

6 November 2009

Federal Trade Commission
Office of the Secretary, Room H-135 (Annex P)
600 Pennsylvania Avenue NW,
Washington, D.C. 20580

Re: *Project No. P092900; Horizontal Merger Guidelines Review Project*

Thank you for this opportunity to offer comments as part of the U.S. Department of Justice and Federal Trade Commission's Horizontal Merger Guidelines Review Project. My comments address the following question: "20. Should the Guidelines be revised to reflect learning based on merger retrospective studies?"¹

I enthusiastically respond yes, and offer several measures to test and further develop five assumptions underlying the Horizontal Merger Guidelines. Commissioner Kovacic, among others, has long called for more empirically-driven research policies.² Competition policy's greatest failing has been its incomplete understanding of how competition works in particular markets in particular communities at particular time periods and the interplay among private institutions, government institutions, and informal social, ethical, and moral norms. By undertaking more empirical research, competition authorities will understand better the competitive dynamics of particular markets and how legal and informal norms interact to influence individual behavior and competition generally.

Competition authorities can use many inter-disciplinary avenues to improve their understanding of market dynamics across different industries. This comment addresses two avenues: post-merger and post-conviction review. My comments are drawn from

¹ Federal Trade Commission and U.S. Department of Justice, Horizontal Merger Guidelines: Questions for Public Comment (Sept. 22, 2009), <http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf>.

² See, e.g., William E. Kovacic, *Rating the Competition Agencies: What Constitutes Good Performance?*, 16 GEO. MASON L. REV. 903, 922 (2009) (noting how investments in knowledge "have long-term capital qualities" as investments "in activities—research, workshops, partnerships with academia—that build knowledge help ensure that the agency stays abreast of important developments in economic theory, empirical study, and legal analysis," is a crucial element of effective case selection, and "increases the agency's ability to attempt more complex and demanding matters, helps the agency ground its cases in the best possible conceptual and empirical foundations, and provides assurance that the agency will not find itself trapped in the wrong analytical model").

two recent articles that address in greater detail the need for such empirically-driven research, its benefits, and several possible concerns of my proposals.³

Based on my experience with the Antitrust Division, the U.S. competition agencies devote considerable resources investigating ex ante the merger. The agencies' lawyers, economists, and paralegals work very hard to accurately predict the merger's likely competitive effects. But they examine only half of the picture, namely the state of competition several years before the merger. Now is the time for the antitrust agencies to review systematically what actually happens post-merger. The agencies should institute specific mechanisms to test empirically the following key assumptions underlying the Horizontal Merger Guidelines: (i) the relevant anticompetitive effects would manifest themselves as higher prices; (ii) anticompetitive effects are likely to occur only in highly concentrated (not moderately concentrated to unconcentrated) markets; (iii) even in highly concentrated markets, anticompetitive coordinated effects are unlikely, absent certain economic conditions that facilitate collusion; (iv) anticompetitive effects are unlikely, absent high entry barriers; and (v) many companies merge to generate significant efficiencies.

1. Price: A merger can substantially lessen competition in many ways, such as significantly reducing choices for consumers, quality, the level of services, or innovation. In certain industries, price is less significant than these other dimensions of competition.⁴ More empirical research is required on what happens post-merger than simply whether prices increased. What happened to other nonprice components of competition, such as choice, service, quality, and most importantly innovation?

2. Coordinated Effects: The Merger Guidelines assume that coordinated interaction (either express or tacit)⁵ is unlikely to occur (i) in unconcentrated or moderately concentrated industries and (ii) absent other conditions conducive to reaching the terms of coordination, and detecting and punishing any cheating. But when one

³ See Maurice E. Stucke, *Behavioral Economists at the Gate: Antitrust in the Twenty-First Century*, 38 LOY. U. CHI. L.J. 513 (2007); Maurice E. Stucke, *New Antitrust Realism*, GCP (Global Competition Policy) MAG., Jan. 2009, available at <http://ssrn.com/abstract=1323815>.

⁴ See Neil W. Averitt & Robert H. Lande, *Consumer Choice: The Practical Reason for Both Antitrust and Consumer Protection Law*, 10 LOY. CONSUMER L. REV. 44 (1998); Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 ANTITRUST L.J. 713 (1997).

⁵ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 2.1 (1997) ("Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or *express* collusion, and may or may not be lawful in and of itself.") (emphasis added).

considers the Antitrust Division's prosecution of durable cartels with many members in unconcentrated or moderately concentrated industries, one wonders why so many competitors could expressly collude if, under the Merger Guidelines' assumptions, agreeing to the terms of such collusion and detecting and punishing any defections thereto would be difficult. Uncritical reliance on the Merger Guidelines' HHI concentration levels may lead to false negatives. More empirical research is needed across industries to determine the relationship between concentration levels (and changes thereto as a result of mergers) and the likelihood of tacit or express collusion.

3. Entry: The Merger Guidelines assume that antitrust enforcers need not be concerned with industries with low entry barriers, as rational profit-maximizing firms will defeat the exercise of market power. But when one examines industries where price-fixing and bid-rigging occurred, not all of these industries can be characterized as having high entry barriers. Some (such as public auctions) have low entry barriers. Thus an empirical challenge for the agencies is to examine past price-fixing conspiracies that occurred in industries with low or moderate entry barriers (e.g., bid rigging in public auctions), and to inquire why entry had not occurred when in theory, it should.

4. Efficiencies: The Merger Guidelines state that the "primary benefit of mergers to the economy is their potential to generate such efficiencies."⁶ The belief is that profit-maximizing firms merge for two reasons: efficiencies/cost savings and/or market power. If the merger generates neither, it would appear economically irrational. The problem is that no one knows whether, and to what extent, mergers in different industries actually generate significant efficiencies. Management consulting firms, for example, have noted that the merging parties' executives, at times, may overstate the likely efficiencies. It is also difficult today for the investing public to measure ex post whether the merger actually yielded the claimed efficiencies. Many public companies report on a consolidated basis, so one may not measure easily the post-merger cost savings for a particular division. Given that antitrust enforcers do not regularly revisit mergers, it is unclear today to what extent the efficiencies claimed as a defense actually materialized. More empirical research is needed to determine to what extent mergers generate significant efficiencies. Such research may help identify factors of when, and under what circumstances, the claimed efficiencies are more likely to be realized.

⁶ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 4.0 (1997).

Recommendation

I recommend five specific actions to advance more empirically-driven competition policies.

First, the federal antitrust agencies should conduct a post-merger analysis of any merger subject to an extended Second Request review in which the agency: (i) took no enforcement action; (ii) permitted the merger in part to be consummated pursuant to a consent decree; or (iii) challenged the merger in court, but lost. The antitrust agency two to five years after the merger was consummated should examine the state of competition in that industry, including pricing levels and non-price components such as innovation, productivity, services, and quality, to the extent observable. To mitigate the burden on the agencies and market participants, the agencies can develop a two-stage post-merger review. In the first stage, the agency staff would conduct a quick-look review of competition in that industry. The staff would interview a small but representative sample of industry participants (for example in a merger involving household consumer products, the staff would interview buyers from food, drug, and mass merchandiser retailers) about the status of competition and request from the merged entity a limited quantity of data, including relevant price data. If the quick-look review suggests that competition significantly diminished, the agencies would engage in a more in-depth review. The agency would report whether other variables, besides the merger, might explain the increase in prices or reduction in innovation, productivity, services, and quality. For those companies identified as potential entrants in the original merger review, the reviewing agency would analyze, based on its interviews with these identified entrants, why they chose not to enter, or if they did enter, why they were ineffectual. The reviewing agency would describe which, if any, of the merging parties' efficiencies it could verify post-merger, the magnitude of the efficiencies, and the extent consumers directly benefited from such efficiencies.

The federal antitrust agencies would also summarize their findings for the public, and describe annually what specific actions, if any, they are undertaking with respect to this data, including how they are incorporating the findings from this data in their merger review.

Second, the Obama administration should request, and Congress should provide, the U.S. Department of Justice with subpoena authority for non-public information to

conduct such post-merger review for its industries.⁷ This subpoena authority should be sufficiently broad to enable the Antitrust Division to test (and eliminate) other explanations as to why competition (which includes important parameters beyond price) increased or diminished post-merger. The federal antitrust agencies should also coordinate with other federal agencies in sharing such information, subject to the data producer's ability to challenge the dissemination of its commercially sensitive information.

Third, to advance the empirical research on coordinated effects, the agencies should report two to five years after prosecuting a cartel, the state of competition in that industry, as described above. With criminal cartel prosecutions, the Department of Justice typically seeks fines and incarceration; whether these measures were sufficient to restore competition and deter recidivism should be assessed. After securing its criminal convictions, the Department of Justice should also inquire, and publicly report, how cartels with many members or competitors were able to collude. Did they act as many profit-maximizer game theories would predict, or were they more trustful and cooperative than these theories' predicted outcome? If so, why? As the number of cartel members increases, were there other specific factors that enabled them to successfully collude? What, besides its leniency program, can the government do to deteriorate that trust and cooperation among price-fixers (without adversely affecting other legal rules that foster socially beneficial trustful relationships)? The agencies should also determine whether any cartel member acquired any competitor, large customer or supplier in the affected industry in the five years before, or at any time during, the alleged violation. If so, the agency should report what impact, if any, that earlier acquisition had on the industry's state of competition and what action, if any, antitrust enforcers had taken in reviewing that earlier acquisition, and identify the reasons for not challenging it.

Fourth, the federal antitrust agencies should make publicly available a computerized database identifying all civil and criminal antitrust consent decrees, pleas, or litigated actions involving cartel activity under section 1 of the Sherman Act. The database should include certain industry characteristics, such as: (i) the number of conspirators (and best estimate of their market shares); (ii) the length of conspiracy; (iii)

⁷ The Antitrust Division appears to be more limited in conducting such general post-merger review. The Division's subpoena authority in civil investigations comes from the Antitrust Civil Process Act, 15 U.S.C. §§ 1311–1314. The Act defines an antitrust investigation to premerger activities or suspected antitrust violations. § 1311(c). The FTC, on the other hand, has broader statutory authority to gather information on the effects of its enforcement measures. *See* 15 U.S.C. § 46.

the product or services market in which collusion occurred; (iv) the number of competitors (and their market shares) who were not part of the conspiracy; (v) the number of entrants (and their market shares) during the period of the conspiracy; and (vi) the nature of the conspiracy. The Department of Justice may delay listing certain nonpublic information if it would compromise ongoing antitrust enforcement. However, after completing its prosecution of the cartel, the Antitrust Division should post such information, absent demonstrating that disclosure would compromise its enforcement activity.

Fifth, any publicly held company that seeks to rely on an efficiency defense before the antitrust agencies and/or the courts should be required to publicly report its claimed efficiencies in its filings with the U.S. Securities and Exchange Commission. (If such disclosure would divulge a trade secret or other confidential research, development, or commercial information that would be ordinarily protected from public disclosure under Fed. R. Civ. P. 26(c), then the antitrust agencies may excuse the *public* disclosure of such information.) For each year post-merger (for the period that it claims the efficiencies will be realized), the company should report the actual amount of efficiencies realized versus the projected amount. This should temper the company executives from inflating the claimed efficiencies, and hold them accountable to the shareholders for pursuing a growth-by-acquisition strategy, while informing the agencies on those efficiencies for particular industries that are more likely to be cognizable and substantial.

The FTC's recent merger retrospective studies have been very helpful.⁸ But there does not exist today a built-in mechanism for routine post-merger review across agencies. Empirically testing and refining the neoclassical economic theories underlying much of Merger Guidelines have several benefits. Such empirical work promotes effective learning by creating feedback about the relation between the situational conditions and the appropriate response. By instituting across agencies a regular and systematic review of cartel activity and close-call mergers, the agencies reduce the likelihood of false negatives and positives in merger review, promote more effective antitrust enforcement, increase transparency of the merger review process, and make themselves more accountable for their decisions. An empirically-driven competition policy may also

⁸ See, e.g., Deborah Haas-Wilson & Christopher Garmon, *Two Hospital Mergers on Chicago's North Shore: A Retrospective Study*, FTC Bureau of Econ. Working Paper No. 294 (Jan. 2009), available at <http://www.ftc.gov/be/workpapers/wp294.pdf>; Steven Tenn, *The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction*, FTC Bureau of Econ. Working Paper No. 293 (Nov. 2008), available at <http://www.ftc.gov/be/workpapers/wp293.pdf>.

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temper the claims, which have also increased over the past quarter century, of partisanship in antitrust enforcement.

I am happy to discuss these comments further and participate in the New York or Washington, D.C. workshops.

Sincerely,



Maurice E. Stucke