like them, they go across and buy them, not for 99 cents from you, but for 79 cents from K-Mart, which does not have any listening booths." Now, this was brilliant advocacy. There hadn't been any listening booths for more than 20 years, but the President could understand that, and it was not the least bit disingenuous. It made the point correctly.

COMMISSIONER KOVACIC: When I think of those who have had perhaps the most formative role in integrating economic concepts into the development of legal principles in this area, I think of people like Judge Posner, I think of Bill Baxter, I think of Ernie Gellhorn, Phil Areeda, and Betty Bock, who as a group had such a facility for telling a narrative that brought, by use of examples, by use of logic, made the reasoning accessible. I sense for myself in the classroom and elsewhere, the challenge for the modern narrators is to do the same with high-powered quantitative techniques, especially for an audience that has been running away from mathematics since junior high school.

JUDGE GINSBURG: Well, judges, at least as much as lawyers in general, tend to be not well educated in mathematics, let alone economics. They are overwhelmingly liberal arts majors who studied history and political science, English literature, and so on, and have never -- they had to take some requisite, limited amount of math, perhaps in college, maybe not --

COMMISSIONER KOVACIC: Did I leave a copy of my college transcript here?

JUDGE GINSBURG: -- and they haven't gone back to it since or had occasion to.

Now, I mean, there is a -- I could give you an oral brief for having generalist judges, but it does create a challenge for a specialized body of knowledge.

JUDGE WOOD: And it really creates -- it puts a huge responsibility on you, the bar, to deal with us generalized judges, and as Ronald Coase put it, to boil it down to something that we will understand.

COMMISSIONER KOVACIC: I want to thank our panelists, to thank Michael and Rick for being good sports and going through the example so skillfully, and especially to thank our two judges, who here were trial judges, but I assure you they passed the trial. Thank you for just a wonderful presentation and for making this the kind of afternoon that I think many of us will remember for a long time.

Thank you.

(Applause.)

COMMISSIONER KOVACIC: I'd like to invite my colleague Tom Rosch with his collection of stellar panelists, Bill Baer, Susan Creighton, Dick Rapp, and Connie Robinson.

(Pause in the proceedings.)

PANEL 4:

EVIDENTIARY ISSUES RELATED

TO PROVING UNILATERAL EFFECTS

COMMISSIONER ROSCH: Good afternoon, everybody. I think it's probably a good thing if we get started, because we have got a lot of ground to cover in a very short period of time.

Let me first introduce the panelists. It is a very distinguished group of people, and I think it will help frame the discussion if you know a little bit about their backgrounds.

On my immediate right is Susan Creighton, who is Co-Chair of the Antitrust Practice at Wilson Sonsini. Susan originally hailed from my part of the country, which is Northern California, but has ended up back here, and she is obviously well-versed in this subject, having served as director of the Bureau of Competition at the FTC. I will only mention beyond that that she clerked for both Pam Rymer in the Ninth Circuit and also for Justice Sandra Day O'Connor at the Supreme Court.

Second, I'd like to introduce Connie Robinson, who in a previous life was the career deputy at the Justice Department, a very distinguished antitrust practitioner. I am very grateful to her for coming out to California every year to participate in the Practicing Law Institute panel out there and deliver remarks with respect to merger analysis. She's now at Kilpatrick Stockton, and she's Deputy Chair of their Complex Business Litigation Team.

Third is Dick Rapp, an old friend who was formerly the President and Chairman of NERA, and he's testified in innumerable antitrust cases of all stripes, including a number, frankly, I think, Dick, where I was lucky enough to be on the defense side, and I had the benefit of his services. So, he will be our economist, our resident economist, on this panel.

And finally, we have the sage or the old sage who's going to be the resident litigator, and obviously you all know him. That is Bill Baer from Arnold & Porter, and he heads their Antitrust Group. I should say that he has a little bit of a conservative stripe in him that I didn't realize, because he went to the Stanford Law School.

Now, let me just tell you what we plan to do today, because it is going to be a little bit different from what the other panels have been like. We are going to discuss evidentiary issues relating to proving unilateral effects, and basically what we are going to be talking about is what the second panel this morning talked about, which is how do you prove your case in a merger case, and more specifically, in a unilateral effects case?

We will begin with a discussion of general principles. We will then move to the role of econometric and noneconometric economic evidence, a subject that was covered today. We will then move on to the role of noneconomic evidence. And then we will move to trial strategy. And then we will conclude with a discussion of weighing the different kinds of evidence.

And what we are going to do to cover those subjects is to ask a panelist or two to address the subject first and then throw the floor open so that the other panelists can comment on what has just been said or elaborate on it. So, let us begin with the general principles, and on that subject, there are two folks who are going to be kicking us off here.

One of them is Dick Rapp from an economic standpoint, and the other is going to be Sue Creighton with respect to the legal standpoint, and we are going to follow, segue, from what was discussed earlier this afternoon, which is the framework for analysis that is available today, what is the proper framework, from an economist's standpoint, from a legal standpoint, and what does that have to teach us about how one should present their case?

So, do you want to start, then, Dick, please?

MR. RAPP: Sure. And I wonder -- it's up to you, but others this morning spoke from the podium. Since your intention is to make this largely a panel discussion and to keep these fairly short, I am just happy to do it from here if that's the way you would --

COMMISSIONER ROSCH: That is fine.

MR. RAPP: Okay, if that's all right with everybody.

It seems to me that stage-setting on general principles after what we have just heard and after this morning's excellent panel is almost unnecessary, so I will just add a few glosses of my own to what people already know. This is an expert audience to begin with, and we have been discussing -- we have already delved deeply.

Let me just start from the Merger Guidelines. Observe, as has been done this morning, that there is a part of unilateral effects that we are not going to be talking about much; that is, the most elementary form of market power, the unilateral ability of a firm to control enough output to raise price all by itself. It comes, notably, at the end of the unilateral section, and the majority of Section 2 of the Merger Guidelines is about differentiated products.

Much has been said about that, and all that I will add, for those who happen to be beginners in the room, is that one way of conceptualizing it, the way that I do, is to think about products as nothing more than collections of product characteristics and then to locate them in some kind of astronomical space that represents the widest of all possible markets.

Cars, if you are talking about BMWs and Kias and what have you. So, if it's not cars but cereals, then Raisin Bran and Special K are somewhere down here; Count Chocula and Lucky Charms are out there; maybe those granolas that they sell at Whole Foods, along the price dimension, are out there somewhere, neither up, down, but in the middle and out in front; then somewhere behind me is Albertson's white box corn flakes.

Bobby Willig's story of generalized versus local competition is not one that is immediately consistent with this point of view, and I am not sure that I share it. One thing about this point of view is that the notion of gerrymandering markets, which we heard this morning, or submarkets doesn't really come into it very much. It is purely an issue of product characteristic proximity, where product characteristics include price as well as other things that consumers care about.

To tie that, as background, to the subject of the panel, let me just rehearse for you, again, things that have been mentioned at length today but never listed, and that is the types of economic evidence that go along with this. They are own price and cross-price elasticity, which have been in the antitrust and merger literature since before *Brown Shoe*; diversion ratios; critical loss analysis. And I will mention about critical loss analysis, that it involves profit margins, and that profits and profit margins, even gross profit margins, where what we are trying to seek is only the incremental margin, is itself problematical. I don't think that has been mentioned, but we might dive into that at some point.

I will add merger simulation without further mention of it, and I want to add to this list natural experiments and distinguish natural experiments that improve our intuition in native form and natural experiments controlled by econometrics, an important distinction, I think. And I think that that sets the stage pretty well.

The key points are, first of all, I went through that whole story without once using the term "relevant market," so you know which party I am a member of, and second, the importance of econometrics is sure to come up in this conversation, not only in its technical guise, but in the form of control over the things that tend to inform, informally, people's intuitions. That's for a start.

COMMISSIONER ROSCH: Thank you, Dick.

Susan?

MS. CREIGHTON: Sure. Thank you, Commissioner.

So, I wanted to kick off the lawyerly part of our discussion by focusing on the way Commissioner Rosch posed the question to us. The first question was, do the Guidelines articulate a framework that is defining a market first and then moving to competitive effects second for assessing unilateral effects that is workable? And I wanted to focus on the "workable" part, because I couldn't possibly match the academics and economists and judges who have been speaking.

So, at the risk of being contradicted by at least half the room, who share the same experience that I do, let me hypothesize, and then you can rebut after the end of this panel, but at least during the time that I was at the Commission, between 2001 and 2005, it was my observation that whether or not that sort of sequential framework is a workable one or could have been a workable one, in practice, it was not what we did do, which is to say that I thought staff, in preparing their memos, you know, would be following the Guidelines, and there would be a first section on antitrust, sort of on market definition, but at least at the front office level, we'd be in discussions with staff from long before we saw any memos discussing the merits of the case, and during all those discussions, I can't really recall, in the back and forth, very much, if any, discussion in deciding is this a good case or not, any real discussion about market definition.

Rather, we were focused on whether we could show competitive effects; what were going to be sort of the effects of entry, repositioning, so forth. And it was really only very late in the game, at least as best I can recall, when we were getting the memos ready for the Commissioners, that we would start to seriously say, "Okay, so, what are we saying is going to be the product market? And what is going to be the geographic market?"

So, let me -- just to crystallize that, let me give one concrete example where I can recall this occurred. Some of you may recall the case, but it was one where we had data very much like that which the Commission relied upon in *Staples*, only it was even more robust, reflecting the fact that data kept by companies has gotten better in the future, since then. As a result of this data, which involved the combination of some retail stores, it looked like we had some very clear and direct data showing that when the two merging parties had stores right next to each other, there was a very strong discounting effect, and when they were a little further away, there was less discounting, and then when they were even further away, there was less, and so on.

Now, the parties had been arguing that there was an online supplier that should be considered as part of the market, but, you know, I have to say, as part of our analysis, we were thinking, who cares, because they are universally there sort of throughout the country, and it's not making this geographic effect go away. Similarly, the parties had pointed to some other less close competitors in the space, and the data seemed to show that while those competitors acted as some kind of constraint on price, the clear price effect persisted, again, depending on how close competitors had in terms of how close their stores were.

So, we thought at that point that we had a great competitive effects case, but then when it came to the point of actually sending up the memos, we said, "Okay, so, now, is this online supplier in the market or not? Are these other retail competitors in the market?" And depending on how you defined it, if you included those other retail competitors, the HHIs basically dropped through the floor, and you had no case at all. But the Commissioners' offices were saying, "Are you seriously proposing a market that excludes those people? That sounds totally gerrymandered."

So, we were facing the question of if we were going to go to court, might we never even get to that competitive effects data? Might we lose really right out the gate with a market that sounded too contrived to the court?

So, I remember raising this issue with the Department of Justice at the time that we were starting to work on the commentary to the Guidelines that eventually came out in 2006 and suggesting that perhaps the agencies needed to be doing more to be educating the courts on this issue before rather than during the time that we were trying to litigate a case like this. And interestingly, it did not seem to resonate with them that there was a problem. You know, I think their approach was pretty pragmatic, which is we have the Guidelines, we have the courts, and that is basically our environment, and we need to match our analysis to what the law is.

So, one way of resolving this issue would be to be changing the way we analyze cases internally at the

Commission, even if that means trying to persuade courts to accept markets like "glasswares sold to the food service industry" in *Libbey* or -- pardon me, Rick -- or "consumable office products" sold in office super stores in *Staples*, or a "geographic triangle of three hospitals" in *Evanston*. So, I would pose to our panelists, that's alternative one.

Alternative two would be to try to change the Guidelines, but that is awfully tough to do if the Department of Justice doesn't really perceive a need for that.

And then third I guess I'd throw out is the possibility of the Commission using its own decision-making in Part 3 to begin to teach on this subject. In my view, *Chicago Bridge & Iron* and *Evanston* posed potential opportunities for the Commission to provide some insights in that regard. I think between Commissioner Rosch's concurring opinion and the majority decision in *Evanston*, there is the beginning of that kind of dialogue, and I guess I'd throw out for the panelists whether that is a profitable avenue for the Commission to continue to pursue.

So, to recap, I'd throw it out to everyone, first, are we better off sort of from the get-go trying to follow a more rigid guidelines approach as opposed to finding ourselves trying to litigate a case which is not really the one that we investigated; or are we better off trying, again, to persuade for the need for a formal change in the Guidelines; or should the Commission be pursuing alternatives, such as Part 3 proceedings or maybe expressly advocating, as the staff did in *Evanston*, but in the district court, that it's sufficient to have direct evidence of competitive effects?

COMMISSIONER ROSCH: Well, that is a very rich discussion, Susan.

Let me throw it open now to both Connie and to Bill. When I do, however, let me just ask you three questions that are going on in my mind as I listen to you and as I listened to the judges this afternoon.

The first is, isn't it critical to know the answers to the questions that have been posed -- that is to say, what is the legal framework -- before you try and put on your case? Doesn't that pretty much determine the kind of case you are going to be putting on and how you are going to be trying to prove it? So, that is question number one.

Question number two is, I think I heard two judges, appellate judges, say that they thought that the law had evolved to the point where you could analyze a merger without up-front market definition, and I think I heard you say, Susan, that you think that that's the case, and I think I heard Dick say that he doesn't even think in terms of market definition when he's using the tools of the trade in that regard.

Then the third question is, do you agree with Dan Wall's observation this morning that the Government is always going to lose these cases or at least is going to be at great risk of losing them without up-front market definition so long as the Merger Guidelines remain unchanged, as they are now?

Do you want to take a whack at that, Connie, or do you want to, Bill?

MS. ROBINSON: Sure, I'll take a first try.

I mean, using the legal standard is the way, as I hear you, Susan, that you are deciding on bringing a case: is the merger substantially likely to lessen competition? While that is not the first step of the Merger Guidelines, I think that's the right way to begin looking at a merger, because I don't think you will persuade anybody that you have a problem unless you are convinced there is a cognizable theory of harm that you can explain to a judge why the loss of this competitor will really hurt somebody somehow.

Having said that, Judge Ginsburg and Judge Wood are unusual judges. They know antitrust law in a way that most judges do not. I am a little more old-fashioned and think that you still have to go to court and prove a relevant market even if you back into it, which I think you can do. I do not think you have to march along to the Guidelines and do the analysis, strictly in the order of the Guidelines.

You can put on your case, showing the harm, and having shown the harm, I think judges, if they are persuaded of the harm, will give you a little leeway in the product market. That was the case in the label stock case, where, quite frankly, I was very worried that the Government could not prove a relevant product market, but there was really strong evidence of anticompetitive harm. If you've got that, you can persuade a judge of harm, and the product market gets fudged somewhat because it is less important.

So, I think it's problematic to change the Guidelines, Commissioner Rosch.

COMMISSIONER ROSCH: It's Tom. For everybody on the panel.

MS. ROBINSON: But I think it is problematic to change the Guidelines if you are the Government. I think it's helpful for those of us in private practice if there are the changes, because it looks like the

Guidelines are changing, so what really should apply? It makes it easier for us to have other arguments against the Government. So, I'd tread carefully before I'd do that. I think the Guidelines are a workable construct, and I think merger cases are just inherently difficult, but I don't think changing the Guidelines would help that.

COMMISSIONER ROSCH: Bill?

MR. BAER: I will be brief, because I know you have got a lot else that the panel needs to get on to.

You cannot go in to court and not prove relevant market unless, you know, Tom Rosch and Dan Wall on behalf of Oracle will stipulate that relevant market is irrelevant. It's -- you don't -- you've got an adversary there who's going to be exploiting every weakness. So, today, you have to assume you have to prove relevant market.

Does that mean that you wouldn't attempt to persuade a trier of fact that the sorts of analysis that went into *Indiana Federation of Dentists* and *Toys "R" Us*, where proof of anticompetitive effects allows you to short-circuit the need to prove antitrust market? Of course, you try and do that, and your long-term strategy, it seems to me -- and this may involve an amendment to the Merger Guidelines -- is an attempt to get the agency's articulation of enforcement principles consistent with the analytics they are doing, but you cannot simply decide you are going to do that and expect the courts and your adversary to go along.

And one final lesson from me is, you look back to the effort, the time -- and Connie will remember this -- that the agencies had to take to get the courts to consider the Merger Guidelines back in '82 and -- what, '82, '84, '92, these are just advisory; they don't mean anything. But you look at it now, the courts -- there is a body of case law where these things are taken seriously, and so if, in fact, looking more to evidence of effects, particularly in unilateral effects situations, is where you want to go, and you want the courts to go along with you, I think you have got to get the process going of changing the way the -- the analytics the agency uses and the articulation of the analytics.

COMMISSIONER ROSCH: Okay. Well, let's move on, then, to the role of econometric and noneconometric economic evidence, and I think Dick Rapp is particularly well qualified to kick that one off.

Dick, three questions: First, how should expert testimony be used in unilateral effects challenges?

Second, what is the probative value of

simulation studies in the courtroom?

And third, what is the probative value of critical loss analysis in the courtroom?

I think we just saw a demonstration that sometimes it doesn't work very well for court of appeals judges, but what do you think about the courtroom?

MR. RAPP: Well, let me see if I can group those together and add a point of my own to them.

I think -- and you have to apply the Mandy Rice-Davies test to what I am about to say. Anybody remember Mandy Rice-Davies? She was the one who was cross examined with the question, "Well, isn't it true that Judge Astor testified that he never slept with you?", the Profumo affair, to which her reply was, "Well, he would say that, wouldn't he?" So, the Mandy Rice-Davies test, even though it's old, is worth remembering.

Economic and econometric testimony should be used to the fullest, and the fact that it's central in all of the cases that we have discussed is obvious. Simulation studies are somewhat more problematic in that there is a degree of artificiality. They require sometimes calibration of the parameters, which seems like making up the data. Their validity and power depends upon their ability to predict, to back-cast successfully, but there are excellent, powerful examples of all of these techniques.

I am thinking of Greg Werden in the *Interstate* -- the bread-baking case. I don't remember whether that -- he actually served as a witness in that, but somewhere on the DOJ web site is a set of slides where he describes what he would have said had he testified or perhaps did, and it is effective, potent stuff.

The thing to remember about both simulation and econometric studies is that it is actually not hard to present. It is terribly difficult to cross examine, but it is not hard to present in the simplest form. In other words, what needs to be shown is the model. There needs to be testimony to the robustness of the model and the fact that it is scientific testimony that passes the requirements of social science hypothesis testing, and past the point, if somebody wants to ask you whether you did the right sort of reset test, well, that's a problem for them more than it is for you.

So, the point that I wish to make to start this conversation off is, first, that these are apt and powerful techniques; that they can be presented successfully. And I guess, in addition to that, the one other thing that I ought to say, although it is not directly in response to your question, is that the econometrics and economic studies generally that we read about in unilateral effects decisions are of the very best of breed. It is excellent econometrics that we see and interesting, well-informed models.

Those of us who live partly in the world of mergers and partly in the world of private action, class action, Section 1 antitrust case, feel a strong sense of contrast, at least I do, to the kind of things that we see in these merger cases and the sort of economics that sometimes confronts us in class action antitrust.

So, I already declared at the outset what party I am for. I see no reason to restrict the use of econometrics either on intellectual or tactical grounds.

COMMISSIONER ROSCH: Connie, what's your reaction?

MS. ROBINSON: I think economic evidence is one type of evidence. I don't think it is the only type. I think it can be a useful aid to help -- in particular, to show some quantification of effects and to get you out of the world of antidotes, but it is only one form of evidence, and it is extremely difficult -- I will disagree with Dick -- it is extremely difficult to articulate econometrics simply so that a court understands it. That is why some courts are choosing independent experts to advise them about what it all means.

COMMISSIONER ROSCH: Sue?

MS. CREIGHTON: I certainly agree with Connie's last point, because I think it is particularly difficult for judges to unpack all of the powerful assumptions that really can help drive the analysis, and so maybe when Dick said that it is difficult to cross examine, I think it is probably difficult for a judge to evaluate it for that reason as well.

One kind of economic evidence, Tom, that you didn't mention but I always found particularly powerful, and maybe because I wasn't smart enough to be understanding some of the more sophisticated stuff, but natural experiments seemed to me to be much more effective with me, and I guess by extrapolation, I'd propose with judges. So, I guess I would throw out there that that may be an underutilized tool and one that should be given more heavy emphasis.

COMMISSIONER ROSCH: Bill?

MR. BAER: Just I agree with more Connie and Susan's view on this. In part it is. I think most of us who do antitrust and particularly people who have been at the FTC or at the Antitrust Division are more familiar with the tools, more used to analyzing the information, and it may come easier to some of us. It certainly doesn't come easy to me, but I am generalizing here.

And one needs to be cautious, I think, about assuming that the trial judge, especially in a compressed trial time, is going to have that same facility with the testimony and with its significance that we might have. So, all that means is you do do it, but you certainly don't put principal reliance on that form of testimony. You really need to make sure you have developed a whole litigation picture, because, once again, in the presence of a skillful adversary, points that may seem simple and clean when we were talking about them inside the agency, about whether to bring the case, can get pretty confused pretty quickly.

COMMISSIONER ROSCH: Yeah. The only thing I would say is that I was kind of impressed with the prior judicial panel in a couple of respects. Number one, I thought that the most salient point that Michael Bloom made was that there was a variety of evidence that supported his position, and the economic evidence was just one part of it, and I think that probably goes to the point you were trying to make there, Susan.

The other thing that I thought was interesting was that even these judges, who were pretty high-powered judges, I think were having some trouble with the economics in this case, and I was a little bit surprised by that, because I have always felt that the appellate court is a different audience from what the federal district court is, a general federal district court, but I will just throw out, did anybody have different reactions than I did to that panel?

MR. RAPP: No, but I have the urge to reply to my fellow panelists.

COMMISSIONER ROSCH: I thought you might.

MR. RAPP: Obviously, I wasn't proposing that economics and econometrics should be used to the exclusion of everything else. Let me just make the observation that whichever side they come out on, the cases that we have been quoting all day long, *Oracle*, *Staples*, *SunGard*, and on and on, have processed that information, the economic information, quite well, and it is not an accident that it has been as prominent as it has in the actual decision-making; that is to say, the decision-making by the judges, however difficult it may have been. So, somebody's been consuming it successfully, unless you think that all of the unilateral cases are just wrong-headed and uncomprehending, which I do not think anybody does.

The -- well, I guess I'll stop there for now.

COMMISSIONER ROSCH: The only thing I'll say about that, Dick, is that -- and I am not sure that he's right about this -- but Bill Kovacic suggested that Judge Hogan had written in a memoir of some kind that while there had been econometric studies that had been presented in *Staples*, that they were way beyond him, and that at the end of the day, he just kind of threw up his hands about it. I don't know whether that's true or not, because I have not read that memoir, but that's what Bill says.

MR. RAPP: I have strong opinions about natural experiments, but I will wait until the question comes.

COMMISSIONER ROSCH: Okay, all righty.

Let's move on, then, to the role of noneconomic evidence, and specifically, I guess, that breaks down into noneconomic evidence from the parties, noneconomic evidence from industry participants, including customers and competitors, industry experts, and trade press and reports.

Susan, do you want to kick this one off?

MS. CREIGHTON: Sure. Thank you, Commissioner.

So, let me start right from the outset by showing my own bias, which is maybe the opposite of Dick's, which is that it strikes me as very strange to suggest that an economist or for that matter a judge is in a better position than industry participants to gauge the likely effects of a merger. Now, let me hasten to add that not all industry participants are well-placed to assess the likely impacts of a merger, and obviously speculative opinions by customers, competitors of the parties, are not very useful.

But to take an extreme hypothetical, if you suppose that the executive team at the acquiring company pitched the deal to the board on the basis that they would be able to raise price afterwards, I wouldn't take very much consolation from the party's economist telling me that they were wrong. And part of what is troubling about *Whole Foods*, for example, is that it seems to me that the judge comes pretty close to doing just that.

Now, in the same way, customers aren't in a good position to opine on what other customers may find to be acceptable substitutes, which is really the question about market definition, but at the same time, knowledgeable and sophisticated customers are the ultimate experts on the question of whether they could switch to other alternatives if confronted with a post-merger price increase by the merging parties. Judge Walker in *Oracle* brushed off such testimony as speculation in the absence of an elaborate cost-benefit analysis by the customers, but this seems to me clearly to give too little weight to the customers' experience and knowledge, even if it can't be quantified.

Now, part of the problem, I think, is that agencies have -- we haven't always done a good job of explaining the underlying market and the competitive dynamics in a way that helps the judge put the information into proper context. In that regard, I will go to Dick one more time and say that I think that natural experiments are probably a tool that we should be using more, as judges probably do understand them better, and that might help to sort of put the dynamics of the market and the documents at their hands that the judges are reading in context.

At the same time, it is my personal view that what the judicial panelists from the last panel said in terms of reflecting their understanding of unilateral effects analysis is much more sophisticated than the average district court, and hence, that it's still a very important duty and still-to-be-overcome task by the agencies to help judges understand how to get past a focus on market definition when there is direct evidence of competitive effects.

So, just to give one example, I agree with Mark Schildkraut -- who I don't think I have seen here today -- that it appears that in *Oracle*, for example, that the Division did provide economic evidence that supported the customers' testimony that Judge Walker had said I'd give it more weight if there was economic evidence to support it, and as you all know, the Division did introduce evidence showing that when PeopleSoft competed in bidding against Oracle, the customers received an additional 10 percent or greater discount. What this evidence was probative towards would have been direct evidence of competitive effects, which is regardless of whether SAP was in the market, it didn't actually act as a sufficient constraint on Oracle.

Now, it might have helped if the Division had also offered evidence, as Judge Walker pointed out they did not, showing lower discounts when Oracle was bidding against SAP or others. It would have made the point more clearly, and my understanding is that such evidence might have been available. More fundamentally, though, in my view, Judge Walker was so focused on market definition, perhaps because of the way the Division had presented the case, that the evidence of competitive effects got lost, which is an important sort of flag for the importance of explication and explanation.

Let me conclude by suggesting that at least in the abstract, in my view, the most important evidence, notwithstanding recent judicial decisions, is the testimony of knowledgeable customers; next is the evidence of the merging parties themselves; and finally, on discrete issues, such as the ability to enter or expand, the competitors themselves.

I think as you indicated, Commissioner, and perhaps Connie said, in my view, the economic evidence is just a quantitative tool for presenting evidence from the very same sources. So, we are just talking about data from the customers; data from the merging parties; data from the competitors. That is not a different type of evidence; it's just a different way of analyzing the evidence.

Now, when that evidence points in different directions, I think the economic evidence can be an important check, calling for kicking the tires on the rigor and sufficiency of the noneconomic data, but I would submit that if the noneconomic evidence flares up under further examination, it would lead me next to ask, "What is going on with the economic presentation?"

COMMISSIONER ROSCH: Okay, thank you, Susan.

Dick, you said you wanted to say something about natural experiments, and you have your chance now.

MR. RAPP: It's good of you to let me. Two quick points:

Not all evidence has to be scientific evidence, we recognize that, but the trouble with customer testimony and other testimony of that sort -- again, not proposing that it should be done away with or anything like that -- is cherry-picking. In other words, the imperfection of the sampling process in an advocacy -- in a setting of advocacy; selection of documents or selection of customers produces outcomes based upon the nature of the choice, and that is different from the kind of methods that are subject to the *Daubert* discipline. So, that is not meant to say no customer testimony should be allowed; it's just meant to say bear in mind that each of these things has their relative merits and demerits.

On natural experiments, all I wish to say is that natural experiments, without controls, are dangerous and misleading precisely because they appeal to intuition. The difference between a -- let us use a hypothetical natural experiment on store openings that stands by itself and says, "Here is a selection of store openings. When merging firm B opens a store premerger, prices of merging firm A's respond to that." That is an experiment that ought to be part of an equation that has a WalMart dummy in it; that has other con -- that takes account of other considerations that might realistically affect the outcome; and that might make the intuition that comes out of the simple experiment intuitive and, at the same time, wrong. It is just an argument for rigor and care in the selection process when dealing with the kind of evidence that, like Susan, in agreement with Susan, I regard as necessary and essential to one of these cases but that ought to be subject to the kind of discipline I have described.

Thanks.

COMMISSIONER ROSCH: Okay.

Connie, let me ask you just boldly here, was Judge Ginsburg just playing with Michael Bloom when he expressed his dissatisfaction with both customer testimony and competitor testimony? Because that one came as a bolt out of the blue to me. It seemed like Michael was darned if he did and darned if he didn't. Who else is he going to put up there in terms -- if you are going to be using anything other than econometric or economic testimony, who else are you going to be relying on?

MS. ROBINSON: Well, I guess I have a slight difference with Susan on the issue of customer testimony. I think customer testimony is a necessary evil, but I think it is -- I always hated to be in trial and watch my customer be cross examined, because you never know what comes out, and it's often bad, because they are not antitrust lawyers, and you haven't had much time to work with them, and they don't -- you know, they have a different motivation.

But their testimony can be very valuable to the extent they are really talking about objective facts, to the extent they have had a natural experiment in their life. Did they have a time when there were fewer players? What happened? Or before this company entered into the superpremium business, what was it like? So, they have a value, but I think you can't -- you have to understand that they have some costs with them as well.

I mean, my preference is for, if you have them, company documents. I think they are often one of the strongest pieces of evidence that you might have. But in terms of the testimony, you need competitors, but you value them for their objective statements, the factual things that they can discuss, not their predictions about the merger.

COMMISSIONER ROSCH: Okay.

Bill, I'd like your views on a number of things. First of all, what do you think about industry experts? And secondly, what do you think about customer testimony? And what do you think about the parties' own documents and statements?

MR. BAER: I think, in telling a story in a trial, if you have a knowledgeable industry expert that can provide some perspective, that can be of value, but it is of value in sort of outlining the nature of the competitive interaction that goes on. At the end of the day, in order to persuade a trier of fact, I think you need both quantitative and nonquantitative evidence.

You know, we distinguish between economic and noneconomic. That may not be the right terminology given that a lot of what some of us think of as noneconomic evidence really involves evidence of pricing behavior and pricing decisions, but it is just not an econometric study, a critical loss study, that sort of stuff.

So, I think at the end of the day, all of us on the panel agree that you need to look at all kinds of evidence, but I do agree with Connie and Susan that understanding how the parties have behaved; how they've viewed their market; how they've set prices; who they've reacted to and who they haven't reacted to.

Going back a couple years, Dick Rapp in a phone call where we were talking about this made the point, which I think is right, you know, you have got to distinguish between different kinds of noneconomic evidence. I mean, some of it, the opinion of a customer or the opinion of a business executive is perhaps considerably less probative than looking at business behavior, what people thought was driving profit and what wasn't. So, I would look both to the merging parties and to competitors to see how they behaved and what seems to drive them as particularly important evidence.

I do think customer evidence can be of value. It's subject to the limitations that Connie pointed out. It's subject to the arms race of affidavits that is often characterized in mergers, where numbers matter more than substance, seemingly, based on the presentations, and where both the staff and merging parties are able to, by presenting the issues their way, get a sympathetic affidavit, which at the end of the day doesn't withstand critical examination, because it was not an informed decision.

So, customer testimony, it seems to me, is relevant. I thought Judge Walker dismissed it much too quickly in the *Oracle* case. At the same time, it has its own limitations.

COMMISSIONER ROSCH: Well, Bill was out there during the *Oracle* case, too. So I think he saw up front and personal, what was happening there.

MS. CREIGHTON: But just on behalf of customer testimony, I wasn't meaning also to suggest that it's always -- just to take it at face value, but, you know, I think in *SunGard*, for example, Bill, you know, when you were talking about sort of the accumulation of affidavits, I think that listening carefully to what the customers are saying might have caused the Division to -- and maybe in retrospect, they have -- think differently about either whether that case was a good one to bring or whether or not they should have been sort of maybe recasting their decisions somewhat.

My understanding is if you go back and look at the declarations, you can actually sort of draw a line between the big customers could self-supply and the little customers couldn't, and then that would raise the question, was there a price discrimination market possibly there? So, you know, I think listening to the customers can be very helpful in terms of figuring out what exactly is going on, as well as how you would present your case.

COMMISSIONER ROSCH: Okay, let me just throw -- before we leave this subject, let me throw three questions on the table and see if anybody has any views about them:

First of all, I really would like views about the paid industry expert, because in my experience, that's the least probative witness.

Second, who are the customers? I was a little bit surprised in this trial or this appellate argument that we listened to before this panel to have some of the questions that were asked. It seemed to me that in *Heinz-Baby Food*, the agencies basically won the argument that the retailers constituted a separate set of customers from the end users, and so I would have thought that the testimony of those retailers would have been quite probative with respect to what they expected in terms of this transaction.

And then the third observation I would make -- and I will just throw this out in the form of a question -- is, are the agencies relying too much on customer testimony when those customers are not end users? More specifically, when the agencies go to customers who are wholesalers and they ask them what their views are with respect to the transaction, and those customers can pass on any price increases that they may experience, of what value is the fact that they are not opposing the transaction? One can argue that particularly if they are pricing at keystone, they'd be all for an anticompetitive merger.

Connie, do you have any views at all on any of those subjects?

MS. ROBINSON: I want to address the industry expert. When I tried cases with the Government, we didn't tend to use the industry expert. In almost every case that I saw, there was an industry expert on the other side, and as you know, oftentimes, the Government loses its merger cases. So, I took away a lesson from industry experts which said to me that judges like to hear facts from people who know the industry. Industry experts, if they are well qualified, may do that and may provide some context.

It also seemed to me it fulfilled the important lesson of repetition, you know, like when you teach a child how to play the violin, they practice the same thing over and over and over, and the more they play it, the more they learn to like it. So, if a judge hears something more than once, it may resonate, and you don't forget it as much. So, I found, you know, when I was watching industry experts on an adversarial basis, that they added value to the case.

COMMISSIONER ROSCH: Anybody else have any observations to make?

MS. CREIGHTON: Well, I guess I would agree with Connie, actually, that I do think there is a lop-sided dynamic going on where the parties have industry experts at hand, whether it's a paid expert or their own -- the merging parties, and trying -- and when you are the plaintiff and you have to go first, it's a difficult question how to introduce the judge to the industry and the dynamics in a way that you want.

I guess at the same time, Commissioner, it is hard to find that good industry expert. So, it may be more a sort of hypothetical than real.

COMMISSIONER ROSCH: Bill, did you have anything?

MR. BAER: No.

COMMISSIONER ROSCH: Okay. Well, you are up next on trial strategy.

MR. BAER: Well, thanks. You know, I was here at the FTC when the FTC won a bunch of cases, although I was not the trial lawyer, but I thought maybe it would be helpful to spend just a couple minutes talking about what problems we confronted when I came to the agency 13 years ago -- six-two and with hair on my chin and my head -- that, you know, both the FTC and the Antitrust Division had had a string of not winning merger cases. There were a couple of exceptions, but we actually sat down, a number of us, including Jon Baker, who's in the audience, who was Director of the Bureau of Economics, and talked through what we needed to do better, and a lot of it really was before we got to trial.

A lot of it was case selection, to make sure we had identified cases that were appropriate, that we staffed them up with a team that would be thinking about going to trial earlier than in some cases the agency had done, integrating both the Bureau of Economics' economists as well as early retention of outside experts. And I don't mean to say, by the way, that any of these things are not being done today or haven't been done since. I am aware that they are, but we tried to figure out where we looked as though we were being deficient.

And a third area, candidly, was we didn't have people who had quite the experience both at trying cases but also managing huge litigation teams. And then a fourth area that we thought was problematic was we hadn't quite yet convinced -- this goes to a point I made earlier -- the courts about the applicability of certain key legal principles using the Merger Guidelines. I had litigated outside the Government against the Department of Justice the *Baker Hughes* case, which resulted in a court of appeals decision that seemed to put the agencies to a huge burden in terms of disproving likelihood of entry, and we worked in terms of all the cases we brought on trying to take the parts of the *Baker Hughes* decision that seemed consistent with the "timely, likely, sufficient" aspects of the Merger Guidelines, as articulated in '92, to try and bring the courts along.

And then we looked at, you know, how we were approaching the trials, and some of the issues that we focused on have already been covered in terms of making sure we had dealt with this tension between market definition and the approach the agencies would take internally in terms of figuring out whether things were problematic. We talked about how to tell the story, not just during the week or two or three in which there would be litigation, but in the briefing.

I was, in listening to the panel at lunch, reminded that in the opening brief we filed in the *Staples/Office Depot* case, which I was -- George Cary said I wasn't the best associate he ever had but that I was the oldest -- I wrote large portions of that brief, and the thing that occurred to me on day one was that we had some economic evidence of pricing differentials between markets where Staples or Office Depot was by itself and markets where they -- and we wanted to get that evidence before the court.

If you look back at that brief, we put a pie chart on page 2, a graphic that showed pricing differentials, and the notion was find a way to take that which we understood on a very detailed and complicated level, make it simple, make it clear, grab the trier of fact as early as you can, well before there is an opening statement.

We tended to favor -- and I still do, and I think Susan may have mentioned had -- multiple story-tellers. It may have been Connie's point, but this notion of explaining what is problematic about a particular transaction, not just through the lawyers and through briefing, but if you have an industry expert, that can help. If I had Dick Rapp to be not just the presenter of the econometric analyses he did, but, you know, he's always shown me to be somebody who is articulate and thoughtful, speaks in layman terms. If I could get him to integrate the rest of the evidence that he reviewed that formed part of his expert opinion about why this is problematic, that's just a way of reinforcing for the court that there is a lot here. And so I would do that.

There are many cases where the witnesses available to the Government are limited. In a consumer-facing transaction, you know, you can't get in, you know, Harry and Steve and Diane to -- oh, Diane's back, probably the wrong term, she would be good -- but to offer credible testimony. You know, it just doesn't work. So, you need to be mindful of what you can do and what you can't do, but I think that notion of not just showing the judge how to get to the decision the agency believes is appropriate, but making him or her feel that this is a problematic transaction in sort of the key, big-picture way of looking at going into court.

COMMISSIONER ROSCH: Okay, Connie, we are running a little bit short of time here. Can you elaborate on that and also describe how you weigh evidence?

MS. ROBINSON: Okay. Well, weighing the evidence is almost a summing up of what we have been talking about. I mean, what Bill has just said in terms of trial strategy is you have to look at the totality of the evidence, and it is all the types, altogether, and I think Susan used the term, in what direction does it all point? If it is all pointing roughly in the same direction, you have a much better case.

We all admire what happened in the *Staples* case, and there you had economic evidence that pointed to the price effect; you had company documents that talked about noncompetitive markets where they got higher prices compared to competitive markets; and you had some wonderful real-life pictures of baskets of supplies from markets where you had one superstore and another where you had three superstores and the individual items were priced higher where there was only one superstore. Wonderful visuals, wonderful evidence pointing in one direction: there is going to be a price rise after this merger.

So, you have to look at the totality of what you have, and you have to look at what the negative side is. Is your economic evidence pointing in a different direction from the documentary evidence? If it is, you have to ask yourself, long and hard, should I be bringing this case? What do those company documents say? Perhaps they have, you know, a wonderfully provocative name, like "Project Goldmine," which some documents in *Whole Foods* case did, but, you know, unfortunately, when you read the judge's opinion, he read further than the name, and he found information in there that showed that if they closed one of the Wild Oats stores, two-thirds of the customers would go to other supermarkets. So, the provocative name doesn't necessarily get you anywhere if the underlying document does not point in the same direction.

Customer testimony, I have already told you my bias about that, but particularly if there is a natural experiment, that can be very helpful. I think pricing evidence in company documents for me is sort of the single best thing if you can find it. It's powerful evidence to the court of what would happen after the fact. I don't think it exists in very many cases, and quite frankly, it would be interesting to look back at *Staples* to see what the other side argued the documents meant to see how strong that case was. I suspect there were some warts in the case that don't come up in the opinion so much, but good for them.

It is that combination of documents; testimony; and even declarations if they are not cookie-cutter declarations, if they make points that underline a key point of your case, and if the declarants are not biased. It seems like a lot of judges are kicking out declarations on the basis of bias. And so that is basically how I weigh evidence.

COMMISSIONER ROSCH: Well, let me tee up four or five specific questions now and ask the reaction of the panel.

First of all, live testimony versus declarations, what's your view?

Second, what's the role of pundits? In the *Oracle* case, Dan Wall used to walk out of the courtroom every day, stroll out to the Hanna Room, and there was just a huge press mob assembled, and he'd hold forth, usually in a very homey way, and that was thought not only by the client but by Dan to be very, very important. What's your view about the press that is received during a trial?

Third, what's your view about a plant or a store visit? I know that occurred in *Staples/Office Depot* as well.

Fourth, what do you think about cross examination? Dan did something very effective I thought in the *Oracle* case where he took the PeopleSoft executive vice president in charge of sales and marketing, who we knew was going to be a very hostile witness, and he didn't even -- he really didn't care what that witness said on cross examination. It was all about flashing -- he was using this witness as a set piece for being able to flash PeopleSoft documents up on the screen, and regardless of what this guy said about them, he looked foolish, because the documents were very powerful indeed. So, sometimes cross examination can be a very effective tool even if you're not getting a lot of really nuggets out of the witness.

Do you have any views about any of these subjects or anything else just to close up?

Susan?

MS. CREIGHTON: Yes. I think that the -- you know, I have increasingly thought that the use of cross, calling hostile witnesses, is something maybe that the agency should think about doing more. I think it was pretty effective in *Evanston,* I think it was effective in *Oracle*, and I think it is one way to sort of get out all those good company documents that can otherwise kind of -- the judge does not really hear or see. So, I think that is something -- I mean, it's risky, particularly if the executive is really good, you know, you're opening yourself up to cross where he then sort of has a chance to tell his whole story, but it might be worth the risk. But I'd be curious what you think of that, Bill.

And I guess I have also thought that for the same reason in terms of telling the story, notwithstanding the fact that the last time I think the Commission won in a district court was *Libbey*, where it was basically all on declarations, I think telling the story really is an important thing that the plaintiff has to do, and so I'd be inclined towards more live testimony and less declarations.

MR. BAER: I agree with Susan. I think I said earlier that I tend to be biased in favor of telling the story, telling the story live, and part of it is, you know, the Government has the burden, and you're going first, and while the opening helps, having somebody up there who's got some credibility independent of the advocate helps.

On the pundits thing, you know, the honest truth is I think what Dan Wall did was brilliant, that you have to be mindful of the environment you are in. You know, you could overdo it. The real action is in the courtroom, but to make sure one is explaining to the people who are covering a trial what's at stake is, I think, part of the Government's obligation. I mean, there is a public interest determination, a reason to believe determination that has been made and what the hell is it? And so, you know, finding a way quietly, not necessarily even with the courtroom advocate, to make sure the press understands why the agency has taken this time, invested these resources, seems to me very important.

I think Sue has it exactly right about -- and Tom -- about cross examination. You know, each trial is different, but looking for what you can and need to do to get your best evidence before the court, sometimes cross examination can be a very effective way of doing that.

COMMISSIONER ROSCH: Connie?

MS. ROBINSON: I like live testimony. I have concern, especially when some of the judges are now requiring canned economic reports, that the first time you see your expert witness is when he or she is testifying on cross examination, which is not the way I think the Government wants to start its case.

I agree with Bill. I think that you need to explain what you are doing to the pundits. I know that at some of the trials I was at, we actually had a press person who had that role, who would every day capsulize what the testimony was and what the key points the Government was making. The other side was doing it, too, but we thought it was essential to equalize that effort.

Plant visits I think can be very effective. Clearly the judge learned something when he looked at different stores and thought that the superstores were a different kind of animal from a WalMart, and so I thought that that if it can be helpful to your case, it's a good idea to suggest it.

COMMISSIONER ROSCH: Dick?

MR. RAPP: Thank you.

Live testimony, well, you know where I stand. He would say that, wouldn't he?

As far as what should come out of the mouth of an economic expert, I think as long as it falls within the broad rubric of discussing how markets work and how this market works, it is in bounds. There is a danger of overstepping that, and overstepping it, being out of bounds, is something that you wouldn't want your expert to -- a situation your expert would be in.

Just a last thought, under your "Other" category, I think -- I have never understood the phrase "gerrymandering markets," because we all start from the Merger Guidelines proposition that markets can be very narrow. It seems to me that there is insufficient attention paid in these unilateral effects cases to the time and cost of supply response and that perhaps some of the skepticism of judges to markets that have more than seven or eight words in their name arises from their saying, "Well, you know, how long is it going to take for Safeway to get into the organic foods business, retailing business," and so on and so forth? So, I think that may be a missing element in the proof of complaint counsel that markets that are small and tightly defined are genuine antitrust relevant markets.

COMMISSIONER ROSCH: You know, I am going to spring this on you, Dick, as sort of a last question. He doesn't know this is coming.

Would you please tell us what you think was the most effective cross examination that you have ever undergone as an expert? Can you kind of sum up for us what the salient points were of that cross examination?

MR. RAPP: The most effective cross examination was cross exam -- this is going to be an uneducational reply. I have to answer truthfully. It was the first time I came onto the witness stand in federal court, and I withheld cross examination very well, but I was unexpected -- I was unprepared for a question that just appealed to the -- this was not a judge, but a jury trial -- to their instincts. It was not a merger case. I was asked at the very end, "Well, you wouldn't want some" -- basically, without going into the facts, "You wouldn't want -- if you were a member of what was then a small firm, you wouldn't want somebody to do that to you." And I didn't know better than to say, "No, I wouldn't want that to happen." And that undid a lot of very effective cross examination, and I hasten to add it was a very long time ago. I'm sorry I couldn't give you a more educational answer, but that's the truth.

COMMISSIONER ROSCH: Well, sometimes those pithy questions are the best ones.

With that, I'd like to thank all the panelists, and thank you for your attention.

(Applause.)

(A brief recess was taken.)

PANEL 5:

VIRTUES AND LIMITATIONS OF

ECONOMETRIC VERSUS OTHER APPROACHES

FOR DEVELOPING ECONOMIC EVIDENCE

PROFESSOR BAYE: Welcome to the fifth and final panel of today. It has been an absolutely great session. I think this last panel will also be excellent.

As you know, this panel is on virtues and limitations of econometric versus other approaches for developing economic evidence, and that seems to imply that there are more types of economic evidence than just econometric evidence. I think oftentimes, when you listen to some people talk, they tend to use "econometric evidence" and "economic evidence" as synonyms. So, we will find out whether or not that is appropriate and to what extent there are some virtues and limitations of different types of analysis.

Before we begin, I'd just like to briefly introduce the panel. To my immediate left is Dennis Carlton. Dennis rejoined Compass Lexecon Economic Consulting after serving as Deputy Assistant Attorney General For Economic Analysis in the Antitrust Division of the U.S. Department of Justice. It was really sad to see him leave, because I spent the first two months of my job working with him on one of our gas price investigations. Dennis is the co-author of *Modern Industrial Organization*, a leading text in the field, as well as numerous articles on a variety of topics in microeconomics and industrial organization. He also holds the position of Professor of Economics At the Graduate School of Business at the University of Chicago and is a co-editor of the *Journal and Law and Economics*. In addition to his academic credentials, Dennis served as the sole economist on the recent Antitrust Modernization Commission, which also had 11 attorneys on there. I guess that was a fair fight, one Dennis and 11 attorneys. Dennis also was a consultant on the Antitrust Division's work on the 1992 Horizontal Merger Guidelines, and I am very happy to have him here today.

Sitting to my far right is Carl Shapiro. Carl is the Transamerica Professor of Business Strategy at the Haas School of Business at the University of California Berkeley. He's also the Director of the Institute Business and Economic Research and a Professor of Economics in the Department of Economics at UC Berkeley. Carl is also a senior consultant at CRA International, where he also serves on the board of directors. He has published extensively in areas of industrial organization, competition policy, the economics of innovation and competitive strategy. Carl served as the Deputy Assistant Attorney General for Economics in the Antitrust Division of the U.S. Department of Justice during 1995 and 1996. He's consulted extensively for a wide range of private clients, as well as the U.S. Department of Justice and the Federal Trade Commission, and testifies, on occasion, as an expert witness in the areas of antitrust economics, including intellectual property and patents. Probably most relevant for our panel today is the recent work that he's done with Joe Farrell that got some positive advertising, I suspect, or we will get what Carl's spin on that is. So, we are looking forward to giving him an opportunity maybe to respond in some ways to some things that might have been said about his work.

Orley Ashenfelter is at the far left. Orley has had a distinguished career and is the Director of the Industrial Relations Section at Princeton University and has been Director of the Office of Evaluation of the U.S. Department of Labor. He's been a Guggenheim Fellow and a Benjamin Meeker Visiting Professor at the University of Bristol. He's a recipient of the IZA Prize in Labor Economics; the Mincer Award for Lifetime Achievement of the Society of Labor Economists; a Fellow of the Econometric Society; the Academy of Arts and Sciences; the Society for Labor Economics; and a Corresponding Fellow of the Royal Society of Edinburgh; and a bunch more stuff that I am not going to read because we would not finish the panel. He's also done an extensive amount of academic research, editing the *Handbook of Labor Economics*, and he's currently co-editor of the *American Law and Economics Review,* and a previous editor of the *American Economic Review* for about six years. Many of you probably know Orley from the work that he did for the FTC as an expert on econometric issues in the *Staples/Office Depot* litigation, and he's also published several articles related to that research, but what you may not know is that Orley is also President of the American Association of Wine Economists and serves no wine until its time.

To my immediate right is Joe Simons. Joe Simons is Co-Chair of Paul Weiss' Antitrust Group. He joined the firm after serving as Director of the Bureau of Competition of the Federal Trade Commission. His history with the FTC's Bureau of Competition started in the late 1980s when he served as the Associate Director for Mergers and the Assistant Director for Evaluation. Joe's published a wide range of articles on antitrust-related topics. Together with Economist Barry

Harris, Joe co-authored the paper that actually introduced critical loss analysis to much of the conversation that we are having today.

MR. SIMONS: I take the blame.

PROFESSOR BAYE: You take the blame, excellent.

His recognitions included *Crain's New York Business* "40 Under 40" and *Chambers USA: America's Leading Business Lawyers.*

So, without further ado, I think we will begin the panel. It will be similar to the sessions that we had this morning, and I will ask each of the panelists to speak somewhere between three to five minutes, starting with Dennis.

PROFESSOR CARLTON: Okay, thank you.

Let me start out by saying that the distinction between unilateral and coordinated behavior that we hear about so often is really not the sharp one that you might think from reading the legal commentary and even some of the economic commentary or commentary by economists. It is not the sharp distinction from an economic point of view.

As practiced, unilateral effects is really a shorthand for saying that there is a differentiated product, or sometimes it is a homogenous product, with an estimated demand system usually. I postulate some usually static game of competition, Cournot, Bertrand, make some assumption about the game, and then I do a merger simulation.

Coordinated behavior, in contrast, is usually thought of as something more complicated, people are coordinating, but in economic terms, in game theoretic terms, that means it is more of a dynamic game. But both are using the economic theory of oligopoly and game theory, and to think there is a sharp distinction could easily lead you down the wrong path.

Regardless of what type of effects you are projecting or postulating for a merger, the relevant question is, how does competition change when you have one less player? You can think about that in the following way: You can say, holding however much rivalry is existing amongst the players in the way they compete against each other, if we have one fewer person, what happens? Or you can ask, is there some mechanism on which they interact that will change? Will more information become available in a way that is not occurring now if a merger occurs? Those are two different questions, but they are relevant. Both can be relevant.

So, with that introduction, let me now turn to what I am supposed to do, which is give you an overview of empirical tools to use to evaluate unilateral effects.

First, I will start out by reiterating something that Tom Rosch was saying earlier, that empirical -- and that Mike just said -- which is that empirical tools are a complement, not a substitute, to other economic evidence and analysis. There are two main empirical approaches econometrically to analyze, let's say, a merger. One is what economists called a reduced form, which you are really not asking the mechanism by which the price is affected. You are just asking, is price affected when you have one fewer player?

This is a -- no longer a very popular approach among new graduate students writing their Ph.D. theses. It is not as interesting as structural estimation, but it does ask the precise question that you want answered; namely, what happens if you have one fewer competitor or what happens as concentration goes up in an industry? The difficulty from an econometric point of view is in answering that question whether you are observing in the data an experiment that allows you to answer the question in a way that avoids a particular problem called endogeneity, but to lay people, really another way of saying it is, can you really determine cause and effect from your data?

And the real difficulty, I will just illustrate it, is that if the number of firms is determined by something other than the price, then you can see the number of firms changing, and you can then observe what happens to price. On the other hand, if the only thing that causes the change in the number of firms is price changes, then it is going to be hard to sort out what's causing what, okay?

Well, it turns out there are ways to deal with that problem. There are plenty of instances in which we have a natural experiment in which you have entry, that will occur in one part of the country, for example, and not another, that occurs for reasons wholly independent of current prices, and, therefore, you can observe what is going on. Well, that is a reduced form. That is one way to do things.

The second way to do things is structural estimation. In structural estimation, you estimate, as the name suggests, the underlying structure, and you try and piece together what is going on. You estimate a demand system, and then you postulate some competitive interaction, and you do a merger simulation.

Now, the estimate of the demand side uses typically sophisticated econometrics, and I think that that is a real gain for the profession. We have learned a lot about how to estimate demand systems. The merger simulation really tells you how to interpret your demand estimates.

Now, the difficulty with doing merger simulation is it requires lots of assumptions. You have to assume what particular competitive rivalry is occurring. It is always a static game, because we are not that good yet as doing dynamic games econometrically. Is it a Cournot game? Is it Bertrand? What do you assume about retail competition? Is it retail competition? Is it not? Is it competition at retail, or are they passing on and earning a margin? Are there dimensions other than price that matters? Advertising? Repositioning the quality of the product? Because of all these assumptions, it can often be hard to present such an analysis in court.

One advantage of structural estimation in merger simulation is it allows you to do lots of robustness checks and to figure out why certain things are happening in the model. If there is a merger, why is price going up? Would price go up if the demand elasticity were different? Would price go up if I assume more rivalry than I am assuming? So, it allows you to answer deeper questions than a reduced form, but it is more complicated.

I will just end by mentioning two other areas.

Consumer surveys, we heard a little bit about that in the previous panel. One thing you should ask is, who is the consumer? If you ask a retail store, what do you think about a merger, the retail store may not care very much if all the retail store is doing is renting shelf space. If it doesn't rent shelf space to this product, it will rent it to some other product, and as long as it has plenty of opportunity, it may be indifferent to mergers. So, you have to ask, is that the relevant consumer?

If you ask the final consumer, you should recall that economists, have a long history of being skeptical of what consumers say? They prefer to rely on what consumers have done.

I will mention critical loss just briefly. My own view of critical loss is that it's a shorthand, a useful shorthand, but a shorthand that simply restates everything about a demand elasticity -- everything about a demand elasticity simply in terms of the amount lost. It does not add anything theoretically to our bag of tricks, although expositionally, I think it can sometimes be very helpful if done correctly. And I think you should just view it as an alternative way to express your findings. Sometimes people take it further -- not Joe, by the way -- and I think make errors in how it is used.

So, I will just summarize, these empirical methods are complements, not substitutes to other types of economic analysis. A reduced form and structural estimation, each have strengths and weaknesses, and both are really powerful and more powerful analytic tools, I think, than either surveys or critical loss.

Okay, thank you.

PROFESSOR BAYE: Okay, thanks, Dennis.

Carl?

PROFESSOR SHAPIRO: I have a few slides, that's is why I thought I'd stand up here to present them, and I am going to talk about this paper with Joe Farrell that has been mentioned before, but it is a bit broader than just a question of econometrics versus other economic evidence, but it really goes to the question about what sort of evidence are we likely to really be able to get in most mergers and believe in and have judges understand, okay? The intersection between those three requirements is pretty small, but it is something that I think is very useful.

I think what my broader theme is is the whole -- the Guidelines now, with the whole market definition/ concentration approach, really distracts us from what we want to be looking at in unilateral effects cases, and it is very interesting to me that earlier today, we have heard people who do this, and the agencies say, "Well, of course, we don't really do that, following the Guidelines, because that's all screwy. We look at the competition between the merged firms, we figure out whether there are effects, and then we find a way to back into a market."

Well, that is telling us, first off, it is bad if your Guidelines don't reflect actually the way the agencies do the analysis, and it's causing problems in court, because it is a very convoluted way to go about things. Market definition actually works very well for coordinated effects cases where you are looking at a set of firms that would find it profitable to collude, but does not work well for unilateral effects cases. It can be misleading, uninformative, very circuitous, and introduces all these arbitrary parameters: The size of the SSNIP; the 35 percent; where do these HHI thresholds come from; some complicated apparatus that distracts; and I think judges will frankly say, "What's going on?" Plus it's suggestive if something is not in the market, it doesn't compete at all, and that's wrong. So, it is really causing problems for the agencies.

There is a much more direct approach to take, and this is in terms of will a merger create upward pricing pressure? And one of the other things we have heard today is how unilateral effects is extremely intuitive. Actually, it is, look, the companies were competing beforehand for customers. That competition will be lost. How significant is that, okay?

Well, we actually have a way to measure those things, and this is the test that I am suggesting. So, let's talk about Whole Foods and Wild Oats, since that's, you know, the recent case of considerable interest. Before the merger, the unilateral effects, when Whole Foods goes out and tries to contract customers, some of those customers will come at the expense of Wild Oats. That will become cannibalization rather than captured business after the merger.

After the merger, that would be -- we could think of that as an opportunity cost, a very key concept in economics. If Whole Foods gets business, if it's lost by Wild Oats, which is owned by the same owners, the same company, that will be a cannibalization and a cost. So, that will tend -- that cost tends -- since it is a higher cost in making sales, the price will tend to go up. On the other hand, there will be some efficiencies which will push the price down.

Overall, will there be net pressure up or down for the price? Well, this is the formula Dan Wall was making fun of earlier, because it actually has two or three variables in it. I might point out to him -- of course, he scurried from the room, I suspect not wanting to stick around to hear the response --

UNKNOWN SPEAKER: There is no Greek in there either, I notice.

PROFESSOR SHAPIRO: What?

UNKNOWN SPEAKER: There is no Greek in there either.

PROFESSOR SHAPIRO: No, there is no Greek. I could put Greek in.

The Herfindahl has many -- is a much more complicated formula, which is far less directly relevant anyhow, so, I mean, the notion that -- I cannot accept the notion that the agencies are incapable of going to a judge and saying we have to multiply two or three things together and subtract something, that that's the test, okay? So, if that's where we're at, it's very sad, okay?

So, basically, it would take a little longer to explain this, but the amount of -- the fraction of the sales coming at the expense of Wild Oats, that would be the diversion ratio, D. The profit margin on each unit sale at Wild Oats, that is the P minus C term. And if that is bigger than the efficiencies, we have upward pricing pressure, okay?

This is extremely robust. It doesn't matter what type of oligopoly conduct is going on. We don't need to know the shape of the demand system. I don't need to estimate a structural model. I don't need to use econometrics. I need to be able to measure a few variables. And I would say, looking at company documents, this is something that is doable. This is very practical, to measure prices and costs. Margins are already measured in merger analysis. In order to do critical loss, you have to measure the margin. That's one of the few things you have to measure to do that.

You do have to measure the diversion ratio. Well, that's what we really care about. How closely are these firms competing, okay? And if there are many other firms that are competing equally or -- you know, then the diversion ratio will be low, and this will result -- this diagnostic test will say we should not worry about the merger. So, you know the famous quote from Einstein: "Everything should be made as simple as possible but no simpler." Well, that is the one thing, besides the margin, prices and costs, to measure the extent to which customers are switching between the two firms, okay?

Go right at it in my view, and I think you see that often in the documents. There is no black box here. There is no simulation. A lot of the criticisms of merger simulation is that it's not robust, that it's hard to understand, don't apply, okay? So, this is very simple and transparent, extremely well rooted in economics, based on the general principle if costs go up, prices will go up, okay?

Samuelson had a theorem in 1943 that was extremely general. As I said, you only need to measure a few variables. And the reason it works so well is it totally focuses on the change due to the merger. If you are going to estimate a structural model, for example, in econometrics, you need -- you are trying to explain basically a master theory of how prices are set in this industry, okay?

I don't have such a vision, okay? I just want to know in which direction is this merger going to tend to push prices from their current levels? So, focus entirely on the change, which is the internalization of what had been competition and becomes cannibalization. There is no arbitrary parameters here; no artificial boundaries. You don't have to say other firms are not competing. You don't run into the traps that Dan Wall has been setting for us at all, okay? Yes, the other firms compete. Mergers with them might also raise price. You know, we will talk about that if they propose one. No artificial boundaries. You don't have to explain a broad structural presumption or what it's based on or Herfindahl levels.

So, this, it seems to me, could really cut through things substantially, and as I said, it is extremely robust. We show in our paper it does not depend on the form of oligopoly conduct. If you wanted to estimate the demand system, go ahead and be my guest, but it won't matter for this test, and we're not trying to predict the magnitude of the price increase; just price pressure. So, we're proposing this as an alternative to the market definition/market concentration screen to tell whether mergers are problematic, and then there could be further analysis beyond that.

And likewise, if this were put in the Guidelines as an alternative, then in court, the agencies could say we did this test, the merger showed that it had a tendency to raise price, and then we did additional analyses to see whether repositioning, entry, additional efficiencies, the back part of the Guidelines, could basically still be used, but we wouldn't get into all these struggles with market definition, market concentration, and getting bollixed up, losing cases, because of an inability to define the relevant market.

I agree with Dan Wall that -- just so I mention, the second-stage inquiry would be similar to what it is now. So, I agree with Dan Wall that it seems to me you need to change the Guidelines to do this, because otherwise, you will have that "gotcha," okay, but it does seem to me that it is somewhat dysfunctional now, does not reflect the actual practice, and this is very strong, solid economics. So, if you have additional evidence so you can do econometrics, that might be very useful at the second stage, but I don't want that -- but you don't -- you often don't have that, and that is not going to ultimately probably convince the judge as part of the story. The story here is very simple. It's a story of loss of competition, and then we have a way of quantifying that.

Thanks.

PROFESSOR BAYE: Thank you.

Orley?

PROFESSOR ASHENFELTER: I have a few slides, too.

I hope you can hear me while I try to -- can you hear me all right? I am losing my voice. Once again, Carl gave me a cold. We were meeting on the --

PROFESSOR SHAPIRO: I liked your work.

PROFESSOR ASHENFELTER: I am sure you did. We had a meeting on the weekend of industrial organization economists at the National Bureau, actually, and it was reminiscent in a way of the difference between this meeting and that one, and the difference is that when you are here, we are the economists, mostly. It is apparent that maybe we are not that welcome. There was a very -- a very good friend of mine sent me -- there is an underground on the internet, by the way, of economist jokes, and I am reminded of -- by the way, there was an article, if you want to send me an email I will send it to you, an article in the *Sentinel Chronicle* where the guy went off on the internet and got all these jokes about economist, and I am reminded of one which is the story of the devil taking a man down to hell, and on the way down, they pass a really beautiful woman who's in a heated discussion with an economist, and the man says, "That's no fair. How come that economist gets to talk to that beautiful woman?" And the devil responds, "Who are you to question the penalty of that woman?" I guess you get the point. Sitting in a room with economists is really no fun, and it is worse when you talk to econometricians, and that's probably me.

The normal -- the standard joke about them -- and this drives lawyers crazy, and it's true -- is about the three econometricians out hunting a deer and with their weapons, and they see one, and the first econometrician raises his weapon to his shoulder and fires and misses by a meter to the left. The second one immediately raises his weapon and fires and misses by a meter to the right, at which point the third one leaps up and says, "We got him." I have heard those comments basically all day long, because precision, we really don't believe in precision that much.

So, let me just make a few comments about the role of econometrics. I was the econometric guy, one amongst others, in the *Staples* case, and I have been involved in several others, including the one that was mentioned here, *Swedish Match*. The first point I'd like to make is to distinguish between -- and this is relevant for Carl's paper, too, which I have read, by the way -- actually, I lost it, did you take it back from me? -- it is a very interesting paper and interesting idea, but the first point is the difference between regulation and trial.

I don't know if you realize, if you are an economist, the undertow this morning. The regulatory agencies operate really in a different way than when they go to trial, and I guess this meeting is, in part, a result of that. So that as I sat and listened to Carl or I read his paper, actually, I think what he has in mind is very sensible from the point of view of regulation; however, I have testified in a courtroom, as have some of the others, and I am not really sure how it would go over in the courtroom itself. So, there is a distinction, I think, that has to be made between those two. I appreciate -- I think lawyers do understand that well -- maybe economists don't understand it so well -- about whether you are really thinking about something that will be done on a day-to-day basis, whether you are just thinking about a regulatory environment as opposed to the courtroom.

Now, the courtroom, let me tell you my defining story about that. It actually changed my whole life in some ways. For years and years, I have taught judges in -- like Vaughn Walker is a student of mine, not a student like at Princeton, but a student in courses for judges. And Diane Wood was a student, and I think Doug Ginsburg, too. All of them were students. And my memory of this started in 1979. We did this starting in 1979. I had done it with a private group at George Mason and also with the Federal Judicial Center, and in my memory of it, I was struck by the following:

We were in a lovely place, and a federal judge at the time, we started talking, and -- very informally, and he explained that he was in Princeton a lot, went to Princeton. I said, "Oh, that's nice. Why are you there so much?" He said, "Well, I am on the board of trustees." Well, that's pretty big, my boss really. I said, "You know, let me ask you a question. There has been this discussion in the press" -- and this has had a big effect on the way judges can learn some of this material, about how judges are being brainwashed by the -- whoever it may be, the Federal Judicial Center, which is actually their own agency, or somebody else. So, I couldn't resist, and I asked him, "What do you think of that, of our brainwashing?" And he said something that I will never forget. "Orley, with all due respect, I have been brainwashed by the best, and you're not in that league."

In other words, the point is we are really rubes as economists when it comes to making arguments, and I took away from that something that I think is very important in litigation but also in my own work, which is the credibility of what you do. So, the discussion of natural experiments, I mean, to some extent, I invented natural experiments. Difference in differences, these are all about, to some extent I invented that, too. I mean, probably one of the earliest papers published uses that, something I did in the Labor Department when I was a bureaucrat, and here is how it came about.

It came about because I wanted something that was credible and simple. A difference in differences regression, I will just take a second, is basically a regression with panel data that takes out fixed effects for individuals and time periods, but all of it can be presented as take a mean, subtract another mean, take another mean, subtract that, and then subtract the two. That's actually a monster regression. It's an extremely powerful technical method, a very, very powerful method, but it can be presented in a very straightforward way, and it is now -- I mean, people talk about it every day. It's kind of almost in the ordinary line of business that people have done that, and most people do not realize it was never a method. It's a regression, but it's a way to present the regression so that anybody can understand it if they can subtract. Now, I admit, not everybody can do that, but subtracting is all you need.

So, let me give you an example of it, because this is a paper actually -- Carl presented this paper, although it's our paper, done with a guy upstairs, Dan Hosken. This is a study, I just want to show it to you the way it looked, a retrospective study of merger effects, and it's actually a difference in differences, just a simple thing. These are mergers that went through.

You can see up there, they are all from the late nineties. I bought the data from IRI. There is, of course, cereals and motor oil and various things, pancake syrup. You can see the change in the HHI that was implied by them, typically problematic. We picked these because they would generally have been considered "problematic" based on public information, public record. I imagine that some people in these agencies would understand more about this than I do.

And then how do we do the analysis? Well, it's just a difference in differences. We had different control groups, but the simplest one is to take the change in prices for an aggregate -- you can do it product by product if you want, whatever -- and take the change in prices pre- to post-merger for the merging products and subtract the change in price from the same period for private label brands in the same category, of which there are many. The gap between the private label brands and others in price is enormous, by the way, as in that case study that was presented earlier.

Now, I only present this because actually, I could take that first number up there, in front of a judge or a jury or anybody, and I could tell them exactly how it's constructed. There's four numbers that underlie it. There's a pre; there's a post; there's a control group pre and post, and I have to subtract all four of those numbers. I could show that to you, and then once you see that, suddenly, I think anybody can understand how credible that is.

Now, I mean, what's the problem? Well, the problem is, of course, I can do this. I was interested -- these were selected, by the way, to be problematic, and they give you some feeling for what merger effects -- mergers that were at the margin, that we think are the worst case, were that were going through, what's the problem? Well, the problem, of course, is that in a merger analysis, you can't do this. These are retrospective, after it's all happened.

Now, Carl and I probably would agree -- Dennis, too, maybe -- that one of the things the agencies have not done very well -- and this was basically touched on this morning -- is some retrospective analysis of mergers that actually go through. One of the reasons that I think people, as it was commented upon this morning, don't see antitrust problems out there is because no one's telling them that prices are going -- relative prices are going up because of mergers. There is no evidence on it.

Now, admittedly, the worst cases probably are not occurring, but it would be logical to see more of this kind of work going on, and I think it would help to inform, in a more general environment instead of a litigation environment, what we mean. But the reality is that you can't do this kind of work going prospectively except in some very, very rare situations.

The rare situation, I fell into it, was the *Staples* case, and I want to mention it only because it leads me to a basic point, which is, what makes, from the point of view of litigation, a good case? I think what makes a good case is one -- it has been said by all the lawyers here -- where you have a good story; where there is disinterested anecdotal evidence, sure, but most anecdotal evidence is not by disinterested parties, so, you know, one of the few legal phrases I know is an admission against interest. Those are very valuable, but there is not very many of them in courtrooms. So, those are valuable.

A story that hangs together with some credible evidence that anybody can really follow -- and I mean by that anybody -- is what makes for a really good case. The *Staples* case was strange in the following way: It was strange because the anecdotal evidence -- anecdotal here in this particular case were business documents. I mean, more or less, you know, like a Kellogg MBA would have written them. What do you do when a competitor comes in? And, you know, make sure 30 days in advance to let everybody know to lower prices, and -- so, this was all kind of out there in the public -- well, it was obtained, clearly not something that really is used in the course of business and not something that was ginned up just for the merger.

And then there was -- there were facts to back it up, I guess Judge Hogan accepted those, and the only reason I got involved is because, really, at some fundamental point, there is a difference about whether cross-section differences are as good as difference in differences, and that was really the source of my initial involvement in it.

But I think that the thing held together because it had a good story and it had very credible evidence, but it did not have -- the thing that surprised everybody -- a great example of market definition, which you can see most of us are driven crazy by this, because it's ginned up so that you can construct an HHI. In fact, when I put those numbers up right there, people ask me, "Yeah, but for what market are those HHIs calculated?" And, of course, the answer is just for the ones that I have that set of data, just a simple-minded idea.

So, anyway, the last thing, I think that a case that would make good litigation is not necessarily the same thing from the point of view an economist as well as the point of view of a lawyer, and being able to go forward with credible evidence that has a good story behind it is really critical, I think, from the point of view of the agency winning cases, and we need for them to do that, because that's the one thing that I think operates as the big background factor that other mergers that might be anticompetitive have to operate in the shadow of. So, we need that shadow. We need to cast a shadow out there so that that issue is credible.

PROFESSOR BAYE: Thank you, Orley.

Joe?

MR. SIMONS: So, Mike will probably wonder why I am standing up. I have no slides; it's just that my back is just stiff.

They pick these panels, you can tell, with a purpose. So, if you looked at the panel that appeared earlier, you would see there was one economist and four lawyers, and I felt bad for Dick Rapp, the lone economist. Dick was ganged up on a little bit. So, that panel was kind of geared toward the more legal stuff, and this panel has four economists and one lawyer, and so this panel is geared toward, the importance of economists. Although you might not recognize that, given my fellow panelists are so self-deprecating.

I think one of the things that's really important for the Commission or any prosecutor to do when they go to trial -- and to do it really early -- is to pay attention to the economics and to the economists. I think that is absolutely critical. These guys sitting here are important, and all the economists in the room here are absolutely critical.

One of the reasons that they are so critical is because everyone talks about telling a story; you want to say something that is consistent; you want to have the judge hear the same thing over and over again from various witnesses. Well, how do you do that? Well, you have a construct. You have an economic theory. That's your story. Your economic theory is going to tell you what evidence is important and what evidence is not important.

So, you can have all the customer affidavits you want, you can have all the hot documents that you want, but if those documents and that testimony doesn't relate to what is relevant, then you have nothing. So, that's why these guys are absolutely critical. And I'll echo something that the earlier panel said, which is that the trier of fact is invariably a federal judge, has very little economics background, probably maybe a little more antitrust, but maybe not much, and so what is that judge going to do during the trial? The judge is going to think, reason the way the judge normally thinks, the way most of us in this room normally think, which is based on experience. You extrapolate. That's what people tend to do.

So, what the judge is going to do to extrapolate based on experience in that courtroom. What does that judge see? So, that's why you have to have this overall construct. You have to tell the judge, "Here's our theory." And you have to tell the judge, "This evidence is relevant, this evidence is not relevant, here's why." And then, "Here's the evidence." And then the judge hears it, sees it, and knows exactly where to put it in the construct, right? That is how people remember things. And if you haven't spent time with your economist during your investigation, then you do not have a really good construct in all likelihood.

One other point I'd like to make about the economists as it relates to the trial is that when you're the prosecutor, at least when I was a prosecutor, the thing I wanted to know really badly, before the

Commission voted out a complaint, was what is the cross examination of my economic expert going to look like? Because if I don't know that, then I have a chance of getting blind-sided. I could have put together an entire case where I am putting all this evidence in, and the other economist gets up and explains, "Well, that evidence is really not relevant and here's why." And then I am really in bad shape.

The only way that you actually get to see the cross examination before the complaint gets voted out is you have to show the merging parties what in effect would be your case on direct, and you have to do it early and often. Have a dialogue. Make sure you are telling them what you are thinking, what your economists are thinking, let them talk to your economists, and make sure there is a real dialogue. Don't have this discussion go solely through the lawyers, which, can get miscommunicated or lost in translation. That, to me, is absolutely critical, and it's really important that the Commission do that as well.

And then the third point I want to make is that I agree with Carl, on the first point he made. I think it's really important. The Merger Guidelines in 1982 were just a huge development, a huge advance in antitrust jurisprudence, and my own personal view is they were an advance because it was a complete, integrated whole. They were geared specifically to evaluating the possibility of mergers causing tacit collusion.

The market definition is structured to deal exactly with that goal. When the Guidelines were amended to include unilateral effects, the market definition was not changed in any meaningful way. So, the unilateral effects was shoehorned into an pre-existing structure, and the Guidelines lost their cohesive whole. And so one of the things that I would strongly recommend is that the Commission not just run in to court and say, "We don't have to do market definition." Go back and think about what the Guidelines -- what the analysis should be done, from A to Z, for unilateral effects. Make it a unifying, whole approach, just like was done for collusion in the 1982 Merger Guidelines.

Thanks.

PROFESSOR BAYE: Thanks, Joe.

To kick things off, I will start out with a question, and I hope it will keep us on the theme of the virtues and limitations of these alternative sources of economic evidence.

Dennis talked about a number of tools that are available, and I think he highlighted one of the tensions that exists between many of the new Ph.D. students who are very interested in structural estimation versus kind of where we are in litigation matters. So, looking at the entire litany of tools that we have available, from reduced form estimation, structural estimation, noneconometric techniques, like critical loss analysis, and so forth, what are the relative limitations of those methodologies or how robust are those alternative technologies for answering unilateral effects questions?

PROFESSOR CARLTON: Are you asking me? Okay, okay. You were looking at me.

Actually, I thought a bit about this. There are a lot of techniques out there, and the question is, has anyone evaluated which techniques work better? I mean, we can all theorize which techniques are likely to work better. Actually, there is a paper in the *Journal of Law and Economics* that evaluates the different techniques in the context of an actual merger, and it says which ones do better, and these structural -- these very complicated structural estimations, which are appealing, you know, to the set of new Ph.D.s, turn out, surprisingly, not to do better in predicting price effects than some of these simpler, reduced forms analyses, and that's not a big surprise for people who sort of learned macro when I learned macro in graduate school.

It was about the time when these giant macro models were losing popularity as predictive tools in contrast to very simple, sort of trend line predictions, so that sometimes simplicity can do a good job of making predictions. So, you know, my own sense is that these different techniques are complements to one another, reduced form and structural are complements, but there is a great benefit for simplicity. And if you think about real simplicity, you don't want to make things so simplistic that they are useless, but market definition is an attempt to make something very simplistic for someone who does not know much about econometric or economic technique, and, therefore, there is a virtue of trying to, if you can, convince a judge that what you are doing is reasonable by saying, "Here's -- you know, I have done this sophisticated analysis, and by the way, another way of thinking about it that might square with your thinking is here's a reasonable market definition, and lo and behold, this is how it emerges," and, you know, from my analysis, that I find a problem, and if you did yours, a more simplistic analysis, which is extremely crude, you get the same answer.

So, I think we have to be a little careful of dumping too much on market definition, because even though we may think it's inferior to a lot of tools we use, it may be something that's much easier for a judge to grasp, and, therefore, he's less likely to make an error.

Now, there was something that Joe said that I wanted to follow up on. I agree with him, that unilateral is kind of stuck in there, and if you really believe in unilateral effects, then -- you know, two firms having an effect on price, well, if two firms are having an effect on price, if all other prices were constant among the products, they alone should be a market, and you get a peculiar situation in which you can get very narrow markets, and I think that makes judges uncomfortable, and that's because, you know, there is just a -- it may be perfectly sensible from an analytic way of interpreting the Guidelines and to an economist, but a judge wants something more heuristic.

That's why I don't like this distinction so much between unilateral and coordinated. I think it is an artificial one, but all I would say is I don't think we should dump too much on market definition, because it is something that can prevent, especially unfamiliar -- judges and juries unfamiliar with economics, from deviating too much.

Having said that, if the other quantitative techniques show that there is an effect, I would say, "Listen, Judge, there's an effect here. One way to think about it is the market exists, but don't, you know, get hung up on sharp dividing lines between what's in and out of a market, and don't let that deter you from understanding the economic forces that my analysis is revealing."

PROFESSOR SHAPIRO: If I could add a comment on that, too, the question you raised, Michael. The fact is these mixed structural models are a lot of fun for the econometricians and exciting methodologically, but they're pretty fragile, and I don't think they have a very good record. I think it is the Peters paper that you are referring to.

PROFESSOR CARLTON: Yeah, Peters.

PROFESSOR SHAPIRO: Which looks at the airline mergers and --

PROFESSOR CARLTON: He's at the Department of Justice.

PROFESSOR SHAPIRO: Is he? Okay. But even holding aside and comparing their predictions versus what actually happened, we just know that they are finicky, these models, and as Dennis said before, there's already this assumption of static model. Well, where did that come from? You know, there's all these assumptions, the functional forms and they require a lot of data, and so I just -- and it seems very -- extremely nontransparent. I just don't see how judges are going to ever put much weight on that. I don't -- not for -- we are nowhere near there, and I don't see why they should.

So, I think the more reduced form approaches are much more promising, and the question is simply, when can you do that? I mean, as Orley pointed out, *Staples* was sort of lucky in that respect. I mean, you could have a case where you could say there was an industry went from five to four players three years ago and we saw the price went up, and so now we really shouldn't let it go from four to three, or you might have different geographic markets or some other way that you could have just a direct test of the question, but that's pretty rare in my experience, and that's -- so, I think, while those are much more straightforward, we can't usually do that, and so that is why I go back to a simple test based on a few observables.

PROFESSOR ASHENFELTER: Let me just comment on one thing, which is that, first of all, I agree with Dennis. The eval -- I mean, to some extent, the failure to evaluate the effect of what actual mergers have accomplished, what effect they have on prices, is related to this problem of evaluating the models. You can't really do that unless the merger takes place. So, there's a sense in which those are related problems, and without having -- and a lot of work. So, that's point one. It's really -- if there were more ex post evaluation, retrospective, there would be more better -- more and better ways to test some of these models.

Point two is the big -- many structural models -- the high end, I will say the most elaborate models that economists use that study industrial organization, are actually undergoing quite a lot of change. At the meeting Carl and I were at, we heard one incredibly disturbing paper where people are using a certain kind of nonlinear estimation procedure, and it's quite unclear whether or not the published literature actually has objective values that have been minimized.

This paper actually took two very famous examples and used ten different algorithms. There are a lot of different ways to solve these very nonlinear problems, like an engineering problem, and with different starting values, many different starting values, and had a quite disturbing record of what was there, and this guy wasn't even trying to reproduce what was already in the literature, but there was a lot of underground discussion -- nobody wants to talk about it very much -- that a lot of -- some of that work may change.

So, the old-timers would say, "Well, maybe it's better, if you are going to use a simulation model, to use something not too complicated," and the grounds for that are at least we know -- you know, better the devil you know than the one you don't. On the other hand -- so, let me just say that.

Now, on the other hand, some -- in effect, everybody's using the simulation model when they do a prospective merger analysis, because even Carl here has to get a diversion ratio. So, that means he's got to fit some kind of demand curve. So, there's got to be some econometric analysis that's going to be done for this exercise or at least something that would give us some idea of what that is, and I think demand estimation is a very difficult subject. I mean, trying to find out what cross-elasticities are is not -- that is not a simple project.

If you want to do that credibly, even if you have a bunch of economists sitting around -- in other words, we are talking about regulation here rather than going to trial -- even then, it can be tricky as to whether or not they'll agree about what they think is the best way to estimate them. And then, if you go further, you get into the courtroom, then, of course, it's a lot more complicated, because you have to try to explain what a cross-elasticity is. Diversion sounds better, I agree, but still, you have to have some measurement of it.

So, the -- I think the answer is that we cannot really do without them if we are going to do anything that is prospective, and so the only correct answer here is we have to work better to try and figure out how to use these things in a better way, and I think all these suggestions have been good ones.

PROFESSOR BAYE: Joe, do you have anything to add?

MR. SIMONS: The only thing I would add is just to say that I think it is really important that, you know, for the trier of fact, for the judge, that you have a whole range of weapons in your arsenal. Some could be complicated; some can be really much more simple; and some could be as simple as looking in the company's documents and saying, "Here, they did this survey, this is consistent; there are these lost sales reports, this is consistent; here is this authorization for capital, which explains what this project is going to do, and that is consistent." So, I think you want to have a full range of economic tools in your testimony.

PROFESSOR CARLTON: Could I just say -- follow up really on two points Orley raised?

You know, I agree with him that, you know, what Carl is doing, you need cross-elasticity, so it is a kind of simulation, but I think a more fundamental point, even when you use market shares, that is a simulation. So, when a judge adds these numbers together and says, "Oh, now I am going to use what they say in the Merger Guidelines to estimate, you know, if it is a price change I should be worried about," that's a simple simulation model. So, the question isn't whether you are going to have a simulation or a predictive model. You do. It is only how simplistic you want it. And the market share is real simplistic, and then you can get increasingly sophisticated.

The second point is really perhaps not so much aimed at the attorneys in the room as at the economists in the room, and that has to do with what do economists know about mergers after they've occurred? And when I was on the Antitrust Modernization Commission, Hew Pate asked a very good question. He says, "How do we know we are doing a good job?" And we chose not to study that question. But this summer, when I was at the -- you know, in the Department of Justice, I decided I'd write a memo, a one-page memo, to Tom Barnett about how to answer that question, and my instinct was to use retrospective mergers, much like Orley was saying.

It turns out that one-page note turned into about a 20-page paper, in the Department of Justice Economic Analysis Group, a web series, because it is a much more complicated question, because the mergers that you see that have gone through are mergers that we have allowed to go through at the Department of Justice, and unless you take that into account, you are going to get a biased answer as to the effect of mergers, because if it is a really bad merger, we don't let it go through. So, you are only seeing the mergers go through that we think won't create a problem.

So, if you look at mergers and you see that most don't create a problem, that is just what you should expect, okay? So, it is not telling you, in general, if you let a merger go through, what happens. So, here is what it turns out: It is very hard to determine if we are doing something right in antitrust policy just looking at retrospective mergers. In general, we are going to find they are not going to cause too much trouble. You have to make a correction for the fact that we are prescreening.

But it is even more than that, and this is where the burden comes on economists at both the Department of Justice and Federal Trade Commission. If you really want to determine if you are doing a good job, what you need is at the time you either decide up or down on a merger, you should write down what your predictions are about prices, about entry, about, you know, product quality, and then what you do retrospectively is not just see what happened in the marketplace, but see what happened in the marketplace relative to our models that you are using to predict, and statistically, that turns out to be a much more powerful way of making a determination as to whether the FTC and DOJ are doing a good job.

And until we gather that data, the most critical piece being what it is you think your models are telling you at the time you are making a decision, I think we are going to really remain in the dark as to whether we are doing a good job or a bad job at the federal agencies regarding antitrust policy. So, I encourage the economists, one, to read the paper I have, and two, to gather the data that intuitively you must have when you are making a decision, and do not be afraid to write it down, data about your predictions.

PROFESSOR ASHENFELTER: Let me just -- I don't really agree with you on that. The -- I agree with the point about, yes, in fact, basically, anybody who fits a simulated model, and then that can be done in the agency, and then you can look later at what happens, it is a good idea. I completely agree with that. Doing all that is a great idea.

But I don't agree with the notion that doing a retrospective merger analysis doesn't tell us a lot about the agency. The reason is because, for example, the design of that paper I was showing you, the design of that is to take the ones that are the most problematic that went through.

Now, if those were big price effects -- actually, a lot of people would have thought they would be negative. They weren't. They were positive. So, there is some mergers going through that have, in that period, small positive price effects, but that does tell you that there is a lot worse ones that didn't get through, but by getting a upper bound on how bad they are, you are getting -- that's what the agency is supposed to do, right?

I mean, the alternative is not that we abolish the whole procedure. If that were the alternative, we could say, "Well, sure, many mergers are probably cost-helping." We are only in -- the business is just to try to get rid of the ones that are going to be anticompetitive. There is lots of others that are not. And the -- I think the best test for is that bound. Now, if, for example, the data we have for the nineties, if, for example, that bound has slipped upward in the retrospective, if I were I were to do this again and the bound has slipped upward, yeah, I'd say we are not doing as well as we used to in terms of finding anticompetitive things and stopping them.

Now, I don't know if that is true, but the point is, in a way, you could almost have a third party -- by the way, you should never ask the agency to evaluate itself. That is like completely crazy. I learned that much a long time ago. So, there has to almost be some third party that does that. I mean, it is just not appropriate -- it is not fair even to ask the FTC to evaluate how it is doing. Somebody else has to do that.

So, to some extent, you could say it should be academics, but, of course, they don't have any interest in doing it either. So, it is kind of a difficulty here. It should be an agency -- like the GAO should do it or something, right, somebody who's at a higher level.

PROFESSOR CARLTON: I don't care who does it --

MR. SIMONS: You said that with a smile, right?

PROFESSOR CARLTON: -- but the point I was making is the information you get from retrospective merger studies would be greatly improved if you could compare it to the predictions at the time.

PROFESSOR ASHENFELTER: I completely agree with that. That would be fabulous.

PROFESSOR CARLTON: The other point is that if you are finding positive effects for some of these mergers, they are actually even more positive than you might otherwise think because of the self-selection problem.

PROFESSOR ASHENFELTER: Well, depending on whether I selected right. In other words, if I picked the ones -- you know --

PROFESSOR CARLTON: Right.

PROFESSOR ASHENFELTER: -- there could be worse ones, you are right.

MR. SIMONS: And also you want to look at the efficiencies if you are going to do that, because some of these might have involved relatively small parts of a transaction or relatively small markets.

PROFESSOR ASHENFELTER: Well, there are a lot of issues about doing retrospective things, right, because you would like to have longer periods. I mean, how to do it -- I think if you were positioned well, as Dennis was describing, I think you could do a pretty good job. I think it would be very informative.

PROFESSOR BAYE: Another question I wanted to ask, I think Dennis touched on this a bit in his opening remarks, but I want you to talk a little bit about the relationship between econometric evidence, proving competitive effects, and market definition.

What are your views on whether or not econometric evidence alone ought to be enough to prove a case? And if not, what other evidence is useful or would be a substitute? And once one has established econometric evidence of competitive effects, is it necessary to do what some of the earlier panelists suggested and go back then and construct a relevant market around those competitive effects?

PROFESSOR SHAPIRO: Well, I think I have stated pretty clearly it would be much better if we did not need to do the market definition exercise. It is not really getting us the answer. It is very round-about. I mean, really, what you -- if you have reason to believe there are effects -- and I don't care what method you are using for this argument, whether it's a simple test that I proposed, whether it's a reduced form, whether it's a big structural model, if that's what convinces the agency, let's say, that the merger is causing a problem, to then go back and do a quite different exercise about market definition, measure shares, in order to use that as a surrogate for effects seems rather retarded, actually.

And I think the only reason we do it is for historical reasons, and I guess -- I mean, according to some people, fine, we have to do it because that's what the case law is, okay? So, if that's what you are telling -- if that is what the lawyers are telling me, then I will say, "Okay, we will do it since we have to do it, but shouldn't we look for a route to a more coherent approach by changing the Guidelines and eventually bringing the courts along in what is a more direct approach?"

So, I think it would be very nice to have an alternative track that didn't go with market definition, not to take away that track as a way for the Government to make its case.

MR. SIMONS: I was going to say, I think, just chiming in for the lawyers here, the statute does say tends to substantially lessen competition in any line of commerce, which means a market.

PROFESSOR SHAPIRO: Really? Why does it mean the market?

MR. SIMONS: Well, because that is what the cases say.

PROFESSOR SHAPIRO: Well, that's different.

PROFESSOR CARLTON: I think you have to ask who's answering the question whether you need a market definition. I think if economists do a study, most economists would say, "If I know there are competitive effects, if I can show you that prices go up, and I am convinced of that, that ends the inquiry." That is precisely the question.

So, the only issue is the decision-maker, who is not maybe an economist, is going to have to evaluate economic evidence, and if the economic experts don't, you know, for and against the merger do not unanimously agree, yes, there are competitive effects and prices going up from this merger, then the judge -- and obviously that won't be the case -- the judge is going to have to decide, "Who do I believe? One economist says there are no competitive effects; the other one says there are competitive effects."

Now, maybe he can weigh those, but the question is, what else can he look at? He can look at other evidence, but I think he -- and I think he will be compelled by the cases to ask, is there some market that would -- if I do a market definition, would give me an inkling as to being an additional piece of information that might help me? Now, in many cases, I agree with Carl, it is a completely circular exercise for the economist if he knows there are competitive effects, but for someone who doesn't know which economist to believe, this can prevent him in some cases from making errors.

Now, in other cases it could cause him to create errors where none would exist. So, that seems to me the relevant question for someone who has to decide which economist is telling the truth, is this helpful or harmful? And, you know, my own sense is that if you are a persuasive economist and you have competitive effects that are clear, you should be able to explain to a judge why that must mean, from an economic point of view, that some relevant market -- and you should, if you can, articulate one as best you can -- that is roughly consistent with your views.

But I think you should emphasize that market definition is not this very highly tuned, scientific, analytic exercise that the Guidelines seem to make it out to be. That I think is something I would certainly, you know, agree with that criticism.

MR. SIMONS: I was going to say this discussion makes me think back to the article by Landes and Posner in which they had that formula, that demonstrated the importance of the demand elasticity is facing the "market" that you've defined. So if you find effects, then, there are potentially a whole series of markets you could define, one more plausible than the next, and I agree with your point completely.

You could present it to the judge in a way that says, "Judge, here, this is -- this merger is going to have an effect or this conduct is having an effect. You could define the market this way, this way, or this way. In either case, the shares are whatever they are, and you will probably be able to define one or several where the shares are reasonably high, and maybe not, 50 percent or 75 percent, but, you know, in the range in which courts have found mergers to be unlawful." And this would make the judge feel comfortable, which is really important.

And then the other thing I was going to say is I think the agency really needs to start -- you know, I am repeating myself -- revamp the Guidelines, come up with its own -- its own analysis, just like they did before in 1982, and start to sell that approach in court in a way that is seeped in through the economists. The judges then start to buy it, and if nothing else, you still may require a market definition, but you end upcoming into an *Indiana Federation of Dentists* world where the court does not pay too much attention to market definition at the end of the day. And the other alternative is, to go to Congress, but who knows what happens there?

PROFESSOR BAYE: What about the first part of the question? That is, is econometric evidence sufficient to prove a case or is there other economic evidence that one would need to present?

MR. SIMONS: With the most brilliant economist imaginable with the most fortunate set of data imaginable, it's just hard for me to believe that you could survive with just that, and I think you have really got to have a full picture.

PROFESSOR SHAPIRO: Well, you know, we heard earlier that, you know, eventually you have to tell a story and convince a judge that the effects will be there. So, I guess the -- kind of what I am picking up is if you do that, then from what the lawyers are telling me, then you would be foolish not to then backfill a market that is consistent with that, which seems to -- I think to the economists to be kind of a pointless exercise, but we are checking off a legal box, and then I think the question is whether Dan Wall and his folks will be able to throw up enough smoke around that and say, "Are you kidding? This stuff that is outside the market. You say they don't compete. That's not true." He cross examines the witnesses. You get all that junk getting brought in, and I guess you are telling me we can't avoid it. It seems like a shame to me, but -- and effectively you are leveraging the effects to define the market to try to check that box.

PROFESSOR ASHENFELTER: There is another point I'd like to make, especially after listening this morning to these other discussions. The value of formal econometric evidence is -- even if we can disagree about its interpretation -- is it's not just my opinion. The power of this is very, very important. You see it every day in medicine. You may have seen that the study of diabetics, maybe there is someone in the room that's been alarmed by this, that worked hard to get their blood sugar down is killing them. They stopped the study part way through. These are randomized trials. It is the gold standard way of doing it.

There is -- everything in medicine says bringing down your blood sugar is a good thing. This is a complete shock to everybody. So, you could have found every doctor who would be saying the more you can do to pound that sugar down, the better, and you would have been killing yourself. We have seen lots of examples in medicine and even in economics occasionally where some powerful facts that just come about because of an accident almost, not an experiment, let us get that new information.

I think what always bothers me about, you know, is this in this market or is this in this market or, you know, I think this car is like -- I like this kind of car a lot and it would be a big substitute for that one or I ski in this place and the other ones are not really close to it or something like that, I always want -- you know, we know consumers have heterogenous preferences. There is absolutely no reason to think that that single anecdote tells you anything about anybody else's preferences.

And there is a -- I think there is a tendency to appeal to that in some ways sometimes when you are not using any kind of econometric evidence. It bothers me. So, it's certainly not -- I agree that it can never be the only thing, the econometrics, but it's pretty scary when you don't have any.

MR. SIMONS: Yeah, those anecdotes that you were just telling are actually the genesis of critical loss. I sat in rooms with people and we had discussions about how much substitution is enough? And it became clear to me after a while that some of the people in the room had in their mind that some large percentage of the customers had to view the other product as a substitute, like 75 percent. It wasn't being stated expressly, but when you peeled away the layers, it was there. The economics helps you get all those assumptions on the table up front. In fact, if you went back and looked at the NAAG Merger Guidelines, they say the same thing. You have to have I think 50 or 75 percent of customers view two products as substitutes for those products to be in the same market.

PROFESSOR ASHENFELTER: Carl's diagnosis -- method here, by the way, does get around that. I mean, you notice how the margin makes a huge difference as to whether -- I mean, that's a simple intuition, right? A little bit of diversion with huge margins is worth a lot, but it is kind of hard to explain that without having, as you say, something that can -- I think it can be explained in words to people, and if you can back it up, it's fine, but I only mention it because the anecdote -- I appreciate you're trying to -- you're trying to find a way to explain something to people that they can't otherwise get their hands around, and I appreciate that.

PROFESSOR CARLTON: You know, there is another issue, and that has to do with what is the proper way to present expert testimony and is our court system geared for that? It is a slightly different topic, but there are other forums in which, when you have opposing experts, what the court tries to do is hone down between the two experts and see what is the consequence for their differences, and when it's just opinion, as Orley was saying, that's hard to distinguish, you know, what is the scientific basis for the difference?

When they are using analytic techniques, it's a -- it can be actually refreshing to see a judge or a panel getting the different experts to explain their different assumptions and then for the arbitrators, for example, to say, "Well, why don't we adopt this one? This is the most reasonable one. Now redo your stuff. Now redo" -- so, you narrow the differences between the experts, and, you know, I have had two experiences with that.

One is when you testify in -- I think it was in New Zealand, they put the experts together, and you don't get cross -- give your direct testimony. You give a presentation, and then the other expert gives his presentation, and you are sitting together, beside each other, and the lawyers can ask any expert a question. So, my lawyer would cross examine Orley, and if he didn't like the answer Orley gave, he would say, "Professor Carlton, what do you think of Professor Ashenfelter, what he just said? Is that baloney or how would you answer that question?"

It turns out to be a more -- a very effective technique of reining in what experts can say. But probably the most unusual experience or -- positive experience I had along those lines was I was in an arbitration, actually, Orley was in the same arbitration, in which the arbitrator was an econometrician, Dan McFadden. Orley and I were on the same side, though, representing different clients.

People got in a room, and they each explained what they did, and then McFadden said, "I think this is the best assumption for that. I think this data set is the best one for that. I think this is the most reasonable way to" -- and there was generally convergence, then, by all of the sides.

So, these more complicated techniques can be quite useful for narrowing differences. I am not sure, though, that a jury system or a judge system, the way we have in the United States, is the appropriate way to use these sophisticated techniques among different experts to narrow a divergence of opinion, but there may be other settings in which that would be desirable to pursue.

PROFESSOR BAYE: Well, since we have converged, we have actually converged to 5:00, which means our time has expired.

On behalf of Chairman Majoras and the Commissioners, the Bureau of Competition, and the Bureau of Economics, I'd like to thank you all for participating in this event, and we look forward to working with you all in a positive way in the future.

(Applause.)

(Whereupon, at 5:01 p.m. the workshop was concluded.)

C E R T I F I C A T I O N   O F   R E P O R T E R

DOCKET/FILE NUMBER: P073901

CASE TITLE: UNILATERAL EFFECTS WORKSHOP

DATE: FEBRUARY 12, 2008

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: 2/25/2008

____

SUSANNE BERGLING, RMR-CLR

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

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

____

SARA J. VANCE