Before the
Federal Trade Commission
FTC File No. PO92700

Comments of the Consumer Federation of America on the Proposed Horizontal Merger Guidelines

Mark Cooper
Director of Research

June 4, 2010

The Urgent Need to Reinvigorate Antitrust Practice

The purpose of the *Merger Guidelines* is to create a better understanding about how the federal antitrust authorities approach the challenge of protecting the public interest in implementing their vital function of overseeing mergers. The current guidelines have ceased to provide that two critical functions for which they were intended – informing the public about how the agencies will act and protecting the consumer interest in merger review. The implementation of the consumer protection function has lost all touch with reality and the actions of the agencies have ceased to reflect the *Guidelines.* For a decade or more, the agencies have routinely approved mergers that blatantly violate the *Guidelines* based on theoretical grounds that do not reflect the reality of the markets in which mergers are taking place. The proposed revision to the *Guidelines* represents a potentially important step in addressing both of the problems. They propose to rescue antitrust practice from the stranglehold of pure theory and ground the *Guidelines* in reality. By doing so, they create the opportunity to ensure that antitrust practice reflects the *Guidelines.* Ultimately, the proof of the pudding will be in the eating. Future actions in merger review should reflect the *Guidelines* more closely.

The weaknesses of contemporary antitrust practice are legion, as summarized in the Exhibit 1, which is based on Robert Pitofsky's recent edited volume, *How the Chicago School Overshot the Mark.* Pitofsky's summary judgment identifies a series of weaknesses that have plagued antitrust practice generally that seem to apply with particular force to merger review:

> "Specific concerns include preferences for economic models over facts, the tendency to assume that the free market mechanisms will cure all market imperfections, the belief that only efficiency matters, outright mistakes in matters of doctrine, but most of all, lack of support for rigorous enforcement and willingness of enforcers to approve questionable transactions if there is even a whiff of a defense. [1]

[1] *How the Chicago School Overshot the Mark* (Oxford: Oxford University Press, 2008), (p. 5).

These flaws in antitrust practice have built up over decades, so they will take time to weed out and the weeding out will have to take place in the real world. The rewrite of the Merger Guidelines is a step in the right direction, particularly since it emphasizes empirical reality. Viewing the rewrite of the *Guidelines* through this lens, it is remarkable how much they could accomplish, although the value of the rewrite can only be assessed as antitrust authorities bring cases and make decisions. The exhibit provides running commentary on how the specific approaches of the revised *Guidelines* can address the flaws that have afflicted recent antitrust practice. It is clear from this analysis that the revisions open the door to a vast improvement in merger review from the consumer point of view, which should be the focal point of analysis.[1] The text of these comments summarizes the broad themes we see in the revision.

Bringing Practice Back to Reality

Antitrust practice prides itself of being a case-by-case empirical discipline, yet, over the past couple of decades major parts of the antitrust law seem to have been captured by pure economic theory that had little grounding in reality.[2] The proposed rewrite of the merger guidelines moves antitrust practice back in the direction of the real world in a number of important ways.

---

[1] Pitofsky, p. 5. "Contrary to what some believe, antitrust is not only or primarily a system to ensure that business rivals do not behave unfairly or in a predatory manner toward other businesses. It is rather a "consumer welfare" system of laws. If businesses grow in unfair ways to be too dominant in their sectors or the market, rivals conspire to raise prices or divide markets, use patent and other forms of intellectual property to fence out rivals in unreasonable ways, merge to monopoly or dormant positions, or engage in the scores of other practices that traditionally have been regarded on balance as anticompetitive, and are protected by less than vigorous enforcement, prices will be higher, quality of products lower, and innovation diminished – and consumers will suffer the consequences."

[2] Robert Pitofsky's (*How the Chicago School Overshot the Mark* (Oxford: Oxford University Press, 2008), judgment identifies a series of weaknesses that have plagued antitrust practice generally that seem to apply with particular force to merger review: "Specific concerns include preferences for economic models over facts, the tendency to assume that the free market mechanisms will cure all market imperfections, the belief that only efficiency matters, outright mistakes in matters of doctrine, but most of all, lack of support for rigorous enforcement and willingness of enforcers to approve questionable transactions if there is even a whiff of a defense (p. 5).

- Emphasizing competitive effects, rather than getting hung up on theory is critical to avoiding many of the mistakes of the recent past.
- Competitive effects will also moderate the excessive importance that has been placed on market definition.
- Speculation about potential entry will be tempered by an examination of the actual history of entry. "Woulda, coulda, shoulda" competition has played far too large a role in justifying mergers. If entry is easy, as theory claims, the antirust authorities must ask, why hasn't it happened.
- Claims of potential efficiency will be tempered by a fundamental commitment to consumer protection.

Profit maximization is the central purpose of firms that propose to merge and efficiency gains are one way to increase profits. However, efficiency gains will only be in the public interest if they are passed through to consumers. They will be passed through to consumers only if the post-merger market is sufficiently competitive to force them to be disgorged by the dominant firms in the post merger market. Mergers in concentrated markets can short circuit the pass through of efficiency gains by affecting the demand-side or the supply-side of the market. On the demand-side they may expand the quantity of demand subject to dominant firm pricing (i.e. the residual demand in a Nash game), or they decreasing the elasticity of demand. On the supply-side, they may reduce competitive rivalry, alleviating pricing pressures or pressures to innovate.

The thresholds that will trigger concern have been set consistent with the finding that "four is few and six is many."[3] Markets where the HHI index is the rough equivalent to a market with six or more equal-sized firms are considered competitive. Markets where the HHI index is the rough equivalent to a market with four or fewer firms are considered higher concentrated. These are a relaxation of the most recent version of the guidelines, in which the thresholds were set ate 10 and six equal sized firms. If the revision enables the antitrust authorities to make the

[3] The earliest English language reference is Reinhard Selton, "A Simple Model of Imperfect Competition: Where 4 are Few and 6 are many," *International Journal of Game Theory*, 3 (1973).

thresholds more binding – to challenge mergers more consistently when they violate the thresholds – this will be an important step forward. Antitrust authorities had failed to challenge and the courts have failed to block too many mergers that result in post-merger markets with equivalent of four, three and two firms.

The Need for Further Clarification

There are several areas where the revision opens the door to important improvements in practice, but does not fully seize the opportunity.

The revised *Guidelines* identify a number of different potential harmful effects that will be considered, but it misses the opportunity to clarify the very different nature of the effects. The revision expands the notion of coordinated effects to include accommodative and interdependent behaviors, which is a major improvement. The *Guidelines* should go one step farther and clearly distinguish three types of effects that can result from high levels of concentration.

- Unilateral ("of relating to, or involving one side: done, made, undertaken, or shred by one side of a subject'[4])
- Coordinated ("to bring into a common action, movement or conditions: regulate and combine in harmonious action"[5])
- Parallel ("extending in the same direction and everywhere equidistant: forming a line in the same direction but not meeting…marked by likeness or correspondence esp. in time, duration, course, tendency or development, similar, analogous, or interdependent in line followed: tending toward the same point or result[6]).

A sharp distinction between coordinated effects, which involve a sense of active "management" of behavior, and parallel behaviors that do not is critical. Modern economic analysis recognizes that the latter category is of considerable importance in industries with small numbers of participants. The small numbers problem is growing, with many important industries

[4] *Webster's Third New International Dictionary* (Springfield: Merriam-Webster, 1986), P. 2499.
[5] Id., p. 501.
[6] Id., at p. 1637.

typified by large minimum efficient scale and few competitors. Coordination and collusion are no longer the prime concern. Demonstrating that there has not been or is not likely to be collusion is only a small part of the challenge of merger review, since parallel conduct plays a large part in oligopoly markets. While the revised *Guidelines* identify the different types of behavior that are of concern, lumping coordinated and parallel behaviors in one category perpetuates the under-appreciation of parallel effects.

The proposed *Guidelines* make a brief mention of concerns about the way in which vertical mergers can have horizontal effects. The *Guidelines* should devote more attention to this issue. The horizontal impact of vertical integration plays an increasingly important role in a number of industries where horizontal markets are highly concentrated and tightly integrated with complementary products. This is especially true in high tech industries where platforms provide the basis for a wide array of services. Vertical leverage to achieve anticompetitive horizontal effects is a severe problem in these cases.

Given the large number of important sectors in which there is a small numbers problem (airlines, railroads, newspapers, broadband access, multichannel video, wireless communications, operating systems, search) the agencies are constantly challenged to find approaches that allow the capture of efficiencies of economies of scale and scope, while preventing the harm of anticompetitive effects. To the extent that the purpose of the *Guidelines* is to provide greater certainty the business community and the public, the agencies should consider adding a section on remedies. While divestiture has been a primary remedy, the much more complex situations faced by the agency, particularly in high technology industries, requires more sophisticated responses. The agencies should begin the process of adding a remedies section by conducting a review of non-divestiture remedies implemented in recent years.

EXHIBIT 1
A DOZEN WAYS THE REVISED GUIDELINES CAN REINVIGORATE MERGER REVIEW

CRITIQUE OF MARKET FUNDAMENTALISM IN ANTITRUST ENFORCEMENT*

Fundamental Flaws

Over-reliance on the market to cure everything (4, 5)
Over-emphasis on efficiency to excuse everything (5)[1]
Over-estimation of ease of entry and expansion of output (42, 236)[2]
Failure to recognize wealth transfers as a cause of consumer harm (90)

Faulty analytic approach

Over-reliance on economic models, that privilege theory over fact (5, 42, 57, 82)[3]
Over-concern about false positives rather than false negatives (52, 123)
Failure to require empirical evidence leads to over-estimation of efficiency gains (18, 42)[1,3]
Failure to require demonstration of mechanism for pass through of efficiency gains (263)
Defines markets too broadly, resulting in underestimation of market power (243)[4]
Failure to recognize non-economic impacts and causes (42)
Places burden on the wrong party and imposes impossibly high standards of proof (164, 260)[3]
Ignores subjective evidence and customer views (165, 243)[5]

Substantive Weaknesses

Underestimation of horizontal impacts[2,4,9]
Overbroad claims of importance of monopoly rents as inducement to competition (85)
Overbroad claims of importance of intellectual property monopoly to innovation and R&D (6, 3, 183)
Downplaying ability of leading firm to raise rival's costs and engage in predatory practices including
pricing, boycott, tying, bundling, retaliation, (27, 57, 80, 126)
Non-cooperative gaming ability to raise prices (6. 56), divide markets (6)
Importance of anticompetitive impacts of network effects (56)[6]

Failure to recognize the anticompetitive potential of vertical leverage (52, 127, 141)[7]

Over-reliance on single monopoly profit to absolve harm of maker power (40)[8]
Overstated defense and incomplete analysis of vertical restraints (19, 186)
Potential effects of vertical leverage by (1) creating market power in tied product, (2) maintaining
market power in tying product, (3) facilitating collusion and parallelism, (4) evading regulation
Enhanced tools of monopolization through (1) raising rivals cost, (2) refusal to deal (3) increases barriers
to entry

Policy outcomes that harm competition and consumers

Under appreciation of the importance of concentration allows merger to domination (6, 236)[9]
Under enforcement and tendency to do nothing (6, 36, 37)
Failure to use structural solution (29, 122, 126)
Over-protection of autonomy of leading or dominant firms (86, 127, 165)[10]
Under-emphasis on dynamic efficiency and competitive rivalry (79, 80)[11]
Lack of appreciation for the role of mavericks (81)[12]

IMPROVEMENTS IN MERGER REVIEW ARISING FROM THE REVISION OF THE GUIDELINES

1. The revision preserves the high evidentiary threshold for crediting efficiencies but combines that with an approach that relies much more on empirical evidence, which should make meaningful the approach that affirms "that the antitrust laws give competition, not internal operational efficiency, primacy in protecting consumers (p. 3).

2. The revision focuses on empirical evidence and history of entry (p.27) and the lengthy discussion of competitive effects moves the review in the same, real world direction (pp. 20-25)

3. To escape from an over-reliance on theory in a predictive undertaking (p.1)

> (a) the agencies move real world, historical and contemporary activity in related and similar markets or actual natural experiments to the center of the analysis (p.3).
>
> (b) Merging parties are required to provide data on a variety of market, company and merger specific issues (p. 4)
>
> (c) including margins and gain/loss analysis (p. 12)
>
> (d) the discussion of competitive effects in relation to price discrimination is another example of the real world orientation of the revision (p. 6).

4. Recognition of the importance of competitive effects for market definition is an important step to restrain the tendency to define markets overly broad (p. 7); the discussion of market definition introduces the problem of overly broad market definitions first (p. 8).

5. Value and use of customer views and other industry participants and observers are analyzed (p. 5).

6. Example 2, p. 3 shows direct relevance of this concept.

7. Example 1, p. 2 involves this effect

8. Discussion of direct customers (p.2) involves this concept.

9. The broad range of measures of market performance helps to overcome this bias (p. 2, 4). The measures identified include price, quantity, quality, variety, service, capacity, R&D, and innovation.

10. Unilateral effects receive a great deal of attention (pp. 20-24).

11. Innovation receives its own subsection (p. 23) and is mention 19 times, compared to a single mention in the 1997 *Guidelines.* Product variety is mentioned a dozen times, compared to a single mention in the 1997 *Guidelines*

12. Importance of mavericks is emphasized (p. 3).

Sources and Notes: Parenthetical page references are to Robert Pitofsky (Ed.), *How the Chicago School Overshot the Mark*, footnoted page references are to *Horizontal Merger Guidelines: for Public Comment: April 12, 2010)*

***"Testimony of Mark Cooper, on Consumers Competition and Consolidation in the Video Broadband Market," *Commerce Committee, U.S. Senate,* March 11, 2010 pp. 7-9 presents this critique as applied to the Comcast-NBCU merger; "The Analysis of Market Failure After the Collapse of Market Fundamentalism: The Implications of the Defeat of the Chicago School for Antitrust and Regulation in the U.S. Energy Sector," *10th Annual energy Roundtable: Major Developments in Energy Markets,* American Antitrust Institute, March 2, 2010, presents a discussion of the critique for energy markets.**