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MEMORANDUM

"**HMG Review Project – Comment, Project No. P092900"**

Comments by Mary Coleman and David Weiskopf re: Questions #2 and #3

2. Should the Guidelines be revised to address more fully how the Agencies use evidence about likely competitive effects that is not based on inferences drawn from increases in market concentration? If such revisions are undertaken, what types of such direct evidence are pertinent? How should the following categories of evidence be used?

Comment: In most in-depth investigations, the competitive effects analysis involves a great deal more than making inferences from increases in market concentration. Certainly, at a minimum, most competitive effects analyses do not simply look at the changes in share and concentration level. The purpose of competitive effects analyses is to predict how the change in the industry structure due to the merger will impact competition and market outcomes such as prices, output, quality and innovation. The question then becomes what types of evidence are most suited to predicting the competitive effects. In some cases, the approach is to model (either implicitly or explicitly) the industry and from this model, predict the merger's impact. This will generally require some information on the scope of the market and its participants, the current competitive dynamics, and an assessment as to which economic model is most appropriate to capture the essential features of the industry. In economic terms, this equates to using a "structural" approach to estimate the effects of the merger.

However, in some instances there may be information that directly addresses the question of the potential effects of the transaction without necessarily (even implicitly) developing a "model" of how the merger will create these effects. In economic terms, this is using a "reduced form" approach to the analysis.

These two approaches are generally highly complementary. While direct evidence can be very useful for assessing competitive effects, its value depends on the quality of the evidence. First, to assess the evidence properly, it is necessary to control for other factors that might explain the patterns derived from the evidence. As such, similar to a "structural" approach, a detailed understanding of the industry and its structure is important for properly analyzing the evidence. Second, in some cases, the "direct" evidence is not based on the actual transaction but rather on evidence that could proxy

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for the transaction. In such cases, it is very important to assess how good of a proxy is the analysis of the evidence for drawing inferences regarding the competitive effects of the proposed transaction. Third, analyzing this type of evidence is generally relatively complicated and requires some assumptions or choices in the approach, and the results may be somewhat dependent on those assumptions and choices. Thus it is important again to understand the industry and to make appropriate assumptions and choices in the analysis. Moreover, analyzing direct evidence in conjunction with a structural approach can be used as a check on each analysis. For example, the implications of the analysis using direct evidence can be compared to what one would predict from the structural approach. To the extent that the two approaches yield similar answers, the more confident in the results one can be. If the two approaches provide different answers, then one should attempt to reconcile the differences or assess which approach is superior.

Clarifying these two approaches in the Guidelines would be useful – particularly highlighting that there can be two complementary approaches to assessing competitive effects. The phrase “inferences based on increases in market concentration” could be taken as simply looking at the changes in the level of concentration rather than what is apparently meant: predictions based on changes in the market structure (i.e., the loss of an independent competitor). Further, defining what is meant by “direct evidence” and how this might be distinguished from the other approach would be useful.[1]

a. For an already consummated merger, evidence of actual, adverse competitive effects.

Comment: Direct evidence is potentially the most informative for assessing an already consummated merger because rather than trying to predict the effects of a proposed merger prospectively, the competitive effects are in theory directly observable. Conducting such analyses may be complicated, however, by many factors. First, if the investigation starts shortly after the merger is consummated, there may be limited “post-merger” information to use to analyze the impact of the transaction. Second, many factors unrelated to the merger can impact market outcomes, and controlling for these factors may be difficult. Certainly, it is not enough to simply compare prices before and after the merger without assessing what other factors could be impacting prices (and this is clearly not the approach either agency would take). Controlling for these other

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[1] In addition, it would be quite useful to provide examples of the types of evidence that might be considered “direct” – particularly indicating the types of issues that can arise and must be addressed. However, this does run the risk of providing too much detail for a Guidelines format and might be better provided in Commentary or speeches.

factors will inevitably require some assumptions about what factors are likely to be important, what data or information can be used as control variables, how to incorporate this information into the analysis and how to handle factors for which information is not available to use as a control.

Because there are likely to be disputes about the approach taken including the choice and quality of treatment and control variables, it is important to consider other methodologies for assessing the competitive effects of an already consummated merger. For example, if the direct approach shows a price increase, one could assess whether the more "traditional" approach to merger analysis would also predict a price increase. It would be useful for the Guidelines to explain that in consummated transactions, the agencies are likely to attempt to determine what happened to prices, output and other market outcomes following the transaction but will also evaluate this evidence in light of a more traditional predictive approach. Further, the weight that the "direct" evidence will be given will vary depending on the specifics of the particular matter.

b. Evidence based on so-called "natural experiments," such as variations across geographic markets, time periods, customer categories, or similar product markets showing how customers are affected by competitive conditions whose variation may be comparable to the change to be wrought by the merger.

Comment: This type of evidence, to the extent available, can be very helpful in assessing the potential competitive effects of a merger and is routinely used by the agencies and merging parties in merger investigations. As such, it may be useful to describe this type of evidence in the Guidelines as descriptive of the types of analyses conducted in merger investigations. However, there are several important caveats to these analyses that should be noted. First, as with the analyses of outcomes before and after a consummated merger, it is important to try to control for other factors that could explain differences in outcomes. Second, it is vital to consider how well the natural experiment proxies for the change that would occur because of the merger. For example, is the impact on price from entry likely to be similar to impact of the merger at issue? This was a key area of dispute in the Whole Foods matter. An important question was whether an analysis of the impact of Whole Foods entry on Wild Oats prices was useful to proxy the effect of the merger. Third, are there other market changes (such as entry, expansion, on-going repositioning) that might cause past outcomes to be unlikely to be predictive of future outcomes? Finally, there are likely to be disputes about the correct approach to conducting the natural experiment and thus again, it is useful to consider the analyses in conjunction with a more traditional approach to assess whether the outcomes are consistent.

c. Evidence of the merging firms' post-merger plans.

Comment: It is common in investigations to review business documents or statements by business personnel to determine how the firms view various issues. At times, the documents related to the transaction will have statements related to the firm's post-transaction plans related to market outcomes such as pricing or supply. It is relatively unusual that these documents would explicitly state an expected anticompetitive outcome from the merger (although this can occur). If such documents or statements exist, they may provide some useful direction to the investigation but should not on their own be dispositive. First, the context and source of the document must be considered as well as whether the author is in a decision-making role. Second, it is important to evaluate whether other pertinent factors are consistent with the claims (e.g., are the planned actions credible given market conditions?). Third, the statements may not be about expected anticompetitive outcomes. For example, in some transactions, the acquiring firm plans to shut down some of the facilities owned by the selling firm. This, however, is not necessarily an attempt to reduce output or raise prices but frequently instead relates to efficiencies. In other cases, documents valuing the deal may have some implicit or explicit assumptions about market outcomes. In some cases, these assumptions may differ from the current market (for example, the documents may assume higher prices). In such cases, the agencies will routinely investigate the reasons for these assumptions. Documents may also provide information as to the pro-competitive intentions for the deal. Again, the credibility of these documents must be tested against market conditions.

It is not clear however that including much discussion of documents in the Guidelines is warranted. At most, it might be useful to include in the list of potential direct evidence, but one which will be given limited weight unless it can be supported by evidence that indicates that the statements are credible given other information about the market.

d. Evidence from customers about how they will respond to, and be affected by, the merger.

Comment: Evidence from customers about how they view the merger and might respond to it is routinely collected in merger investigations and is useful, particularly in early stages, in providing insight into the potential for competitive effects. However, such evidence cannot alone generally be conclusive on competitive effects. Customer evidence in general is most useful for providing facts as to what has historically occurred in the industry. Customer views about the future potential effects of the merger are generally less useful. First, unless all customers or a representative sample are surveyed, the information may not reflect the views of the important marginal customers (assuming no price discrimination). Second, even if a representative sample is surveyed, customer views may differ – in part because some are more at risk than others and thus one must consider whether enough are concerned that an anticompetitive effect is likely. Third, concerns (or lack of concern) about the transaction have limited value unless the customers can articulate specific reasons for the concerns (beyond that they prefer more to fewer suppliers) that are consistent with their past behavior. Thus, customer opinions can be used to test the predictions from other analyses but should not be viewed as conclusive on their own. For example, if other factors indicate competitive concerns but customers are not concerned, further investigation might be needed to test the information used in the other analyses or why customers are not concerned even though they could be harmed. Given recent court opinions that place limited reliance on customer views to predict the outcome of a merger, it may be useful for the Guidelines to indicate that while the agencies will continue to survey customers as to their views of the transaction, these views will not be used on their own to determine competitive effects.

e. Evidence that the merging firms have engaged in significant head-to-head competition leading to lower prices or other customer benefits.

Comment: The agencies routinely evaluate evidence that the merging firms have engaged in head-to-head competition. This evidence, however, should not be used on its own to predict anticompetitive effects. While the lack of direct head to head competition certainly suggests that unilateral effects are unlikely in most cases, the presence of significant head to head competition does not itself indicate that a merger would necessarily be anticompetitive or result in unilateral effects. Rather, one needs to model how competition works in the industry and assess whether the loss of head-to-head competition is likely to be significant. It may be that competition from other firms will be adequate making anticompetitive outcomes unlikely. It may be worthwhile to indicate that this evidence is more likely to be used as part of the overall competitive effects analysis rather than as direct evidence of the effects of the merger on its own.

f. Historical evidence of actual or attempted coordination in the industry.

Comment: The usefulness of evidence of actual or attempted coordination in the industry depends on the nature of the coordination. For example, if there is evidence of ongoing tacit coordination in the industry, this likely would increase concerns about the transaction as it would either remove one of the coordinating firms or one of the firms in the “fringe.” Generally, this might make coordination easier for the coordination group or make the coordination more stable. In some cases however the merger could destabilize the coordination by altering incentives to participate. If the evidence relates to attempts in the past to coordinate tacitly that have failed, such evidence will not necessarily provide information regarding whether the merger will increase the likelihood of coordination. Rather, this evidence might indicate reasons why coordination is difficult and thus point to the types of analyses that might be useful for assessing whether the merger will alter this outcome. Similarly, evidence regarding past explicit coordination may not be indicative of the potential effects of the merger. If the past explicit coordination required significant information exchange and monitoring to be successful, the merger may not change the likelihood of tacit coordination. Rather, past coordination may indicate the factors that are important to successful coordination and thus indicate the types of analyses that might be useful to determining if the merger will make coordination in the future more likely. Clarifying the role of past coordination in the Guidelines, either as part of the direct effects evidence or more likely in the general discussion of coordinated effects, is likely to be useful.

3. Should the Guidelines include a more detailed discussion of how the hypothetical-monopolist test for market definition (§1.11) is applied? This could include discussion of the following points.

a. Why the hypothetical monopolist approach often leads to properly defined relevant antitrust markets that do not include the full range of functional substitutes from which customers choose.

b. How to conduct "critical loss analysis," including the proper use of evidence regarding pre-merger price/cost margins.

Comment: Given the substantial recent controversy on the use of critical loss and how best to define markets, it is likely worthwhile to expand more fully on how the hypothetical monopolist test is implemented. One potential issue, however, is whether there is enough consensus as to the correct approach. Key issues to address include:

- Does the SSNIP refer to an increase for all products in the candidate relevant product market or a subset and is the increase uniform? In practice, the most common approach is to assume a uniform increase for all products and this approach is certainly the easiest to implement; however a monopolist might not find it most profitable to take this approach. A discussion of how to analyze whether non-common price increases are profitable and likely as part of a merger is better done as part of the competitive effects analysis.
- Acknowledgement, at least for non price discrimination markets, that the hypothetical monopolist test focuses on customers that would switch at the margin, not whether all customers would switch. The question is whether the marginal group of customers is large enough to make the price increase unprofitable. Thus a showing that many (or even the majority) of customers would not switch does not necessarily mean that the hypothetical monopolist test is met.
- Discussion of what critical loss is and how the critical loss level fits well into the hypothetical monopolist test – a point which is relatively non-controversial.
- Discussion that implementing the critical loss approach however requires estimates of:
    - The appropriate margins to use to assess the profits the hypothetical monopolist would lose on sales that would shift following a price increase
    - How much volume would shift (the actual loss).

These are among the more controversial areas. First, what is the correct margin to utilize and should it be assumed to be constant? Second, how does one gather information on actual loss? Some argue that the margins themselves provide information on actual loss – at least for individual firms (and presumably the actual loss for the group of firms is no greater than this) but others argue that this is not the case. Given this controversy, it may not be possible to have a consensus view reflected in the Guidelines. However, it would be worthwhile in some forum to address these issues. It is also possible to take a middle ground

– state that information on likely actual loss is important to gather (although estimates of the actual number may not be available) but also that the agencies will routinely consider whether the estimates are consistent with margins earned or whether there are reasons for those differences.

It may also be useful to briefly comment as to why not all functional substitutes need to be included – that is, the market definition exercise is an attempt to identify the products that provide the most significant competition to the merging parties. Products that are functional substitutes may not be considered good options by consumers and would require a substantial price increase to cause consumers to shift and thus provide substantial potential scope for price increases in the smaller set of products. Thus, simply looking at all functional substitutes is likely to result in too broad a market. I note that there are some who would suggest that not all producers of the products in the market need to be included if a subset when acting as a cartel could raise prices because the other suppliers do not have enough capacity to constrain a price increase. This however confuses competitive effects with market definition. Moreover, by this approach, the suppliers in the minimum viable cartel would have 100% share – which would not appropriately capture their incentives to raise price (the lower their share, the less likely a price increase would be profitable).