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LITIGATION COMMENTS ON THE DRAFT HMG Project No. P092900

These comments respectfully show that recent Supreme Court decisions in antitrust and on expert witnesses in the *Daubert* Quartet1/ as a litigation matter provide at least three separate grounds for the draft Horizontal Merger Guidelines (HMG) to be bogged down in litigation for years, that ultimately the agencies are likely to lose, and thus the Guidelines should be re-written in accordance with this Supreme Court precedent.2/

#1. THE LEGAL STANDARD UNDER SECTION 7 IS NOT EFFICIENCY ECONOMISTS' UNILATERAL AND COORDINATED EFFECTS

The draft HMG correctly state the applicable law: "Section 7 of the Clayton Act prohibits mergers if "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."" (Emphasis added).

However, without citation to any Supreme Court authority (there is none), the draft HMG adopts a different standard, efficiency economists' standard:

> The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish

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1 *Daubert v. Merrell Pharmaceutical, Inc.,* 509 U.S. 579 (1993); *General Electric Co. v. Joiner;* 522 U.S. 136 (1997)(a tort case alleging that exposure to PCBs "promoted" plaintiff's small cell lung cancer); *Kumho Tire Co. v. Carmichael,* 526 U.S. 137 (1999) (holding *Daubert* applied to all experts, and ruling that plaintiff's' tire expert did not meet *Daubert* standards and thus was properly excluded by the trial judge); *Weisgram v. Marley Co.,* 528 U.S.440 (2000)(holding plaintiffs have only "one bite at the apple," so that if their experts are excluded on appeal after testifying and winning at trial, the case is over).

2 For more detail, see Charles Weller, "Litigator's Guide to the *Daubert* Quartet," 1 *BNA Expert Evidence Rep*. 61 (Sept. 10, 2001); "Antitrust Economics As Science After *Daubert*." 42 *Antitrust Bulletin* 871 (1997); "Litigator's Guide to Applying *Daubert* and Climategate to the EPA's Greenhouse Gases Rule," 10 *BNA Expert Evidence Rep*. 61 (March 8, 2010); "Winning Antitrust Litigation," Chap. 7, pp. 187-223, *Unique Value* (2004); "The Supreme Court's New Antitrust Law for the Global Knowledge and Entrepreneurial Economy in a 'Perfect Storm' of Danger – and Opportunity," 54 *Antitrust Bulletin* 157 (2009).

innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm's behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

Thus, as a basic legal and litigation matter, there is no legal authority for much if not all of the HMG standards, thus inviting litigation the agencies are highly likely to ultimately lose.

#2. ***KUMHO'S* AND *CONCORD BOAT'S* RELIABILITY REQUIREMENT FOR EXPERTS OFTEN WILL EXCLUDE EFFICIENCY ECONOMISTS' AS EXPERTS IN LITGATION**

To date, it has been widely assumed that a properly qualified economist will be allowed to testify that a merger violates Section 7 under the draft HMG. Given the importance of mergers to some companies, this assumption is likely to be challenged. In *Concord Boat*3*,* however, the economist was excluded. Surprising to many perhaps, economic experts proffered to present evidence proving a merger violation are likely to be excluded too if properly challenged, for the reasons shown next.

Today, the controlling test for the admission or exclusion of experts in litigation under the *Daubert* Quarter is reliability (the *Frye* test of general acceptance by peers, like fellow economists, was overruled in 1993).

The most recent and most extensive exegesis of how to determine reliability by a current member of the Court is Justice Breyer's opinion in *Kumho.*

First he underscored that "'evidentiary reliability,'"4/ quoting *Daubert* itself, is the key test.

Then, in ruling plaintiffs' expert was properly excluded, he articulated the test for reliability that applies now. Specifically, in *Kumho* plaintiffs alleged that a defective tire caused a terrible automobile accident with a number of fatalities. The *Daubert* reliability issue was, in Justice Breyer's words, "whether the [plaintiffs'] expert could reliably

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3 *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000)(cert denied 2000). *Concord Boat* was a major antitrust case with 45 trial witnesses, 800 trial exhibits and ten weeks of trial that resulted in a $140 million judgment for plaintiffs. On appeal, however, the Eighth Circuit reversed and entered final judgment for the defendant. Citing the *Daubert* Quartet, the court held that plaintiffs' economic expert, Robert Hall, a highly regarded Stanford University economics professor, should have been excluded at trial and thus plaintiff did not prove its case.

4 *Kumho*, 526 U.S. at 150.

determine the cause of this tire's separation."5/ He concluded no, it was not reliable, by applying basic legal analysis of the facts to the expert's theory to determine reliability, expalining, inter alia, Mr. Carlson

- "could not say whether the tire had traveled more than 10, or 20, or 30, or 40, or 50 thousand miles,"
- conceded that the tire should have been taken out of service because of the miles used, had been repaired inadequately for punctures, and that the tire bore marks consistent with tire abuse, rather than a tire defect,
- no other tire experts used his theory of defective tires, and
- there were no published articles that validated or used his theory.6/

Seven other members of the Court agreed with Mr. Breyer's *Daubert* reliability analysis, and conclusion that Mr. Carlson was properly excluded as an expert (Justice Stevens dissented).

The reality for efficiency economics theory was summarized by Judge Posner regarding the Chicago School antitrust theory of Prof. Director:

> It is a curiosity, and a source of regret, that to this day very few of Director's ideas have been subjected to systematic empirical examination. 7/

That is, efficiency economics theory has not been subjected to systematic empirical examination and thus it has not been demonstrated to be reliable. Accordingly, under Justice Breyer's standard for reliable expert witnesses for litigation, the efficiency economists' necessary to prove cases under the draft HMG will be excluded at the trial or a higher level, as in *Concord Boat.*

#3. THE *PNB* PRESUMPTION, LIKE THE PRESUMPTIONS IN *LEEGIN* AND 11 OTHER SUPREME COURT DECISONS SINCE 1977, WILL BE OVERRULED OR REJECTED

The draft HMG rely in part on the *Philadelphia National Bank* ("*PNB*") merger presumption. However, starting with *GTE Sylvania* in 1977, the Supreme Court has issued 12 decisions eliminating or rejecting the use of various antitrust presumptions:

1. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977)
2. U. S. Steel Corp. v. Fortner, 429 U.S. 610 (1977)
3. Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979)
4. Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2 (1984)
5. NCAA v. University of Oklahoma, 468 U.S. 85 (1984)
6. Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988)

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5 *Id*. at 154.

6 *Id*. at 153-58.

7 Posner, "The Chicago School of Antitrust Analysis," 127 *U. Penn. L. Rev*., 925, 931 n.13 (1979).

7. State Oil v. Khan, 523 U.S. 3 (1997)

8. NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998)

9. California Dental Assn. v. FTC, 526 U.S. 756 (1999)

10. Texaco Inc. v. Dagher, 547 U.S. 1 (2006)

11. Illinois Tool Works, Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006)

12. Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007)

All 12 decisions implement the basic policy the Court announced in *GTE Sylvania* that any "departure from the Rule of Reason standard must be based upon demonstrable economic effect," rather than upon "formalistic line drawing."8/

The Court has also made clear that it will reconsider "its decisions construing the Sherman Act when the theoretical underpinnings of those decisions are called into serious question,"9/ as *Leegin* and *Illinois Tool* recently demonstrate.

As shown below and elsewhere, the factual and theoretical underpinnings of the *PNB* presumption are as weak, if not weaker, that those in the cases from *GTE Sylvania* to *Leegin* that have overruled or rejected numerous antitrust presumptions. For example, Judges Easterbrook and Posner have written that "new studies call into question the position which underlies much of antitrust law that increasing concentration creates a significant risk of cartels (or cartel-like oligopolistic interdependence),"10/ and Professors Scherer and Ross report that "most, if not all, of the correlation between profitability and concentration found by Bain and his descendants," which is critical to the *PNB* presumption, "was almost surely spurious."11/

Although it is often noted that the Supreme Court has not decided a merger case for a long time, the same could be said about these 12 presumption decisions, patent law, Constitutional limits on punitive damages, and *Booker* before those cases were decided. It thus seems highly likely that the *PNB* presumption will be overruled if properly presented to the current Court.

#4. AS PUBLIC POLICY, EFFICIENCY ECONOMIC THEORY IN TODAY'S GLOBAL KNOWLEDGE ECONOMY IS A "CALAMITY" AS THE BASIS FOR ANTITRUST

Judge Easterbrook cogently stated that an "antitrust policy that reduced prices by 5 percent today at the expense of reducing by 1 percent the annual rate at which innovation lowers the cost of production would be a calamity."12/

As Brookings economist Dr. Charles Schultz makes clear, efficiency economic

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8 Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58-59 (1977).

9 State Oil Co. v. Khan, 522 U.S. 3, 20 (1997).

10 Richard Posner & Frank Easterbrook, *Antitrust Cases, Economic Notes and Other Materials* 41-43 (2d ed. Supp. 1984).

11 Frederick Scherer & David Ross, *Industrial Market Structure and Economic Performance* 411 (3d ed. 1990).

12 Frank Easterbrook, *Ignorance and Antitrust, in ANTITRUST, INNOVATION, AND COMPETITIVENESS* 119, 122-23 (T. Jorde & D. Teece, eds. 1992).

theory, the current basis of antitrust policy and the draft HMG, is such a theory. "Formal economic theory of the market" is limited to a market's "static-efficiency characteristics," that is, "its ability to get the most out of existing resources and technology," but efficiency theory, like Judge Easterbrook explained, can only lead to "miniscule" increases in the standard of living:

> Had the triumph of the market meant only a more efficient use of the technologies and resources then available, the gains in living standards would have been minuscule by comparison.13/

Peter Drucker similarly observed that "we are usually told, especially by economists" to "focus on costs" and "efficiency," but "no amount of efficiency would have enabled the manufacturer of buggy whips to survive."14/

Miniscule increases in the American standard of living would be a "calamity." Thus as policy matter, the HMG, antitrust, and the country urgently needs to go beyond efficiency economic theory.

CONCLUSIONS

For these Supreme Court, litigation, and public policy reasons, it is respectfully suggested that the draft HMG be rewritten to avoid the fate of *Oracle* and similar cases15/ -- extensive litigation the government loses, and to avoid miniscule increases in our, and the world's, standard of living.

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13 Charles Schultze, *The Public Use of Private Interest* 65 (1977)(emphasis added).

14 Peter Drucker, *Management* 45 (1973).

15 *See, e.g., United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004); *United States v. SunGard Data Sys*., 172 F. Supp. (D.D.C. 2001).