Hearing #5 on Competition and Consumer Protection in the 21st Century

Georgetown University Law Center

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Welcome

We Will Be Starting Shortly

Welcome

Bilal Sayyed

Federal Trade Commission

Office of Policy Planning

Introductory Remarks

Commissioner Noah Joshua Phillips

Federal Trade Commission

Revising the Vertical Merger Guidelines

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Introduction

- **Goals of Presentation**
  - Overarching goal is to stimulate deeper discussion and analysis.
  - Provide an overview of the rationale, basic structure of potential revised VMGs.
  - Flag several policy economic, legal and policy issues involved in revising the VMGs.

- **Caveat: Given time restrictions, this deck and the presentation are limited**
  - See Appendix slides for further discussion of the economic analysis.

- **Many of these issues are analyzed in more detail in these academic articles**
  - Salop, *Invigorating Vertical Merger Enforcement*, YALE L.J. (May 2018)
  - Salop & Culley, *Revising the U.S. Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners*, J. ANTITRUST ENFORCEMENT (2016)
  - Riordan & Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, ANTITRUST L.J. (1996)
  - Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Gain Power Over Price*, YALE L.J. (1986)
  - Salop & Culley, *Vertical Merger Enforcement Actions: 1994–July 2018* (posted on SSRN) (listing of agency challenges)

- **Selected articles by others also are referenced in these academic articles.**

Overview of Initial Presentation

- **Introduction: Why revise the vertical merger guidelines (VMGs)?**
- **Economic Analysis**
    - Basic economic analysis of vertical merger potential harms and benefits.
    - Why competitive effects of vertical and horizontal merger are not inherently different.
- **Policy Analysis**
    - Why claimed efficiencies and other arguments do not justify more permissible policy presumptions for vertical mergers.
    - Summary of proposed 3-step competitive effects analysis.
- **Appendices summarize some other VMG drafting issues**
    - Appendix A: Some further details of economic analysis.
    - Appendix B: Some implications of AT&T/Time Warner opinion.

Key Points

- **Enforcement should be focused on oligopoly markets**
- **Harms and benefits from vertical and horizontal mergers are not inherently different in oligopoly markets**
  - Vertical merger form is “vertical” but harms are “horizontal”
- **A stronger overarching procompetitive presumption for vertical mergers does not make sense in oligopoly markets**
  - Elimination of double marginalization and other efficiencies are neither inevitable nor necessarily merger-specific
- **Only cognizable efficiencies (verifiable, merger-specific, procompetitive) should be credited, with the burden on the merging parties**
- **Revised Vertical Merger Guidelines should reflect these points**

Why Revise the Vertical Merger Guidelines

- **1984 VMGs are woefully out of date**
  - Do not reflect current economic learning
  - Do not reflect agency enforcement (consent decrees; FCC proceedings)
- **1984 VMGs do not provide useful guidance on current economics or merger policy to the various players**
  - Courts analyzing agency complaints
  - Agency staff investigating mergers
  - Businesses considering vertical mergers
  - Outside attorneys counseling
- **Professional consensus exists for revision of 1984 VMGs**
  - AMC
  - ABA Presidential Transition Reports (2012; 2016)

Common Counter-Arguments Against Revising the VMGs

- **Counterargument #1: Revision fails a cost-benefit analysis**
  - Cost is high because drafting would use up scarce resources
  - Cost is high because the analysis is complex and difficult
  - Benefits are low because analysis is complicated, so devising useful guidance would be impossible
  - Benefits are low because proper analysis is well-known
  - Benefits low because there is so little vertical merger enforcement (50+ consents in 20+ years)
  - Benefits are low because there should not be any vertical merger enforcement

- **Counterargument #2: Revised VMGs will lead to more enforcement by educating and empowering the agencies**
  - This will lead to more false positives *(relative to the reduction in false negatives??)*

Economic Analysis and Policy Implications

Vertical Mergers Defined

- **Horizontal merger**: merging firms sell products or services that are substitutes for one another
  - Two products are *substitutes* if the demand for one product *increases* as the price of the other product rises
  - Diversion ratio is positive
- **Vertical merger**: one merging firm is an actual or potential supplier or customer of the other merging firm
- **Complementary product merger**: merging firms sell products or services that are complements for one another
  - Two products are *complements* if the demand for one product *decreases* as the price of the other product rises
  - Diversion ratio is negative
  - Complementary product mergers raise similar issues and can be analyzed similarly to vertical mergers
- **A particular merger may be both horizontal and vertical**:
  - Substitutes for some consumers and complements for others
  - Vertical in one market and horizontal in another
  - Complementary product firms may be potential competitors into each other's market
  - One or both merging firms may already be vertically integrated

Basic Economics (Competitive Effects) Issues

Competitive Harms

- **Foreclosure**
  - Force 2-level entry or eliminate potential competition
  - Input foreclosure
  - Customer foreclosure
  - Strategic misuse of rivals' confidential information
- **Collusion/Coordination (Upstream or Downstream)**
  - Foreclosure leading to coordination
  - Disadvantaging disruptive buyer or maverick
  - Collusive information exchange
- **Exercise of pre-existing market power**
  - Evasion of regulation
  - Facilitation of harmful price discrimination

Enforcement should be focused on oligopoly markets

Competitive Benefits

- **Coordination in production, design, innovation from information transfer/exchange**
  - Cost reductions
  - Quality improvements
  - Faster/better innovation
- **Harmonization of incentives in vertical and complementary mergers**
  - Elimination of free riding (including investment)
  - Elimination of double marginalization ("EDM")
- **Creation of a maverick**

Only cognizable efficiencies should be credited (i.e., verifiable; merger-specific; procompetitive)

Overall effect on consumers compares likelihood and magnitudes of harms to cognizable efficiency benefits, based on factual analysis

Key Policy Issues

- **This presentation focuses primarily on the policy issues that may arise in drafting VMGs**
  - Economic theories of harms and benefits appear less controversial
  - Appendix A provides details of economic theories and questions regarding merger-specificity
  - Salop & Culley *JAE* article lists potentially probative evidence to evaluate these various theories

- **Key policy questions**
  - Are vertical mergers so less concerning than horizontal mergers that the legal and policy analysis should differ substantially?
  - Should vertical mergers be treated systematically more permissively than horizontal mergers? If so, how?

- **My conclusions and recommendations**
  - **Problematic vertical mergers are "vertical," but the harms are "horizontal"**
  - **A stronger overarching procompetitive presumption for vertical mergers does not make sense in oligopoly markets where vertical merger enforcement would be focused *(same as horizontal mergers)***

Vertical and Horizontal Merger Competitive Issues are Not Inherently Different: Summary

- **Foreclosure harms from vertical mergers are similar and not "less inherent" than unilateral harms from horizontal mergers**.
  - In the pre-merger market, the upstream merging firm that supplies a downstream firm is inherently an "indirect competitor" of the future downstream merging firm. That indirect competition is eliminated by merger. This unilateral effect is exactly parallel to the unilateral effect from a horizontal merger.
  - In fact, the vertical GUPPI is similar to the horizontal GUPPI (though reduced by the upstream pass-thru rate and increased with a higher diversion ratio if foreclosure targets multiple downstream rivals).

- **Vertical integration (including combining complements) is common. But so is horizontal integration, combining substitutes, as result of economies of scope & scale.**
  - Many firms sell multiple substitute products (e.g., Coke and Sprite; premium and value products).
  - Partnerships among competitors and horizontal mergers are common.

- **Vertical merger efficiencies are not inevitable. Vertical integration is common. But vertical *non-integration* also is common.**
  - Coca Cola has not merged with McDonalds; Pepsi acquisition of KFC& Pizza Hut failed.
  - Sony Betamax was beaten out by JVC's VHS open standard.
  - Fox bought but then sold DirecTV and Time Warner and TCI/Liberty separated distribution and content.
  - Alcoa has broken up into separate upstream and downstream firms (Alcoa and Arconic).

- **The key issue is not about whether there are efficiencies, but rather whether the efficiencies are merger-specific**.
  - Efficiencies often can be achieved without merger: ***i.e., vertical integration "by contract."***
  - The burden to show merger-specific efficiencies should be placed on the merging firms, just like they are for horizontal mergers and other antitrust areas.

Vertical and Horizontal Merger Competitive Concerns are Not Inherently Different: *Unilateral Effects*

- **Vertical merger harms are involve "horizontal" effects (i.e., reduce horizontal competition).**
- **Upward pricing pressure (UPP) analysis is similar:**
  - Horizontal mergers have UPP from the unilateral incentive to raise price to drive incremental sales to the merger partner.
  - Vertical mergers have UPP from the upstream firm (U) having a unilateral incentive to drive incremental sales to its merger partner (D) by raising the price it charges to downstream rivals (R).

Vertical GUPPI$_R$ = Div Ratio(R,D) x Margin (D) x Cost Pass-Thru Rate (U)

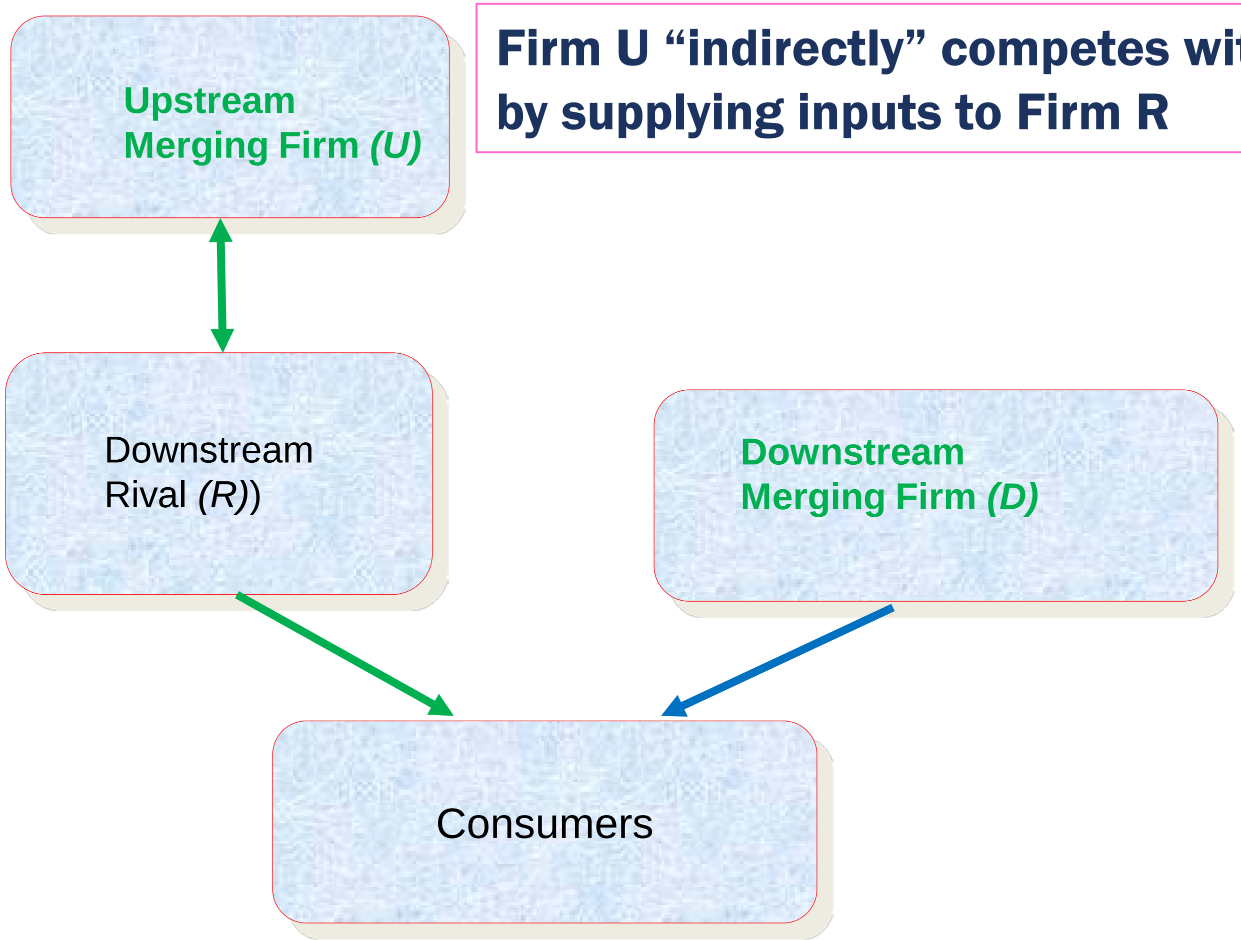
Diversion Ratio rises if more rivals are targeted simultaneously

Vertically merging firms are "indirect" competitors.

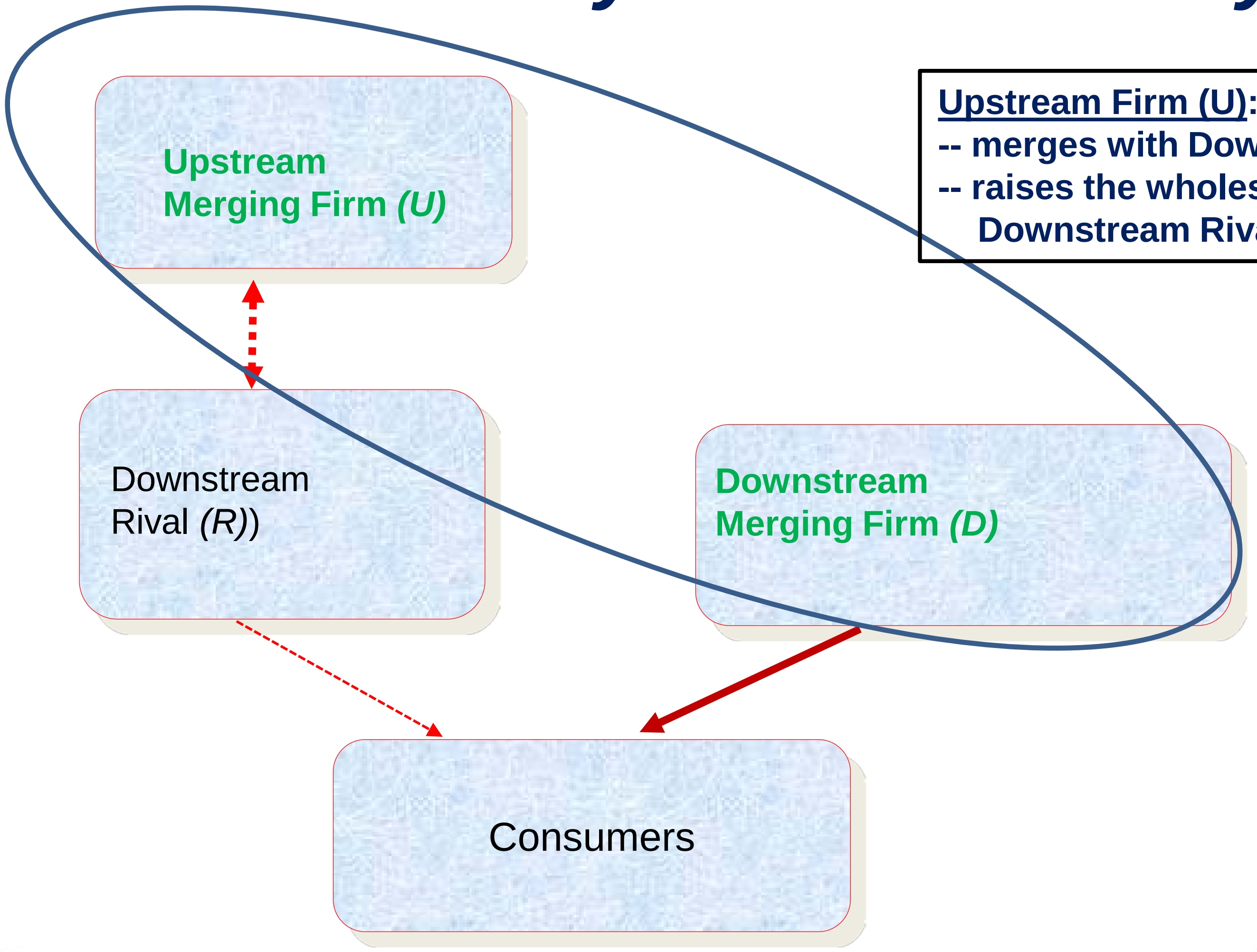
- **See diagrams on next slides.**

Pre-merger Indirect Competition Between *U* and *D*

Firm U "indirectly" competes with Firm D by supplying inputs to Firm R



Merger of *U & D plus Foreclosure* Reduces Indirect Competition between *U* and *D*: *Forces Involuntary Coordination by R*



<u>Upstream Firm (U)</u>:
-- merges with Downstream Firm (D)
-- raises the wholesale price to Downstream Rival (R)

"Indirect Competition" Characteristic: Summary

- By supplying cost-effective inputs to a downstream rival *(call it R)* of another downstream firm *(call it D)* in the pre-merger market, an upstream supplier *(call it U)* "supports competition" by this downstream rival *(R)* with the other downstream firm *(D)*.
- **Thus, the input supplier *(U)* effectively is an "indirect competitor" of the other firm *(D)*.**
- If the supplier *(U)* and other firm *(D)* then merge, and the supplier (U) raises price to the rival *(R)*, then this "indirect competition" can be reduced or eliminated.
- Raising the costs of the rival *(R)* may essentially coerce it involuntarily to coordinate with the merging downstream firm *(D).*

Vertical and Horizontal Merger Competitive Concerns are Not Inherently Different: Impact on Mavericks

- **Horizontal mergers can eliminate a maverick or change its incentives.**
- **Vertical merger effects on mavericks can be analogous in several ways:**
  - If the upstream merging firm *(U)* is a "maverick" that prevents coordination among upstream input competitors, a merger between downstream firm *(D)* and upstream firm *(U)* could eliminate this incentive and lead to a higher likelihood of coordination in the upstream market.
  - If merging downstream firm *(D)* is a "disruptive buyer" that prevents coordination among upstream input competitors, a merger between this merging downstream firm *(D)* and one of the upstream firms could eliminate this incentive and lead to a higher likelihood of coordination in the upstream market.
    - ***Downstream merging firm would be protected from input price increases.***
  - The upstream merging firm can be incented by the merger to exclude or raise price to an unintegrated downstream maverick in order to facilitate downstream coordination that will benefit the downstream merging firm.

Vertical and Horizontal Merger Competitive Concerns are Not Inherently Different: Coordination

- **Horizontal mergers can facilitate horizontal coordination in various ways.**
- **Vertical mergers also can lead to horizontal coordination:**
  - Merger can facilitate coordination by, for example, raising costs of smaller rivals.
  - Merger can enable reciprocal pricing or licensing coordination by integrated firms.
  - Merger can change incentives of a pre-merger maverick or disruptive firm.
  - Merger can lead to horizontal information exchange.

Potential Efficiencies Do Not Call for a Different Approach than Horizontal Mergers

- **Both horizontal and vertical mergers may lead to merger-specific efficiencies:**
  - Many firms produce multiple substitutes from economies of scope, information sharing, and reputational goodwill benefits.
- **Claimed justifications for a differential approach for enforcement in oligopoly markets are invalid:**
  - Old Chicago-school economic theory presumptions are not economically correct.
  - Econometric evidence does not support a procompetitive presumption for vertical mergers in oligopoly markets.
  - Complaints by downstream competitors do not justify a procompetitive presumption.
  - *Sylvania* and *Leegin* do not mandate or support a procompetitive presumption for vertical mergers in oligopoly markets.
- **Recognition and acceptance of these points also can avoid "confirmation bias" by merger analysts and courts.**

Old Borkian Claims Do Not Support a Stronger Procompetitive Presumption

- “Foreclosure” is not illusory, and is not simply a neutral rearrangement of supplier-customer relationships.
- Markets do not inevitably or quickly self-correct, especially if the conduct raises the costs of rivals or erects barriers to entry.
- The “single monopoly profit” theory only applies to limited, extreme market structures.
- Elimination of double marginalization (EDM) and other efficiencies are not inevitable and may not be merger-specific.
- See Salop *(YLJ)* for details.

EDM and Other Efficiencies are Neither Inevitable nor Necessarily Merger-Specific

- **Efficiencies are not inevitable. Many firms are not vertically integrated, despite imperfect competition at both levels.**
- ***Coase's door swings both ways*: Efficiencies often can be achieved by vertical contracts, without the potential anticompetitive harms from merger.**
  - In that vertical restraints are characterized as "just" vertical integration "by contract," then claimed efficiencies in problematical mergers might be achieved with non-merger contracts that do not raise the same anticompetitive concerns.
- **EDM may not be merger-specific**
  - EDM might be achieved with non-linear prices or quantity-forcing contracts.
  - Note also that EDM incentives are mitigated by the "opportunity cost" of shifting more profitable sales that upstream merging firm makes to downstream rivals and impact of lowering prices to existing customers. *(See Moresi/Salop; Rogerson)*
- **Failure to achieve efficiencies pre-merger does not prove merger-specificity**
  - Failure could suggest that they also would not be achieved post-merger.
- **A general claim of "bargaining frictions" is *not* sufficient evidence of merger-specificity.**
  - Merging parties must provide rigorous explanation, identifying specific pre-merger impediments that are not themselves anticompetitive.
  - They must explain why impediments solved by the merger.

Econometric Evidence Does Not Support a Stronger Procompetitive Presumption

- **See econometric studies listed in LaFontaine & Slade; Cooper et al*;* Salop (*YLJ*).**
  - Estimated competitive effects are mixed.
- **In addition, various caveats apply to evaluation of econometric studies:**
  - Selection bias towards no effect because antitrust deters the most worrisome mergers.
  - Many studies involve competitive markets where problems are unlikely.
  - Some studies are not capable of distinguishing RRC from EDM; some studies find neither effect.
  - Sample of studies (industries) is not random – limited by data availability.
  - Studies of **intrabrand** restraints are not good predictors of impact of **interbrand** effects of vertical mergers in oligopoly markets.
  - Stock market event studies are subject to fundamental criticisms.
  - Some studies have data or econometric issues.

Complaints By Downstream Competitors Do Not Support a Stronger Procompetitive Presumption

- **Chicago-school inference that complaints by competitors imply that horizontal merger is procompetitive.**
  - If merger will reduce costs, then competitors are harmed and will complain.
  - If merger will facilitate coordination, then competitors benefit and will not complain.
- **Inference fails if horizontal or vertical merger will raise rivals' costs.**
  - Now interests of consumers and interests of competitors are aligned.
- **A view that firms tilt testimony towards self-interest would lead to equal skepticism of testimony by merging firms.**

Sylvania and *Leegin* Do Not Mandate or Support a Stronger Procompetitive Presumption

- **Both cases involve a small manufacturer's <u>intrabrand</u> vertical restraints.**
  - e.g., Territorial restrictions; RPM

- **But vertical mergers are more like <u>interbrand</u> restraints, which are more concerning.**
  - e.g., Exclusive dealing

- ***Leegin* did not adopt an overarching procompetitive presumption.**
  - *Leegin* adopted the conventional rule of reason, which corresponds to a "relatively neutral" competitive presumption.

Legal Context and Impact on VMG Policy

VMGs in the Shadow of the Law

- ***Issue: Should VMGs simply describe agency analysis, irrespective of merger law?***
  - HMGs do not make legal judgments, but they follow merger law.
  - The VMGs (as prosecutorial judgments) also must be consistent with basic merger law.

- **Legal framework choices**
  - *Autolite, Brown Shoe,* and *Freuhauf;*
  - Horizontal merger law *(as DOJ recommended in AT&T/TW);*
  - Judge Leon's 3-step legal approach in *AT&T/TW* ;
  - Wait to see how DC Circuit sets out the law in *AT&T/TW.*

- **Likely DC Circuit approach in AT&T/Time Warner**
  - Follow the same basic 3-step burden-shifting structure used in *Baker Hughes,* subsequent horizontal merger cases, and Judge Leon in *AT&T/TW.*
  - The question is the plaintiff's burden in light of Section 7.
  - **My proposal: Require the same structure and standards as for horizontal mergers**.

Application of Basic Merger Law

- **In *Baker Hughes*, the DC Circuit set out a 3-step burden-shifting approach for horizontal mergers (with sliding scale extended in *Heinz*):**
  - ***Step 1:*** Agency establishes sufficient evidence to establish a prima facie case of harm (ignoring potential efficiency benefits); if so, ….
  - ***Step 2:*** Burden shifts to merging firms to rebut by showing no harm; or by producing sufficient evidence of cognizable efficiency benefits; if so, …
  - ***Step 3:*** Burden shifts back to agency to establish overall anticompetitive effects.
- **Standard of proof takes into account the role of "incipiency" in Section 7 standards:**
  - Prediction
  - Probability, not certainty
  - Prominence of "false negatives" (including under-deterrence) concerns
  - *Philadelphia Nat'l Bank:* Application of anticompetitive structural presumption to replace or supplement case-specific evidence in Step 1.

Possible Policy Criticisms of Applying the Same 3-Step Approach as for Horizontal Mergers

"Vertical mergers in oligopoly markets should be presumed to be highly efficient and procompetitive"… So,

"Plaintiff should face more demanding standard of proof."

"Plaintiff should bear burden to disprove efficiencies."

"Efficiencies should be conclusively presumed to be merger-specific."

But …

- **These attempts to distinguish vertical and horizontal mergers in oligopoly market are not supported by rigorous analysis (as discussed earlier).**

"Unlike horizontal mergers, there is no *PNB* structural presumption" … So,

"Plaintiff should bear all burdens"

But…

- **The 3-step decision process is used throughout antitrust without a structural presumption, because there are other ways to establish a prima facie case….**
- **Presumptions can be based on factors other than the increase in market concentration.**

DOJ PCOL in AT&T/TW
Proposes The Following Legal Standards

- Section 7 of the Clayton Act proscribes mergers that may substantially lessen competition.
- **To "arrest restraints of trade in their incipiency," Section 7 proscribes any merger creating a "reasonable probability" of harm.**
  - Harm from the merger need not happen immediately for Section 7 to apply.
  - <u>A Section 7 plaintiff does not need to quantify the potential harm</u>.
  - Section 7 does not contain an exemption for "minor" price increases.
  - <u>The same Section 7 standards apply to horizontal and vertical mergers</u>.
- **Courts analyze Section 7 claims through a burden-shifting framework.**
- **A vertical merger may substantially lessen competition by giving the merged firm the incentive and ability to disadvantage its rivals.**
  - When a vertical merger enables the merged firm to raise its rivals' costs, competition is lessened substantially.
  - When a vertical merger enables the merged firm to encumber its rivals' access to a unique resource, competition is lessened substantially.
  - When a vertical merger enables the merged firm to impede innovation, either unilaterally or through coordination, competition is lessened substantially.
- **Defendants may rebut a prima facie case *only* by showing that competitive harm is not "reasonably probable."**
  - Entry must be timely, likely, and sufficient to prevent competitive harm.
  - Claimed efficiencies (which arguably cannot ever save a merger) must withstand "rigorous analysis."
    - <u>Defendants bear the burden of their efficiencies defense</u>.
    - Efficiencies must be reasonably verifiable, <u>merger-specific</u>, and likely to benefit consumers in the affected markets, and must offset the harms of the merger.
    - The Court cannot credit Defendants' purported efficiencies.
    - A unilateral behavioral promise, such as an arbitration offer, cannot rebut a prima facie case.

Further Analysis of 3-Step Decision Process

Step 1: Establishing Prima Facie Case

- **Step 1 prima facie case satisfied with evidence (including applicable presumptions):**
  - Evidence of oligopoly markets with entry barriers.
  - Economic and documentary evidence of likely consumer harm.
- **“Reasonable probability” as my proposed evidentiary standard:**
  - “Incipiency” concern suggests a less demanding standard.
  - Step 1 is implemented under the interim assumption of no efficiencies, which reduces the burden.
  - This also suggests that (precise, if any) quantification should not be required.
  - Query: Since zero efficiencies are assumed, is it sufficient to show harm to downstream competitors in Step 1?
- **VMGs might formulate a safe harbor (as do HMGs):**
  - E.g., Both upstream and downstream markets are unconcentrated.
  - *Note*: This test should require both standard and modified HHIs (not including the merging firms) also be unconcentrated.
- **VMGs might formulate types of anticompetitive presumptions, such as the following…**
  - One merging firm is dominant in its market and other merging firm is a unique (or critical?) entry sponsor; or
  - Upstream merging firm has (significant) market power in a concentrated input market and supplies a critical input to the competitors of the downstream merging firm; or
  - Downstream market is highly concentrated and upstream merging firm is a maverick that supplies a critical input; or
  - Upstream market is highly concentrated and downstream merging firm is a disruptive buyer or accesses sensitive competitive information from upstream firms; or
  - Vertical merger structure would permit evasion of price regulation.

Step 2A: Structural Rebuttal

- **Potential rebuttal based on various structural and other factors (even aside from efficiencies) that would prevent competitive harm**
  - Follow *Baker-Hughes*, *Heinz* and HMGs

- **Factors can include the following …**
  - Substantial input substitution
  - Easy entry or repositioning
  - Sufficient competition from non-targeted rivals
  - Countervailing buyer power
  - Failing firm
  - Relevant natural experiment evidence

Step 2B: Efficiency Rebuttal

- **Burden on defendant to produce reasonable evidence of “cognizable” efficiencies**
  - Verifiable; Merger-specific; not flowing from anticompetitive conduct or effects
- **Burden to prove merger-specificity typically placed on defendants**
  - Firms have superior access to information on claimed efficiencies
- **Merger-specificity requirement also is appropriate for vertical mergers**
  - Efficiencies often can be achieved by contract, without the potential anticompetitive harms from merger (Coase)
  - Elimination of double marginalization (EDM) might be achieved with non-linear price or quantity-forcing contracts
  - Failure to achieve efficiencies pre-merger does not prove merger-specificity, but instead could suggest low benefits or inefficient management
  - A general claim of “bargaining frictions” is not sufficient evidence
- **Verifiability requirement is also appropriate**
  - Efficiency may be difficult to achieve in light of differential knowledge
  - As noted earlier, EDM incentives are mitigated by “opportunity costs”

Step 3: Ultimate Burden of Persuasion

- **Plaintiff must show “reasonable probability” of anticompetitive effects:**
  - Section 7 (“may substantially lessen competition”)
  - “Reasonable probability” evidentiary standard flows from “incipiency” concerns in statute
  - “Overall” anticompetitive impact on consumers
  - “Overall” means harms sufficient to outweigh competitive benefits to consumers from merger-specific efficiencies
- **But this still raises two possibly contentious issues:**
  - What if there is harm to customers of downstream rivals (from RRC) but benefits to customers of merging firms (from efficiencies)?
  - What if there is harm to direct customers of the upstream merging firm, who are competitors of the downstream merging firm. Must harm to the downstream rivals also be established?

Is Injury to a Subset of Customers of Downstream Firms Sufficient for Liability?

- **Suppose harm only to the customers of foreclosed downstream rivals.**
- **Suppose in a differentiated product market it is found that** …
  - **RRC**: Input foreclosure leads **downstream rivals** to raise their prices
  - **Efficiencies**: Merger-specific EDM leads **merging firm** to reduce its downstream price
  - *Example: Coke & Pepsi bottler mergers has these estimated effects(Luco & Marshal)*
- **Finding liability here is consistent with HMGs analysis of harm in targeted buyer markets:**
  - In horizontal mergers, balancing benefits in one market to offset anticompetitive effects in another market is not permitted (i.e., *PNB*)
  - Aggregating effects involve difficult interpersonal comparisons because no compensation
- ***Issue for Discussion:* Should VMGs contain some limited balancing under prosecutorial discretion, as in HMGs "inextricably linked" footnote?**

Is Injury to Downstream Rivals Sufficient for Liability?

- **Must the plaintiff show harm to customers of the downstream firms?**
  - Or, is it sufficient to show harm to the direct purchasers of the upstream firm, who are also the (downstream) competitors of the merged firm?
  - In *AT&T/TW*, DOJ focused on injury to *customers of downstream firms*, but proposed that harm to the *downstream competitors* is sufficient for liability.
- **Conflicting overarching antitrust views:**
  - Downstream firms are the “direct purchasers” of the upstream merging firm; and “direct purchasers” are the usual antitrust focus.
  - But, it is said that merger law protects “competition, not competitors.”
- ***Issues for discussion:***
  - Suppose the merger likely would *facilitate coordination among upstream firms*. Would it be sufficient in this situation merely to show harm to the *unintegrated* downstream firms?
  - Suppose foreclosure harms the unintegrated downstream competitors and there are *zero merger-specific efficiencies*. Then harm to the competitors might lead to a *presumption of harm* to the customers of the downstream firms. *(But not a certainty: what if consumers would switch to non-foreclosed rivals or other products?)*
  - What if there are merger-specific efficiencies? Should effects on downstream consumers be *paramount*? Or, should harm to downstream rivals be *balanced* against downstream consumer benefits?

Remedy Formulation

***Issue for Discussion*: Should VMGs discuss remedies?**

If so, …

- **Structural remedies are preferred**
- **Behavioral remedies can be problematic**
  - Difficult to monitor and enforce
  - Often fail to foresee future anticompetitive concerns or conduct
  - But, better than clearing anticompetitive mergers
- **Consent decrees can be strengthened**
  - Include look-backs and potential for revisions if decree fails to preserve competition
- **Or, “just say no.”**

Conclusions

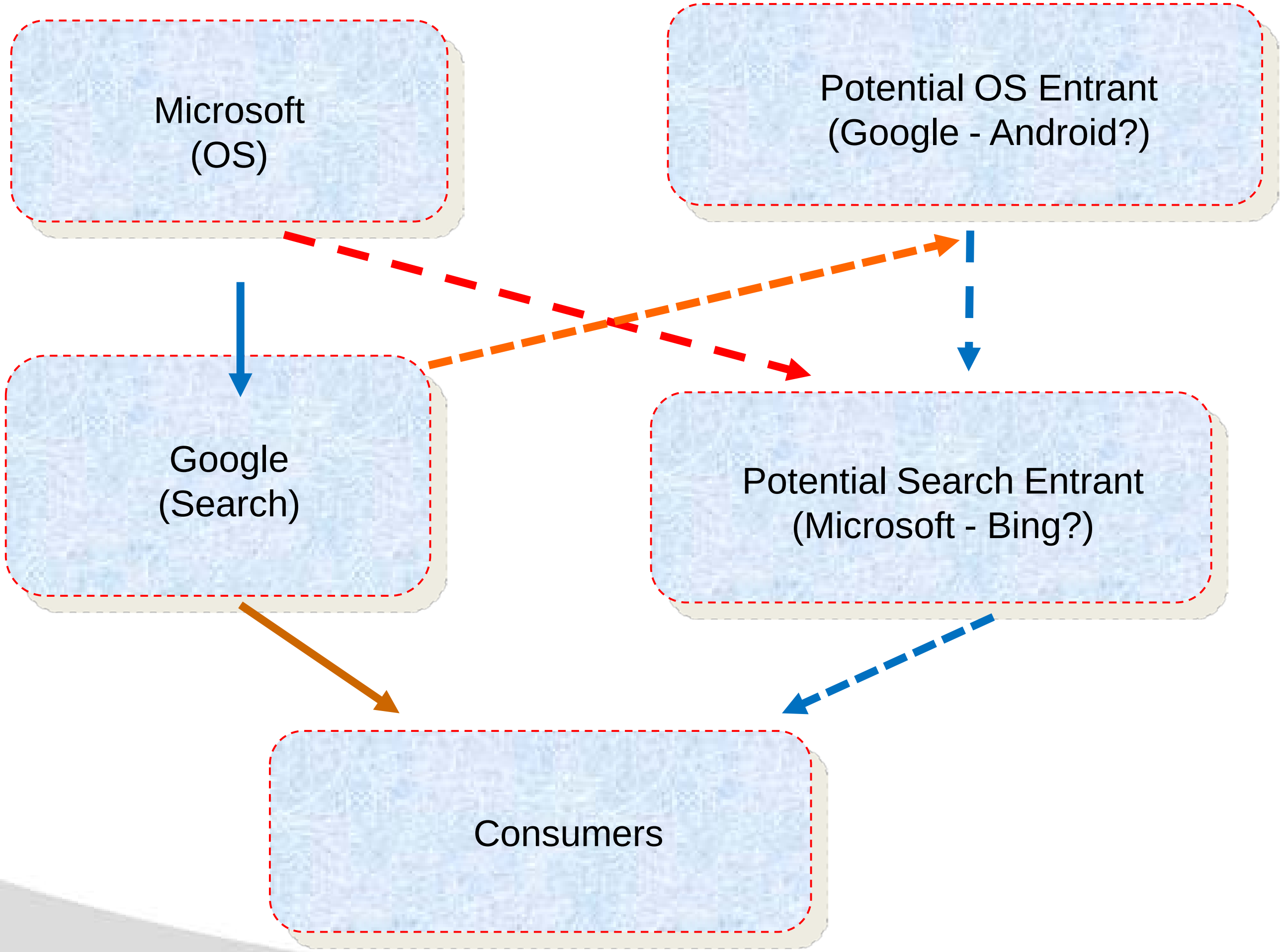
- **Agency Process**
  - New VMGs are needed.
  - New VMGs are doable.
  - The DOJ’s AT&T/TW case began a useful process.
  - The DOJ and FTC do not need to wait for AT&T/TW opinion to begin work.

- **Analytic Framework**
  - The *Baker Hughes/Heinz* 3-step analysis can be adapted and applied to vertical mergers.
  - The economic categories and issues can be described and analyzed, and probative evidence can identified.

- **Recommended Policy Approach**
  - Vertical mergers in oligopoly markets do not deserve a differential presumption or inherently more permissive standards than horizontal mergers.
  - Both deserve rigorous, yet balanced, agency analysis.
  - Analysis and interpretation should avoid “confirmation bias.”

Appendix A:
Basic and Illustrative Economic Analysis

Forcing 2-Level Entry
Hypo Merger (circa 2000) : Microsoft (OS)– Google (Search)



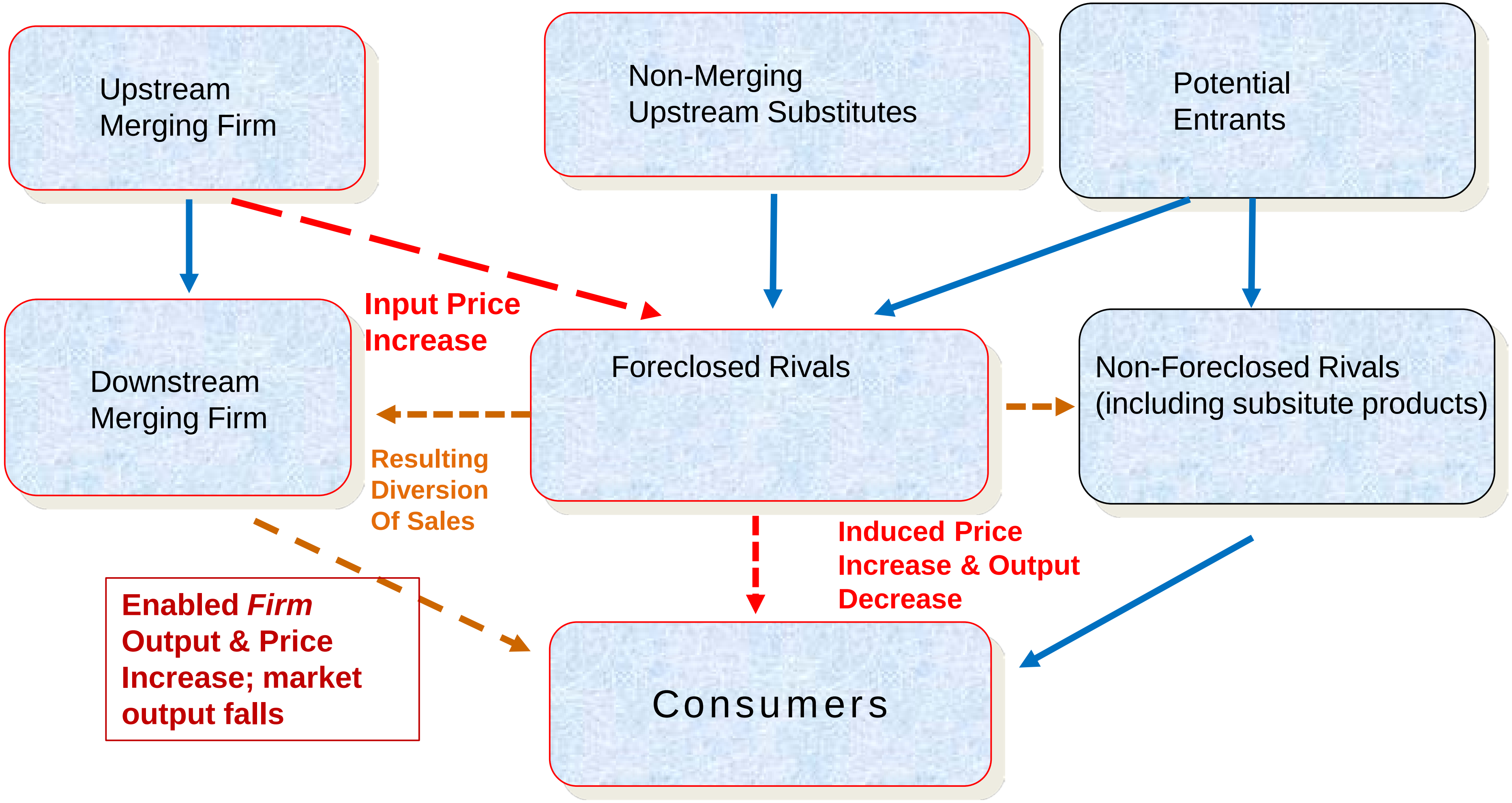
Refuse to enter or sponsor entry at other level

Maintain monopoly prices at both levels

Input Foreclosure

- Probably the most common claim
- Several ways to “raise rivals’ costs”
  - Refusing to sell input (“withholding;” “total foreclosure”)
  - Unilaterally raising price
  - Increased bargaining leverage, leading to higher negotiated price
  - Variant: Reducing/degrading quality; withholding critical information
- Potential harms at 2 levels
  - Harm to “direct customers” (i.e., downstream rivals)
  - Harm to “consumers” (i.e., customers of downstream firms)

Input Foreclosure: Basic Economic Logic



Input Foreclosure:
Basic Competitive Harm Analysis

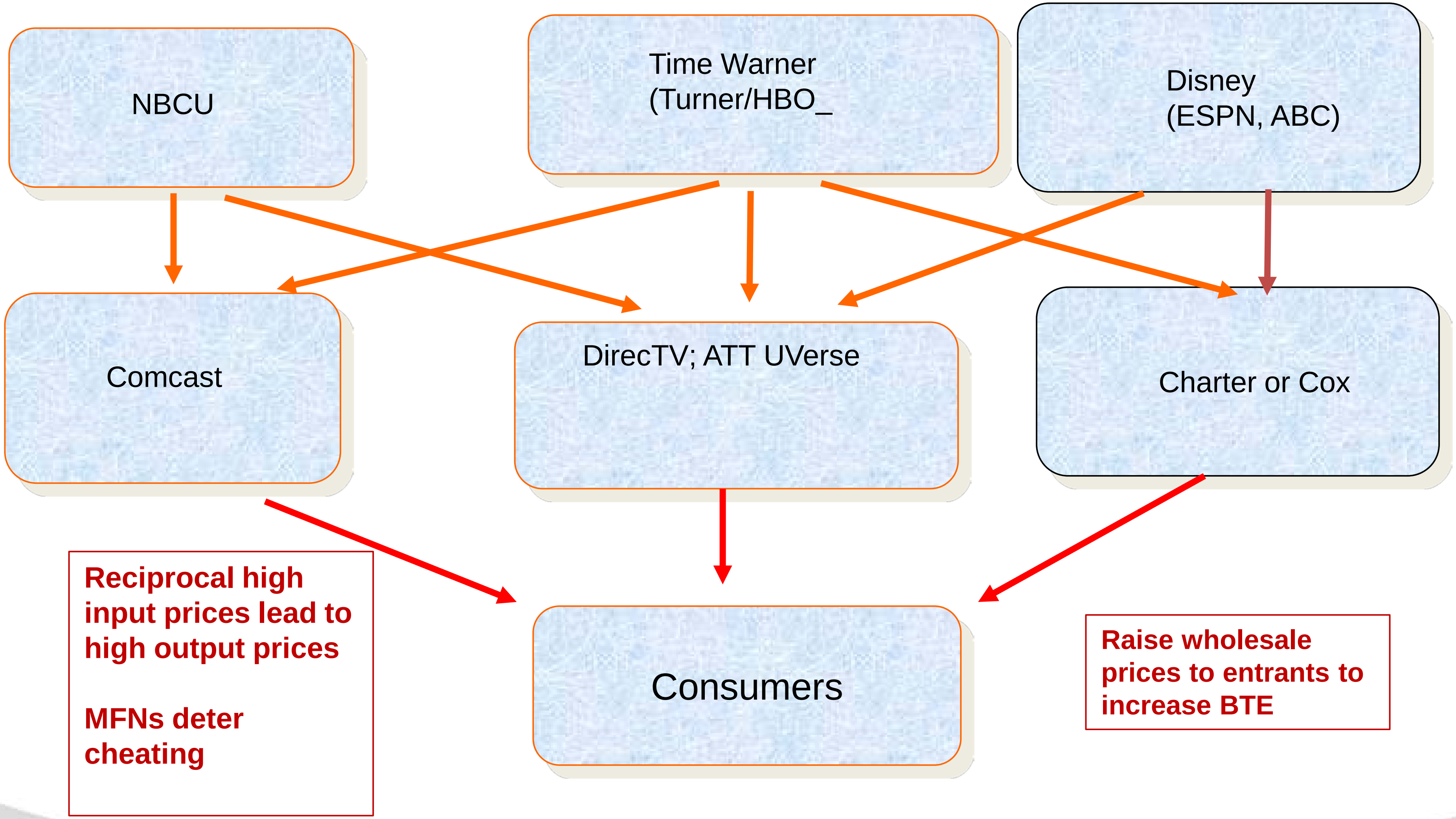
- **Upstream (Input) Market: Raising Rivals' Costs**
  - Will firm have power/incentive to raise input price or refuse to sell to targeted rival(s)?
  - Do rivals have cost-effective substitutes (including backward integration or entry)?
    - If input is distribution, can targeted firm engage in cost-effective "direct" distribution?
  - Will substitute input providers have power/incentive to raise prices, unilaterally or thru coordination?
    - *Note: This "multi-lateral" competitive response is typically overlooked in unilateral analyses of input foreclosure*
  - Will rivals' costs rise materially?

- **Downstream (Output) Market: Power Over Price**
  - Will merging firm have power/incentive to raise prices to consumers, either unilaterally or thru coordination?
  - Is a targeted rival a downstream maverick or disruptive buyer?
  - Do consumers have sufficient cost-effective substitutes – other products or non-targeted rivals? Will they compete or coordinate?
  - Are there other vertically integrated competitors? Will they compete or coordinate?

Note: Distribution services (distributors) are an input.

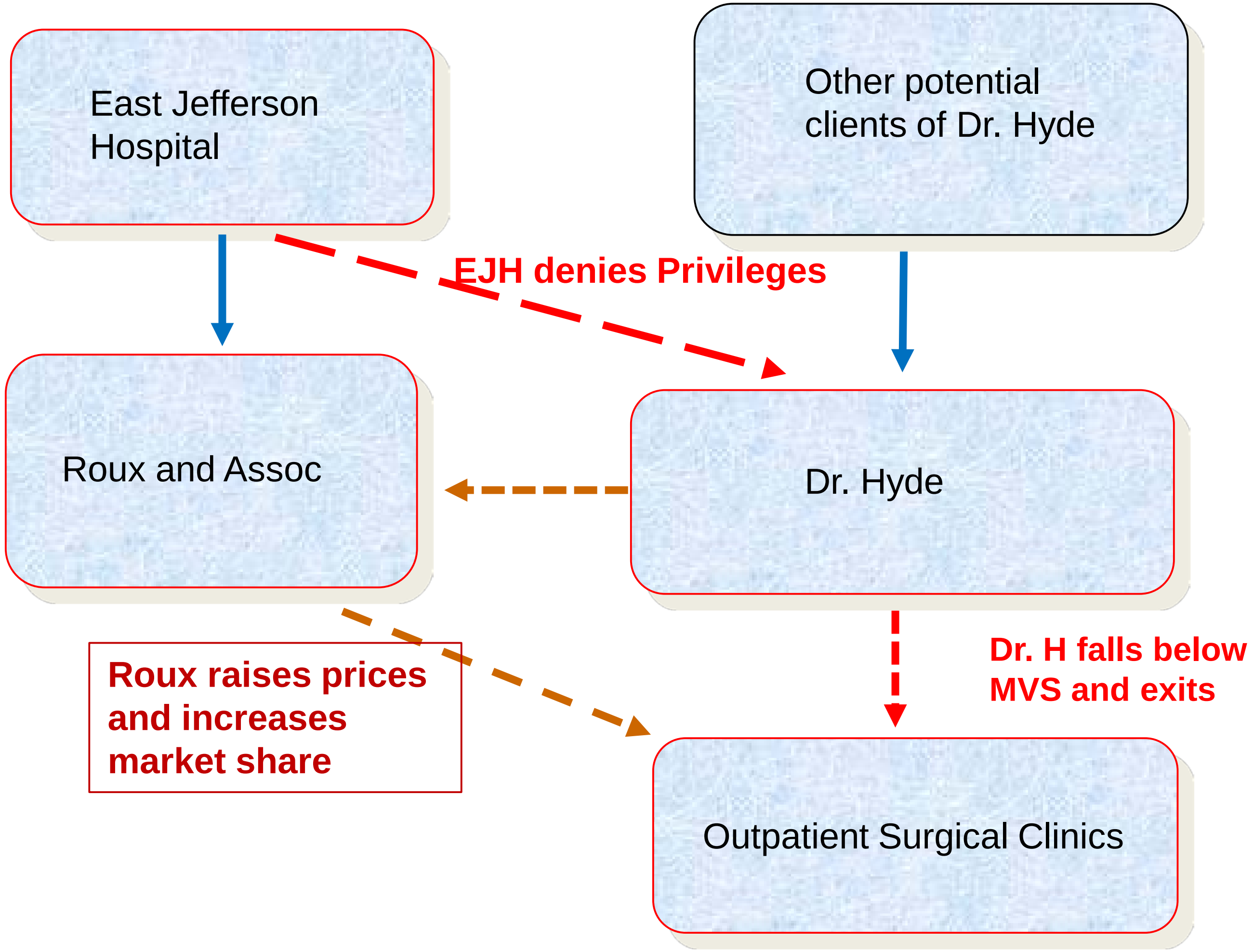
Reciprocal Coordination Equilibrium

Multiple Vertical Mergers with Reciprocal High Prices and MFNs



Customer Foreclosure

Example: Hospital/Anesthesia Group Merger



Customer Foreclosure: Competitive Harm Analysis

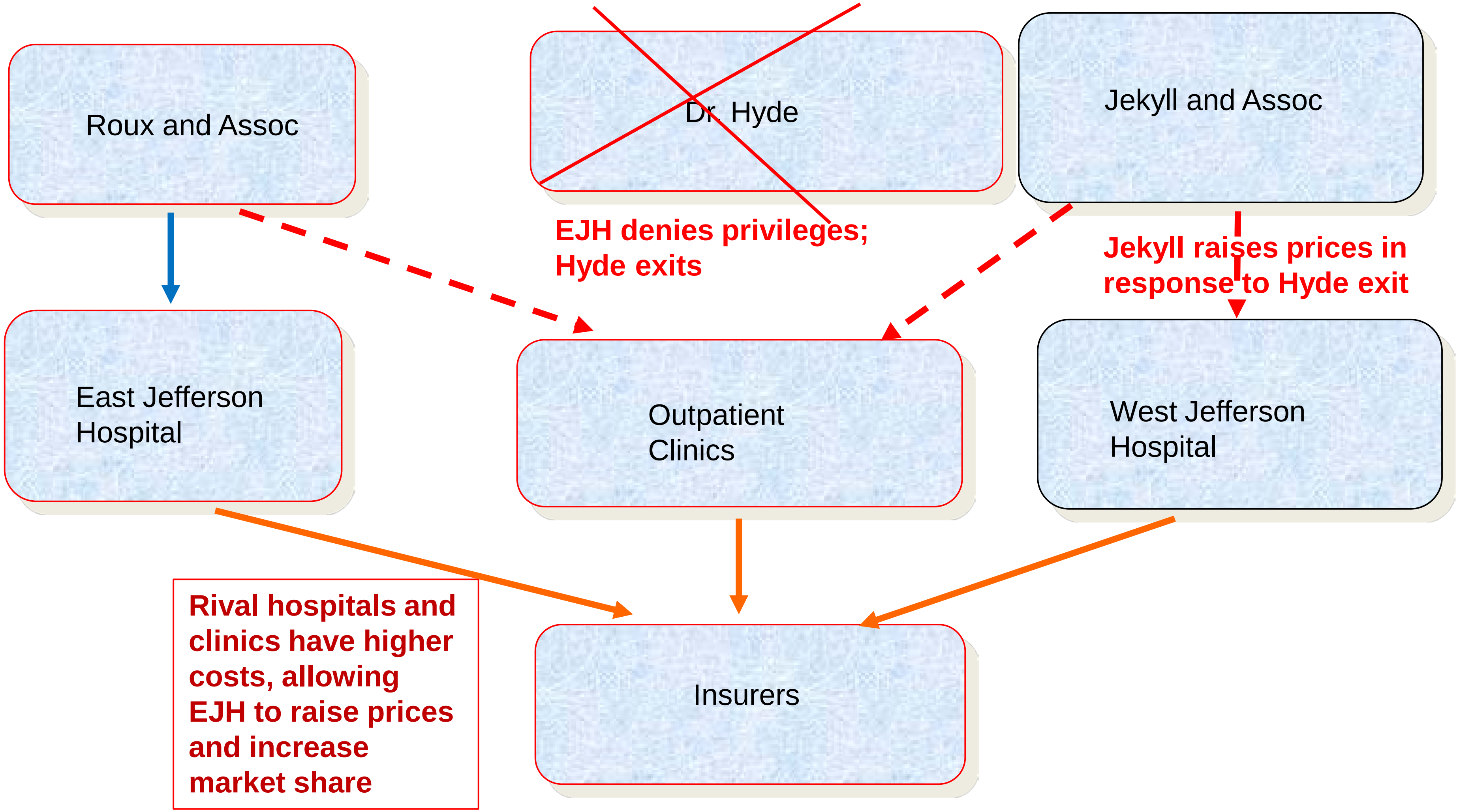
- **Reducing Rivals' Revenues (Customer Market)**
  - Will targeted rival(s) lose significant revenues from loss of merging (downstream) firm as a customer?
  - What fraction of rivals' sales are accounted for by merging firm? (foreclosure rate)
  - Do targeted rival(s) have ability/incentives to replace lost sales?
  - Are there sufficient other customers/?

- **Power Over Price (Input Market)**
  - Will merging input supplier gain the power/incentive to raise or maintain supra-competitive prices?
  - Will targeted rival(s) fall below MVS and exit ?
  - Will targeted rival(s) have higher marginal costs?
  - Will targeted rival(s) be marginalized into niche position by inability to grow? Will they reduce investment?

- Will successful customer foreclosure lead to or reinforce input foreclosure?

Input *plus* Customer Foreclosure

Example: Hospital/Anesthesia Group Merger



Examples of Other Coordination Theories

- **Collusive Information Exchange**
  - In 1990s, if a drug company (say, Lilly) acquires a pharmacy benefit manager, PCS, it might be able use PCS information about rival pharma prices to coordinate at manufacturer level by deterring cheating.
- **Eliminating/Disadvantaging a Disruptive Buyer**
  - In 2010, if Amazon was a disruptive buyer of books and thereby preventing publisher coordination, its incentives might change if it acquired a large publisher.
- **Eliminating/Disadvantaging an Upstream Maverick**
  - In 2010, if (say) Prentice Hall were a maverick in selling hardcover books to brick-and-mortar stores and thereby preventing publisher coordination, its incentives might change if it were acquired by Amazon.
- **Eliminating/Disadvantaging a Downstream Maverick**
  - Suppose that a downstream soft drink company (e.g., Dr. Pepper/7UP) is preventing downstream coordination by Coke and Pepsi. A vertical merger by which Coke and Pepsi acquires Bottlers can lead the Bottlers to raise price to the maverick to facilitate downstream coordination.

Evaluating Merger-Specific Efficiencies: Some Probative Questions

- Did the merging parties attempt to achieve efficiencies by contract?
  - If there were no attempts, why no attempts?
  - If there were attempts, why did the negotiations fail?
  - What specific contracting impediments existed?
  - How will the merger eliminate these impediments
  - Could the efficiencies have been at least partially achieved by contract?
- Will the post-merger firm face any impediments to achieving the efficiencies?
- Will the post-merger firm have opportunity costs that would lead them to avoid passing through the benefits to consumers?
- Is achieving these efficiencies inextricably linked to denying the efficiency benefits to rivals?
- Will the merged firm have the incentive to deny the efficiency benefits to rivals?
- Do other unintegrated firms in this or similar industries achieve some or all of the claimed efficiencies by contract?
- Do other integrated firms achieve the claimed efficiencies?
- How large are the efficiency benefits?

Appendix B:
AT&T/Time Warner
Suggested Drafting Issues

AT&T Case Indicates Some Bargaining Leverage Theory Issues to Explain in VMG

- District court opinion in AT&T/Time Warner merger was confused about important several economic issues:
  - Will separate divisions of integrated firms attempt to maximize total corporate profits?
  - Is the Nash bargaining model premised on frequent or permanent blackouts?
  - In exclusion cases, does the self-interest of foreclosed competitors inherently conflict with consumer interests?

Joint Profit Maximization

- Judge Leon was skeptical that Time Warner would take benefits to AT&T into account in bargaining with AT&T's competitors, leading him to reject applicability of Nash bargaining model.
- That skepticism is economic and legal error:
  - Contrary to *Copperweld*, which conclusively presumes that divisions of integrated firm act to maximize joint profits.
  - Rejecting this presumption would permit Coke and Pepsi to justify merger on the grounds that each division would be instructed to maximize division profits, not overall corporate profits.
  - Illogical in that taking AT&T interests into account actually will lead to Time Warner obtaining higher negotiated prices and higher profits, not lower *(i.e., unlike total foreclosure where there is profit-sacrifice).*
  - Note: EDM also is based on joint profit-maximization, so illogical to assume EDM while rejecting Nash bargaining model.

Nash Bargaining Equilibrium and Permanent Blackouts

- Judge Leon was skeptical of the Nash Bargaining model because …
  - Blackouts were rare.
  - Permanent blackouts would be “catastrophic” for the video content firm (e.g., TW).
- But, blackouts are not inherent in Nash model.
- Assumption is that agreements will be reached before any blackout occurs *precisely because* blackouts are costly, or even catastrophic.

Competitor Testimony

- Judge Leon was skeptical of testimony of AT&T's distribution competitors about Time Warner's increased bargaining leverage from the merger.
- This skepticism corresponds to the view that in horizontal mergers, competitor complaints suggest that merger must be procompetitive.
- That inference fails in vertical mergers where competitors are foreclosed:
  - The competitors are also customers.
  - If their costs are raised, that fact leads to a likelihood that prices will be raised to the customers of the downstream firms, the relevant "consumers" in such cases.
  - This analysis suggests that the competitor/customers testimony is less likely to conflict with consumer interests.
- Judge Leon also did not apply such skepticism to the testimony of AT&T executives, who would gain from an anticompetitive merger.
  - Nor was he so skeptical of testimony by Time Warner top executives, who would achieve a windfall from consummation of the merger.

Vertical Mergers (Session 1)

Session moderated by:

Bruce Kobayashi

Federal Trade Commission

Bureau of Economics

Vertical Mergers:
Is it Time for New Vertical Merger Guidelines?

Daniel P. O’Brien

Compass Lexecon

Rationale?

Rationale for vertical merger guidelines?

General Principles?

What general principles would guidelines articulate?

Principle 1?

Principle 1? – Harm from input foreclosure is more likely the greater is the market power of the upstream firm.

But in canonical models, the benefits of vertical mergers tend to increase with upstream market power, too.

Principle 2?

Principle 2? – Harm from customer foreclosure is more likely the greater is the market power of the downstream firm.

But in canonical models with downstream monopoly and nonlinear pricing, the harm is zero unless there is dynamic foreclosure, which is already treated in the Guidelines.

Principle 3?

Principle 3? – Harm from input foreclosure is more likely the greater the downstream value of diverted sales and the smaller the upstream margin.

But in canonical models, small relative margins imply:

(1) Upstream competition is constraining; or

(2) Prices are determined through nonlinear contracting; or

(3) Prices are determined through bargaining.

Principle 4?

Principle 4? – Harm from input foreclosure is more likely when contracts are nonlinear.

But in some canonical models with nonlinear contracting, vertical mergers lower prices.

Principle 5?

Principle 5? – Under bargaining, harm from input foreclosure is more likely the greater the value of diverted sales relative to the upstream margin.

But in some canonical bargaining models with small upstream margins and high downstream margins, vertical mergers reduce prices.

General Principles?

…And so on…

What are the robust principles to write into guidelines?

Conclusion

Whatever we do:

We should start with foundational economics.

Vertical Mergers: Measurement Issues

Margaret Slade
University of British Columbia
Vancouver School of Economics

My Presentation

Most vertical mergers are efficient, some are not
One must have ways to distinguish between the two
Screening rules of thumb that are easy to apply
More formal assessment of challenged mergers

Will look at efficiencies and competitive harm in practice

Empirical work --- What do we know about vertical integration vs. separation?

Measurement --- Quantitative techniques for vertical merger assessment

Challenged Vertical Mergers

Not a random sample, markets tend to be characterized by

- High concentration
- Economies of scale
- Networks

Challenges tend to be based on

- Foreclosure
- Facilitating coordination and exchange of sensitive information
- Elimination of potential entrants or creation of entry barriers

What Do Vertically Integrated Firms Do?

Atalay, Hortacsu, and Syverson (2013) study vertical integration in manufacturing

Caveats:

- Many challenged mergers are not in manufacturing
- Assess vertically integrated firms, not vertical mergers

Find:

- **One half of upstream establishments do not ship to their integrated downstream establishments**
- The median internal shipment share is 0.4 % (equally weighted) or 0.1% (value weighted)

When no vertical shipments occur, it lessens the strength of certain motives

- Foreclosure
- Elimination of double marginalization

Why Do Firms Integrate Vertically?

Four Nobel prize winners have studied this question

Caveat: in the context of perfect competition or monopoly

Focus on efficiencies such as

Mitigating contracting costs

Facilitating specific investments

Providing efficient effort incentives

Risk sharing

These efficiencies are not related to product flows and pricing

Related to the transfer of intangibles

Extremely hard to estimate

Safe Harbors or Safety Zones

Vertical merger guidelines should provide a simple and clear initial screening process

What should the screen be based on?

Concentration indices such as the **HHI**?

Far from perfect, especially with differentiated products

Require market definition

Easy to calculate, given a market

Safe Harbors or Safety Zones (cont.)

What should they be based on ?

Vertical upward pricing pressure, **vUPP**s and **vGUPPI**s?

- There are many formulations
- Each formula is simple but the information required is not
- They involve own and cross price elasticities and marginal costs
- Approximations based on prices, shipments, and average variable costs can be poor
  - Example: Elasticities based on market share --- back to market definition
- Each partner (rival) can produce many products
- Must determine targeted rivals --- perhaps all --- back to market definition
- Not practical as screening devices

Empirical Studies:
Estimating the Effects of Vertical Integration

Most studies compare VI to non VI firms, not vertical mergers
Most look only at one side --- costs or benefits

Foreclosure: (about 15 studies)
- Features:
  - Many define foreclosure as favoring integrated products
  - Industries: cable TV, cement, iron ore, energy, transportation
- Results: Mixed -- Just over one half conclude that foreclosure occurred

Efficiencies: (a very large literature)
- Features:
  - Most markets are not concentrated: Fast food, hotels, retail sales, trucking
- Results: Overwhelming support for theories of organizational economics
  - One exception – risk sharing

Predicting Merger Effects: Horizontal Merger Simulations

Prediction of competitive harm: (forecasts that use pre merger data)

Merger simulations assess unilateral effects in markets for differentiated products
(Nevo 2000, Pinkse, and Slade 2004, Ivaldi and Verboven 2005)

1: Estimate demand for **brands** to obtain a matrix of own and cross price elasticities
2: Specify the market game (usually Bertrand)
3: Marginal costs are constant for a given brand
Usually do not change with the merger
Often obtained from first order conditions
What would costs have to be to rationalize the assumed game, given demand?

Conclusions are sensitive of all of these choices (*Slade 2009*)
Post merger analysis indicates that simulation models have not predicted well
(*Peters 2006, Weinberg and Hoskin 2013*)

Predicting Effects: Horizontal Merger Simulations (cont.)

Prediction of efficiencies*:* (forecasts that use pre merger data)

Greico, Pinkse, and Slade 2018) develop a structural model

Based on supply, not demand

Estimate a flexible production function

Performance measures: (pre and post merger)

- Economies of scale
- Technical change
- TFP growth
- Marginal costs (a schedule)

Findings:

The key factor is technology transfer -- the ability of the merged firm to adopt the best practices of the more productive partner

Difficult to predict

Predicting Effects: Vertical Merger Simulations

Prediction of competitive harm:

Research that forms a basis for vertical merger simulations
(Brenkers and Verboven 2006, Berto Villas-Boas, Bonnet and Dubois 2010)

1. Estimate **downstream** demand to obtain a matrix of own and cross price elasticities
2. Up and downstream games and vertical interactions (e.g., bargaining game) must be specified
3. Up and downstream marginal costs obtained from first order conditions

Many more assumptions and modeling choices
Conclusions will be sensitive to all of these choices

Predicting Effects:
Vertical Merger Simulations (cont.)

Prediction of efficiencies:

Requires another assumption --- How are products transferred in the integrated firm?
Full efficiency is not always achieved after a horizontal merger (*Michel 2016*)

Crawford, Lee, Whinston, and Yurukoglu (2018) develop a structural model
Forecast both harm and efficiencies
Specific to television (cable and satellite) markets
Assume Nash-in-Nash bargaining *(Horn and Wolinsky 1988)*
Conclude that vertical integration can be beneficial under one set of circumstances, harmful under another

Final Remarks

Compared to horizontal, vertical mergers are much less likely to be challenged

One vertical to 40 horizontal?

Most mergers, both horizontal and vertical, are efficient

Guidelines should include clear indications of which mergers are unlikely to be challenged

A need for easily calculated rules of thumb

Probably based on HHIs in both markets

Vertical merger simulations will be even more sensitive to assumptions

I am skeptical about our ability to obtain precise numbers for merger costs and benefits

Fine requires very specific assumptions

Estimates are easy to challenge

Vertical Mergers

Carl Shapiro

University of California at Berkeley

Vertical Mergers

Francine Lafontaine
University of Michigan
Ross School of Business

Recall Vertical Merger Definition

- Involves firms at consecutive stages of the production process.
- Examples:
  - Film studio and movie distributor.
  - Car assembly and car retailing.
  - Gasoline refiners and gasoline stations.
  - TV program production and cable TV company.
  - Beer production, beer distribution, and beer retailing.
- All such relationships can be viewed as producing **complementary products**; each firm produces an essential service to the creation of the final product.

From Horizontal Merger Guidelines

- “Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry.”
- “The interests of firms selling products **complementary** to those offered by the merging firms **often are well aligned with those of customers**, making their informed views valuable.”
- Suggests authorities should have a much more positive presumption for mergers involving complementary products, including vertical ones.

Why? Efficiencies From Vertical Integration

1. Harmonization of Incentives:
   - Reduce transactions costs and risks of "hold up."
   - Increase investment incentives and reduce free-riding.
2. Eliminating "double markups:"
   (or: what's worse than a monopoly? A succession of monopolies!)
3. Coordination in Design and Production:
   - Cost reductions and quality improvements.
   - Acquisition of an upstream or downstream firm can allow the merged firm to more efficiently produce a good (e.g. remove input distortions due to prices above MC for some inputs).
   - Facilitates information gathering and sharing (centralization v. delegation).

Prof. Salop's Main Arguments for new/revised VMGs

1. Efficiencies are not merger specific

- Says double markup efficiencies can be achieved via contract.
- In theory, yes (e.g. Mathewson and Winter (1984) refer to "minimally sufficient set" of restraints).

Prof. Salop's Main Arguments for new/revised VMGs

1. Efficiencies are not merger specific (cont'd)

- But in practice, there is strong evidence that the two are not the same in more complex (realistic) contexts:
  - E.g., GM/Fisher Body exclusive dealing contract did not suffice, ultimately they merged;
  - High prices set by franchisees despite many contract tools;
  - Lafontaine and Slade, *Journal of Economic Literature*, 2007 gives a summary of empirical literature on the Make-or-Buy decision: strong evidence in support of efficiencies associated with specific assets and incentive problems;
  - In AT&T/TW case, DOJ expert granted double-margin reduction efficiencies except for HBO, where found a way to address;
  - Crawford et al (Econometrica, 2018) found substantial efficiencies from vertical merger in cable industry – if available via contracts, why not solved via contracts already?
  - Many other studies have found evidence of important efficiencies from vertical mergers, large enough to make consumers better off in the end.

Prof. Salop's Main Arguments for new/revised VMGs

1. Efficiencies are not merger specific (cont'd)

- In sum, two-part tariffs and quantity forcing and other contracting solutions are great in theory to address double markups, but problematic in reality:
  - Demand uncertainty, risk aversion, information asymmetry, incentive effects, etc.

Prof. Salop's Main Arguments for new/revised VMGs

1. Efficiencies are not merger specific (cont'd)

- Importantly, there are antitrust rules against vertical restraints, not clear that contracts are preferable to vertical mergers from a policy perspective.
  - Seems we could get into an impossible situation where vertical mergers are prevented because efficiencies deemed non merger specific, but then firms are prevented from using the contracts that they are supposed to turn to.
- And vertical contracts **give rise to the same potential anticompetitive concerns** if they are used to achieve results of vertical mergers.
  - Incentives to raise cost to non-integrated is the same if succeed in resolving issues using contract.

Prof. Salop's Main Arguments for new/revised VMGs

2. vGUPPIs can be used as a screen

- But many recent analyses show that vGUPPIs do not predict outcomes well, they do not fully take effects into account.
  - (Das Varma and De Stefano, WP, 2018; Domnenko and Sibley, WP, 2018)
- Until we understand better the limitations and contexts where they may be useful, I think these are very problematic as a tool to determine which mergers warrant attention.

Prof. Salop's Main Arguments for new/revised VMGs

3. Vertical and Horizontal Merger Competitive Concerns are Not Inherently Different

- Per above, there are important differences, which should not be ignored.
- The games are much more complex, involving lots of interactions.
- For horizontal, at least we can count on the fact that max of joint profit for two substitute products involves higher prices than does max of individual profits.
    - On the likelihood that a vertical merger is anti-competitive, from a theoretical/simulation exercise, *see* Sheu and Taragin (2017), who simulate the outcome of both horizontal and vertical mergers in the same framework.
    - They show that consumers are worse off in most horizontal mergers (i.e. mergers among only upstream parties, or among downstream parties), but often better off or no worse off as a result of vertical mergers (mergers of an upstream firm with a downstream firm).
- Not clear more market power and high diversion ratios should make us worry more: in fact, with more market power, there is more scope for efficiencies.

Organizing the Evidence on Effects

- Prof. Salop indicates that econometric evidence does not support a procompetitive presumption for vertical mergers in oligopoly markets.
- Margaret Slade and I produced three papers, all around the same time:
  - Paper on evidence regarding effects of **vertical restraints**, in *Handbook of Antitrust Econ*, in 2008;
  - Paper on evidence regarding reasons for and effects of **vertical integration**, in *JEL*, 2007; and,
  - Paper on evidence regarding **contract choice and contracting practices**, in *Handbook of Organizational Economics*, 2012.
- We were clear that some of the early empirical evidence is less than ideal, in terms of data and methods.
- But we summarized by saying that the empirical literature reveals consistent evidence of efficiencies associated with the use of vertical restraints (when chosen by market participants) and, similarly, with vertical integration decisions.

Organizing the Evidence on Effects

- From papers published since, some find negative effects from such mergers, but many find positive consumer welfare from vertical restraints and from vertical mergers, e.g.:
  - Research on exclusive dealing in beer distribution, by John Asker (JIE, published in 2016, though included as WP in our tables);
  - Research on vertical contracts in the Video industry by Julie Mortimer;
  - Experimental studies by Chris Conlon and Julie Mortimer, on the snack industry and vending machines;
  - Research on bundling or full-line forcing; Wang (2011) on bundling gasoline and groceries, and Ho, Ho, and Mortimer (2012) on full-line forcing in the video rental industry; no or little evidence of foreclosure, and strong evidence of efficiencies;
  - Atalay, Hortaçsu, Li and Syverson, WP, 2018, “having an additional vertically integrated establishment in a given destination zip code has the same effect on shipment volumes as a 40 percent reduction in distance;”
  - Crawford et al (Econometrica, 2018) mentioned earlier;
  - And many more.

Back to Horizontal Merger Guidelines

- We have merger guidelines basically to tell the world (i.e., courts, businesses) **how** antitrust authorities analyze horizontal mergers, and to explain **why** they sometimes challenge them.
- "The Agencies seek to identify and challenge competitively harmful mergers while **avoiding unnecessary interference with mergers that are either competitively beneficial or neutral**."
  - "These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition.
  - These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement decisions."

So… Use of Vertical Merger Guidelines?

- Can we write useful guidelines for vertical mergers?
  - Theory and evidence do not provide clear standards/understanding or simple tools and analyses to identify the potentially anti-competitive vertical mergers a priori with some confidence.
  - Instead, likely to lead to a long list of potential conditions to check.
- Not clear **we can avoid interference with beneficial mergers** if we shift energies towards creating and implementing VMG.

Presumption

- Prof. Salop indicates that recent decisions regarding vertical restraints took a “relatively neutral” competitive presumption.
- Is the same a correct approach for vertical mergers, as he seems to suggest?
- If so, given limited resources of the agencies, and the anti-competitive presumption for horizontal mergers, should resources be increased at the agencies, or diverted, **to pursue more of the less likely to be anti-competitive** mergers?

Presumption

- Why might a vertical merger increase total firm profits?
  - As mentioned earlier, the merger might create efficiencies, giving the merged firm an incentive to lower its prices and increase its output. **Bad news for rivals, but good news for consumers**.
  - The merger might allow the merged firm to raise its rivals' costs or foreclose entry, thus allowing the merged firm to profitably raise its price. **Bad news for rivals AND consumers**.
  - It is possible (probable?) that the merger might create efficiencies AND raise rivals costs! **Bad news for rivals, but (possibly) good news for consumers, depending on which effect dominates**.
- So what presumption is appropriate?
- Bottom line: vertical mergers can be hard to analyze – and information from rivals is seldom helpful.
- Also efficiencies are discussed in context of agency reviews, but still difficult treatment in court; risky to now presume that firms will be able to argue these in court in proposed 3 step process.

One Last Point

- The theoretical literature can easily posit and then analyze a vertical merger.
- Empirically, studies have been about only a small set of industries so they can focus on mergers that are clearly vertical as well.
  - This has limited the number of studies and the set of industries/settings that authors can look at.
  - In many contexts, mergers are not purely vertical; worse when firms are highly diversified; what threshold of “vertical” activity will warrant a deep dive?
  - For diversified firms, if the agencies will investigate and potentially block due to horizontal effects, likely to prevent potential vertical effects too.
    - So guidelines for vertical only relevant if no horizontal concerns?
  - Finally, per Atalay, Hortaçsu and Syverson, often no shipment between same firm establishments in “vertical” markets – do these raise concerns? How would we define those that do and those that don’t a priori?

Conclusion

- Vertical mergers (and vertical restraints) can be problematic – agencies should be open to reviewing those.
- But given current state of theory and empirical evidence, guidelines are not what I would propose.
- Rather, look to academic community and perhaps some specific cases (e.g. AT&T/TW) to develop better understanding and clear tests and analyses to predict effects; not there yet in my view.

Useful References
(not meant to be comprehensive)

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Vertical Mergers

Panel Discussion:

Steven Salop, Daniel O'Brien,
Margaret Slade, Carl Shapiro,
Francine Lafontaine

Moderator: Bruce Kobayashi

Break

11:00-11:15 am

Vertical Mergers (Session 2)

Session moderated by:

Bruce Hoffman

Federal Trade Commission

Bureau of Competition

Vertical Mergers

Panel Discussion:

Steven Salop, Gene Kimmelman,
Sharis Pozen, Jonathan Sallet,
Laura Wilkinson, Paul Yde

Moderator: Bruce Hoffman

Lunch Break

12:30-1:15 pm

Alternatives to the Consumer Welfare Standard

Session moderated by:

Howard Shelanski

Georgetown University Law Center

Alternatives to the Consumer Welfare Standard

Barry Lynn

Open Markets Institute

Alternatives to the Consumer Welfare Standard: A Brandeisian Perspective

Jonathan Sallet

Senior Fellow,

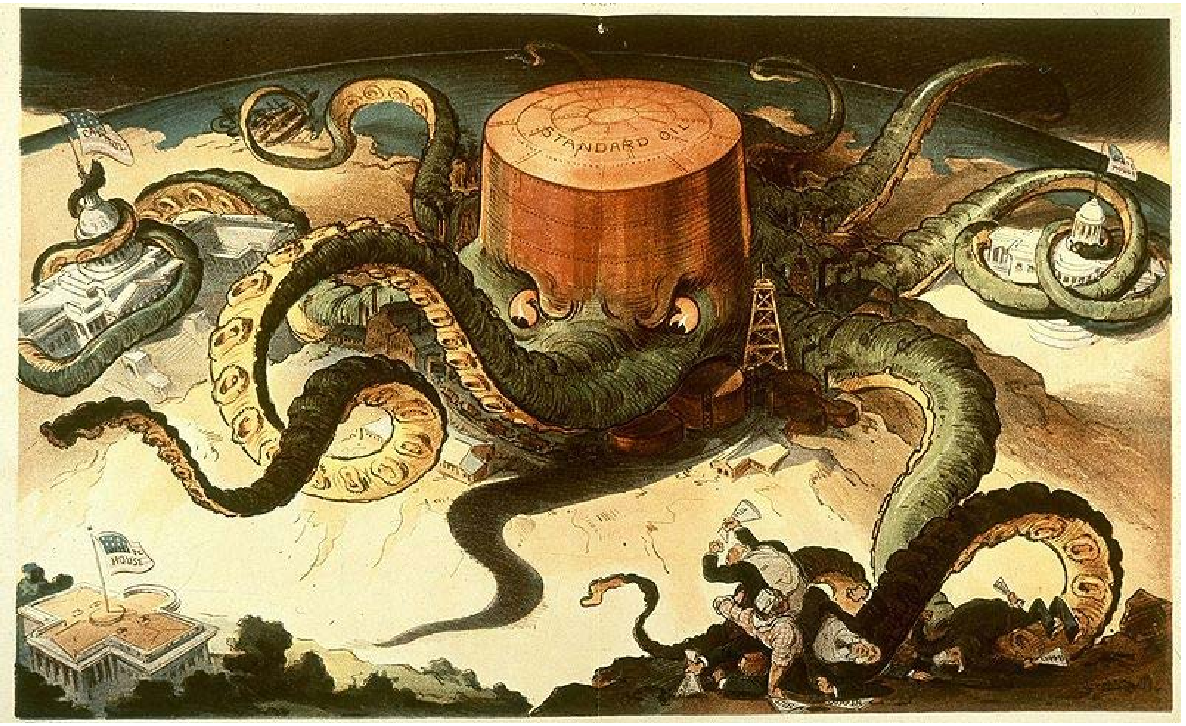
Benton Foundation

Antitrust Structure & Competitive Process: A Brandeisian Perspective

Jonathan Sallet, Senior Fellow – Benton Foundation

Structuring Antitrust: The Brandeis View

- **First**, Brandeis believed that legislators creating antitrust laws should consider broad economic and social issues.
  - For Brandeis, democracy included the ability of Americans to participate fully in the 20^{th} Century economy.
- **Second**, the core of Brandeis's approach was to find enforceable legal standards that identify harmful industrial (that is to say, economic) conduct in a manner that vindicates social and democratic values.
  - For example, his 1911 draft bill to reform the Sherman Act targeted "unfair or oppressive methods of competition". [1]



Structuring Antitrust: The Brandeis View

- **Third**, Brandeis's focus on institutional roles relied on the expertise, training, and professional responsibilities of law enforcers, lawyers, and judges to implement the chosen legal standards. Antitrust enforcers should not rest decisions on political grounds, and judges are not to indulge their own philosophical impulses.

  - Facts matter: Ex facto oritur juris ("the law arises out of fact").[2]

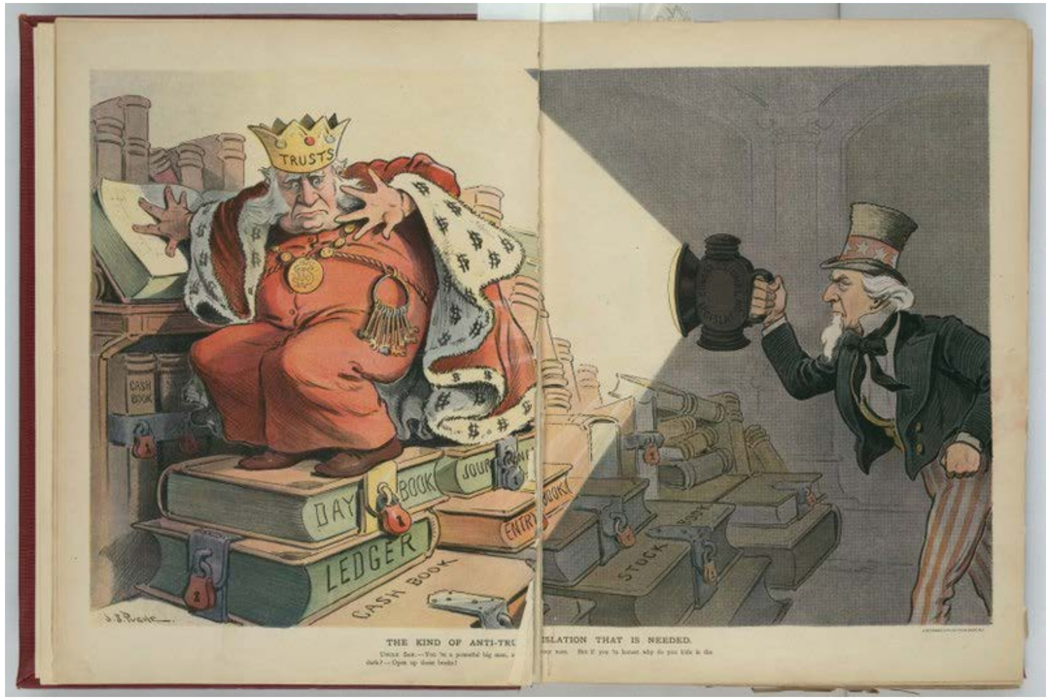
  - Formalisms are to be avoided: Brandeis favored inductive reasoning, based on facts, over deductive reasoning derived from abstract principles or "scientific half-truths".[3] Remember: Brandeis was living in the shadow of *Lochner v. New York.*[4]

  - Understanding the practical lessons of economics is necessary, including conclusions about the impact of market structure.

Structuring Antitrust: The Brandeis View

- **Fourth**, Brandeis was creative in thinking of ways to improve sectoral regulation when competition could not be expected to flourish.
  - Sectoral regulation is narrower in scope but much more detailed and expansive than the antitrust laws.

- **Fifth**, competition policy (both antitrust and sectoral regulation) is to be informed by a spirit of experimentation.
  - Brandeis pushed for the FTC, Clayton Acts, and statutory presumptions.
  - The FTC: a "new device in administrative machinery".[5]



The Competitive Process: Chicago Board of Trade v. United States

- "The true test of legality is whether the restraint imposed is such as merely regulates, and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition."[6]

- For Brandeis, competitive benefits arose from the creation of a competitive market structure that better served sellers who would otherwise stand at an information disadvantage vis-a-vis buyers.

- Thus, the "call" rule aided the competitive process by improving the ability of distant farmers and their agents to bargain with "actual knowledge of market conditions."[7]

Today's "Competitive Process" Standard

"Although the Sherman Act is a 'consumer welfare prescription,' courts do not enforce that prescription by making their own judgments about the allocation of resources that would best serve consumers' interests. **Instead, consistent with the Sherman Act's fundamental policy of market competition, courts protect consumers by protecting the competitive process. … Accordingly, antitrust law 'assesses both harms and benefits in light of the [Sherman] Act's basic objective, the protection of a competitive process**.'"[8]

- Important in (i) **buyer-power**, including labor markets, (ii) **intermediate purchasers**, and (iii) **information-exchanges**.

- From a litigator's perspective, "competitive process" provides clarity about what is at stake and helps to avoid confusion that can arise, for example, from a focus on the consumers rather than sellers or workers[9] or the invocation of "low prices" in buyer-power analysis.

Endnotes

1. *47 CONG. REC. 4183 (1911).* https://commons.wikimedia.org/wiki/File:Standard_oil_octopus_loc_color.jpg

2. Louis D. Brandeis, *The Living Law, An Address delivered before the Chicago Bar Association*, BRANDEIS SCH. OF LAW (Jan. 3, 1916), https://louisville.edu/ law/library/special-collections/the-louis-d.-brandeis-collection/business-a-profession-chapter-21 [https://perma.cc/TTJ3-VMXU].

3*. Id.*

4. Lochner v. New York, 198 U.S. 45, 53 (1905

5. FTC v. Gratz, 253 U.S. 421, 432 (1920)(Brandeis, dissenting).

Illustration at https://commons.wikimedia.org/wiki/File:The_kind_of_anti-trust_legislation_that_is_needed_-_J.S._Pughe._LCCN2010651561.tif

6. Chicago Board of Trade v. United States, 234 U.S. 231, 239 (1918).

7. *Id*. at 240.

8. Brief of the United States, Ohio v. American Express. https://www.supremecourt.gov/DocketPDF/16/16-1454/23008/20171207143101478_16-1454%20State%20of%20Ohio.pdf (citations omitted.)

9. Guidance for Human Resource Professionals, https://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-release-guidance-human-resource-professionals.*See* Marinescu, Ioana Elena and Hovenkamp, Herbert, *Anticompetitive Mergers in Labor Markets* (February 20, 2018).

U of Penn, Inst for Law & Econ Research Paper No. 18-8. Available at SSRN: https://ssrn.com/abstract=3124483.

Alternatives to the Consumer Welfare Standard: The Effective Competition Standard

Maurice E. Stucke

University of Tennessee

College of Law

Report


THE EFFECTIVE COMPETITION STANDARD
A New Standard for Antitrust
REPORT BY MARSHALL STEINBAUM AND MAURICE E. STUCKE
SEPTEMBER 2018
ROOSEVELT INSTITUTE
REIMAGINE THE RULES

Effective Competition Standard

Agencies and courts shall use the preservation of competitive market structures that

- *protect individuals, purchasers, consumers, and producers;*
- *preserve opportunities for competitors;*
- *promote individual autonomy and well-being; and*
- *disperse private power as the principal objective of the federal antitrust laws.*

Effective Competition Standard

The effective competition standard differs from the consumer welfare standard in several important ways:

- **First**, a substantial lessening of competition suffices. Enforcers and courts need not ramble through the wilds of economic theory to prove how the lessening of competition harms the welfare of consumers, nor balance the harms to one set of stakeholders against the supposed benefits for another.
- **Second,** it recognizes that competition needs competitors. Thus, it takes a tougher stance on monopolistic, predatory, and exclusionary practices, which often reduce the competitive opportunities for entrants and competitors.
- **Third,** unlike the consumer welfare standard, which considers the impact only on consumers, the effective competition standard protects market participants throughout the supply chain, including workers and sellers.
- **Finally**, by eliminating the precarious step of how the lessening of competition will harm consumers' welfare, the effective competition standard restores the purpose of the Clayton Act to "arrest restraints of trade in their incipiency and before they develop into full-fledged restraints violative of the Sherman Act." As Congress noted, "A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints."

Legislative Changes

- Aim is to Displace the Rule of Reason as the De Facto Standard with Better Legal Presumptions and Rules to Effectuate the Effective Competition Standard

Areas for Legislative Change

1. Stronger Presumptions in Merger Review
2. Tougher Position on Monopolies and Monopsonies
3. Reorient Courts and Enforcers to Look More Often Upstream
4. Right of Market Access
5. Vertical Restraints
6. Looking Beyond Price Effects
7. Relief

Mergers

- Congress is already considering amending Section 7 of the Clayton Act to establish a simple, cost-effective decision rule "to promote competition and prevent harmful consolidation by restoring the original intent of the Clayton Act to address the full range of anticompetitive harms."

- Toward that end, the amendments should require the parties to acquisitions that either
  - (1) significantly increase concentration levels or
  - (2) are undertaken by firms that already possess significant market power

  to bear the burden of establishing, supported by specific facts, that the acquisition will not materially lessen competition, create a monopoly or monopsony, or help maintain their market power.

Market Power

- To correct the Supreme Court's recent, faulty reasoning in *Amex,* significant market power can be established with direct evidence or circumstantial evidence, including high market share (over 30 percent for downstream sellers and 20 percent for upstream buyers) in any market with significant entry barriers.

- Other "direct" indicia of market power (i.e., not necessarily requiring that antitrust markets be defined)

Looking Beyond Price Effects

The amendment would also require the court to determine the likely effects of an acquisition to lessen competition:

- Not only on prices, but other parameters of competition, including quality, choice, innovation, and privacy; and
- Upstream on labor, suppliers, and other market participants, as well as
- downstream on customers or other individuals whom the acquisition may harm.

Behavioral Discrimination

- Congress would either amend Section 2 of the Clayton Act or add a new provision to prohibit price discrimination where it generally harms consumers overall.

- Such would be case with behavioral discrimination where firms use the data accumulated on individuals to get them to purchase things they otherwise wouldn’t buy at the highest price they are willing to pay.

- Alternatively, Congress can consider safeguards to make it harder for firms to collect data on users and effectively identify their reservation price.

Section 1

Congress should either amend Section 1 of the Sherman Act **<u>or</u>** add a new provision that:

- States that the federal antitrust laws protect both inter- and intra-brand competition;
- Presumes price and non-price vertical restraints to be illegal, including in the labor market, with narrow exceptions when
  - (1) the seller and buyer both lack market power, or
  - (2) the restraint is shown to be reasonably necessary to foster entry into a new market or to curb free-riding; and
- Prohibits attempts to engage in unlawful conduct (such as invitations to collude).

Section 2

Congress should either amend Section 2 of the Sherman Act **or** add a new provision that would establish a *prima facie* violation when a dominant firm engages in:

- Otherwise unlawful conduct (such as deception) that reasonably appears capable of making a significant contribution to its attaining or maintaining monopoly or monopsony power;
- Pricing below marginal (or, if that cannot be shown, average variable) cost for a sustained period of time, without the need of the plaintiff to show that defendant has a dangerous probability of recouping its "investment" in below-cost prices; or
- Cheap exclusion (conduct that "costs or risks little to the firm engaging in it, both in absolute terms and when compared to the gains (or potential for gains) it brings, and which is therefore attractive for an aspiring monopolist" and "does not raise any cognizable efficiency claims").

Duty to Deal

Congress should also clarify when a dominant firm has a duty to deal with others, namely where:

- The firm controls a product, service, resource, or facility that is necessary for carrying on a particular business;
- The refusal is likely to significantly exclude competition;
- The refusal prevents the emergence of a new product for which there is potential consumer demand, or the refusal prevents improving current products in a relevant market; and
- The defendant cannot objectively justify, with particular facts, its refusal.

Alternatives to the Consumer Welfare Standard

Timothy Wu

Columbia University Law School

The Consumer Welfare Standard: Considerations When Adding Goals to Antitrust

Tim Brennan

University of Maryland, Baltimore County

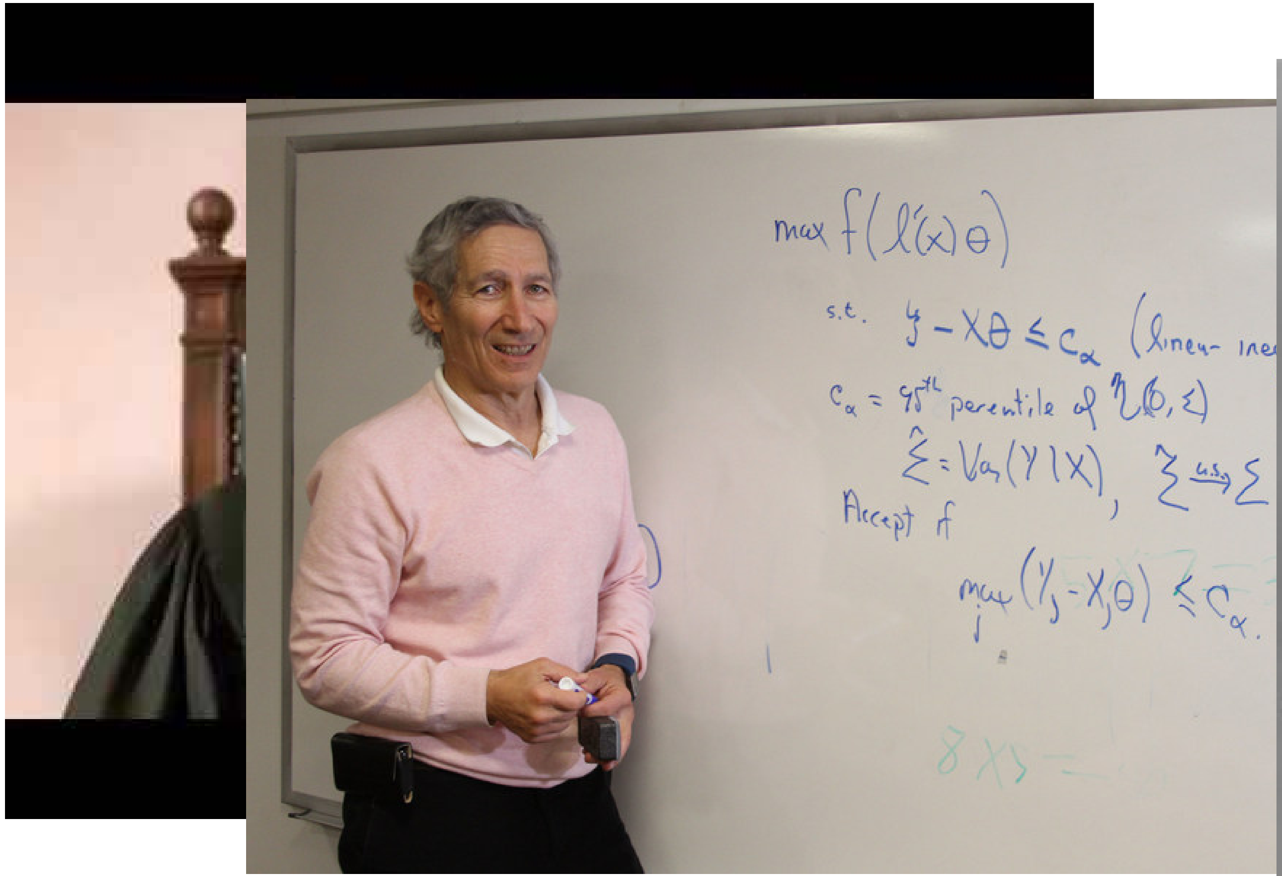
School of Public Policy

Resources for the Future

Options “out there”

- Fairness
- Inequality
- Labor share of income
- Jobs
- Competition as process
- Consumer choice
- Political power
- Anti-globalization
- Media veracity
- Environmental protection
- Managerial competence
- Mitigating consumer error

If antitrust pursues other goals…



Other points for discussion

- Would adding other social policies put antitrust "on the radar screen" in a helpful way?
- "Competitive process" – additional goal or limitation on domain?
- Is this about rejecting consumer welfare or expanding antitrust toward "no fault" monopolization?
- If one wants to promote those other important goals, PLEASE do not waste energy on antitrust!

The Consumer Welfare Standard

Deborah Garza

Covington & Burling LLP

The Consumer Welfare Standard

Gene Kimmelman

Public Knowledge

The Consumer Welfare Standard

Sharis Pozen

General Electric

The Consumer Welfare Standard

Fiona Scott Morton
Yale University
School of Management

The Consumer Welfare Standard

Panel Discussion:

Barry Lynn, Jonathan Sallet, Maurice Stucke,
Timothy Wu, Timothy Brennan,
Deborah Garza, Gene Kimmelman,
Sharis Pozen, Fiona Scott Morton

Moderator: Howard Shelanski

Break

3:10-3:25 pm

Consumer Welfare Standard (Session 2)

Session moderated by:

Derek Moore

Federal Trade Commission

Office of Policy Planning

Consumer Welfare Standard:

Antitrust in the Internet Era

Jon Nuechterlein

Sidley Austin LLP

Think of a company—past or present—that:

- uses scale, vertical integration, and innovation to transform retailing;
- becomes America's largest retailer by giving consumers a wider range of products than the competition and at lower prices; and
- whose very success prompts calls for radical changes to the nation's antitrust laws.

“By 1929, when it became the first retailer ever to sell $1 billion of merchandise in a single year, A&P owned nearly 16,000 grocery stores, 70 factories, and more than 100 warehouses. It was the country’s largest coffee importer, the largest butter buyer, and the second-largest baker. Its sales were more than twice those of any other retailer.”

- Marc Levinson

How did A&P do it?

- **Disintermediation.**
  - A&P built its own distribution network to bypass “jobbers” and other profit-taking middlemen that mom-and-pop grocers relied upon for delivery.
- **Scale.**
  - Once it had eliminated the middlemen, A&P persuaded food producers to sell to it on highly advantageous terms.
  - A&P won deeper discounts than other purchasers in part because, given its scale, it bought in such large and predictable volumes that it offered the producers major cost savings.

How did A&P do it? (cont'd)

- **Vertical integration.**
  - A&P kept costs low by vertically integrating—not only into distribution, but into food production as well (*e.g.*, bakeries).
- **Innovation.**
  - A&P used data to create greater consumer value.
    - "Philadelphians, it found, liked their butter lightly salted, with a light straw color, whereas New Englanders preferred more salt and a deeper yellow coloration."
    - The company's "mass of sales data allowed A&P's bakeries to forecast demand with a high degree of accuracy, minimizing returns of stale bread and doughnuts."

*Mark Levinson, *The Great A&P and the Struggle for Small Business in America*

- Who benefited?

  Consumers.

- Who didn't?

  Smaller competitors and displaced middlemen.

Punishing A&P for its success (Part 1)

- State and federal taxes on chain stores.
- Robinson-Patman Act.
  - Originally entitled "the Wholesale Grocer's Protection Act."
  - Rapid expansion of efficient chain stores was taking money "right out of [the] pocket" of "the producer and shipper[]" and "giving it to the consumer."

    - Statement of Nat'l League of Wholesale Fresh Fruit and Vegetable Distributors
  - The Act imposed a general prohibition on selling "commodities of like grade and quality" at different prices to different buyers, subject to various exceptions.
  - The Act's "fit with [contemporary] antitrust policy is awkward, as it was principally designed to protect small businesses" at the expense of consumers.

    - *Woodman's Food Mkt. v. Clorox Co*., 833 F.3d 743, 746 (7th Cir. 2016)

Punishing A&P for its success (Part 2)

In 1946, A&P and its key executives were convicted of *criminal violations* of the Sherman Act. 67 F. Supp. 626, *aff'd* 173 F.2d 79.

- Predatory pricing.
  - Morris Adelman (1959):

    "No reasonable and prudent A&P management would have incurred losses to drive out competition because it would have been impossible to claim the pay-off," given that "[e]ntry into the food trade was so cheap and easy that any attempt to raise prices would immediately have resurrected competition."

- Monopsony theory: because A&P forced suppliers to give it such deep discounts, those ***suppliers responded by raising prices to other grocery stores***, such that "[t]he consumers who buy food in stores competing with A&P pay part of the low cost of A&P's operations."
  - Were those suppliers really leaving money on the table before?
- DOJ: "A&P sells food cheaply [to consumers] in its own stores because it is a ***gigantic blood sucker***, taking its toll from all levels of the food industry."

Punishing A&P for its success (Part 2)

- Vertical integration: A&P's affiliated purchasing agent sold to third-party grocery stores whatever fresh produce A&P's retail stores did not need, typically at higher (*i.e.*, market) prices.
  - The court characterized these payments as "***unearned tribute,***" noted that they "could be used as [A&P] wished in competing with others"; and concluded that these "***odorous unjustified transactions***" and "[t]he multiple roles of [the purchasing agent] ***taint[ed] the whole fabric*** of [A&P's] operations."
  - But third-party grocery stores would have been no better off, and perhaps worse off, had the purchasing agent thrown out the produce that A&P did not need rather than offering it to them.
- At bottom, the complaint was not that the purchasing agent charged third-party grocers too much, but that vertical integration with the purchasing agent enabled A&P to obtain produce too cheaply and pass the savings to consumers.

Punishing A&P for its success (Part 3)

- DOJ next sought the breakup of A&P
- Case stalled amid personnel changes at the end of the Truman Administration.
- Eisenhower DOJ settled the case on condition that A&P divest its purchasing agent.

A prescient retrospective

Note, *Trouble Begins in the "New" Sherman Act: The Perplexing Story of the A&P Case*, 58 Yale L.J. 969 (1949).

- The district court never "dr[ew] the line between 'predatory' and 'competitive' price cutting," and thus its "general broadside against A&P's reduction of gross profit rates is a direct attack on the competitive process. … Does the Government or the court feel that business should never risk a loss for the sake of ultimate gain? If so, a good share of competition must be consigned to limbo."
- The court's decision implied, nonsensically, "that vertical integration is illegal *per se*."
- "The lure of temporary monopoly profits is an important impetus to the introduction of new products and new techniques, which rudely upset the peaceful, profitable existence of long-entrenched business firms. This constant change to the new, the more efficient, is the very heart of the process of effective competition."
- "But in [the A&P case] the defendant corporation represented the forces of competition, efficiency and change. *The potential contradiction in the New Sherman Act is sharply exposed*."

In other words, the antitrust philosophy on display in the A&P case was …

… ***a paradox—a policy at war with itself***.

Who wrote that 1949 Yale note?

Bork?

No.

Someone else from the Chicago School?

No.

Don Turner.

Fast-forwarding to the deep doctrinal past

Lina Khan, *Amazon's Antitrust Paradox*, Yale L.J. (2017).

- Argues for dispensing with below-cost/recoupment analysis by reinstituting the "rich set of concerns that had animated earlier critics of predation, including an aversion to large firms that ***exploit their size***."

Where have we heard this before?

> *"A&P sells food cheaply in its own stores because it is a gigantic blood sucker, taking its toll from all levels of the food industry."*

Fast-forwarding to the deep doctrinal past

2017 Yale note:

- Criticizes Amazon for "***creating a logistics empire***" to "reduce its delivery times, raising the bar for entry yet higher" and "receiving [fulfillment] business from its rivals, ***even as it competes with them***."
- Concededly, Amazon "offer[s] independent sellers the ability to ship goods more cheaply and quickly than they could by using UPS and FedEx directly."
- But its "***conflicts of interest tarnish the neutrality*** of the competitive process."

Where have we heard this before?

> *"The multiple roles" of A&P's purchasing agent were "odorous" and "taint[ed] the whole fabric of [A&P's] operations."*

A counterfactual world

- Imagine that antitrust focused as much on protecting smaller businesses as on consumer welfare, and you must give antitrust advice:
  - Should Apple launch devices and a vertically integrated music service that will shutter local record stores across the country?
  - Should Netflix launch a low-priced streaming service that renders neighborhood DVD stores obsolete? Should it vertically integrate into content creation?
  - Should Amazon launch the Kindle? Amazon Prime?
  - How much of a price umbrella should you counsel these companies to hold over their smaller competitors?

A counterfactual world (cont'd)

- Herbert Hovenkamp:
  - Suppose that "lower prices or higher quality [are] condemned … when it creates or threatens to create a monopoly."
  - "That … would be a strong barrier to innovation, and particularly to market shifting innovations that result in dominant firms."
  - "There would go Ford, Bell, IBM, Kodak, Polaroid, Xerox, Microsoft, Google, Apple and numerous others."

A counterfactual world (cont’d)

- Tim Wu:
  - *“The enforcer should ask …. Does the complained-of conduct or merger tend to implicate important non-economic values, **particularly political values**? Might it tend to preserve a long-standing, **politically influential** oligopoly?”*
- Donald Trump:
  - “*So sad and unfair that the FCC wouldn’t approve the Sinclair Broadcast merger with Tribune. This would have been a great and **much needed Conservative voice for and of the People. Liberal Fake News** NBC and Comcast gets approved, **much bigger**, but not Sinclair. Disgraceful!*”
  - *“As an example of the power structure I’m fighting, AT&T is buying Time-Warner, **and thus CNN**, a deal we will not approve in my administration[.]”*
  - *“Social Media is totally discriminating against **Republican/Conservative voices**. Speaking loudly and clearly for the Trump Administration, we won’t let that happen.”*

Antitrust’s big tent

- The consensus objective of contemporary antitrust:
  - the use of rigorous economic analysis
  - to advance the interests of consumers
  - in virtually all market settings.
- Different people can have very different views about how to apply that objective:
  - how to assess error costs
  - when to use bright-line rules vs. the rule of reason
  - concentration presumptions
  - how to think about vertical integration
  - when to supplement antitrust with sector-specific regulation.

Further reading:

Timothy Muris & Jonathan Nuechterlein, *Antitrust in the Internet Era: The Legacy of United States v. A&P* (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3186569.

Breathing New Life Into
The Consumer Welfare Standard:
The Protecting Competition Standard®

Carl Shapiro
University of California at Berkeley

See Carl Shapiro "The Consumer Welfare Standard in Antitrust,"
Testimony Before the Senate Judiciary Committee, December 2017, http://faculty.haas.berkeley.edu/shapiro/consumerwelfarestandard.pdf

The Protecting Competition Standard®

[The Consumer Welfare Standard Done Right With Better Name]

A business practice is judged to be anti-competitive if it harms trading parties on the other side of the market as a result of disrupting the competitive process.

- **In many cases, those “trading parties” are consumers.**
- **In other cases, those “trading parties” are business customers.**
- **In some cases, those trading parties” are suppliers, such as farmers or workers.**

Protecting Competition:
The Sole Goal of Antitrust Law & Policy

Protecting Competition Means Safeguarding the Competitive Process

- **Antitrust Accepts the Outcomes Resulting from Legitimate Competition**
- **Sector-Specific Regulation Needed if Outcomes Are Seen as Unacceptable**

Effective Competition in Turn Promotes Some Social Goals

- **Reducing Corruption; Reducing Inequality; Economic Growth**

Effective Competition May or May Not Promote Other Social Goals

- **Preserving Small & Local Businesses; Clean Environment; Worker Safety**

Structuring the Antitrust Inquiry

Ask Whether Harm to Trading Parties Has Resulted From a Challenged Practice that Disrupts the Competitive Process

- **Protecting Competition, Not Competitors**
- **Protecting Competition Does Not Mean “Big is Bad”**

Gives Coherence to Antitrust Law & Economics

- **Many Business Practices Commonly Harm Rivals By Putting Them Under Additional Competitive Pressure Without Disrupting the Competitive Process**
- **Example: Introducing New and Improved Products**

Examining Impact on Trading Parties Helps Distinguish Bad from Good

Horizontal and Vertical Agreements

- Horizontal: Price Fixing vs. Standard Setting
- Vertical: Inter-Brand Exclusion vs. Intra-Brand Distribution Strategy

Horizontal Mergers

- Loss of Head-to-Head Competition vs. Synergies

Unilateral Conduct

- Boundary Between Predatory Pricing and Aggressive Pricing

Attacks on the Consumer Welfare Standard

Some Criticisms Are Simply Based on Misconceptions

- NOT Just About Price: All Impacts on Trading Parties Count
- NOT Just About Short-Run: Innovation & Long-Run Count
- NOT Ignoring Suppliers: All Trading Parties Count

Some Criticisms Relate to Excessive Burdens of Proof on Plaintiffs

- Presumptions and Burdens Can and Should Be Adjusted Using the Protecting Competition Standard®

Some Populist Attacks Simply Miss the Mark

- Suggestion That Virtually All Antitrust Lawyers and Economists Have Been Hypnotized or Blinded by Robert Bork is Nonsense

Do Not Confuse the Protecting Competition Standard® With Weak Antitrust Enforcement

Widespread Consensus that Antitrust Law in the 1960s Was Not Well Grounded in Business Reality or Economics

Necessary Corrections Were Made Based on Economic Learning

Courts Overshot, Imposing Excessive Burdens on Antitrust Plaintiffs

- **General Belief that Markets Self-Correct Not Warranted; Error-Cost Errors**

Today We Can Restore Balance & Reinvigorate Antitrust Enforcement Using the Protecting Competition Standard®

Economics is Fundamental to Antitrust, Not a Defense Tool

Protecting Competition in the 21st Century

Globalization and Technological Advances Have Fueled Economies of Scale & Network Effects in Many Industries

- Firm Size and Market Concentration Have Grown
- "Superstar Firms" Are Highly Efficient

As a Result, We Need Antitrust Enforcement Now More Than Ever

- The Dangers of Horizontal Agreements Have Grown
- The Dangers of Exclusionary Conduct Have Grown
- The Dangers from Horizontal & Vertical Mergers Have Grown
- True Whether or Not Antitrust Has Been Too Lax in the Past

FTC Should Focus on How to Strengthen Antitrust Enforcement Using the Protecting Competition Standard®

Reinvigorating Antitrust Using the Protecting Competition Standard®

Enforcement Agencies, Courts, and Congress Can Do Much More Using the Protecting Competition Standard®

Horizontal Mergers: Stronger Structural Presumption Plus

- **Predictive Exercise is Imperfect; Use Pricing Pressure Metrics; Require Strong Evidence for Entry Defense**

Exclusionary Conduct: Greater Use of Direct Evidence of Effects

- **Pay for Delay; Exclusive Dealing; Bundled Pricing**

Strengthen Antitrust Enforcement Based on New Economic Evidence and the Reality of Today's Economy

The Consumer Welfare Standard

Barry Lynn

Open Markets Institute

The Consumer Welfare Standard

Maurice Stucke

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College of Law

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Geoffrey Manne
International Center for Law and Economics

The Consumer Welfare Standard

Fiona Scott Morton

Yale University

School of Management

The Consumer Welfare Standard

Panel Discussion:

Jonathan Nuechterlein, Carl Shapiro,
Barry Lynn, Maurice Stucke,
Geoffrey Manne, Fiona Scott Morton

Moderator: Derek Moore

Closing Remarks

Commissioner Christine S. Wilson

Federal Trade Commission

Thank You

Hearing #6: November 6-8