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JOINT WORKSHOP ON MERGER ENFORCEMENT

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OPENING REMARKS

MR. ABBOTT: Good morning, everyone. Welcome to the Joint Federal Trade Commission Department of Justice Antitrust Division Workshop on Merger Enforcement. This workshop will be held here today in the new FTC conference center -- and we hope you all enjoy the facilities -- for today, tomorrow, and Thursday.

We welcome members of the audience to listen in, although all questions during the proceedings will be handled by members of the panels.

We will start out today -- and I am not going to go into thanks, but I owe a debt of thanks to staff at both the Federal Trade Commission and the Antitrust Division, and certainly Bob Potter, head of the policy office of the Antitrust Division, for tremendous collaboration and support in putting on this event, which we hope will clarify a number of issues regarding the current application of the merger guidelines.

And we are delighted to start things out with a bang with the leaders of the federal antitrust community. We will lead off with brief remarks by Assistant Attorney General Hew Pate, and follow up with remarks by FTC
Chairman Tim Muris.

And both General Pate and Chairman Muris have quite a few significant accomplishments, but I won't take away from their important time at the podium by going into them. Suffice it to say that they are welcoming you, and also to the audience that is listening in on the 800 telephone line to this important conference.

And we hope to obtain some valuable information which will inform our activities in the future, as a result of the conference. So, let me turn it over right now to General Pate.

MR. PATE: Thanks very much, Alden. Thanks to the Federal Trade Commission for providing this great facility to host our look into the operation of the merger guidelines, and to consider improvements -- we hope -- in thinking, or developments in thinking, in the way that the agencies carry out their responsibilities under Section 7 of the Clayton Act and under the FTC statute.

I think that it's fair to say that this is one part of a very significant amount of policy activity that's going on at the two agencies. And frankly, I think Tim Muris deserves the lion's share of the credit for that, in terms of bringing forward the concept of joint work between the two agencies.
That has been producing a great deal of thinking, in terms of the IP and antitrust hearings, which are now drawing toward a final close, hopefully with the publication soon of the antitrust and IP report. That's happening in the health care antitrust arena, in the context of the hearings that were held there, and this merger conference is yet another example.

Both of the agencies, likewise, have been active individually on the policy front. I think of the report on patent practices and procedures, that the Trade Commission has issued, which is a very important document, and likewise, in just a few weeks we at the Division will be heading up a conference looking at pricing practices.

And I think all of this is really an important part of our mission, and I want to thank and acknowledge my colleagues at the Federal Trade Commission, starting with Tim, for putting in place the circumstances that have made for a very good relationship there.

Obviously, at the Division, merger enforcement is a key part of our mission. Depending on the activity level, it might be fair to say that roughly one-third to two-thirds of our effort goes into merger enforcement. As I have mentioned elsewhere, merger enforcement is different from some of the other things that we do in the
antitrust world, certainly different from cartel enforcement, where there is little or no serious controversy about the need to aggressively intervene where cartel activity is detected.

It is different, too, from the unilateral conduct sphere, where it's very important for the agencies to have a very high degree of caution about where they intervene, because of the possibility of chilling competitive conduct in the guise of combating anti-competitive conduct.

Obviously, it's a gross over-simplification, but I suggest that merger enforcement falls somewhere in the middle, that there is a broad consensus about what we are trying to achieve, but plenty of room for debate and discussion about what the best use of the tool set that we have to evaluate mergers.

Obviously, merger enforcement requires us to make predictive judgments. Section 7 is described often as an incipiency statute. That's obviously true, but that term can carry different, very freighted meanings, depending on who the speaker might be.

And what we're about here is to try to determine how best we can make predictive judgments about proposed transactions to make sure that those that would bring efficiency and better outcomes for consumers are
allowed to go forward. And likewise, that those that have the real prospect for substantial lessening of competition don't happen.

Obviously, the Horizontal Merger Guidelines are the Agency's most important statement of how we go about doing that. The merger guidelines of 1982, which have been revised now several times -- in 1984, 1992, 1997 -- revised with some significant language changes, and some significant changes in approach.

Certainly the agencies, even apart from those textual changes, have, throughout this period, incorporated advances in economic thinking and improvements in our own practices and learning.

The guidelines are flexible, they are practical. At the same time, I think it's fair to say that both agencies are in a period of trying to emphasize transparency. It may not be quite enough simply to say that those in the bar who are very experienced repeat customers of the agencies have a good idea of how we do things, but rather that we have an obligation to be as transparent as possible to the public generally.

You can see that in terms of the increased incidents of the issuance of closing statements at both agencies, to try to give some amount of guidance to the public, when we decide that government intervention is
not warranted.

And I think you can see that in terms of the release of data that has preceded this conference. The agencies jointly, as you know, have released data on merger challenges from 1999 to 2003.

The Federal Trade Commission has now released significant data on cases in which a challenge was not brought, and also issued some data that shed light on other factors, customer complaints, hot documents, other things that the agencies looked at in evaluating a proposed merger. And we hope very much that this will set the stage for some very interesting discussion and improved learning in this conference.

Transparency, as I have said, is important, not only for the repeat players in the merger bar who are likely to be most interested in this, but for other enforcers, both here and internationally. I think that we need to be very mindful, not only of enforcing in a sound way, but explaining what sound enforcement entails.

Whether we like it or not, the two federal agencies are not the only game in town in terms of how merger policy is going to go forward, and it's incumbent on us to show our reasoning and be part of the broader discussion of what appropriate enforcement criteria are. And I hope this conference will contribute to that.
We certainly have a wide range of topics and a wide range of speakers, most of whom are very familiar to anyone who is involved in merger policy. If we had an antitrust ego-meter to put up here on the podium during the next three days, it would break.

Fortunately, we have got some very good moderators, mainly from the two agencies, who have put a great deal of time into preparing to keep these panels under control and hope to get some insight from them.

One thing you might ask is, "What is our goal here?" Well, it's certainly not the case that this conference has been called because anyone thinks something is broken. Nor is it the case that the conference has been put together because there is some pre-ordained goal of producing any particular output from the conference. I think that's a question that we're not really in a position to answer until we get the benefit of hearing what reactions and thinking, based on the data that's released, based on work that many of the panels have done independently over the past several years.

Until we hear that, it's hard to say whether and what might come next. But just as with the process side, where both agencies have done a good deal to try to improve our procedures, this conference does demonstrate our open-mindedness to try to make sure that we are
keeping up with the best thinking on substance.

So, with that, I will conclude simply with a very big thank you to those at both agencies who have put a great deal of time into organizing these panels. I look forward to participating in some more of this, including a round table Thursday afternoon, and will keep things moving now by introducing my good friend, Tim Muris, for his opening remarks to help us kick off the conference. Thanks very much for being here.

(Applause.)

MR. MURIS: Thank you very much, Hew. It is certainly a pleasure to be here. This should be an interesting three days. Hew and the Department of Justice are, obviously, our most important partners and colleagues, and I greatly appreciate their help and work on their effort.

And I wanted to thank our staff at the FTC and the Justice Department staff. The data we released, which I will discuss briefly here in a second, is quite interesting, and I am sure many of those who will be talking over the next few days will remark on that data.

I particularly wanted to thank our economist who worked on that data. It was a lot of work. I see a few of them out there in the audience. It required a lot of people to read a lot of our memoranda from the past.
It is certainly a pleasure to me, and an honor, that -- I noticed Hew's interesting comment about the ego-meter -- that we will have so many prominent practitioners, academic and enforcement officials here over the next few days.

I won't repeat the mistake I made about a decade ago, when I was at a gathering of -- a conference with many of the leading economists, and I was on a panel, and I said, "This is the greatest gathering of $500-an-hour economists every assembled." This was a long time ago when billing rates were lower. And one of them took great offense, and it was immediately obvious to me and everyone else that this person billed considerably higher than $500 an hour.

(Laughter.)

MR. MURIS: And the others were all making notes. And I felt like a facilitating practice, so --

(Laughter.)

MR. MURIS: As Hew mentioned -- you know, well, whatever one's billing rate -- we are going to discuss the impact of the guides. And as Hew mentioned, they have an impact not only at the federal level, but also at the states and internationally.

There are over 60 countries that have merger control regimes, and you can see the influence on the
Let me tell you what my view of what we can achieve over the next three days. The guidelines, as I think we all know, are not a cookbook. They don't provide specific details on every aspect of a merger investigation. They do detail a methodology, whether to analyze -- to analyze whether a merger is likely anti-competitive. And what the workshop is going to do is explore state of the art application of the guidelines by those with the most experience at using them.

We will publish an edited transcript on our website so that people can refer to it. I know there are a lot of people at the FTC -- I'm sure at Department of Justice -- listening on their computers. There are other people listening on their 800 number. We are actually going to film this so I can watch it on my exercise bike, and other people can refer to it as well.

As Hew mentioned, we at the FTC have also emphasized transparency over the 32 months that I have been at the Commission. We have released statements in several cases in which we did not sue, including three cases very recently.

We have released the two data sets that Hew mentioned. The first one contained market share and concentration levels associated with the FTC and DOJ's
decisions to challenge mergers in a wide range of product markets. And then a few weeks ago, the FTC released data on 151 horizontal merger investigations from the beginning of fiscal year 1996 through the end of fiscal year 2003.

Unlike the December data, this release included data when no enforcement action was taken, as well as data on additional key facts. One statistic we released involved the numbers of significant competitors. Many practitioners I know think and talk in these terms, rather than concentration.

These data also look at enforcement decisions, depending on whether hot documents exist or strong and credible customer complaints are received. These data should become core information in a healthy debate about the level and direction of merger policy.

I note that our recent data released largely reflects cases in which I did not participate. Indeed, I participated in cases involving only about 10 percent of the markets analyzed.

As I have said elsewhere, current merger practice reflects a bipartisan approach. And the release of this and similar data in the future should help us understand merger enforcement in practice.

The data we released highlights several
important issues in merger analysis. One involves the long-standing debate about the significance of concentration and HHI numbers. I hope the data we released and the breadth of analysis we will hear this week will finally put to rest the notion that HHI levels have any special significance, except at very high levels.

Instead, the agencies try to answer the ultimate question. Will the merger impair competition? We consider several variables that have an impact on the likely level of competition in post-merger markets. Fealty to the original guideline numerical levels was abandoned as the agencies gained experience. In 1992, the guidelines were amended to codify the existing practice of giving great weight to qualitative factors.

The 1982 and 1984 guidelines had given more emphasis to quantitative thresholds, particularly involving HHI levels above 1800. I remember Jim Miller and Bill Baxter discussing what the appropriate levels ought to be, and it was clear to me from those conversations that Bill retained some of his views that he had expressed in the 1960s about the strong presumptions one could gather from concentration.

In any event, the 1992 guidelines reduce the significance of the 1800 threshold by inviting fuller
consideration of other conditions that help predict
whether price increases are likely, post-merger.

Thus, the pre-eminence that some would continue
to give to concentration or HHI numbers is misplaced.
State of the art merger analysis has moved well beyond a
simplistic causality of high concentration leading to
anti-competitive effects.

The number of competitors is certainly
important. Four to three gets our attention quicker than
six to five. But current merger practice does not
elevate a single fact or number to dispositive
significance. The totality of the evidence must point to
an increased likelihood of anti-competitive effects
before we act.

Much of this experience with merger
investigations is captured in the guidelines themselves.
One of the salutary effects that the guidelines have is
the transparency they help bring to government. They
help us clarify enforcement policy and doctrine so that
practitioners and their clients can make better
judgments.

Government officials should explain the basis
on which they exercise their authority. Stakeholders can
expect clear and consistent enforcement actions. Of
course, application of the guidelines is not always
obvious. Hence, the high billing rates.

We constantly strive to bring more transparency to our merger process, and we hope this workshop will result in a better understanding of current merger policy. Equally important with providing increased transparency for consumers in the business community is the feedback this workshop should provide for the agencies.

We want to obtain important information that will assist us in doing our jobs. We thus expect to learn from you over the next three days. We will hear from the most experienced practitioners who work with the guidelines every day, as well as academics doing state of the art research. We want to know how you think the guidelines are working, what you perceive to be their strengths and weaknesses, what are the issues in which there is agreement and disagreement, and what areas you consider important for further study.

Research and clarification. Application of the guidelines must respond to new legal and economic analysis. With your help, we will continue that process at this workshop. Thank you very much, and we can get started.

(Applause.)
MR. WERDEN: Good morning. I'm Greg Werden, and I am the moderator of this, the first session of the merger enforcement workshop, which focuses on the hypothetical monopolist paradigm for market delineation.

The hypothetical monopolist paradigm was elaborated, and certainly popularized, by the 1982 merger guidelines, but the basic idea was not original to the 1982 guidelines, as I think a lot of you realize. In the late 1970s, some of the Antitrust Division were already applying the test, and there is at least one documented example in print in 1978 to prove that I am right about that.

And I have uncovered antecedents much earlier than the 1970s. The following passage I'm going to read, and from which I have just edited out a few words to make it shorter, was written by Morris Adelman in 1953. "In asking, 'What is the market,' we must ask, 'What substitutes exist at what price for the product or service in question. Assuming that a single business concern were the only occupant of the allegedly separated market, would it have the power to raise price?‘ If the answer is yes, then the separate market exists within which competition can be lessened."

Well, that's the idea of a hypothetical
monopolist test, and I believe Adelman probably was the first one to have it. His 1956 article has been quoted more widely, but I just dug up this 1953 article last year.

The 1982 merger guidelines did a lot to develop this basic idea into something quite useful for market delineation. And revisions of the guidelines in 1984 and 1982 fine tuned that approach. Our panel today is going to draw on experience of 20 years plus in applying the hypothetical monopolist test, and offer insights on possibilities for refining its application further.

I won't waste any time on introductions of our speakers, I will just turn things over to our first speaker, John Harkrider.

MR. HARKRIDER: Thank you, Greg. The hypothetical monopolist test is one of the organizing principles of the horizontal merger guidelines. And it is a test that is increasingly applied to define markets, not just in merger cases, but throughout antitrust. And not just in the United States, but throughout the world.

But the hypothetical monopolist test is not "flawless." Indeed, three years after the 1982 guidelines were published, a leading IO economist commented that, "The guidelines market definition test has one wholly decisive defect. It is completely non-
MR. HARKRIDER: Well, history has proved that concern is overstated, as there clearly are data and quantitative methods that will operationalize the hypothetical monopolist test.

It is important to note that using reliable data is critically important. Because without such data, we quite frequently resort to the Brown Shoe factors that the hypothetical monopolist test was meant to supersede, or at least clarify.

My remarks address how to render the hypothetical monopolist test operational by using sound, empirical methods that answer the question posed by the guidelines market definition test.

At the outset, it's important to realize that the hypothetical monopolist test asks two subsidiary questions. The first is, what volume of lost sales will make a SSNIP unprofitable? And second, what volume of sales will, in fact, be lost as a result of a SSNIP? Much of the economic literature has focused on the first question. And that is, in fact, the question that critical loss attempts to answer.

The second question, however, what volume of sales will be lost as a result of SSNIP is frequently not
answered. And as a result, a fact-finder, whether an agency or a court, may have confidence that a hypothetical monopolist could not profitably impose a SSNIP if it were to lose X percent of its sales. But that fact-finder may have no confidence that the hypothetical monopolist would lose more or less than X percent of its sales.

The purpose of these remarks is to provide some guidance towards answering the second question: What volume of sales would the hypothetical monopolist lose if it were to impose a SSNIP. To that end, we will discuss four forms of evidence: historical evidence; econometric evidence; affidavit evidence; and survey evidence.

The merger guidelines expressly authorize the use of historical data, although they have cautioned it may produce misleading results. Past price changes will often reflect changes in cost affecting the whole industry, rather than market power. And consumers' reactions to such changes do not illuminate how they would respond to a hypothetical monopolist.

Moreover, price changes typically are of short duration, and thus do not satisfy the non-transitory requirement of the SSNIP test. For that reason, the guidelines themselves caution that the picture of competitive conditions that develops from the use of
historical evidence may provide an incomplete answer to the forward-looking inquiry of the guidelines.

When considering historical evidence, it is important to distinguish between two types of evidence. First, evidence that consumers switched in response to past price changes, and second, evidence that consumers did not.

If a significant number of consumers switch from Product X to Product Y in response to a small but significant price change in X relative to Y, this seems to be evidence that the two belong in the same relevant market.

The criticism that the price change on X may be cost justified or not sufficiently long in duration would simply suggest that even more consumers may switch from X to Y if the price increase were not cost justified, imposed by monopolists, or of longer duration.

Alternatively, evidence that customers did not switch from product X to Y in response to a small but significant price change in X relative to Y, may have little bearing on whether the products belong in the same relevant market, as customers may be more likely to switch if the price increase were not cost justified, imposed by a monopolist, or of longer duration.

Another form of historical evidence are natural
experiments. In an extreme case, if the firm is selling the products in the proposed market, and had in the past engaged in cartel activity, there should be little reason to doubt that the market is properly defined.

One court wrote that, "Every price-fixing conspiracy thus identifies directly, in a real-world context, a group of firms which is insulated from outside competitive pressure." This is precisely what conventional market definition evidence attempts to identify artificially.

Another example of a natural experiment is the court's analysis in Staples. In that case, the FTC's various price studies which, on the whole, the court found persuasive, tended to show that a hypothetical office superstore monopolist could impose a SSNIP on the sale of consumable office supplies, because when it was an actual office superstore monopolist, that is precisely what it did.

A form of historical evidence is econometric evidence. Econometric evidence uses historical evidence in a controlled and scientific manner to answer the hypothetical monopolist test.

In fact, Judge Easterbrook, just a few weeks ago, in Menasha Corp v. News Corp criticized a plaintiff for failing to introduce econometric evidence of any kind.
in defining the relevant market.

There are many types of econometric analysis that can be used to answer the hypothetical monopolist test. One type of the sort used in Staples, which, in effect, allows for a controlled natural experiment. This type of analysis requires geographic variation as to the number of competitors, as well as information on pricing, number of competitors, and factors that may influence the price of goods.

A second type of analysis directly estimates market elasticities. To be done properly, this type of analysis requires time series consumer-level information on price and quantity. While there is general agreement that in appropriate circumstances, econometric estimates of elasticities can provide perhaps the best evidence as to market definition, there are significant issues with respect to its use.

One issue involves the ability of data. It is quite unusual for private parties to have access to price and quantity information from all market participants. This is, of course, less of an issue for the government, but it raises important issues about transparency, as the government may be unable to share this data typically collected through the CID process with the merging parties.
A second issue involves the quality of the data. For example, retail scanner data, which is one of the few forms of time series data that is available, frequently does not give sufficient information on coupons or other discounts. And so your economist needs to opine on whether that level of competition is important.

A third issue involves the appropriateness of the data. Retail scanner data, for example, may not be the appropriate type of data to analyze mergers between manufacturers.

If you want to know what somebody would do in a hypothetical situation, one alternative simply is to ask them. This may explain the practical appeal of the guideline’s 5 to 10 percent price increase formulation of the SSNIP test. It gives lawyers and economists a concrete question to ask customers in interviews and depositions. It also has led to the frequent use of customer affidavits and merger litigation.

There are, however, significant issues with respect to the use of customer affidavits. Areeda and Turner go so far to suggest that customer affidavits are "the least reliable evidence of whether consumers would switch in response to a SSNIP."

Despite this criticism, the government and
litigants in merger cases frequently use affidavits. A review of cases involving the use of affidavits revealed two frequent errors. First, affidavits frequently ignore the presence of switching costs. And second, affidavits frequently do not cover a representative sample of consumers.

As to the first question, if consumers will not switch between the products being grouped together for the purposes of applying the hypothetical monopolist test, it may not be meaningful to ask whether they would switch to a product outside of the proposed market following a SSNIP. For example, in Englehard, the DOJ argued that current GQA customers would not switch to alternatives in response to a SSNIP in GQA was evidence that there existed a relevant market for GQA.

However, the 11th Circuit rejected the DOJ's argument in part because Englehard's GQA customers would not switch to other sellers of GQA in response to a SSNIP in the price of Englehard's GQA.

The guidelines acknowledge a variation of this point when they speak of adjusting the size of a SSNIP to account for situations where the relevant product constitutes a small percentage of the overall cost of the goods or service.

Affidavits also must cover an adequate sample
of customers, and it's important to consider this point in the context of critical loss. Consider, for example, you hire Barry Harris, and he tells you that in response to a SSNIP, a hypothetical monopolist would find it unprofitable if it lost 8 percent of its sales.

Then, imagine the government goes out and interviews 100 customers, randomly selected -- which, it is doubtful, that that is the case, but let's say that they interview 100 random customers. And let's say that 92 of them say that they wouldn't switch and eight of them say that they would. And let's assume that all the customers purchase an equal level of the good. In that case the government may very well win.

Now, the government frequently doesn't have a random sample. And so, when you think of it this way, if the government has 100 affidavits or 200 affidavits, or if a private party has 100 or 200 affidavits, that may not be meaningful if there are, of course, more than 100 or 200 customers out there.

And two cases make this very point. In Englehard, the 11th Circuit said, "It is possible that only a few customers who switch to alternatives to make the price increase unprofitable, thereby protecting a large number of customers who would have acquiesced to higher GQA prices."
No matter how many customers in each end-use industry the government may have interviewed, those results cannot be predictive of the entire market if those customers are not representative of the market.

In SunGard, the court made a similar point. The court wrote: "The sampling of customer statements before the court is minuscule when compared to the entire universe of defendant’s shared hotsite customers. Although the government has submitted approximately 50 statements from customers stating that they either would not or could not switch from shared hot sites, there were more than 7,500 customers that currently used defendant’s shared hot sites. Without more information, the court simply cannot determine whether these 50 declarations are representative of the shared hot site client base."

In some instances, a few customers, however, may be able to speak to the overall demand elasticities of an industry. For example, in Swedish Match, the FTC may have avoided the sampling problem when it used affidavits of looseleaf chewing tobacco distributors as a proxy for the views of a broad spectrum of customers.

The last form of evidence I want to talk about is survey evidence. A frequent criticism of consumer affidavits is that they are form affidavits, which simply give yes or no responses to a series of questions,
including whether a customer would switch in response to a SSNIP. Well, that may not be an affidavit; what it really may be is a survey.

And so, if the goal of a client is simply to obtain as many affidavits as possible without taking the time to create detailed, customer-specific affidavits, it may be advisable to conduct a survey instead. Indeed, if conducted properly by an expert trained in acceptable survey methodology, surveys should carry more weight than even an allegedly representative sample of affidavits.

For example, surveys may have more methodological controls concerning leading questions, selection bias and randomness. Surveys may also make it easier to organize customers by key competitive traits, reflecting the probable elasticities of their demand. And perhaps, as an added benefit, it's very difficult for the government to depose survey respondents.

For the hypothetical monopolist test to serve as something more than an instructive theoretical paradigm, litigants, agencies, and courts should look to empirical evidence that can directly answer the question: How many customers will switch in response to a SSNIP?

Well, historical evidence, affidavits, econometric evidence, and survey evidence can all be subject to criticism. There can be little question that
they are better than conjecture on what is a critical question on market definition.

MR. WERDEN: Thank you, John. And now the cross-examination phase.

MR. HARKRIDER: Do I sit over there for this, or --

MR. WERDEN: Wherever you like. You're supposed to stand in the dock, I believe, as the defendant.

MR. HARKRIDER: Fair enough.

MR. WERDEN: I am intrigued by your suggestion that we should care whether price increases are cost-justified in examining historical evidence of how customers reacted to price changes.

I don't know how customers would know, and I don't know why they would care, whether price increases are cost-justified. So, would you elaborate your thinking on this subject?

MR. HARKRIDER: Yes. I'm not sure if it's particularly important whether they are cost-justified or not. The point I'm trying to make is that prices frequently change in an industry. And in response to those price changes, which may very well be cost-justified price changes, you need to look at that context of a price change in order to determine whether it's
instructive on the hypothetical monopolist test.

I'm not sure if I'm making a significant point as to whether they're cost-justified or not, just simply pointing out that they may very well be cost-justified.

MR. WERDEN: Okay. Let's turn to your suggestion that somehow switching costs have to be taken into account in market delineation. Let me give you a very simplistic hypothetical, because any real case is way too hard to do in the time we have.

Let's suppose that all the current users of a product are totally locked in, but there are new users. The hypothetical monopolists might be limited to exploiting the current users, and giving up on any new customers, or might be able, in some circumstances, to discriminate between the two.

In either event, my question is: Is there any way that the presence of switching costs would cause you to depart from the standard 5 or 10 percent price increase as the significance threshold for market delineation?

MR. HARKRIDER: Yes, I think you make an interesting point, and I think the court in Englehard makes this very point. When you're dealing with customers that may be locked in, the dynamic of competition you may want to be looking at is the
competition for new customers. I think that's the first point.

I think the second point is that in order for any test or hypothesis to have any meaning, I think a yes answer needs to mean something different, or lead to a different conclusion than a no answer.

So, if you ask someone whether they would switch in response to a SSNIP to another product that you believe is in the relevant market, and you ask them the same question with respect to a product that is not within the relevant market, and the answer to both of those questions is no, they would not switch, in order for that test to have meaning you cannot reach different conclusions with respect to whether one is in the relevant market or the other one is in the relevant market.

So, if the customer would not switch -- in response to a SSNIP -- to another product in the relevant market, I think you need to take into account switching costs. You need to be able to get a yes answer to products that were within the relevant market and a no answer to products that are not within the relevant market, or the test -- or the question has no meaning.

MR. WERDEN: Well, frankly, I just don't understand why that is so. This evidence may suggest
that there isn't any competition between the merging firms, and that would be an interesting thing, if that was the conclusion.

But that's not what we're asking when we're delineating the market. We are asking whether a hypothetical monopolist would raise price significantly. And I am really having trouble seeing how switching between incumbent sellers of the relevant product who are, by everyone's estimation, in the same relevant market, how switching among them is relevant to the question that market delineation poses.

MR. HARKRIDER: Well, I think you're actually answering the question the same way that I would answer it. I think the answer is no, it's not particularly relevant, and so the point I was making is that affidavits that ask the question that you say is not relevant are probably not relevant to the issue of market definition.

So, if the court -- if both the agency and the court had focused on those customers that are not locked in, I think that those are the questions that they should have asked. But asking the hypothetical monopolist test to customers that are locked in answers nothing, other than the fact that these customers are locked in.

MR. WERDEN: It seems to me that the theory of
the case might be that the locked in customers will be
exploited, and that the merging firms will quit selling
to new customers. If that's the theory of the case, then
of course, evidence has to be mustered to show that
that's a sensible strategy after the merger.

But if that is so, then clearly the focus in
market delineation ought not to be on the new customer,
should it?

MR. HARKRIDER: Well, I think it's important --
I am an antitrust lawyer, and you're an economist. And
not to make that distinction, but the court in Englehard
certainly gave no weight to the affidavit statements,
because of the presence of switching costs.

And I think that unless you're arguing and can
persuasively argue that Englehard is wrong, I think that
it's very difficult to argue that switching costs don't
matter in that context.

MR. WERDEN: Well, I have it here.

MR. HARKRIDER: Okay.

MR. WERDEN: And I don't read it that way. But
we don't have time to go into it.

(Laughter.)

MR. WERDEN: So we're going to move on to our
next speaker, Barry Harris.

MR. HARRIS: Thanks, Greg. Two comments,
first. Just -- you mentioned about being in the dock. I actually testified a few months ago, and there was a federal judge in Rhode Island that actually makes the witnesses stand.

And I didn't understand that, I thought the chair was just missing, and I went to bring a chair over when it was time to testify, and they told me, "No, we don't do it that way, so you have to" -- and I guess it's an incentive to give short answers.

But in any case, second thing, everyone is talking about 20 years of experience. I am getting old. I will be -- it was 30 years ago that I came to work for the Antitrust Division, so I hope senility hasn't set in. The one good thing about having done it so long is that I am now able to do analysis by anecdote, so let me start by telling a story about a hypothetical monopolist case.

I started working in the Antitrust Division in October of 1974, and a year or two after that I was asked to draft an affidavit on a case that I was working, a merger case, for a possible challenge.

And I looked at some old affidavits, and as I went through them I learned, "Hey, I'm supposed to define a market." And being recently out of graduate school, I didn't have a clue how to define the market. So I did what seemed to me to be obvious, I went around and I
talked to senior lawyers and senior economists, and they
gave me a lot of different suggestions.

The lawyers gave me the Brown Shoe standards,
and some of the economists said, "Look at price
correlations." Some others said, "Look at cross-
elasticities." But none of the suggestions -- not one --
had anything to do with the actual exercise of market
power, it had to do with things that you might observe if
market power were being exercised, but it wasn't a kind
of a logical progression.

So then I finally did what I should have done
first, and I went to see my boss, who was George Hay, and
he suggested looking at it as a hypothetical monopolist.
And it was the first I had heard of it. I wasn't like
Greg, I hadn't gotten to reading books from 1952 in a
systematic way, and probably should have.

But in any case, once the question was put with
that type of framework, it all started to make a lot of
sense to me. And that ultimately gets to what is the
logic of the hypothetical monopolist principle. And at
least as I understand it, the point of it is simply to
identify a group of producers that would be able to
exercise market power if -- and this, for me, is a key
second part -- if they were able to coordinate their
pricing output decisions.
So, it's basically a two-step process. One thing that I notice that I think often is not done properly is that when you're considering whether or not the group can coordinate, it seems to me you have to ask what the nature of the coordination is going to be, and it has to be consistent with the logic of what that hypothetical monopolist is going to do.

In other words, as Greg points out, the basic principle is would the hypothetical monopolist price in a certain way and would it be profitable. Well, if you're going to ask the questions about coordination, the second step, it seems to me you have to go back to your definition when you're doing your competitive effects analysis.

Let me just reiterate that. The hypothetical monopolist proposition tells you what the hypothetical monopolists would do. You look at that, and then when you do your competitive effects analysis it seems to me it's incumbent upon you that you look at that in the context of what that hypothetical monopolist would be doing.

And let me give you an example. Let's say that a hypothetical monopolist prices differentially -- so it might be unilateral effects, might be something more complicated than that. Analysis of that market must
consider the likelihood that the coordination of this
type of differential pricing could actually be achieved.

The basic concept related to the hypothetical
monopolist principle brings me to the focus of the
outline that I provided Greg for this session. As John
pointed out, I often use critical loss both before the
agencies and in testimony. And recently there have been
several questions raised about the use of critical loss.
Is it appropriate? Under what conditions is it
appropriate?

And to understand, let me just give brief
background on critical loss. In my mind, what critical
loss basically does is it makes the hypothetical
monopolist principle operational.

And all critical loss is is a two-step process
that first identifies for any given price increase the
sales that can be lost before the price increase becomes
unprofitable. So, in effect, it's setting a target. How
much sales have to be lost before it becomes
unprofitable?

The second step considers whether the actual
sales loss associated with the hypothesized price
increase will exceed the calculated critical loss. So
it's two distinct steps. And one might even argue it's a
third step, because this form of the critical loss looks
at a particular price increase. And in fact, the profit-
maximizing hypothetical monopolist can charge any number
of prices. So, a full application of critical loss would
look at a variety of prices and try to answer that
question.

Now, a practical consideration is -- as the
size of the price increase goes up, the confidence you
have in any answers you get seem to me to become less and
less. For example, you have greater confidence when
you're working with an observed interval of price
increases. Whether people deal with 5 percent increases
or 10, if you're talking about a 50 percent price
increase, you probably haven't observed changes like
that, and people's opinions are probably not as reliable.

Now, the answer to the first step, what is the
critical loss, how much can you afford to lose, that
ultimately depends on the size of the price increase
you're postulating, and the cost structure of the
hypothetical monopolist. In effect, the cost structure
tells you for every unit of sales you lose how much it
hurts.

The answer to the second step, how much will
actually be lost, can be ascertained by traditional
antitrust methods such as econometrics, other statistical
techniques, looking at business records, and going
through testimony. And this, in part, was what John had
talked about in the previous talk.

Now, one of the questions that has been raised
about critical loss concerns the relationship between
cost price margins and demand elasticity. There have
been three or four articles that raise this point. But
in particular, Michael Katz and Carl Shapiro have raised
the point that economic theory indicates that high
marginal cost margins tend to imply that actual loss
sales associated with the price increase will be small.

Well, the Carl Shapiro observation is based on
a theoretical inverse relationship between marginal cost
margins and demand elasticity that's encompassed in
what's called the Lerner index. And that, effectively,
is a residual of looking at profit maximization under
certain circumstances.

Now, there are several reasons why large gross
margins may be consistent with unit sales actually being
sensitive to price changes, and Katz and Shapiro identify
three of them. They note that firms in the market may
already be coordinating prices, and that will sever the
relationship. They also identify situations in which
there is a kink in the demand curve, and also situations
in which there is a kink in the supply curve.

I think there are a few other issues you have
to look at, and one of those, I think, is that the use of
the Lerner Index for this purpose fails to distinguish
between margins that are based on marginal cost --
meaning the margin of the last unit -- and those that are
based on the average variable cost of a significant
increment of quantity, where the answer may be quite
different.

The correct margins used in a critical loss
analysis should consider the actual average variable cost
associated with a significant loss of sales, often more
than 10 percent of current sales. And just to give an
example, one of the situations where I presented critical
loss was the Poplar Bluff Hospital merger case. It's FTC
v. Tenet.

And there, when we went back and we looked at
the costs, the question we asked -- and there is a little
bit of a chicken and egg thing there, and you have to be
careful -- but we knew from previous work that margins
for hospitals were somewhere in the range of 60 percent,
because there are a lot of fixed costs there, a lot of
fixed staffing.

So, what we did there was we got a hold of the
accounting system, we sat down, we worked with their
internal cost accounting system, and went through, item
by item, and asked the question in conjunction with
business people, "What would happen if you knew you were
to lose 10 percent of your sales for a year? Like, let's
say you lost a big managed care contract. What would
happen to the individual cost elements?"

So, in effect, asking what's variable over the
course of the year. And the answer we got was what we
used, and we ended up with margins there that were
similar to other hospitals. But lesson learned -- not a
surprise -- that if you took greater change in demand,
say 20 percent, or took a longer period of time, say two
years, then a lot of costs that are not variable under
the hypothetical that we presented become variable, and
the calculated margins change.

So, I guess the lesson from this is simply get
the right costs. Make sure that it fits the situation
and the questions being asked for the specific case.

Now, second point with regard to the Lerner
Index, going back there, is that the relationship that it
describes is limited in some sense. It applies to
monopolists and dominant firms, and it also applies to
industries where Bertrand-type competitors sell
differentiated products.

Now, and despite the fact that many, many years
ago I majored in math, I don't consider myself a
mathematician, so this is -- when I went back and looked
at Cournot models, you don't get the relationship in
Cournot models -- at least my understanding of that.

Now, it seems to me that if you're going to be
questioning things like critical loss, or anything else
based on particular models such as Bertrand-type models,
then the analysis in the case has to fit that model, and
has to incorporate all the implications of the specific
form of the Bertrand model -- in this case, that applies.

So, for example, Bertrand models tend to apply
best for differentiated products. But the relationship
that you have -- the relationship that Katz and Shapiro
talk about that comes from the Bertrand model doesn't
tell you a whole lot about closeness of substitutes.

Again, my understanding is that it doesn't tell
a whole lot about cross-elasticities. But when you're
analyzing differentiated products, a key issue is are
these close substitutes, and what happens, for example,
if you raise the price of one of them. The relationship
doesn't apply there.

And ultimately, this all brings us back to the
hypothetical monopolist principle -- I see my time is
running out. My overall view is that the application of
the guidelines is a major leap. Although there are
probably very specific circumstances where other
principles can apply, what it does is it focuses analysis
specifically on the questions that it's supposed to be
asking, and that is can market power be exercised.

Actually, I assume my time is up, so I'm just
going to just say thank you, and leave myself open to
Greg's questions.

MR. WERDEN: Thank you, Barry. I want to ask
you a couple of questions about your reaction to Katz and
Shapiro, and I want to start at an extremely basic level.

Their most basic point is that anybody who is
trying to make something out of high margins ought to
have some idea of what competitive process produced those
high margins, and be able to construct a comprehensive
argument that takes into account the competitive process
that produced those high margins. Do you agree with
that?

MR. HARRIS: I mean, it seems almost
tautological. Of course you want to understand the
process. The question, I think, is -- where we differ is
-- the last unit may be very small, but the question is
what does it look like over the range of the lost sales.
And that is basically a function of the cost structure in
the particular market is a market that has high fixed
costs. In the case of the hospitals, does it have high
minimum staffing that's not going to change?

Ultimately, any firm has to recover its costs,
or it goes out of business. And the high margins may simply be reflecting high fixed costs.

MR. WERDEN: Well, unfortunately, Mike can't be here today to say no, that isn't right, so I will say it for him.

I think what Mike would say is, "Have you got it backwards?" Prices aren't high because fixed costs are high. If fixed costs are high, then some competitive process will, in equilibrium, allow you to recover those fixed costs, and that may mean that there isn't much competition. Because if there was competition, you wouldn't be able to recover those fixed costs.

So, whatever the facts are, there is a competitive process out there that's producing those margins. And what Mike and Carl say you need to do is to examine that process and try to make sense out of it.

I think that you're disagreeing with them at square one, and saying they're wrong about saying that the competitive process had to be responsible for creating the high margins. You're saying costs create margins. Is that right?

MR. HARRIS: Well, that wasn't exactly what I intended to say. I mean, I think competition ultimately provides competitive prices equal to marginal costs. Maybe included in that is going to be the return on some
costs, or people will not enter, and they're not going to have as many competitors.

But I think part of the problem, too, is that we're talking about a loss of sales here. So if you are having some costs, you may have entered -- you may have, at the margin, a very low margin -- by at the margin, I mean the last units or so.

But if you have a large amount of fixed costs, as you eliminate, let's say, 10 percent or 15 percent of your sales, you may have a cost curve that has a slope on it. And the difference between the price and the cost curve can be substantial. It ultimately depends on what the shape of that cost curve is. And you needn't have a large margin for the very last unit, which is all the Lerner-index relationship says.

MR. WERDEN: Okay. Let's change the topic only very slightly. You point out that their analysis is based on the Bertrand model, and obviously, that isn't the right model for all industries. But there is no doubt in my mind that it's the right model for some industries.

And so, my question to you is, well, if it is the right model and the margins are high, then doesn't the analysis lead to their conclusion that the high margins are consistent with very narrow markets, not...
broad ones?

MR. HARRIS: I think it's going to depend --
and I'm not sure I completely understand the question --
but I think it's going to depend -- because in the
Bertrand model, you have differentiated products and you
may very well have different margins with the different
firms.

But that doesn't say anything is -- ultimately,
you know, you're getting to the merger, you're asking
what the cost elasticities are between different firms in
the market. That's important when you're dealing with
differentiated products, and I'm not sure --

MR. WERDEN: And they say it is.

MR. HARRIS: That --

MR. WERDEN: That the result is that if you're
in this Bertrand world with very high margins, then it
turns out that you need very little substitution, very
low cross elasticities among the firms in the industry in
order for the right conclusion to be that they form a
relevant market.

MR. HARRIS: Well, I mean, in the simple model,
for example, let's say you just have two firms and they
produce similar products but have different costs -- not
exactly the same products, but have different cost
structures. You're going to have one firm that has much
larger margins than the other. They compete, they're close competitors, but if that firm with the better cost structure is fully maximizing price, it's going to have the large margins to move up to the cost structure of the other firm. But if it raises it any further, it loses sales. I mean, that's basically the Cellophane issue.

So, again, I'm not sure that I am understanding your question, but I don't see that there is a conflict there.

MR. WERDEN: Well, the question is: Aren't they right in their case? In the Bertrand world, isn't it true that high margins are almost always going to lead to narrow markets because even if there isn't that much competition among the firms in the market, there is enough so that the market elasticity is enough lower than the individual firm elasticities which, of course, have to be low if the firms have high margins?

MR. HARRIS: I guess I just don't know the answer.

MR. WERDEN: All right. Thank you, Barry.

MR. HARRIS: Okay, thank you.

MR. WERDEN: Our next speaker is Will Tom.

MR. TOM: Thank you, Greg. I'm not quite as old as Barry, but I'm getting there. And I think back to my first year as a young lawyer in the Antitrust Division.
in 1979. And despite the fact that sophisticated thinkers like Greg were already using the hypothetical monopolist test, according to Greg at least since 1978, I was there as a brand new lawyer, given my first merger matter to look at, and I have to say I had a complete sense of befuddlement about what to do, how to define a market, and how to start thinking about this case.

And had I had more sense, I would have went up a flight of stairs and asked Greg what to do, just as Barry was able to get good guidance from George Hay. But I didn't, and so I muddled along as best I could. From that perspective, I think the 1982 merger guidelines was really an advance. And if any ego-meters should be going off the charts or breaking here, I think it should be the ones in front of the people like Greg, who were actually involved in that effort and in developing the guidelines and propagating its use.

From that perspective, I think what I have to offer are really just a handful of modest suggestions. I think, on the whole, the guidelines are working well. I think the guidelines approach is a good one, and notwithstanding the quote from George Stiegler that John mentioned, it really is operational, by and large.

And my handful of modest suggestions come under two headings. Heading one, we ought to have a more
explicit recognition of the role of uncertainty as we apply these guidelines. And heading two, I think, is that we ought always to bear in mind that the underlying purpose of market definition is the assessment of competitive effect. I think that's a truism, but I will try to put a little bit of flesh on it as I go along.

Under the role of uncertainty, I guess my first suggestion is that the staff be aware of the tendency of the iterative hypothetical monopolist test to unconsciously reverse the burden of proof.

Now, I know that the guidelines explicitly say this is not intended to say anything about burden of proof, burden of persuasion, where that lies, or anything else. But there is a natural human tendency to put the burden of proof on those who are asserting that something inherently uncertain will occur, as opposed to those who say that something inherently uncertain will not occur.

And if you think about how the iterative hypothetical monopolist test works, you start by positing a 5 percent -- or, you know, some other significant non-transitory price increase. So, the price increase is taken as a given, that's a fact. Now you ask, well, what would happen in response to that price increase by a hypothetical monopolist if that price increase were to take effect? Would competition come into this tentative
market to defeat that price increase? Right?

And so, you know, the real answer in many cases
is, well, who the hell knows? Right? But since that
really is a non-operational approach to the practical
question of getting through the analysis of a particular
merger, you know, the next step is to say, well, what do
we think is going to happen?

And it is a very small step to slide from there
to saying, well, parties, you know, prove to us that the
price increase by this hypothetical monopolist will, in
fact, be defeated, right? And you go through enough
iterations, you know, prove that the price increase would
be defeated, and you end up with, you know, a very high
threshold, I think, of establishing that the market is as
broad as maybe it really is.

And so, there may be a certain inherent bias in
favor of markets that are too narrow. And now, I can't
prove it, it's just an intuition, but I think that that
may be just a natural consequence of the way we approach
questions that are inherently uncertain.

My second point about uncertainty is in a
similar vein. And it's not really a market definition
question as such, it's a question of, you know, the next
step after market definition, and the next step after
that, and how it relates to the process of market
definition.

And I am reminded of a scene in the play or movie, "Amadeus," where the Emperor Joseph says of a Mozart opera, "Well, the only problem here is too many notes." And there may be a sense in which the effect of the many steps in the merger guidelines process is to lead to some errors in situations of an inherent uncertainty.

And to take a very stylized example, imagine a merger investigation in which the analyst concludes that there is a 51 percent probability that the merging parties A and B are actually in the same market themselves, right? I mean, the -- you start with a product of one of the merging parties, and you ask in the event of a SSNIP what would happen, and would the product of B come in to thwart a price increase by A. And then you go from there.

Okay. Let's suppose that there is a serious question about that first step, and maybe the merging parties aren't even in the same market. But you conclude with 51 percent probability, they probably are in the same market.

All right. Next step you have got another player, C. He might be an uncommitted entrant, right? He might be able to start selling this product, even
though he is not currently selling the product without substantial cost in a very rapid period of time.

    Well, let's suppose you can reject that proposition, again, by a 51 to 49 percent margin, right? There is only a 49 percent likelihood that uncommittedentrant would come in. And so you say C is not a participant in the market.

    And let's suppose there is another potential entry, D. And maybe he's not currently producing a related product, so he would have to expend some costs. And so, after careful analysis, you conclude that, well, there is only a 49 percent likelihood of committed entry. And therefore, more likely than not, D will not enter the market.

    Okay. Well, how do you analyze this merger as a whole? If the question is: Is this merger likely to be anti-competitive, and assuming a lot of those probabilities are independent, you ought to say, "Okay, well, what's 51 percent times 51 percent times 51 percent," and you come out with about a 13 percent likelihood that this merger is going to do any harm, right?

    I think there is a tendency for at least beginning analysts to say, well, more likely than not A and B are in the same market, okay? Now, is there going
to be uncommitted entry? What are the participants in the market?

Well, more likely than not, there is not going to be uncommitted entry, so we will reject the argument that the parties are advancing about uncommitted entry. Now, you know, is there going to be entry as the guidelines define it? Well, more likely than not there is not going to be entry, right? So you have got, you know, two merging parties in the same market. Nobody else in that market, no entry likely to come in. Therefore, we should challenge the merger.

It is, I think, really difficult for the merging parties counsel to know when the staff is thinking this way. You have a somewhat asymmetric process whereby the staff is properly reticent about sharing information that they are learning from third parties, and that can sometimes inhibit the dialogue. And if they are thinking this way, it's sometimes hard for the parties even to know it, let alone talk them out of it.

So, I throw that out as something for the agencies to at least be cautious about in their internal deliberations.

Third uncertainty point, if you want to call it that, is the whole issue of customers say they wouldn't
switch. And we're talking about that at some length this
today morning about affidavits and survey evidence, and so on
-- particularly in intermediate goods industries, where
the staff is relying on customer telephonic interviews in
ways that they probably are not in consumer goods.

Again, it can be hard to tell what's actually
going on there behind the curtain. I think John pointed
out that when you're doing survey evidence, your survey
experts will take quite a lot of pains to work with you
to get the biases out of the questions and to, you know,
avoid some of the more obvious errors about how the
questions are phrased, and the sample of respondents
they're posed to, and so on.

Where you're relying on the telephonic
interviews with customers, the danger of badly worded
questions eliciting misleading information about the
inherently unknowable is probably at its highest. And it
is also the situation in which fruitful dialogue between
the party's counsel and the staff is at its most
difficult because of concerns about third-party
confidentiality.

And it is very easy to slip into highly
unproductive dialogues that start and mostly end with
staff saying, "Well, customers say they wouldn't switch."
And I know Greg has been preaching this for a very long
time, and I think, by and large, the agencies are doing this: The dialogue is much more productive if you ignore what the customers say they would do and focus all of your attention on the reasons that they give for what they say they would do, and really dig into the objective facts that make switching more or less likely, because that is something that the parties generally can engage on.

And it is a lot more concrete and reliable, I think, than the speculation about what, you know, what third parties -- what customers say they would do under circumstances that they may not really have faced and really may not have thought through.

All right. Well, let me turn to the other major heading, which is that assessment of competitive effect is the underlying purpose of market definition.

And I guess the first question I want to address is when should we depart from five percent? You know, the guidelines say that in appropriate circumstances, we can use numbers other than five percent as your SSNIP, but they don't say what those appropriate circumstances are.

And let me take you through an example that's already covered by the guidelines, because I think it's easier to understand and then go from there to situations
I think that aren't really covered by the guidelines.

Well, let's suppose you have got a market in which a five percent price increase is unprofitable, but a 10 percent price increase is profitable. I mean, why would that happen? Well, in response to a five percent price increase, you lose a certain block of customers. You don't make enough on the customers that you keep to make up for the loss of revenues from the customers you would lose. And therefore, the five percent price increase is unprofitable.

The next tranche of customers you would lose is highly price-inelastic, though. So if you raised the price by 10 percent instead of 5 percent, you don't lose very many more customers, but you make a lot more on the customers that you do keep. And I gather Greg, in some of his writings, has dealt with this situation, and maybe others have, as well.

In that situation, if the guidelines simply said, you know, look at a SSNIP and see what would happen, then you would say, "Well that would be a good case for upward departure on the five percent, because after all, the purpose of the guidelines is to detect the likelihood of competitive effect, I'm simplifying past the coordinated effects step, and assume perfect coordination, or assume only two players or something --
it wouldn't make any sense to have a set of guidelines that protected against a 5 percent price increase but didn't protect against a 10 percent price increase.

As Greg has pointed out, the guidelines say "at least." So, if a hypothetical monopolist could maintain a price increase of 10 percent, then the SSNIP test is satisfied, even under the hypothetical that I am talking about.

So, the case for an upward departure would have to involve somewhat more exotic examples. Imagine that A and C are merging. B is a closer competitor than C. A hypothetical monopoly of A and B could not sustain a 5 percent price increase for the same reasons I described, but could do so with a 10 percent price increase.

And you know, should you call this a market and examine the competitive effects of a merger of A and C, or should we say that C is outside the market all together, and kind of stop your investigation there. There are scenarios in which it would make sense to keep going.

The downward departure scenario is more straightforward. Five percent price increase is not sustainable, but a one percent price increase would be, because relatively few customers are diverted. It's going to be the inverse of the example that I started
And there, I think the theoretical case is there for a downward departure I guess I have qualms -- hearkening back to the theme of uncertainty in the last group of examples I talked about. If, by hypothesis, a price increase of five percent or more couldn't happen, even with perfect coordination among all marketplace participants, that puts an upper bound on how much damage can be done if you fail to challenge the merger.

Given the vagaries and the uncertainties of life, maybe that should be enough. I have suggested somewhat facetiously that maybe we should delete the part of the guidelines that says this five percent is not a tolerance level. And yet there ought to be some tolerance level in the merger guidelines.

And I am not sure what the right tolerance level is, but it should be one that recognizes that, you know, the whole process of merger analysis is an inexact science, at best. And if you're reasonably confident that there is a fairly low upward bound on any damage, maybe you ought to stop there and let this merger go through.

All right. I am running short of time, so let me hasten quickly through my last two points. Just for aesthetic reasons maybe, if nothing else, can we do
something to reconcile the unilateral effects discussion
of competitive effects with the market definition
process?

And here, in particular, I focused on the
sentence in Section 1.11 of the guidelines that reads --
and I quote -- "In performing successive iterations of
the price increase test, the hypothetical monopolists
would be assumed to pursue maximum profits in deciding
whether to raise the prices of any or all of the
additional products under its control."

And I am not entirely sure what that means, but
I think what that means is that if you can show the
sustainability of a five percent price increase in only
one of the hypothetical monopolist products, that's
sufficient to define a market.

You know, if that's right, then why do you need
analysis? This aspect of market definition that says you
define a market based on the hypothetical monopolist
raising price on one product, you know, doesn't that mean
that any decent unilateral effects case is a merger to
monopoly?

And I guess, you know, the bottom line on this
one is I'm just confused. I'm not sure that this anomaly
has actually done any harm to merger analysis, but it
certainly has made it a whole lot more confusing and
maybe has made the guidelines just a little bit less transparent to pick up one of the themes raised by our keynote speakers.

And given the amount of time, I am going to drop my last supply substitute ability point, which Greg tells me fits better in another session, anyway, and open myself up to the cross examination.

MR. WERDEN: Okay. Thanks very much, Will. I want to explore some of these suggestions you made, and I want to start with the issue of the upward departure. It might not be an accurate characterization, but we will use that as a shorthand.

And the case -- I think the only case -- that really focused on this issue is the Olin case in the 9th circuit where, in order to sustain the FTC's decision that the merger was unlawful, the 9th circuit had to be persuaded that a 5 percent price increase ought not to be looked at, but rather a 10 or more percent increase needed to be looked at. And it maybe needed to be more than 10.

And the FTC did persuade the 9th circuit of this, and I think this illustrates what I think you had in mind by an upward departure. And what I want your comment on is whether you think the FTC and the 9th circuit had it right.
MR. TOM: All right. I am not going to comment on the specific case, only because I haven't studied it recently. And giving the advancing age I alluded to at the beginning, one of the first things that goes is memory.

MR. WERDEN: Well, neither of us actually knows the facts of the case, so that's not really what my question is. My question is: Is the idea if for a 15 percent price increase these two swimming pool sanitizer chemicals would be in the same market, should you just say, "Well, okay, put them in the same market?"

MR. TOM: Yes, I think it depends. If there is a credible theory of competitive effect that says, in effect, that, unless we do something there will likely be an anti-competitive effect -- I wonder whether we ought to let market definitions stand in the way.

And I alluded to the hypothetical situation in which you have got three players, and they really aren't -- back up a second, because I didn't go into this hypothetical too deeply.

I posited three players, because you can imagine a two-player market in which a five percent price increase would not bring one of the party's closest competitor into the market. I mean, yes, let's start with not a hypothetical monopoly, but an actual monopoly.
Even a five percent price increase will not bring the closest competitor in.

And you say, should you, let A merge with B, its closest competitor? And I think most of us would say intuitively, no. It wouldn't make any sense to allow what would be a fairly dramatic competitive effect under that circumstance.

Well, one might cavil about whether that hypothetical is realistic in the first place, because if a five percent price increase by the monopolist wouldn't bring closest competitors in the market, then why isn't the monopolist pricing it at that level already?

And so, I posited another competitor, B, that is closer than competitor C that A is acquiring. So the current price is constrained by B. And that's why prices haven't gone up already.

Now, the question is can the acquisition still make a difference? I think there are certainly models in which the acquisition of the next closest competitor does make the difference.

In such a circumstance, does it make sense to say, "We should treat C as not being in the market in the first place so why worry?" I think not. I think you probably want to look at that model a little more closely and see this competitive effect really realistic? Is it
likely to happen? Are you convinced as a factual matter?

MR. WERDEN: One last question relating to your comment on tolerance level. I think it is important, as you suggest, to recognize uncertainty in our forecasts. But I want to try to flesh out exactly what you're saying here.

Let's suppose we had a unilateral effects case in which the government believed that the result of a merger would be one merging firm would increase price eight percent, and then the other one would increase price four percent, for a market-wide average price increase of three percent, or make it two percent.

The three and the two percent are below the magic five. In fact, even the four percent for one of the merging firms is below the magic five. Assuming that there isn't a tremendous amount of certainty, so that we really don't know anything, do you really believe that the agencies should say, "Well, eight percent, four percent, forget it. It's not that much."

MR. TOM: The assumption was there is not a tremendous amount of uncertainty, or --

MR. WERDEN: Well, not so much that we really don't know anything. There is always significant uncertainty.

MR. TOM: Yes. No, I'm not proposing selecting
a magic number of five percent, or whatever, as a
tolerance level. Yes, I do think that, in circumstances
where we can be pretty confident about the upper bound of
harm, and we can't be at all confident -- or we can be
somewhat confident, but only barely so -- that there is
any harm at all, I think we ought to very seriously
consider letting that one through.

MR. WERDEN: And not a question, but just a
comment. The sentence of the guidelines that you quoted,
in fact, does not mean what you supposed, but the
following sentence does.

(Laughter.)

MR. TOM: Okay. I stand corrected. Thank you.

MR. BLUMENTHAL: Good morning, everybody. I am
Bill Blumenthal, and as the clean-up hitter, I suppose
I'm going to reshape my comments a little bit to address
some of the things that were said by the three earlier
batters.

We begin by noting that there is not a whole
lot of disagreement among the speakers, at least so far,
save for two things that my former partner and good
friend, Will Tom, said in passing.

The first was simply the reference to too many
notes. And my recollection is that that was not Emperor
Joseph criticizing Mozart, but Mozart criticizing
Salieri. And I'm pretty sure Tim Hulce was the one who said it, but we're going to have to go back and check the tape. I'm not going to dwell on that point.

The second thing where I think we had a little bit of disagreement -- and again, it was sort of a throw-away line by Will -- was the observation that, all in all, the guidelines are working well. I'm going to spend more time on that one because, to me, I mean, the guidelines are working well, I suppose, but only because most of the people who are using them know what the code words mean, and are largely ignoring them as the recipe for which they were originally intended.

And that's really the point where I am going to devote most of my remarks, but let me first begin with a little bit more on the areas of agreement -- or I think agreement -- among us all.

The hypothetical monopolist test has basically won. I mean, I think pretty much all analysts adopt it, most of the commentators adopt it. It is not universally adopted in the courts, but it has largely prevailed in the courts. We generally know which tools work. We had some tools as early as 1983 or 1984. Those, obviously, have been amended substantially.

We had a pretty good set of information about which tools do not work. I agree completely with John
Harkrider and Will Tom, that affidavit battles are not an especially productive or illuminating form of arms race.

I agree with Will on the issues of burden of proof, and biased narrow markets, although whether it's too narrow is sort of a judgment call we can talk about. But unilateral effects, I agree with Will about his supply-side point that he didn't make here, but you will have to read the paper.

And basically, I think pretty much all of us would say that if market definition is to remain a discreet early step in merger analysis, that the hypothetical monopolist test is the right test.

Now, to the disagreement, let me be a little bit incendiary at least, and pose to you the question of whether, in fact, we ought to be retaining market definition as a discreet, early step in the analytical process as it is used nominally, under the guidelines.

For at least five years now -- and just watching the way we work, watching the way the agencies work -- I have been posing to people the question of whether market definition is an input into the competitive analysis, or whether it isn't really an output. And I think that Greg has largely convinced me that it's neither, it's really an issue of simultaneous determination.
But the one thing that I think is fairly clear -- at least the way that most of us go about our business day to day -- is that it is not a pre-standing form of analysis done by reference to a hypothetical monopolist test, where you then plug that answer into the stuff that follows.

On the defense side, in the U.S. I have not defined a market in at least 10 years -- I think it's probably 15. I mean, we defined it on the plaintiff's side, because that's one of the things you have to do if you don't want to have your complaint thrown out of court. We define it sometimes in some European jurisdictions, because that's one of the things you have to do there if you don't want to have your filing thrown out of the agency.

But as an analytical tool in the U.S., we don't use it. My sense is that, by and large, the agencies don't do it. I mean, what the agencies, I think, typically mean by market is that grouping where, at the end of the analysis, a product -- the problem -- is found. And from my perspective, that is a perfectly sound way to go about the analysis.

You know, I noted that Jon Baker and Dale Collins are both on the final panel on the third day. And I note that here, in particular, because I was not
aware of that fact when I cited both of them in the paper that I guess has not yet been released or put out front, but will be. I'm sure sooner or later, the papers will emerge from this conference.

I cited to Jon for purposes of his paper on "res ipsa loquitur" market definition, and "res ipsa loquitur" merger analysis. And we, of course, in the private side all beat on Jon for being lawless -- for reasons I will get into in a minute -- because it is fundamentally lawless. But it's actually a pretty sound way of thinking about the issue.

And I cited to Dale for a three-step analysis that I first saw him use about 12 years ago, and that I and a lot of others have picked up. I mean, rather than going through the guidelines type of test, what we usually do when we sit down with clients is pose three short-form questions: Where is the value of the deal; what are the customers going to say; what is going to happen to price?

And for this purpose, I am using price as a surrogate for all of the other competitive variables that you might get into. And when you poke and probe, you might get into innovation, into quantity, into just all of the things you might worry about.

The first two of those are really background
information. I mean, where is the value in the deal? You want to hear whether it's on the price increase side or the cost decrease side. We take it as a given that the assets are going to be more profitable in the hands of the buyer than in the hands of the seller. Otherwise, presumably, a deal wouldn't happen. Presumably, there is some margin increase somewhere, and the question is what's the source of the margin increase.

And in terms of what customers are going to say, that's partly just to find out what's going to happen if we do get into an affidavit battle, and it's also to poke and probe a little bit about, well, why are the customers going to say that? Why do they care? Why don't they care?

And it's really that third question, the what's going to happen to price, what's going to happen to other competitive variables. We want to hear the answer. And as often as not, you will pose the question 15 different ways. One of the ways I'm fondest of posing it is, "Well, in which of your products are you most likely to have a price increase that sticks?" And sometimes they will say, "Well, it's this grouping right over here," and then you poke and probe on that.

But I would suggest to you that if you really want to handle the merger efficiently -- if we all want
to handle mergers efficiently -- and I pause a little bit
before saying this, but I think we will say it anyway, we
have a lot to learn from the doctors.

I mean, when you go in and you have a problem,
typically what the doctor does is take a bit of the
history and formulate some hypotheses, and then you flip
into a mode of rule out a problem. And the way the
medical profession does it is they run a bunch of tests
sequentially to rule out this problem, rule out that
problem. And at the end of the process, if you have
tests that are consistent with the problem, then you
treat the problem.

And if at the end of the process you don't have
a problem, and you can't come up with any other
hypotheses, well, then you move on.

Now, the issue we all have is how do you
translate this into legal doctrine in a system where you
have case law that has very, very strong authority on two
propositions?

First, you have to define a market. And
second, the market definition is step one of the
analysis. And I muse a little bit about that in the
paper that will eventually be forthcoming. I mean, there
are several approaches, none terribly satisfactory, that
one might come up with to try to reconcile case law with
the mode of analysis that's actually practiced.

And it seems to me that if we were going to try
to take the next set of steps and conform guidelines to
practice as we know it, that is the fundamental problem.
I mean, how do we skin the cat of not getting thrown out
of court? Well, actually, it's not my problem, it's the
Agency's problem, but how would the Agency skin the cat
of not getting thrown out of court?

But let me leave you with this thought. I'm
going to close with this. First, it does seem to me --
and this is where, again, I join up with Will, or maybe
against Will, in saying the guidelines are working well.
It does seem to me that the guidelines are affirmatively
misleading as a recipe for how analysis is actually
conducted, you know, 12 years after their most recent
revision.

Second, the business community is fundamentally
confused about how you do the analysis. I mean, it's
pretty common that we will sit down with a client for the
first time and the client will have worked through the
guidelines. And you can't believe how far off the
analysis is.

Now, the 68 guidelines went 14 years before
they were revised, and we're obviously not at 14 years
yet. And I would not lightly call for the Agencies to
undertake a process of revising the guidelines, because I know how complex that is and how burdensome that can be. So I'm not going to say that.

But I will say that the time probably should come one of these years -- almost certainly not before the election, but maybe 2005, 2006 -- it probably would be productive for people to sort of sit back and say, "What do we mean by market, and how, really, are we going to try to operationalize what we're doing, if what we're going to seek in the way of guidelines is a pretty transparent set of recipes that depict the enforcement practices to the public?"

And with that, any questions, Mr. Moderator?

MR. WERDEN: I have a few. First, I'm actually quite confused about what you mean when you say that the guidelines are misleading on how the analysis is conducted. I'm not sure that they tell anybody how the analysis is supposed to be conducted, so I don't know how they could be misleading. What is it, exactly, that you have in mind?

MR. BLUMENTHAL: Well, I guess I'm using misleading in the FTC Bureau of Consumer Protection sense.

(Laughter.)

MR. BLUMENTHAL: Which basically means that you
have a population of readers that are interpreting the
words in a way that is not entirely consistent with what
the words literally are intended to convey, that you have
-- and by the way, I mean, it's not just the public. It
seems to me that the same thing applies to certainly
agency staffers overseas who try to apply our guidelines,
and I think I would go on to say some agency staffers
within our borders who try to apply our guidelines.

The iterative aspect of the analysis is
something that is often fundamentally missed. The fact
that market shares are not what you see in the documents,
but rather what you calculate after going through all of
the rest of the steps preceding competitive analysis,
that's something that is quite commonly missed.

You know, Will's point on unilateral effects, I
think, is pretty fundamental. So that's what I mean by
misleading, that people -- large numbers of people -- are
simply misconstruing how you're supposed to do the
analysis. And in particular, where market definition
comes in.

MR. WERDEN: Well, in that regard, let me
suggest that the guidelines disclaim being a step-by-step
instruction manual, and perhaps best should be described
as an outline for how one ought to present the results of
the competitive analysis of a merger.
And if viewed in that light, is there anything misleading about the guidelines? Is there anything problematic about the way they choose to organize these issues in a manner, as you commented in some of your articles 20 years ago, fairly consistent with the case law that constrains how the government can litigate its cases?

MR. BLUMENTHAL: Yes. I think with that qualification, the guidelines remain reasonably accurate. I'm not sure about a separate 35 percent test for unilateral effects -- which I think is still in there -- well, depends on how you define the market, I suppose, which is sort of the point.

But I'm not sure that that component is something that withstands challenge. But that's a really minor quibble. And yes, subject to the observation that the disclaimer says they are not a recipe, and that the public -- if you're going to say the public shouldn't use them as a recipe, then they hold up pretty well. The problem, of course, is people do use them as a recipe because they don't have any other recipes.

MR. WERDEN: Okay. Thanks very much, Bill. I have a large number of prepared questions. But before I launch into them, I want to offer the panelists an opportunity to respond to what else they have heard thus
far.

MR. HARRIS: I actually have a question of you. I think it was you asking questions about when there were switching costs and issues with exploiting the installed base, and at least it wasn't clear to me exactly what you were asking, so I ask that you kind of elaborate on it and explain better the situation that you have in mind where a merger might harm competition.

MR. WERDEN: Well, sure. I had in mind a very simple-minded situation in which every current user is locked in to his supplier, for whatever reason. Don't ask me to explain, I think it will be hard to explain that. But suppose it is so.

The hypothetical monopolist could exploit these guys, because they're locked in. And then the issue would be, well, what about new customers? That's usually where the competition is, of course, to attract the new customers and to sign them up and to get them locked in. And a hypothetical monopolist might be able to discriminate between the two, and might not.

And one would have a somewhat different analysis of the merger, depending on which of those circumstances you thought you were in. But one clear possibility is that you can't discriminate, so all a hypothetical monopolist could do is exploit the guys who
are already locked in.

And my question is, well okay, in that event is there any way that you would specially account for switching costs in the application of the 5 to 10 percent price increase test, and my answer would be no. You don't do anything different or special in that case, not in delineating the market.

MR. HARRIS: But you would not ignore it in looking at competitive effects, is that accurate?

MR. WERDEN: You would not ignore anything in looking at competitive effects.

MR. HARRIS: I understand.

MR. WERDEN: But part of what the guidelines are trying to tell you is what category various issues fall into. And the guidelines say, "Well, some issues are market delineation and some aren't." And a whole lot of them aren't.

MR. HARRIS: Okay. And then I guess the follow-up question I have in the context of a merger, if these customers are locked in, is your suggestion that there is a way in which the merger can make that situation worse? And if so, what is that?

MR. WERDEN: Oh, that's an excellent question. It isn't necessarily so that the merger can make the situation worse, and that's where the competitive effects
analysis ought to be. It may very well be that when you get to the competitive effects analysis you conclude that the locked-in customers are exploited as much as locked-in customers can be exploited, and the merger doesn't affect that, and the focus ought to be on the new customers, because that's where all the competitive action is. I have certainly seen mergers where that was my view.

But you can imagine, certainly, that the switching costs between incumbent suppliers are much smaller than the switching costs between an incumbent supplier and somebody outside the candidate market, in which case it may very well be that there is some effect on the degree of exploitation of the locked-in customers, because they're not completely locked in.

Anybody else have any comments or questions?

No? Okay. The hypothetical monopolist test has come in for almost entirely praise from our panelists today. And my question is has it completely won the intellectual and legal battle -- and those are two different battles -- and I think the answers may be different.

Put another way, is there an alternative that makes any sense to use? And I think this question has to be posed in two different ways. One, an economic/policy perspective, and the second one, a legal one. And with
respect to the economic perspective, I pose the question to Barry. Does economics offer any alternative?

MR. HARRIS: Well, the first thing would be my disclaimer, "Never say never." But I'm hard pressed, with a few exceptions, to think of something that performs better, and it gets back to what question are you asking: What is the group of competitors, that if they were able to coordinate, could exercise market power?

Now, it seems to me -- alternatives that -- at least the ones I have seen -- are inappropriate. Maybe I haven't seen them all. Or, alternatively, they default to the same question asked in a different way.

And just as an example, I think it was John, in his talk, he mentioned successful price fixes, and he also mentioned the Staples case. Well, I think it is fair that if you can look at real-world information, it may tell you what the market is. But what is a successful price fix? At the end of the day, assuming all the conditions are reasonably similar, what you have done is you have done the hypothetical monopolist test, you have just run it out in the real world.

Same in Staples. My understanding of that case -- which is imperfect; I didn't work on it -- but despite all the talk about econometrics, at the end of the day,
if you read the decision, you will see the judge kind of ignored everybody's econometrics. But my understanding, an important fact of that case was that the two companies each had pricing zones that were defined by the existence of the other company, and these were the low price pricing zones.

Well, again, you can say that's real-world information, and it's a different way of going about it. But at the end of the day, it's telling you an answer to the hypothetical monopolist question. So there may be different paradigms, but I'm not aware of them. And the ones I am aware of seem to me to be just a round-about way of getting to the same point.

MR. WERDEN: Okay. Thanks, Barry. Bill, I will ask the legal side of the question to you. In your remarks -- I paraphrase -- you said -- I didn't get the exact remarks -- you said the hypothetical monopolist test has "won." But yet we still read district court opinions that cite the Brown Shoe practical indicia.

Is it your view that the courts are really relying on the practical indicia, or are they ultimately really relying on the hypothetical monopolist test, or some interesting combination of the two?

MR. BLUMENTHAL: Well, when I say "won," I mean primarily in the hearts and minds of commentators,
analysts, and the antitrust cognoscenti.

     With respect to the courts, I think, increasingly, the test is the decisive test. But there still are some courts that are laggards. I think the question, in large part, turns on how economically sophisticated the judge is. I think it turns, in large part, on how facile the judge is on reconciling the legal standard which perhaps she believes makes sense with what she thinks she has to put down to avoid getting reversed by the court above.

     So, as an evidentiary matter, the courts continue to rely pretty heavily on Brown Shoe. And the practical indicia, of course, are a submarket test. But as Brown Shoe says, a submarket can, itself, be a market. So it all gets completely commingled.

     And I think that for a long time to come we will continue to see courts citing to the tests that have been articulated by other courts, it's just that we're beginning to see more and more courts speaking favorably about the guidelines, about the hypothetical monopolist test, and that then creates a body of precedent where, sooner or later, courts will be able to rely just on that without necessarily linking it back.

     MR. WERDEN: Let's get a little more specific, and talk about the Staples case. There is, you know, at
least three or four pages in the *Staples* case relating to
the practical indicia.

    MR. BLUMENTHAL: Yes.

    MR. WERDEN: Is there doubt in anybody's mind
here that the only fact -- and it may be more than one
fact, but I will call it "a fact" -- that ultimately
persuaded the reasonably skeptical judge about this
funny-looking market was that there was very clear
pricing evidence that the number of office superstores
really was affecting prices?

    MR. HARKRIDER: Greg, if I can make a point?

    MR. WERDEN: Sure.

    MR. HARKRIDER: I think that *Staples* actually
provides an illustration of the relationship between
*Brown Shoe* and the hypothetical monopolist test. I think
that the hypothetical monopolist test is frequently used
as an economic test as opposed to *Brown Shoe*, where there
is quantitative evidence of the sort, or very clear
evidence of the sort that directly bears on the
hypothetical monopolist test.

    I think where there is very little evidence as
to whether a hypothetical monopolist could, in fact,
impose a SSNIP -- which -- and by that I mean there is no
econometric evidence, there is no natural experiment,
there are no surveys, there are no affidavit evidence --
I think in that context they frequently rely upon Brown Shoe. And if the quantitative evidence is relatively weak or not determinative, then they rely upon Brown Shoe.

I think Staples is a case where you have essentially, a natural experiment that allowed you to get direct evidence and get some purchase on the hypothetical monopolist test. And so, Brown Shoe wasn't particularly instructive.

MR. WERDEN: Okay. Well, let's try a different case. Let's try Swedish Match. There was quantitative evidence in the case, but the court was totally unpersuaded by it on both sides. And the court cited Brown Shoe factors.

But the way I read the decision, ultimately the judge sat back and looked at the totality of the evidence and said, "Well, if I think of a hypothetical monopolist raised the price five percent, he would make more money." So it's a market.

MR. HARKRIDER: I think that that's right, but I think that there is uncertainty when you read the cases, whether the Brown Shoe factors are something that gets you an ability to analyze whether a hypothetical monopolist could, in fact, increase the price, or whether the hypothetical monopolist test is, in fact, to some
extent, one of the Brown Shoe factors.

And you really see courts -- and I think this is one of the problems, is that the courts really haven't figured out where the hypothetical monopolist tests relate to Brown Shoe.

I think that once you get outside of the merger context, you see that a great number of courts, whether in a Section 1 or a Section 2 context, where a definition of the relevant market is important, are not in fact looking at the hypothetical monopolist test, although it clearly is an increasing trend to do so.

MR. WERDEN: All right. Let's try another topic. An early criticism -- and not necessarily just an early criticism -- of the 1982 merger guidelines approach to market delineation was that it would systematically bias the analysis -- yielding overly broad markets. And hence, understating market shares.

I didn't think anybody believed that any more until a week ago, when the American Antitrust Institute released a statement in conjunction with this workshop, which they officially filed with the Agencies as their comments, which asserts "that there are common market definition procedures" in the guidelines that "create the potential for systematic errors in defining markets."

They don't explain.
But my question for the panel -- and I will start with Will -- do you believe that the guidelines' articulation of the hypothetical monopolist test gives rise to the sort of systematic errors that people were worried about back in the mid-1980s?

MR. TOM: Certainly to the extent that people were worried about a systematic bias toward overly broad markets, I think probably most perceptions of the time -- and certainly subsequent experience -- has shown that to be completely unfounded.

I have suggested a reason in my opening remarks why we might have a systematic bias toward overly narrow markets. Not because of anything analytically wrong in the guidelines, but simply because of some perhaps unfortunate interaction between the guidelines and human nature. That is the tendency to treat one side of the equation or one hypothetical part of the analysis as fact and another hypothetical part of the analysis as speculative.

But other than that I don't see any particular systematic biases at all.

MR. WERDEN: Can any of the panelists think of any matter they worked on, or one they didn't work on, where the guidelines, as opposed to some view of the facts, led to a market that they thought was overly
broad?

MR. HARRIS: I'm not sure that I can answer that, but a curious fact that I have raised with Greg in a different context was -- must be 10 years now -- in the Dubuque hospital case, there was an oddity there, and that was that the lesser of the two hospitals in the period before the merger had lowered their prices by roughly 40 percent in an effort to get more patients and get more managed care plans. And they had gotten virtually nothing.

And for some reason, they left their prices down. They had an experiment sitting out there that said, oh, they could raise their prices 40 percent, get back where they were, and presume the elasticity symmetric, and they didn't do that.

So, that sort of raises the question -- and it's not exactly your point -- but how low does the market have to be in a situation like that to include the merging parties? So it's sort of a related question.

An attempt to answer it directly, the only thing that comes to mind -- and I didn't look into this, and I may have the facts wrong -- but I have a memory of the antacid case that had very, very different looking competitors in there. And that might be a candidate for a very broad market in which a case was brought on that
may or may not have been supported. But it's at least one that comes to mind.

MR. WERDEN: We referred to that one as stomach remedies.

MR. HARRIS: Okay.

MR. WERDEN: Because it included a lot more than antacids.

MR. HARRIS: Yes. And again, I don't know the process that got to the market, and I don't know very much about the market, except that my doctor tells me to take two every day for the calcium. I think that struck a lot of people at the time, and it certainly struck me at the time as being a market that was way too broad. And that was based on just kind of being a consumer, rather than any antitrust analysis.

But other than that, I am hard-pressed to think of one.

MR. BLUMENTHAL: Well, I don't know that it's possible for the guidelines, if applied literally, to yield an overly broad market. It depends a little bit on what we mean by overly broad.

But if the breadth from which you were either too broad or too narrow is what you would otherwise get by reference to the standards in the courts, the non-guideline standards, it seems to me, as it does to Will,
that there is almost a chronic bias in the direction of narrow markets.

Whether that's appropriate or not is something we can talk about, but for 20 years I have been saying that a 5 percent one-year test is going to lead to markets that are a lot narrower than what business people conventionally think of as being the market. And the reason for that is that business people tend to take more of a strategic perspective on things. And you don't see a whole lot of shifting for five percent one year.

MR. WERDEN: Of course, it's not one year in the 1992 guidelines, it's for the foreseeable future.

MR. BLUMENTHAL: Yes, foreseeable future. Fair enough, fair enough.

MR. WERDEN: Okay. Do you have any theory for why people like Bob Pitofsky thought what they thought?

MR. BLUMENTHAL: You know, I was not among those who thought it at the time, and I didn't understand it at the time. And I went in writing in the other direction at the time.

Recalling the political climate in 1982, when the guidelines were released, you know, as much as anything else it seems to me sort of a knee-jerk reaction to a perception that this was what some would have called Reaganism run wild.
And that, from my perspective, at the time was what was motivating it. And after the fact, 20 years after the fact, that wasn't what was motivating it. That's the best I can come up with.

MR. WERDEN: Okay, thanks. Next topic. A long-standing issue in the application of a hypothetical monopolist test is how to account for pre-merger elevation of price above cost. The merger guidelines say that we generally use the prevailing price, but there are provisions in there referring to possibility of pre-merger coordinated interaction that say maybe not.

The AAI statement that I alluded to a few minutes ago issued last week argued as a general matter, that the “use of the prevailing price should be carefully evaluated in every merger investigation.” And of course, they didn't say what that evaluation might look like.

So, I am wondering what the panelists think about this. And I will throw the first question out to John. Assuming that by the term "competitive price" we mean something like short-run marginal costs, which is generally the way economists think of the term "competitive price," do you think that that's really ever the proper benchmark in a merger case?

MR. HARKRIDER: Well, I think that you can think of -- I don't want to skip ahead in the question --
but you can think of many different contexts in which you may be uncomfortable using the prevailing price, and I think at least one context you're talking about is where there is some evidence of pre-merger coordination.

And I think that you would want to use the competitive price, as you defined it, if there were evidence that absent that coordination or collusion, that price -- that goods were, in fact, being sold at short-run marginal cost, which may not be the case.

I think that I can imagine many instances in which the prevailing price, but for coordination, may not, in fact, be short-run marginal cost. And I would be inherently suspicious of efforts to calculate short-run marginal cost. That's both because the goods may not be sold at that price, but also because people may be relying upon accounting data in order to calculate it.

So I would be very nervous about agencies trying to calculate that price, and then going to customers and saying, "Okay, well, would you switch," in response to a SSNIP on that.

So, I think the bias should be towards using prevailing price, and I think you should use something other than prevailing price and, in fact, the competitive price as you defined it -- if there is evidence but for collusion goods would be sold at that price.
MR. WERDEN: Well, that gets to the next question, which is what is that evidence? What would persuade you that but for the merger, some lower prices have to prevail in the future?

MR. HARKRIDER: I would probably say some sort of evidence -- I am generally a quantitative person. So I would be looking towards what goods were being sold at before the coordination. Or, in a market in which that coordination doesn't exist.

MR. WERDEN: Well, you're apt to be hard-pressed to figure out when the coordination started, or to observe the industry in that kind of depth. So I guess my question really is, since you don't know that much about how coordination is going on -- because if you did you would probably just refer this case over to the criminal people and be done with it -- but it is your observation that prices are awfully high here. So, you know, something must be going on.

If that's the level of your analysis, how can you incorporate that into some sort of conclusion about what prices are likely to be, but for the merger?

MR. HARKRIDER: But I think that the government has -- or the Agencies have -- a burden. And I think that if you have no certainty that the price, but for the prevailing price, but for the coordination, would be
short-run marginal costs, and it seems unclear why you should be using that as the relevant benchmark.

I can also imagine industries where even in the absence of coordination, because there are differentiated products and there is some degree of market power exercised by or held by each individual firm, that goods would also not be sold at short-term marginal costs.

So, I just think it's very dangerous to have a bunch of economists calculating what the price would be without any clear evidence of what, in fact, the price would be.

MR. WERDEN: Okay. In fact, the guidelines don’t use the competitive price as an alternative to the prevailing price; they refer to the use of a price that is -- I forget the phrase, but "closer to" is kind of the concept -- the competitive price, i.e. a lower price.

And they don't say which one.

But, Will, I will put it to you now. If you thought you had pre-merger coordination, and certainly it is possible -- and that might even be the theory of the case, that the merger may help that coordination persist where it might not otherwise -- what price would you use? How would you come up with some alternative?

And then if you did come up with some alternative, how would you implement it?
MR. TOM: This is a hard question. I don't think that we have got a lot of tools at our disposal to create prices other than the prevailing price to use as our benchmark.

I can think of some half-measures that one might start with in appropriate cases. You know, one thought experiment that is sometimes useful is to -- and I credit Jon Baker for this -- is to say, what would happen if prices were to fall five percent? And you know, what products would exit the market?

And that may give you some feel for what a more realistic market somewhat less affected by the Cellophane fallacy would be. But if you start turning people loose into trying to estimate what prices would be in a market without the collusion, you're in a pretty tough spot.

And I guess the one other thing that occurs to me is that the -- in some cases, you may be able to find alternative explanations for prices seeming to be unusually high. And I don't know if your hypothetical was meant to exclude situations in which, for example, the high prices are, you know, a return to the cost of innovation, or things like that.

If you were intending to exclude that by positing coordination, then I think you really are in a fairly difficult spot where, you know, you really do need
to find some other price benchmark, but it's not obvious what it is.

MR. HARRIS: May I?

MR. WERDEN: Yes, but let me throw one thing out before.

MR. HARRIS: Go ahead, sure.

MR. WERDEN: I limited my question to the scenario of pre-merger coordination because that is the only scenario which the guidelines endorse using a price other than the prevailing price. But if anybody wants to suggest that there are other circumstances in which you should do that too, feel free.

MR. HARRIS: I mean it strikes me in listening to this that let's say you do have coordination, and somehow you have reason to believe you have coordination. Well, in effect, whether it's legal or illegal coordination, you have what we were talking about before, the price fix that defines the market for you.

So, it seems to me -- taking Greg's advice from before -- is the market definition and the competitive effects are two separate analyses. Well, from the pure market definition point, if you really have coordination, and you're in around where the monopolists would price, well then you have kind of defined your market in advance, and a further price increase would be going past
what the monopolist wants.

But when you're asking the competitive effects question, it seems to me the question you want to ask is is there something about this merger that makes it more likely that you will be able to continue to coordinate. But as far as the pure market definition point goes, I think if you really understand that there is coordination there, that, in effect, has defined the market for you.

MR. WERDEN: Thank you, Barry. Next question.

The hypothetical monopolist test, as articulated in the merger guidelines, includes what's referred to in the guidelines and elsewhere as the smallest market principle.

Interestingly, in last week's AAI statement, it is asserted without any elaboration: "The smallest market principle should be deleted from the guidelines entirely."

I want to throw out to the panelists whether they think that makes any sense, and whether they are inclined to make offensive use of the smallest market principle. But I will start with a question to Barry. Do you think the existence of the smallest market principle in the guidelines has caused the agencies to miss significant competition between the merging firms?

MR. HARRIS: I think the answer is no, and I
think the reason for that goes back to what Bill Blumenthal said, and that is in the real world what the agencies seem to do is they basically do a hunt to see where the problem may be. And from -- and then they work to an answer from that.

And I don't know that the narrowest market principle really has much of an impact on how they address the issues. How they present it is a different question.

Another thing is -- maybe this is sort of a question for Greg -- but I always thought of the narrowest market principle as basically having two different possibilities, one that I think is appropriate and one that I think may not be.

The one that's appropriate would be, well, let's say we have a well-defined market, the hypothetical monopolists could raise price profitably. Let's just say it's for cars, automobiles. And then the car monopolist goes out and buys General Mills, as opposed to General Motors, you know, making cookies and things.

Well, clearly, the analysis should be in the car market, not in the car-plus-cookie market. But the hypothetical car-plus-cookie monopolist certainly could raise the price of cars. So, it struck me that the narrowest market principle was intended to exclude those
kinds of circumstances.

What I think it doesn't exclude, and probably should not exclude, is let's say there are a variety of strategies that a hypothetical monopolist could take. And one involves, let's say, four firms and a different equally plausible strategy involves seven firms.

It would seem to me that there is a separate market that would encompass, depending on what competitive issue you're trying to address, would address the four firms, and a separate one that would address the seven firms. And I don't see that the narrowest market definition says you can't look at the issues involving the seven firms.

And again, it may have to do with differential prices, or what's the next best alternative to the hypothetical monopolist, rather than just the merging parties, or things like that. But I don't see the principle -- cutting it off at just the fourth firm situation and saying you can't go look at the broader market that includes seven.

MR. WERDEN: The 1982 and 1984 guidelines had a lot of qualifying language in there about independent competitive concerns in the larger market. That was taken out in 1992. So the suggestion may be that you can't look at that seven-firm market. But I think,
clearly, that hasn't been the practice.

John, a question for you. If you come in to lobby the Agencies, are you prepared to try to use the smallest market principle offensively and say that under our own guidelines, the merging firms don't compete in the same market?

MR. HARKRIDER: Yes, absolutely. I would have no hesitation doing that. And let me give you two examples where we have done that.

I have been involved in three scientific journal mergers, all of which got similar requests, and I know of a fourth. And in each one of those cases, it was very clear that somebody who is buying a journal on brain surgery is probably not going to switch to one on foot surgery in response to a SSNIP. And if they do -- if you're a patient, you're in a lot of trouble.

So, I think an argument can be made -- and a very strong argument can be made -- that each one of these scientific journals do not belong in the same relevant market. That being said, and in due respect to the Agency, in each case they were explaining a different theory, which was a portfolio theory, where they weren't necessarily looking at bundled goods, but they were trying to figure out, okay, well, if you increase the price of a very expensive journal, does this cause some
sort of externality that is, to some extent, outside of that narrow market where the library, who is buying 1,000 journals, drops something else. It doesn't technically compete.

I think that's an instance where the Agencies didn't necessarily follow their guidelines but were looking at competitive effects where they could find them. And you know, thankfully, in each one of those cases the government chose not to challenge the merger.

I think another instance where that occurs is in software cases. I have definitely been involved -- and then gone down to the Agencies -- where my client may have a sort of software, let's say, that does sort of back-office sorts of things. And, within a given industry, the company that we're acquiring has a software that does front office sorts of things.

So, if you do sort of an analogy between, like, Excel and Word, you know, both Excel and Word do some sort of spell check, both Excel and Word allow you to add and subtract and do little charts. But no one -- hopefully -- would say that they are in the same relevant market -- at least if you're not looking at these things as suites.

So, I think that you can definitely -- and at least in the case that I'm talking about, a second
request was issued. And I think, for the purpose of trying to figure out, well, do people buy these as suites, are they within some broader relevant market. But certainly, I think in highly differentiated goods, especially with software goods, it frequently is the case that goods may be either compliments -- but certainly not substitutes, although it kind of looks to somebody who doesn't know much about the products, that they compete.

MR. WERDEN: Were you successful in your software argument to the Agency?

MR. HARKRIDER: Not successful in avoiding the second request, at great expense to the client, unfortunately. You know, we were successful at the end of the day. A case wasn't brought.

MR. WERDEN: Well, that's what really matters, isn't it?

MR. HARKRIDER: Yes, it is what really matters.

MR. WERDEN: You get to bill your hours, and --

MR. HARKRIDER: Well, no, that's not what really matters. But I think that, you know, for those of us that care a lot about the cost imposed on business with respect to second requests, I think that, you know, the scientific journal case is a very good example.

I mean, in the last 10 years there have been four different second requests, all looking at the exact
same theory, where the guidelines, in fact, would seem to
suggest to you that the products don't compete.

MR. WERDEN: Well, I won't comment on what the
theory of any of those investigations was, because I
don't know. So, let's move on to another topic.

Section 1.11 of the guidelines states that what
constitutes small but significant non-transitory increase
in price will depend on the nature of the industry and
the Agency, at times, may use price increases larger or
smaller than 5 percent.

Will has already addressed this subject of
using price increases greater or less than five percent,
but there is one particular question I wanted to ask him
about on this subject that he didn't already address.
And that is the case of a low profit margin industry.

There is some commentary, including from Bob
Pitofsky, and some precedent -- I think all the FTC
supermarket cases, but I don't have any inside
information on that -- have used a price increase smaller
than five percent on the theory that it was appropriate
because profit margins were low.

Do you think that's right? What do you think
about the import, if any, of low profit margins?

MR. TOM: I wouldn't think that one should
systematically adopt a percentage increase less than five
percent in all low-profit margin industries. I would be
a little worried about the implications of that.

I in part, for the reasons that I articulated
earlier, which is you are getting down to finely granular
judgments about what the competitive effect is likely to
be in situations where the unknowability of it all may
simply swamp what you're trying to achieve.

And given the fact that we're dealing in an
area where there are very likely pro-competitive effects
from mergers, you know, I would be concerned about it. I
recognize the intuition on the other side is with profit
margins very low in an industry, you know, a relatively
small price increase is more significant to the players
in the industry.

But it's not obvious to me that catching the
additional mergers that might have anti-competitive
consequences in that circumstance is going to be worth
the risk of erring in the other direction.

MR. HARRIS: Think what's going on with
groceries. A very successful grocery store is going to
run maybe two percent return. And the reason for that is
they have to pay for all the products.

So, if you limit it to questions where you only
look at five-percent price increases, you have basically
almost created situations where entry is going to solve
all your problems. Because a five-percent price increase
is going to be increasing profits like three or four or
five-fold.

    So, what that means is if you don't have some
flexibility in situations like this, you have basically
defined away those industries because basically, all the
problems are solved by entry in those kinds of markets.

    MR. WERDEN: But there is no necessary reason
why the entry analysis has to perfectly parallel the
market delineation analysis.

    MR. HARRIS: I --

    MR. WERDEN: And the question I put was for
market delineation.

    MR. HARRIS: I agree. But again, you have to
be careful how you use the market. If you're going to go
against what Tim Muris said and start talking about
shares and things in that market, those shares don't mean
a whole lot if you're looking at a five-percent price
increase, because entry or uncommitted entry, I mean,
depending on the circumstances, is very important.

    That's going to drive the competitive analysis.
So I think almost as a way of screening within the
Agency, it seems to me more prudent to be looking at
smaller price increases and asking questions there. But
maybe not.
But it strikes me as a danger in setting five percent as a threshold and not being able to do this type of analysis in these kinds of industries -- not because it's going through a cyclical margin, but rather because it's inherent in the make-up of the particular industry.

MR. WERDEN: My suspicion is if one seriously considered only a one or two percent price increase for supermarkets, you would find that supermarkets a couple of miles apart aren't in the same market, and that -- although I have never worked on a supermarket merger, I have worked on a lot of local market retailing-type mergers, and I can't imagine that you actually get the right answer, in some sense, from using such a tiny price increase, because you're going to keep the merging firms from competing with each other.

MR. HARRIS: Actually, I didn't mean that you wouldn't necessarily use one or two, I meant that you shouldn't limit it to the use of five percent. So I wasn't suggesting that should be a standard to only use one or two. So I don't know that your comment actually applies, then. Maybe I was just not clear.

MR. WERDEN: Okay. Well, thanks. Final topic -- and Bill already touched on this quite a bit -- Brown Shoe, I think perhaps more than any other case, holds that you cannot challenge a horizontal merger without...
pleading a relevant market, and coming up with some
shares, and et cetera, doing the structural analysis.

But that's a long time ago, and antitrust law
has evolved considerably. And in the Section 1 area, the
courts now pretty uniformly hold that you can do a rule
of reason analysis without defining a market.

So, my question is even though no court yet
hinted at the possibility of accepting a merger challenge
that doesn't involve market delineation, is sooner or
later that where the law is going?

And I will put the first question to John. Do
you believe that a court should, and separately would,
accept a merger challenge? And I will make it simple. I
will use a fairly straight-forward unilateral effects
analysis supported by some quantitative analysis, but
with no allegation of a relevant market.

MR. HARKRIDER: Well, I think the question is
when. If you do this tomorrow, will they accept it? I
would think probably not. I believe that it is very
important in merger policy to be both transparent and
predictable. I believe the courts are also aware of that
need.

I think the fact that the current guidelines at
least speak of market definition, and aren't entirely
clear on the issue of whether market definition is
necessary with respect to unilateral effects, and given
the line of commerce provision in the statute and the
Supreme Court's interpretation of that as requiring a
relevant market, I think that going into court in a
merger case without alleging a relevant market is
something you do at your peril.

So, I think that if the question is right now
is that going to be successful, I think absolutely not.
I think that if 10 years from now you have a period of
time where the merger guidelines have made it clear that
you do not need market definition, at least in the
context of unilateral effects so that there is at least
guideline precedent for that, I believe that there
probably is some probability, just like the hypothetical
monopolist test was accepted by the courts, that that
formulation would be accepted by the courts.

Even though, for example, Bill says that he
doesn't define relevant markets, at least at the lower
end, you still have safe harbors. I think that the safe
harbors are still things that people look at, especially
in the context of commodity goods, where there sort of is
an established precedent on what the relevant market is.
So I think it would send a very scary signal to the
business community that that market definition wasn't
necessary, and I think that you need to do so in very
slow steps.

MR. WERDEN: Go ahead.

MR. BLUMENTHAL: Can I just add one thing?

Just to be clear, what I said is I don't define markets on the defense side. But I raise that not just to be defensive here, but also to go on to say that on the plaintiff's side it seems to me -- at least if you're a private practitioner -- it's virtually malpractice per se not to define a market, given where the courts are today.

And I would think that while the Agencies, as a matter of not so much prosecutorial discretion, but as a matter of wanting to move an enforcement program in a particular direction, might try to do otherwise.

MR. HARKRIDER: I think that that's fair. And while I do agree -- and I'm sure -- you know, obviously, I can't speak for you, so I won't try to -- but while you certainly say that you don't define relative markets, I am sure you're aware of sort of the precedent.

For example, if you're doing a deal in aluminum, or you're doing a deal in polypropylene, and you may say to your client, "Okay, gee, there have been, you know, 10 other cases either litigated or consent decrees. The DOJ has defined the market, the FTC has defined the market, and looking at our concentration numbers, you know, we have a post-merger HHI of 1,000," I
would be very concerned that if, at the end of the day, the Department of Justice said, "Okay, yes, I know. We have defined markets this way and I know the guidelines say that, you know, we have a post-merger HHI of, you know, 35, but we're going to go and look to see if there is a competitive effect," I just think, given the level, there are, what, 2,000 HSR's that were filed last year, there are 30 or 40 second requests. I would not want to open up the possibility of second requests on the balance.

MR. TOM: Can I just add one thing?

MR. WERDEN: Sure.

MR. TOM: While I agree with all that, I think that the legal barrier to bringing a merger case without defining a market is the -- "in any line of commerce, in any section of the country," language in Section 7 of the Clayton Act. Of course before there was a Section 7 of the Clayton Act it was established that mergers could also be challenged under Section 1 of the Sherman Act. And the Supreme Court has now made clear that in challenging conduct under Section 1 in the Sherman Act you don't have to define a relevant market.

So, you know, if one were pressed to it, and if one, for whatever reason -- which I'm having trouble imagining -- I wanted to try to do a run around the case
law that says define a market in a merger case, there is your precedent. *Indiana Federation* with the old Section 1 merger cases, and you have got a legal theory.

MR. WERDEN: And I could add that in the Rockford hospital case, Posner held that the substantive Section 1 standards for merger are identical to the substantive Section 7 standards. So there is no higher burden for the government if they went under Section 1, at least if they went into the 7th circuit.

MR. TOM: Right.

MR. WERDEN: Let me, in the closing minutes, pose a fall-back to going into court without a market. And the fall-back is that instead of leading with the market, you trail with it. You lead with your competitive effects story -- and this is the way you write your briefs, this is the way you try your case, this is the way you do your oral argument.

Say, "Look, we've got this straight-forward competitive effect story. Here is evidence that supports it. And if you demand that we talk about markets, we will, but we're also going to explain to you that it's not really going to help you understand the story. In fact, it's going to be affirmatively misleading, because you could say the market is this, but that ignores this factor; you could say the market is that, but that
suggests that somebody is more important than he really is, et cetera."

What would you think about litigating a case that way?

MR. HARKRIDER: Well, I would think that the district court would be very concerned that if they didn't start off with relevant market they probably would run a significant chance of being overturned on appeal. So I think that if you're end game is to get away from relevant market, that's probably the first way to start, so you could have a district court, say something in what may effectively be -- you had to find a relevant market, but it really wasn't necessary.

And that could be the first part of the step of getting away from relevant market. I think that, as I said before, if that's your goal, probably the way you're suggesting it is the safe way to go, and I'm sure the court, as the safe way to go, would probably say, "We don't need to, but we're going to define a relevant market in case you do think we need to."

MR. WERDEN: Anybody have any view on that? Yes.

MR. BLUMENTHAL: Well, I think for the foreseeable future, whatever the mode of analysis is internally, by the time it gets to court it has to be
translated into the framework with which the court is familiar.

And the way the jurisprudence on something like this tends to evolve, the cutting edge stuff happens at the Agency. It slowly seeps into the courts, but for a long time, the courts hold to the old framework. And at a certain point, some wise judge looks back and says, "Look what we have been doing for the last 10 or 15 years, let me try to translate it in a way that is consistent with what the Agencies are doing."

But for purposes of pleading, for purposes of the theater of the courtroom, I would think that that approach is still a little bit perilous.

MR. WERDEN: Okay. Well, I think we will end it on that note. I thank our four panelists for an interesting discussion, and that will conclude the first session of the workshop.

(Applause.)

(Whereupon, at 12:00 p.m., a luncheon recess was taken.)
MR. SIBLEY: I'm David Sibley, from the Antitrust Division, and this particular panel is concerned with the role, defined as broadly and vaguely if you like, of concentration and market shares in antitrust analysis as influenced by the data recently released by the Agencies.

Now, we're going to have most of the discussions structured around three questions. The first one is: At some point in the future there is bound to be a new version of the merger guidelines. Whenever that is, what should future guidelines say on the subject of concentration and market shares defined in any way you want?

And John Kwoka, from Northeastern University, and Steve Newborn are going to talk about that. And I have encouraged them to use less than their usual amount of gravitas, and try to seem a little bit extreme.

(Laughter.)

MR. SIBLEY: The second main question is do the Agencies place too much or too little emphasis on market shares and concentration when it comes to analyzing mergers? And Rick Rule and Jan McDavid will be talking about that.

Then Craig Newmark, with some kibitzing from
me, is going to talk about whether the empirical evidence
in economics relating prices to concentration and a bunch
of other things, or profits to concentration and a bunch
of other things, does that say anything very specific
about the extent to which concentration ought to underlie
the guidelines or underline merger policy?

And then finally, we're going to have a talk
from Vincent Verouden, from the EC, about the EC
guidelines and the way that those guidelines treat market
shares and concentration.

Now, with the exception of Vincent, who is
going to get 10 or 15 minutes to say what he wants to
say, the rest of them, in extremely impressive display of
go on the conference call last week, suggested that each
speaker take maybe five or 10 minutes, and everybody else
pile on.

So, I am expecting great things from them. And
to sort of up the ante and make them feel as embarrassed
as possible if they don't come through for me here, I
will mention that at the beginning of this conference
call last week, when I had my sort of reasonable -- not
very inspired way of allocating speakers and time and
questions, someone -- in fact, everyone here has denied
that they are that someone -- said, "David, have you any
idea of the amount of ego on this conference call?"
So, that argues to me that these folks -- well, if it was you, you must have had a cold, or tonsilitis.

MS. MCDAVID: No, it was Steve.

MR. SIBLEY: Okay. So, anyway, it's going to be a little like an economic seminar at the University of Chicago, where the speaker gets maybe 10 minutes, and then the audience piles on.

So, with that, we will start with the first question. What should future guidelines say about how concentration and market shares are defined, analyzed, used, whatever? And we will start off with John Kwoka.
CONCENTRATION & MARKET SHARES

MR. KWOKA: Out at the University of Chicago, of course, David, you hardly get your name out before people jump. But thank you very much. It's a privilege and a great pleasure for me to be here to discuss some aspects of the question of where we stand with regard to one of the most prominent and perhaps most controversial aspects of the merger guidelines. Namely, the role of concentration and market shares.

I want to devote these few minutes to a couple of issues that I hope go beyond some of the old debates. There are really two disconnects that I see with regard to economics versus the merger guidelines versus enforcement policy.

The first of these is the growing disconnect, I believe, between the way the guidelines are written and what modern economics teaches about the anti-competitive effects of mergers.

And the second is the disconnect between the structural criteria in the guidelines and actual agency action, which is underscored by the data recently released by the Justice Department and the FTC.

So, in these few minutes I will try to summarize these thoughts. I have more extensive written remarks that are available in limited numbers in hard
copy here, but also will be posted on my website at Northeastern University.

First, with regard to the guidelines and the economics of mergers, I believe there are really three major categories of competitive theories of the effects of mergers: cooperative effects, the long-standing notion of tacit or explicit agreement among parties; unilateral effects, which has been in the guidelines now for 10 years, but certainly has been an issue longer than that; and strategic behavior.

Concentration is an important predictor of the price effects of mergers when the concern is cooperation. I think this is the implication of a wide range of economic theories and has been confirmed by a large body of empirical work. Neither theory nor empirical work is without its limitations. Neither theory nor empirical work implies precisely what level or change in concentration matters.

Certainly none of it implies that any concentration matters, and there is very little guidance as to what the trade-offs may be with other causal factors. This is a well-established relationship, I believe, and lies at the heart of traditional merger enforcement practices.

But concentration is much less important in the
case of unilateral effects. In the case of unilateral effects, what matters is demand substitutability between the merging firm's own products. Substitutability hinges on elasticities. Those may be informed by diversion ratios. And in turn, some light may be cast, under certain conditions, on diversion ratios and elasticities, by market shares.

So, that's an informational content to market shares in the case of unilateral effects, but I believe that their concentration plays no analogously important role in theories of anti-competitive harm that derive from unilateral effects.

In fact, there is a conceptual matter. The guideline's exercises involving market definition, product heterogeneity and entry conditions do not matter, either. Careful measures of the relevant elasticities incorporate essentially all of the information that one would otherwise seek on those questions.

Thirdly, firms may engage in any competitive conduct against their rivals. And merger may make this more profitable, more feasible, and therefore, more likely. Raising rival's cost, foreclosure, disciplining behavior, and so forth, are different insofar as they do not involve efforts directly to raise product price. But rather, are intended to handicap rivals, and thereby
diminish their competitive effectiveness.

There is, of course, no unified theory of such behavior, and so there is no simple enumeration of causal factors. Concentration may matter, share may matter, other factors may matter more in analyzing and predicting the effects of mergers where strategic behavior is a central concern.

These remarks themselves probably strike no one as very novel, but the implication is that there really are ways in which mergers may raise competitive concern. Each, however, has its own distinctive set of factors that we look to for analysis and prediction of those effects.

That's not the way the guidelines read. The guidelines set out a common methodology involving first product and geographic market definition, identification of participants, calculation of shares and concentration. After that, we are supposed to come to a determination of whether coordinated effects or unilateral effects is the likely mechanism of concern. But these steps I just enumerated are appropriate only if coordination is the central concern. They are far less so, if at all, in the case of unilateral effects. And they are rather murky in their relationship to theories of strategic behavior.
The present guidelines approach is, of course, rooted in earlier versions that were explicitly and exclusively concerned with coordination. But that approach is not an equally logical statement with the analytical process for mergers that involve unilateral effects or strategic behavior.

What should be done? The problem is clear, but the practice is a good deal less so. In principle, one can envision a triage system, whereby there is a prior determination of which theory of anti-competitive effect is the concern. Cooperation, unilateral effects, or strategic behavior. And then, based on that assessment, one could set forth the relevant information and decision rules appropriate to that category of concern, much as is done now for coordinated effects.

Now, I recognize -- and my panel members here, I'm sure, will be quick to explain -- the practical problems with such a triage approach. And I do understand that there is information value in some of the other exercises that the guidelines suggest, even for non-coordination concerns.

But I would urge that the logical structure of the guidelines could be revisited so that the world of concentration versus shares and other factors can be better matched to each theory of competitive harm so as
to better inform outside observers as to the method of analysis that compares with modern economics of mergers effects.

The second disconnect, as I said at the outset, that I would like to discuss briefly, stems from the fact that the guidelines are supposed to inform outsiders as to the criteria by which the Justice Department and Federal Trade Commission evaluate those mergers.

That the guideline standards do not really reflect Agency action has been no secret for quite a long time. In December, the Justice Department and FTC released data on their challenges to mergers, and early this month the FTC released additional data on their investigations and resulting cases.

The data offered considerable new insight into enforcement practice, and raised some additional questions about that enforcement. Merger challenges data revealed that very few mergers with HHIs less than 2,000 are challenged, as are very few mergers with changes in HHI less than 300.

In fact, more than three-quarters of all the challenged mergers involve markets with HHIs in excess of 2,400 and simultaneously with changes in HHI greater than 500 points.

In these respects, the de facto standards

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differ considerably from the thresholds written into the guidelines. That is not such large news. There is significant variation in these patterns by industry. That, I believe, is to be expected, since the threshold levels of concern under any theory -- for example, cooperation -- should differ, depending on other factors that arise that are specific to each industry.

The more recently released FTC data on investigations in cases corroborate this impression of enforcement as very heavily focused on large mergers in the most concentrated industries. Very few investigations of mergers in markets with HHIs less than 1,800 or changes in less than 200, for example, ever result in cases.

For a closer and more systematic examination of the likelihood that the Agency will bring an enforcement action against mergers that are subject to investigation, I have performed some regression analysis of these case-bringing probabilities relating, essentially, the fraction of investigations that result in cases to the level of HHI and the changes in HHI caused by the merger. This is, essentially, a straightforward examination of the data in table 3.1 of the February FTC release.

The analysis essentially infers what criteria the agencies use in coming to the point of an enforcement
action in a merger subject to investigation, and looks at
the relevant importance of the factors that do matter at
all.

The results demonstrate statistically that both
HHI and changes in HHI matter. That is, they affect the
probability of an enforcement action following an
investigation. The estimated coefficients imply that for
every 1,000 point higher HHI, there is an additional 5.75
percentage point risk that an investigated merger will
trigger an enforcement action. And every 1,000-point
greater increase in the change in HHI, results in an 8.5
percent added probability of a case.

Now, the results, which are explained in
greater detail in my written comments, can be used to
predict the probability that any investigated merger
might ultimately be subject to some enforcement action.
And they could also be used to define combinations of the
HHI and changes in HHI that result in a given probability
of enforcement.

The latter exercise is very close to a test of
whether the standards in the written guidelines in fact
reflect current agency enforcement. And once again, it
is no surprise to anyone that they do not.

While the statistical results imply bright
lines, of course, lines are not bright. Some
investigations above any line end up not resulting in cases. And others -- at least a few -- below any line you might draw occasionally, for good reason, do trigger an enforcement action.

The data do not make clear which theory of anti-competitive concern is at issue for any of the cases that are enumerated in those data. Concentration matters more for some theories, market share matters more for other theories.

I think it would be useful to know, from the FTC and hopefully from DOJ as well, what the relevant theory is, so as to be better able to assess Agency behavior against alternative theories of anti-competitive harm. And I would urge both agencies to consider such a breakdown in their future data releases.

Let me thank you again for the opportunity to summarize these remarks.

MR. SIBLEY: Okay. Thank you, John. And you may have noticed the recurrence of the phrase "may have" a lot in John's remarks, so he is emphasizing subtleties and fine distinctions, and sophisticated behavior by firms.

Now, I hope we're going to get an opposing view from Steve Newborn.

MR. NEWBORN: Well, I have no regressions to
run, sorry.

MR. SIBLEY: You're ahead of them already.

MR. NEWBORN: I have no website, either, I don't think. But other than that, we don't disagree horribly. I am very disappointed, John, that we don't, because you seem to think predictability is very important, and I was hoping that you were going to say getting to the truth was more important. And my thesis is that getting to the truth is far less important than predictability, and that's what I want to explore today.

Now, you in the audience who are government officials always know that we're supposed to say -- or I was supposed to say once -- that, "The comments I'm about to make are not necessarily those of the Agency or the Department." I will just say that because David asked me to take a rather extreme position, the comments I'm about to make are not necessarily my own.

(Laughter.)

MR. NEWBORN: But having said that, I kind of believe in this, that predictability is more important than getting it right, and I believe that it's far more important than getting it right. So, let me try to prove that theory to you.

But by the way, by predictability, I mean that businesses can, with intelligent lawyers at their side,
who are making a lot of money, predict the ability of to
the merger through. And by getting it right, I mean
there is some ethereal other dimension where economists
know this is the right way of doing it, and we should be
doing it this way. And I do believe predictability
outranks that getting it right.

So, why is predictability so important? By the
way, I wrote these notes down last night, so excuse me if
I'm a little disjointed. Why should we care about
predictability? And I always knew we should care about
predictability.

First of all, I will give you a few quotes in a
second about what the whole concept of the guidelines was
at the beginning, in 1982. I'm sure many of you -- I
think, Rick, you might have been there at that time, and
been part of it, but I think predictability is very
important to the business community for a number of
reasons.

One, a failed merger is a terrible thing. It's
just a terrible thing for the acquiring company. You
lose money, you lose time. But for the acquired company,
not only do you lose money and time, the morale of your
people is completely shot. You're losing business in the
marketplace. And in the extreme case, you fail. You
fail because you weren't able to predict whether or not
that merger could go through.

And therefore, predictability is so incredibly important. And predictability is even more important than that, because if you are doing a merger that ultimately gets challenged, you're not doing a merger that might not get challenged.

And if people believe -- and there are economists in this room, I know, who believe -- that most mergers are benign, and there are efficiencies to be obtained in those mergers, you are losing the opportunities of obtaining those efficiencies. Either losing them because you're taking too long in your earlier deal, or losing them completely because the opportunity is gone, for one reason or another.

So, I think there is no doubt in my mind that predictability is important. And of course, I wanted to give you a couple of quotes from the versions of the guidelines that show how important predictability was, even in the 1984 guidelines.

And this is by -- I guess he was the Attorney General, William French Smith. And he said, "The principle of law embodied in the merger guidelines are designed to give businessmen the certainty they need to make legally correct and economically beneficial business decisions."
In 1992 guidelines, which I was a small part of, it says, "By stating its policy as simply and clearly as possible, the Agency hopes to reduce the uncertainty associated with enforcement of the antitrust laws in this area."

And even in 1997, with the efficiency guideline revision, it said, "By setting forth our policy as simply and clearly as possible, the public better understands how the government evaluates mergers, and firms have less uncertainty about how the anti-trust laws will be enforced, with respect to prospective mergers."

So, clearly, predictability is important in the U.S. guidelines. But they are even equally important in the EU-proposed guidelines. There are a number of articles written that I found on the Internet this morning that talk about one of the reasons they wanted revised guidelines was to obtain the very predictability they believe we have here, with our guidelines.

And it would be a shame -- and here is kind of where I'm going with this -- it would be a shame to change the guidelines. Not to tweak it, John, not to tweak it and say, "Instead of 1,800 it's 2,400," or, "Instead of 100 it's 300," because that really does reflect Agency policy.

But it would be really a shame to change the
guidelines radically so that the new theory is not the unilateral theory, or the close substitute theory, or the coordination theory, as shown in our guidelines, but some theory which sounds so good today, and tomorrow is going to be rejected by the same person who authored it today, because it doesn't make any sense.

So why are we considering radically changing the guidelines -- and people are considering radically changing the guidelines now.

So I think that we don't disagree, John. The present guidelines, in numbers, do not reflect Agency policy. But the present guidelines in concept absolutely reflects Agency policy, as it should, and I have done a million cases already and I haven't seen anyone go beyond the guidelines, except one Justice Department case, which I will have to talk to you about later, Dave.

People sometimes think that transparency is a substitute for predictability, and it isn't. Transparency, that is explaining why a particular case was decided in this way -- for example, Jan got a great case through the cruise line case, and there were, like, five decisions, five statements by each commissioner explaining that. And that's very helpful. Transparency is very helpful.

But transparency does not equate to
predictability. Transparency is: "In this case we deviated from our predictability because of A, B, C, and D." Well, those complications make predictability a joke. There is no predictability any more when you start doing that.

So, despite the fact that it might hurt me in the future -- and might hurt my clients -- I believe predictability should be done. And if some new theory has been proposed that indicates that there is no anti-competitive effect from this merger, and therefore you shouldn't challenge it, I think that theory better have the test of time behind it before agencies decide to use it and allow the deal to go through.

I think it's even more important -- and this is really where I'm coming from -- when the market shares are low, and the HHI under 1,800, every now and then the agencies decide, "Well, we have a new theory, and we're going to test it out on you." And although, generally, that new theory is not tested, $10 million have been spent while they're considering this new theory.

My feeling is dump the new theory. It's not important enough. Predictability is far more important than that new theory. Even though there may be a slight anti-competitive effect from this deal, the greater good is that we can predict in the future that the 99.9
percent of the other deals that fall into that category are not going to be challenged.

I don't want to go too much on this, because I don't want people to come down on me -- but I have a modest proposal that probably everyone is going to disagree with. By the way, you know a modest proposal. Most of you are literary types, and you know that Jonathan Swift's "Modest Proposal" for eliminating the population explosion in England -- or Scotland, maybe -- was for parents to eat their children.

And so, I don't propose quite that. My modest proposal in changing the guidelines, though, is, I think, a good one. But two parts. One part is pretty easy. That is, the guidelines should not be modified unilaterally by either the Department of Justice or the Federal Trade Commission. It should be a joint effort. I think that's great that they have joint guidelines. I think it makes shopping -- although it exists and is useful -- less useful, and that's important. But I think that should be kind of the law of the land.

But my other proposal may be a little radical, and that is I really do believe that the economic theory du jour is only for the day, or it's only for the year, it's only for the decade. It's going to change. And so, why do we have to adopt it? I think it spoils the
So, here is what I suggest to avoid that happening. I think that if there is a new economic theory that should be made as part of the horizontal guidelines -- I am only talking about the horizontal guidelines now; it should be proposed in one administration, and accepted by the next administration. That means the test of time has been met. Maybe we should put it in the guidelines.

The last thing I want to say is that predictability is not something peculiar to antitrust. It's something that is important to law in general. And I will read you just a short quote from Lord Eldon. Lord Eldon was a judge in England, I guess in 1803. And what he said was, in a very similar situation, where people were talking about making sure that things were kind of modified so that it would serve the purpose for that particular case, he said, "It is better that the law should be certain and perhaps wrong, than that every judge should speculate upon improvements in it."

MR. SIBLEY: Okay. Thanks very much. Now, at this point, the panelists should feel free to say whatever they like to. In fact, the audience should, as well. So I will throw it open to everyone.
MS. MCDAVID: Well, as a practitioner, I second what Steve says about predictability. It's very important that the bar and our consulting economists be able to give our clients guidance about the transactions that are likely to succeed and the transactions that are likely to fail, and those that may be worth taking a chance on, because the ultimate gain and the client's objectives in the transaction can be achieved, or may be achieved.

The guidelines, in my view, have always provided a useful framework, as opposed to a box to check as part of one's analytics. And the framework gets elaborated on in things like the statements that the agencies issue, the decided cases, of which there are many too few, and the speeches that the agencies give. It's been known to those of us who do this work for a long time that the statistics and the guidelines in the HHI threshold were not the real thresholds, but we knew roughly where the real thresholds were, even if they weren't written down.

The interesting thing, I think as John pointed out in some of his statistics, is how different they are in some industries. Rick and I had a transaction where they really did apply a 1,600 threshold, much to our surprise.
So, I would second what Steve has said about predictability, and tweaking around the edges, if we're going to tweak.

MR. RULE: I think the lawyers are all going to agree on predictability. In part, because, frankly, it makes our job a little easier when we're advising clients.

I will say -- and I think when Jan and I talk I will say some more about this, but it's always struck me that per se rules, particularly in this area, are important, but they are important as safe harbors, not as determinants of when a transaction gets challenged.

It's important to be able to tell your client, a businessman or woman, "Look, if you're within this range, unless there is some data that we didn't quite get so that the market definition changes, or whatever, you really don't have to worry very much about antitrust. You can go worry about, the various other things that stand in the way of putting a deal together.

It's less important, it's always been my view, that number is not just a safe harbor; it's the line between legality and illegality. Again, I will talk a little bit more why I think an HHI is a bad determinant of whether something is truly anti-competitive.

But my view has been -- and still is -- that
companies may decide that notwithstanding they are outside a safe harbor, that there are reasons that the transaction ought to be blessed, because it doesn't threaten competition. And it's important in those cases for the agencies to apply a fulsome and well-advised and well-informed rule of reason analysis.

So that I agree 100 percent, it's very important to understand the predictability of where the safe harbors are. I would disagree a little bit in saying that when you get beyond that, I don't think predictability of knowing that the deal can't go forward is the right way to go, because a lot of times business people will decide that, "Yes, there are reasons that this deal ought to make sense to the agencies, and we are willing to take the risk that we can persuade them of that."

And I think that the guidelines are good in that sense -- allowing that sort of rule of reason analysis when you get outside the thresholds. And I think it would be a mistake to move away from that.

MR. SIBLEY: John?

MR. KWOKA: Let me take you up on your challenge to be a little more provocative here, David. I hear a round of endorsements of predictability, and there is no quibble with that. The question, of course, is at
what cost do you achieve predictability.

What I haven't really heard expressed here is
what trade-off anyone thinks is an appropriate trade-off
for the virtue of predictability against getting the
story right. And I would offer, as evidence, that there
is an important trade-off there, the following two
observations. One is that a view of what the numerical
thresholds mean has surely changed between the 1968
guidelines and the present. If you want predictability,
take the 1968 guidelines.

The second factor is that there are new
theories, and some of them, like unilateral effects, have
wide acceptance in the economics community. And while
that adds unpredictability to the process, it does -- I
think in principle at least -- substantially improve the
likelihood of getting it right.

Those two factors I think prove that we do make
those choices between the continuum of getting it right
and predictability. And I would simply caution that we
need to think very carefully about the type of errors
being made for the virtue of predictability. I'm not
sure anyone would disagree with that, but I am also not
sure I am hearing people say that.

MS. MCDAVID: Well, I think in a way, David,
that takes us to the question that Rick and I were going
to talk about, because that takes us to the question of what is the role of concentration.

MR. SIBLEY: Well, it does, but I want to torment Steve a little bit here.

MS. MCDAVID: Okay, go right ahead.

MR. NEWBORN: No, not tormented at all. I was kind of hoping no one would put their finger on that particular matter. Of course we're always making that choice between predictability and getting things right.

And you're right, I wasn't thinking of the 1968 guidelines so much for predictability, I was thinking of the practice that, as Justice Stewart said, government always wins. That's the only universality in the 1960s.

But having said that, I guess my point is not that we don't change. My point is that we change only for a very good reason, and the reason I haven't seen an economic theory -- not that I would understand it if I did see it, I might add -- but I haven't seen a consensus behind any economic theory that's greater than that in the guidelines right now. And when we do, I think my modest proposal should be invoked.

MS. MCDAVID: And the data that were put out by the FTC a couple of weeks ago also show that almost as important as concentration levels and increases in concentration levels are the factors like the existence
or non-existence of a complaining customer and the
existence or non-existence of hot documents. And those
may be as outcome-determinative as concentration levels.

My guess is this 1,400 case that you have
pointed out John, in your statistics, had oodles of both.

MR. SIBLEY: Now, that sort of bright line
stand may also run into problems with one of Rick's, you
know, favorite clients. Microsoft and other firms are
what we would call members of network industries, where
the more people that use a product, the more it becomes
useful. In cases like that you would expect market
shares of these successful firms to be extremely high.

And whatever bright line thresholds might be
for the cement industry, they might be unduly
constraining for a network-type industry.

MR. RULE: Right. And that certainly is true.
The one point I was going to make is -- in response to
John's -- it is certainly true that guidelines that
generate false negatives have a cost. The thing that
certainly has never been done -- maybe it's just because
it's impossible to be done -- is some analysis that
suggests that -- let's just take a number -- mergers that
result in HHIs of above 2,000 and an increase of greater
than 50 but less than 200 somehow have generated any
economic harm.
I don't know of any evidence to suggest that is true. And I certainly haven't heard of any evidence that would suggest that if you use the current thresholds, that transactions that aren't brought have generated any economic harm.

Indeed, I am not sure I am aware of an example -- but maybe you can enlighten me -- of a single merger that fell in those areas where an economist has been able to show, going back, that there has been harm.

Now, there had been harm, arguably, from certain transactions that were consummated. But typically, if you go back and look at those, at the time they were consummated for various reasons the Agency let them go, even though the HHIs were greatly exceeded.

So, while I think John is right, I think we always have to be worried about false negatives. I think the cost to the economy of those has never really been established, there has never been a study that says that.

And I think if one moved -- as we will talk about -- moved the thresholds up substantially but maintained that predictability, I think the burden would be on those who wouldn't move it up to prove that the cost to the economy would be great. And I just don't think the evidence is there.

MR. SIBLEY: Let me sort of make a comment, and
then sort of take a poll amongst the panel members here. The comment is I am sure you're right, that there hasn't been a well-done, carefully done economic study that demonstrates that a particular merger, which was allowed to take place, shouldn't have been.

But you know, that's partly because the only way you would get such information is if you had the sort of CID power to get data that you do prior to a merger, except I think the FTC does have some powers in that area that the Justice Department doesn't. But that's got to be part of the reason why such data don't exist. It's not to say people have looked at it, it's just not there.

MR. RULE: Right. But if it was systemic in the sense that the guidelines set thresholds that were too low or too high, and systemically, transactions that were really harming the economy were getting through, you would think that there would be a way to evaluate that and measure that.

And my point is I don't really know of anybody who has successfully posited that. That doesn't mean that there may not be outliers somewhere. But the fact is that if there are a few outliers, or a few bad transactions, or transactions that are sufficiently unique that it causes harm, to me that doesn't say anything except that yes, there is a cost to everything,
there is a cost to predictability.

But if it's only slight, and it's only a few aberrations, then it's not something that we ought to be terribly concerned about.

MR. SIBLEY: Let me ask Steve a bit more about predictability here. Certainly one aspect of predictability are specific numbers, like, say, what a safe harbor would be.

Now, in that sense, the guidelines are extremely predictable. Now, there are lots of other things that we look at all the time with mergers, which are not numerical, but nonetheless you can see them listed as factors that we might take it into our heads to think about.

Would the guidelines become less bright line if following John's suggestion, we thought of four or five things that had to do with firms' strategic behavior to make other firms less competitive, that might conceivably be enhanced by a merger? Is that just sort of too much?

MR. NEWBORN: Well, I was going to say that there were two points I would make, two observations, as someone once said.

One is that, obviously, the more factors you put in there, the less predictable one would think it would be, unless those factors are measurable, and you
could make it even more predictable with more factors. I mean, you could construct something where you have 40 factors and they are all measurable, and you know your deal is going to go through or not.

That's not what you're thinking of. You're thinking of five more variables that one has to think about before you know whether or not the deals go through. I suspect that would make it less predictable, but not significantly less predictable, unless they were broad.

Second thing I think it's important -- and Rick put his finger on it I think, or at least implied it -- is that predictability is most important when we're talking about safe harbors. When I talked about a high predictability for high HHI mergers, that's one thing. And I actually would give ground on that one, because I understand that companies, as long as it's not a hostile deal, can make intelligent decisions as to whether or not they're willing to undergo this process.

However, for low HHI deals, for safe harbor deals, I think the Agency should just cut it off if it's 1,800 or less, or less than 2,200 in the new guidelines, whatever they are, there should be no new theory coming up to implode in the faces of those people who went down this road thinking there was no problem at all.
I think that's very important, and I really think that both the Justice Department in a case I did last summer, the FTC in a case I'm doing right now are both exploring those type of theories, and I think it's just the wrong thing to do, for the reasons we have talked about.

I will give you one more quote, because I love quotes. This is from the european round table, and they were trying to figure out why predictability is important. I just found this now, so I haven't explored it too much -- but they go so far as to say, in light of the new EU guidelines, the stability of the framework within which companies act is decisive for economic growth and development.

So, I think the more predictability we get -- and I want to be more provocative now -- despite the fact that we're pretty sure the economic theory we're working under now in the guidelines is wrong, is what we should be seeking, rather than going further to some ethereal feeling of --

MR. SIBLEY: Okay. We do need to move on to the next topic. Now, in fact -- you have all fulfilled the promise you made to me to talk a lot -- but before we do, I would sort of like to poll you on whether the safe harbor should be raised from 1,800 to, let's say, 2,200.
Starting at this end, Craig, do you have any views on that? I guess, judging from your paper, you can't, actually, but --

MR. NEWMARK: Yes, I would say I don't have enough evidence to know, and I would adopt Steven's point that if I don't, then I should stick with what we have got.

MR. SIBLEY: Okay. Steven?

MR. NEWBORN: Okay, and I am going to deviate from my point, since I don't care what the evidence is. Since the policy of the Agency is clearly to not challenge deals in the 2,200 or under range, let's make it 2,200, and start anew.

MR. SIBLEY: Stop pretending?

MR. NEWBORN: Yes, stop pretending.

MR. SIBLEY: Yes.

MS. MCDAVID: It matters less to me what the exact number is than that we understand what role it's serving so that we can take it into account in our counseling, for the reasons that I am going to explain.

I would probably raise the break-point more to around 1,800.

MR. SIBLEY: Okay. When you talk about clarifying the role, do you mean that you want to distinguish between a bright line in the sense of go or
no go, or bright line in the sense of safe harbor, and
take your chances after that?

MS. MCDAVID: In the sense of where do I expect
that the Agency is going to focus.

MR. SIBLEY: Mm-hmm, okay.

MS. MCDAVID: First screen.

MR. KWOKA: Two comments. One is that I think
that some relaxation of the standard is probably
appropriate. It certainly would reflect Agency action.
Whether that's an iron-clad irrebuttable safe harbor I
think moves into my second point, and that is that we
have continued to discuss this as if only concentration
mattered.

And as I stress, for unilateral effects that
ain't really what's most important.

MR. SIBLEY: Give an example of that. I meant
to ask you about that.

MR. KWOKA: Well, it seems to me that for
unilateral effects, one is concerned about firms with
particular configuration of their products and product
space -- demand substitution is particularly strong. So
the acquisition of one by the other internalizes the
profit loss that otherwise would occur.

That really is a phenomena that focuses
attention on their market shares -- though, admittedly,
even defining markets in that context is a bit dicey.
But one can bite the bullet and perform such aggregations
and calculations.

My point is, however, that the anti-competitive
effect is really much more a function of if you had them,
the elasticities, or if you don't have them, diversion
ratios. If you don't have those, then market shares will
give you some information.

But it doesn't really depend on the broader
level of concentration in the industry, because it does
not presume, does not focus on the prospects of
coordinated behavior amongst a larger number of parties
in the industry. That's not the competitive theory.

And so, you know, in response to Steve's point,
too, the safe harbor for coordinated effects may well
deserve to be higher, but interpreting that as a safe
harbor against all anti-competitive theories of mergers
is really to potentially give some firms a pass when the
concern is really with unilateral effects localized and
measured, to some degree, by their respective market
shares.

MR. SIBLEY: Okay. Rick?
MR. RULE: Let me hold that until I get to my
remarks, and then address that there.

MR. SIBLEY: Okay. Vincent, anything you want
to say at this point?

MR. VEROUDEN: Yes. The same for me, I guess. It's not really for me to say in what direction the U.S. guidelines should go.

MR. SIBLEY: Of course.

MR. VEROUDEN: Well, I could say at this point that actually we have adopted what one could call a safe harbor approach in the EU guidelines with respect to HHI, and the level is 2,000. That's the only thing I would like to say at this moment.

MR. SIBLEY: All right. The next question, some variation of do the agencies place too much or too little reliance on shares and concentration, and the lead-off hitters there will be Jan McDavid and Rick Rule. We will start with Jan.

MS. MCDAVID: My view in merger analysis is that it does no more than set the stage for us. One of my concerns about concentration for years is that it creates a false and artificial sense of precision that doesn't actually exist in a transaction. You start with the fact that it's based on market definition. Market definition is rarely as precise as a lot of lawyers and economists might pretend it would be. There is a lot of movement at the edges. For example, in the Carnival Cruise lines case
that Steve referred to, if the market were defined as
cruise lines, the market shares were very high. If the
market were defined as all vacations, the market shares
were very low.

The Agency defined a market of cruise lines,
and let the transaction go, in part, because they thought
the definition was really pretty squishy and not
particularly accurate. So you start with the fact that
market definition is a scientific thing. Market shares
aren't scientific.

How do you measure them? Are they based on
capacity? Are they based on unit sales? Are they based
on dollar sales? And then the numbers we have are rarely
completely accurate. When you square them, it's no more
accurate than where you started. It's just that you're
doing math. And because it's math, a lot of people think
it really matters.

MR. SIBLEY: Actually, when you square them,
that means the inaccuracies go up.

(Laughter.)

MS. MCDAVID: Yes, that's true. So, in
practice, when I'm doing transactions -- with rare
exceptions, and cruise lines was one where we argued for
a broader market definition, and I think the other
economic data substantiated that -- I rarely define
markets, I rarely present HHI calculations to the agencies. I use them in understanding whether this is a transaction on which the agencies are likely to focus and devote resources, or is it a transaction that's likely to get a pretty easy pass.

There is no bright line that separates those deals, and there is no industry, as the data that have been presented by the FTC and the Justice Department show, where the numbers are absolutely critical. This is a game that we play between the 20-yard lines on either end of the field. And what the concentration statistics give me is the ability to determine whether I am between the 20-yard lines or in the red zone on either side.

There are benchmarks that are useful for the bar to explain to our clients to understand the transactions that deserve further analysis. And the guidelines actually make this point themselves in the introduction, where they say, "Mechanical application may provide misleading answers." And the guidelines should be applied reasonably and flexibly to particular facts and circumstances.

So, the role that I use the guidelines for, and I think the role that the agencies actually use the guidelines for, is to provide a framework for analyzing the transactions on which additional work is desirable.
And then we get to the fun part, and that's all of the other factors that are in the guidelines, which really are the outcome-determinative issues in most instances.

Is entry possible? What are the characteristics of the buyer? What's the nature of the product? Is demand lumpy? Is there a General Dynamics defense that would suggest that market shares of the past are not indicative of ongoing future market conditions? Is one of the firms failing?

Is there some other fun fact about the particular industry that means that the statistics that provide, in my view, an interesting and useful first screen for both the agencies, in terms of where they devote their resources, and the bar and the business community, in terms of the transactions on which they're prepared to devote resources where we can start playing with all of the other factors, which is where the game really gets decided.

MR. SIBLEY: Rick?

MR. RULE: Thank you. When asked to participate in this, and after our little conference call, it seemed to me that we ought to subtitle this -- and I'm even more convinced of that after hearing what's been said so far -- "Lies, Damn Lies, and Statistics."

It is the latter category, the worst and the
least reliable that HHIs fit into. A couple of anecdotes are kind of interesting in terms of understanding the guideline's numbers.

When Baxter set about rewriting the guidelines I was not actually there. I came shortly after they were published, and then wasn't involved in the 1984 revision. But the story was that Baxter initially set out to find the magic number.

He told Tyler Baker, who was the special assistant who was focusing on the guidelines, to go off and figure out a way to incorporate all of the relevant factors and come up with a number that would determine whether or not a merger would pass or fail -- at least that's what I have been told. Of course, Baxter couldn't find the magic number.

One of the innovations, though, that he did come up with was the HHI number, as opposed to four/eight-firm concentration ratios, which were what had been used in the 1968 guidelines. And that was considered a great innovation. People didn't know what it meant, and it seemed like this really great economic statistic named after two guys nobody else knows what they do, except I'm sure the other economists here. And they sort of implemented those.

But ironically, because they thought that was
pretty innovative, and there are a lot of other innovations -- at least since I have been told -- that the thresholds that were used in the 1982 guidelines were, in some ways, designed to sort of mimic the four and eight-firm concentration ratio thresholds in the 1968 guidelines.

So, you know, if you thought that Baxter, as smart as he was, and all the folks around him, and Greg Werden, and everybody else sat around and really came up with a great new idea about where the thresholds ought to be, think again. It was really Don Turner, and God knows how he came up with the 1968 guideline thresholds.

And finally, in the mid to late 1980s, you know, we just sort of took the guidelines. And at that point I think we viewed the thresholds as safe harbors, and then if you got past them, the government would look at all of the factors, the ones that Jan talked about and other things, to try to determine whether or not there was a threat to competition.

But we kept hearing these stories about practitioners who would sit around once a week and have a meeting, and try to come up with the new secret guidelines numbers.

And apparently, the number was fluctuating all over the place, and it always kind of amused us because,
you know, other than sort of getting into the process of understanding what deals we should look at and what we shouldn't look at, and to some extent trying to understand what the dynamics of the market were, we certainly didn't have any secret guidelines that we were operating on the basis of.

With that as background, I would say that there are definitely weaknesses to concentration ratios. I think they have been discussed here. Even theoretically, as John has pointed out, market shares and concentration ratios are proxies for a particular harm. I do think the HHIs are a better number because, to some extent, they reflect unilateral market power -- at least indirectly. But even theoretically, I don't think any economist would say that they are the end-all be-all.

Moreover, as Jan has pointed out, there is a lot of subjectivity in terms of the calculations: market definition; the data, frankly, which is one of my pet peeves in diversion analysis and residual demand analysis, which I think sometimes leads to a number that economists like to think has some concreteness to it, but in fact, I think often is a reflection of poor data.

So, there are data problems, and then you have got the fact, as I said, that the thresholds are arbitrary. And notwithstanding the decision in 1982 to
follow the 1968 guidelines, and notwithstanding that
everybody sort of understood that nobody was
realistically going to bring a merger case that had a
post-merger HHI of 1,001 and an increase of 150, nobody
had the political courage in 1984 or 1992 or thereafter
to raise the thresholds. And I think there is a question
as to whether or not they would do it today.

So, as a practical matter, those are purely
arbitrary numbers. They probably always will be purely
arbitrary numbers, but that's why I go back to the point
that I made with John, that, in having predictability
there is always going to be an element of arbitrariness.
And I think the burden is on those who would say that,
"Gee, the thresholds are wrong, and there is a lot of
harm being done to the economy" to prove that if they
want to change the thresholds.

So, you know, I think that's the situation.
The bottom line is that it's bad to use concentration
numbers to decide whether to block a merger. Again, I
don't think that at least since the mid-1980s, that the
agencies have relied on numbers to block transactions.

I think since, really, around the mid-1980s,
what's really become important is looking at all the
factors and engaging in a pretty fulsome rule of reason
analysis to analyze a deal. I think that as Janet
pointed out, if you look at the FTC numbers, there are factors, principally the two that Jan mentioned, customer complaints and hot documents, which probably play a much more significant role when there is actually a significant investigation. But there are other factors.

Now, having said that, again, as we have discussed, that doesn't mean that the numbers are irrelevant. They are important to predictability and they should be around. That, then, brings me to the question of whether or not there should be an update.

I generally think that there probably ought to be. I mean, there is always a downside to getting into too much changing of guidelines. It's never easy to write guidelines, it's become more complex when you get the FTC involved. But I do think the numbers ought to be updated, and I think the statistics that were published support that.

At the very least, it seems to me that those statistics indicate that the thresholds should be post-merger HHIs of greater than 2,000, and changes in the HHI of greater than 200, because if you take out petroleum mergers and banking mergers, then you will see that less than 2 percent of the challenges came below those ranges.

And frankly, from my perspective, you could probably raise the thresholds to greater than 2,400 and
greater than 300, and again, you would only be cutting
off a little bit more than 10 percent of the transactions
that are challenged.

I think when you look at those numbers, you
really do have to throw out petroleum mergers and banking
mergers. I'm not quite sure what fever afflicted the FTC
in the late 1990s about petroleum mergers, but they acted
way too emotionally, and I don't think based on very
sound evidence in the way they defined certain markets
and the challenges that they brought, particularly in
local petroleum retailing and wholesaling markets.

Jan and I were victimized by that, but I don't
think there really was a very credible theory, and it was
just more or less a concern about changing times.

Banking, as anybody who has been in the
Department knows, is an exception. They basically send a
letter off and indicate they have got a problem. And the
way bank mergers have been analyzed for the last 20 years
is pretty much by rote, using numbers.

Arguably, the Department ought to update its
practice, but the result of that is that, you know,
banking mergers are handled much differently from all
other mergers. And if you take those out, then I think
that the case is extremely compelling, based on the
practice of the agencies, that the thresholds really are
too low and ought to be 2,000 and greater than 200.

And the final point that I would make is -- we haven't discussed it, but it's real relevant to what John talked about -- the merger guidelines have not been updated with respect to non-horizontal merger concerns since 1982.

And if you go back and look at those, even the theories and the sort of analysis on which they're based, you could defend them maybe, but they certainly reflect nothing of the concerns that the agencies have when they have looked at those mergers. And there is literally no guidance provided by the merger guidelines, in terms of non-horizontal merger concerns.

And it's something that the agencies ought to look at, and I think they ought to work on trying to develop thresholds, safe harbors, that practitioners can use to know when a deal is clearly not going to raise a vertical or non-horizontal problem.

MR. SIBLEY: I would like to just comment on the last thing that Rick said about looking at non-horizontal mergers, and this is really quite an interesting area. Over the last roughly five to 10 years, there have been some nice new papers in economics which have looked at that.

And the general theory, the sort of intuition
behind them is that you can imagine the situation where we have two upstream suppliers of an input to a pair of downstream firms. If there is a vertical merger, you can imagine the situation where the remaining un-merged, downstream firm chooses to buy from the upstream division of the new merged firm at an inflated price, instead of buying from the unintegrated upstream firm at a lower price, solely because that reduces the incentives of the merged firm to compete on price very vigorously downstream.

There are lots of very nice intuitions that way. It is not easy, I would say -- speaking as one who spent as much as a half-hour trying -- to come up with ways of sort of making these theories testable. But they certainly are intriguing.

Okay. Any other comments on these remarks?

MR. KWOKA: Let me offer a couple of observations on Rick's very thoughtful comments. One is that there is probably no more sweeping expression of the value of predictability than critical values in concentration ratios.

Because apart from safe harbors, the rest of what, the guidelines have said does not represent statistically observable bright lines in the empirical work and economics.
I think Craig will talk about some of that work, and there are suggestions in the literature -- to which, once upon a time, I contributed a modest amount myself -- that shows that there may be some indication of break points at 35 percent for two-firm ratios, or 50 percent for four-firm ratios, and all of that. Many of us are familiar with those.

But one would not predicate sound economic policy on the belief that those really are hard and fast break-points in behavior. The very point of the guidelines is to enumerate all the other factors that bore those lines. We understand the importance of those other factors.

But there is value, nonetheless, to break-points, or articulating something as simply raising degrees of concern, but not necessarily tipping a merger from one category unambiguously over into another.

Another comment that Rick has made a couple of times now concerns the lack of proof that some mergers that have been allowed to occur may have caused harm.

You know, it's a concern of many of us empirical industrial organization types that there really aren't very many studies of the effects of consummated mergers showing their anti-competitive effect, and there are few. There are not none, but there are few.
There are reasons for that, methodological reasons for that. And I think the methodological reasons are, in the first instance, the explanation rather than the substantive conclusion that there are no such anticompetitive mergers, that have been allowed to occur.

Let me just take a moment and sort of contrast this with a kind of standard exercise in empirical economics, where one looks at the impact of, say, a regime change, a deregulation in an industry, looking at the effects of a merger is really very much different.

You don't have a whole industry, you have an individual firm. The signal to noise ratio in your data is much lower. There are many other contravening factors affecting an individual firm's experience that make it far more difficult to tease out, convincingly, the effects of merger versus all the other influences that occur.

You never have -- or rarely have -- kind of cross-sectional observations. You are forced to deal with time series and all the other myriad influences that affect the productivity, profitability, margins, whatever, of a firm come into play, and that's unlike our standard comparison exercises, looking at the value, say, or effects of deregulation.

But it does mean -- and with this I certainly
would agree -- that there are too few follow-up analyses
of the consequences of consummated mergers for us
reliably to know precisely what to conclude about the
impact of policy decisions not to act.

MS. MCDAVID: But as David pointed out, the
Federal Trade Commission has done a few retrospective
analyses, and I have always found them extremely useful.
And we may have the opportunity to see more as the
records in the cases that they have been litigating
involving closed mergers become available.

The most recent Evanston hospital decision, and
Chicago Bridge and Iron, they may yield information, but
one of the things that I tell all my clients -- because
they will look at a particular transaction that was
allowed to proceed, and they will say, "Well, if they can
do that, why can't we do this" -- is that every merger is
sui generis.

And that's one of my concerns about the
concentration data, is that they blur the things that
make these transactions sui generis.

MR. RULE: John, let me just ask you, and
really make it clear. There have been some attempts -- I
think they have been somewhat feeble -- to look at
transactions that were investigated and were allowed to
go forward. Typically, those have been above the
thresholds. In fact, in all the cases I think they have.

And my point is -- and really goes to Steve's -- the predictability in establishing a safe harbor. And it seems to me that, unless you can show that currently that a great mass of transactions that are operating in the safe harbor are having some sort of systemic adverse effect on the economy, you would have to say that at least the current thresholds are okay. But maybe I'm wrong about that.

But then you go beyond that to look at the data that you have now, and you basically see that the agencies -- notwithstanding that they are looking at deals that are above certain thresholds -- they have decided to almost never challenge anything below 2,000 or an increase of less than 200.

I mean, doesn't that suggest to you, as an economist, that those are then more appropriate safe harbors than what we have now, and that, even though there may be, somewhere down in the bottom, a few adverse deals, that the costs or the benefits of predictability likely outweigh those costs?

MR. KWOKA: I think I would agree with that, Rick, at least in terms of the safe harbors and the likely value of raising them. And I think that most of us here probably agree that safe harbors are particularly
useful for enforcement and for the private bar in
advising clients.

Now, I have no quarrel with that, whatsoever.
I think that your point is well taken. Larry White and I
put together something called the "Antitrust Revolution,"
which is a series of case studies. Some of you may have
seen this, and every edition that comes out, we always
ask our authors of cases that moved from edition to
edition to go back and evaluate the consequences of
actions taken, or some instances actions not taken as,
especially, retrospectives.

These are people familiar with the industry,
familiar with the data sources, probably follow this over
time. And we have very few instances in which people are
in a position to make that evaluation. And these are
skilled, informed observers of these particular
industries. It's just extraordinarily hard to make
meaningful analyses after the fact. And again, it is for
the reasons I have said before.

I think that is one of the challenges. And as
-- rightly points out, the agencies have offered now at
least the information necessary to do some of that. And
I know that David, is fostering that kind of analysis,
both within the agencies and outside. I think that's one
of the great areas of research that would be
MR. NEWBORN: To increase the predictability, which seems to be something that everyone seems to agree with now. That's great. Raising the HHI standard in the guidelines doesn't do anything. It's got to be a hard and fast safe harbor. That increases the predictability.

And as far as John's point that there may be harmful mergers in the under-1,800 category, I think someone made the point that probably if there were, you would have the customer complaints, you would have the hot documents, and you would have the challenges. The fact that you didn't have them indicates that the vast majority aren't problematic -- although I'm sure there are a few that would be.

My point is that if we're going to do anything, in terms of the guidelines, it's got to make the safe harbor a hard and fast safe harbor. I think that would really improve predictability to all of us.

It could be 1,800, it could be 2,200. It doesn't matter.

MR. SIBLEY: Well, I mean, leaving the number aside, hard and fast, to me, suggests that whatever the number is -- are you saying you ought to remove the current wording, which says -- Greg Werden would know
this by heart -- something to the effect that the agencies are unlikely to oppose a merger? Would you like it changed to "will never?"

MR. NEWBORN: Yes, yes, that's exactly what I'm talking about.

MS. MCDAVID: What do you do, Steve, with an industry with, for example, a history of collusion? I would really love to know what the 1,400 case was.

MR. NEWBORN: Well, my feeling about the history of collusion is if you had to collude, then the merger really wasn't particularly relevant; you colluded. And I understand the history of collusion seems to be a big thing.

I really am enforcement-minded, even though I'm not sounding that way today. But I really believe that if you had to collude in order to get a higher price, then it's hard for me to believe that the merger is going to do anything, one way or another. I don't see it. I guess you don't have to collude with one more guy, but you're colluding anyway. So what's the merger have to do with it?

MR. SIBLEY: Well, see if you can push it a little further in what you would like done to the guidelines. So far, with the exception of perhaps wanting a higher threshold and something to be clarified
as a safe harbor, mainly you're saying don't make it
worse by adding more half-baked theories until they're
fully browned, or something like that?

MR. NEWBORN: Yes, I think that's fair.

MR. SIBLEY: Now, you know, currently the
guideline consists of these numbers, whatever they are,
plus a bunch of other stuff you ought to look at. Would
you -- if you were revising the guidelines, would you
take things off the table? You say there are too many
theories, or too many factors right now, proposed as
things we ought to consider.

MR. NEWBORN: If I were rewriting the
guidelines in one administration and it was approved in
the next -- if that's your question -- I think I would
probably make it far simpler than it is, yes.

MR. SIBLEY: Okay, so rough justice but
extremely swift justice.

MR. NEWBORN: Rough justice is the right way to
go.

MR. SIBLEY: Okay.

PARTICIPANT: There is nothing swift about it.

MS. MCDAVID: No.

PARTICIPANT: We don't want it to be swift,
let's not get carried away.

(Laughter.)
MR. NEWBORN: The reason it's not swift is because of all the variables that are written into the guidelines. My problem is that there are people who want to change the guidelines in a radical way that don't make it any more predictable; make it far less predictable.

MR. SIBLEY: Are any of them in the audience, by chance, who would like to speak up and expose him for the troglodyte he seems to be here?

MR. NEWBORN: Thank you.

(No response.)

MR. SIBLEY: Well, if there are, they're not saying. Okay. Anyway, we have been talking glibly about the relationship between enforcement and market shares and stuff, which might suggest that economists have a trove of knowledge that is fairly precise relating concentration to something like prices or costs or profits we might be interested in.

Craig Newmark has written a very readable and enjoyable statement containing more quotes to be refuted than I have ever seen in a single paper in 30 years of being a professional economist.

You know, most of us will sort of start a paper by saying, "So and so said such and such," and then you sort of refute it. Well, that's not good enough for Craig. He has five or six pages of so-and-so’s saying
various things he's going to refute. In any case, Craig, tell us the awful truth.

MR. NEWMARK: Well, I'm torn. After listening to three prominent attorneys say negative things about economics, part of me wants to give a wringing defense of my profession. But unfortunately, at least in one stream of literature, I have to support them and agree with them. But nothing is perfect.

I want to talk about price-concentration studies. John Kwoka has already talked about how we have relatively little direct empirical evidence on the effect of mergers, and I think we could all agree that we would like to have some empirical evidence. Economists have lots of theories, but the theories don't make sharp predictions. So any number of people said, "What the guidelines do is dependent, in part, on empirical evidence, but we don't have direct empirical evidence."

So, what kinds of evidence do we have? Well, there are several types. I'm going to focus on one called price-concentration studies. The idea that if you have a market that's defined locally -- grocery, retailing, most banking products, gasoline retailing -- that you go and you track the concentration levels in various local markets, compare them to their prices, and try to get an idea whether concentration is, in fact,
associated with price.

One of the speakers earlier this morning called it a kind of natural experiment, with concentration varies in different localities, you get an idea of how tightly concentration relates to price.

The vast majority of studies that have been done find a positive relationship. As concentration in the local market increases, it's associated with an increase in price. Those studies are important, therefore, for three reasons. Number one, they are used to justify the structural presumption. Why do we care about concentration? Why do we care about market share? Again, leaving aside theories of which we have many.

The argument is offered that, "Gee, because we have these price-concentration studies, there is something to our standard story about concentration harming welfare, something to our story about large market share possibly harming welfare."

David has recently co-authored a study in which he talked about two kinds of evidence to support the structural presumption. One of the kinds he mentions is price-concentration studies.

Second reason is the antitrust agencies -- at least as far as I'm aware, and based on statements I can read -- use these a lot. Michael Whinston at
Northwestern says, "They're the most commonly used econometric technique in current merger evaluations."

Messrs Baker and Rubinfeld recently wrote that they are the "workhouse empirical methods for antitrust litigation."

So, they seem to be popular, they seem to be used at the investigation stage. We do know that something like a price-concentration study played a role in the Staples case.

In fact, in much of the public statements the FTC made about Staples, an example very much of the price concentration ilk was proffered. You go to Leesburg, Florida, and you go into the office supply store that's there -- there was only one firm that was there, it was Staples -- and they would charge you $4.17 for a box of file folders.

You go 50 miles away, said the FTC, to Orlando, where there are three office supply superstore firms, and it costs you $1.95. QED. In fact, it's reliably reported that that very example played a role in Chairman Pitofsky's support for the case. So, the antitrust agencies use them, at least currently.

Third, I think they have good growth prospects. We have some sectors of -- at least the retail sector -- that are consolidating. Again, grocery retailing,
banking. So there are going to be more mergers proposed. And we have enormous strides being made in gathering this price data. We have enormous amounts of price data the firms are now collecting. They're starting to marry that price data to customer loyalty cards and information.

So it's an enormous sand box in which econometricians and antitrust people could play. I read an article just recently that Wal-Mart now gets sales data from each of its cash registers all over the world every 15 minutes. So there is enormous amounts of data being generated in a context where mergers are more likely. I think price-concentration studies will continue to be important.

Let me preface my criticism by saying many other people have noted weaknesses in these studies. You can find reservations expressed, you can find criticisms expressed. But the point of the 24 quotes that begin my paper is I claim that most of the current criticisms and warnings about these studies are fairly characterized as perfunctory.

They're in the vein that these studies might have problems, and we know that they might have problems, but at the end of the day you have got to decide whether you believe them or not, whether you're going to use them or not. And despite the criticisms that are on the
record, my impression, I think, is that there is a large
number of people who believe that they are useful
evidence. They do tell you something about the
likelihood of increased problems as concentration and
market share rises.

At least one key problem, as I see it, with
these studies is that there are two types of competition
that exist in the economy. And for one type of
competition, the price-concentration studies might be
very reasonable, although I still would have some
problems.

I will call the first type of competition Wal-
Mart competition. Wal-Mart is currently running ads, at
least in my area, where the little cartoon character
comes out and says, "Look out below, prices are falling
again." This is the kind of competition we economists
stress in our early courses. If there is some industry
with a couple of firms making a little extra money, what
happens? Firms coming piling in, competition breaks out,
they drive those prices down and down and down and down
to a minimum average cost, and the operative means of
competition is through price.

But that's a bit of a simplification. It is a
simplification that we make so as not to complicate the
theory and completely bore the freshman. What we really
want to talk about is quality-adjusted price, and then
that leads us to a second form of competition, which I
will label Starbucks competition.

Lots of people can make you a hot cup of
coffee. It's not hard. You have lots of choices. You
can go into Starbucks and you can get a very nice cup of
coffee served by an uncommonly polite young person in a
wonderful ambiance and you can pay $1.85 or more for a
cup of coffee. How can they do that?

The answer would seem to be that something
about the coffee seems to appeal to people. And that's a
very important ubiquitous powerful form of competition.
Competition through quality, amenities, and services.

And if we agree that that's powerful -- and I
could demonstrate that some more, but let me just add two
other pieces of evidence to support that it's important
-- Dennis Mueller, who studied the success of firms over
long periods of time, says that if you find a dominant
firm in the United States, and possibly his evidence
applies elsewhere -- it is not likely to be a firm that
is selling at a lower price.

The first competition, the Wal-Mart
competition, is certainly possible, but Professor Mueller
says that by far, the more likely instance is a dominant
firm is selling at a higher price a branded product that
people think is superior.

The second thing I would throw in for those of you in the Washington area, supermarket chain Wegman's is going to open a grocery store at the end of the month near Dulles. That grocery store will have a cappuccino bar, a sushi bar, a patisserie, offer cooking classes, European bread, and a wood-fired brick oven, among other things.

Now, maybe around Dupont Circle that's a big yawn. But in most parts of the country, that's a heck of a supermarket. Presumably they're going to charge higher prices in that supermarket, and people will find the bundled services and amenities useful.

So, if we accept, for the sake of argument, that this form of competition is important and very intense and very powerful, what problem does that pose for price-concentration studies? It simply poses a problem of interpretation. You can no longer associate the high prices that you might see with high concentration with consumer harm. They might be all paying Starbucks prices and being happy to pay it.

In other words, superior firms compete through non-price competition, they concentrate the industry, and yet we see higher prices. So the positive correlation between concentration and prices -- which I know in the
Wal-Mart story is competitive harm -- is no longer competitive harm if there is non-price competition.

So, the interpretation problem gets very serious. I would add, for those of you who might follow the economics literature on this, we had this problem years back with the profit-concentration literature. There was and is a very tight correlation between profits and concentration, which, once upon a time, was used to justify the structural presumption.

We no longer pay attention to that literature because it has the same interpretation of problem. Superior firms tend to earn higher profits, superior firms tend to concentrate the industry. It's not at all clear what that correlation means for consumer welfare.

If I have enough time, let me just add one more point. Someone will raise the question, "But that's what we have multiple regression analysis for." Isn't it true that you can control for the non-price characteristics? Well, some of us would say that's what you have multiple regression analysis for.

(Laughter.)

MR. NEWMARK: Isn't it true that if I say, "Well, gee, there is a lot of non-price competition in this industry," we can add to the regression model some factors that control for that quality?
And my answer is, "I don't think so." I offer three brief responses to the notion that this can be statistically controlled for.

Response number one: I think it's very difficult to figure out -- at least for an outsider, or even for an insider -- all the various forms of non-price competition. What's going to be important to consumers?

Now, people in the antitrust community says, "We can ask them. We can bring them in, we can interview them, and if we don't know, they surely know." Well, I'm not so sure. And even if they do know, it's going to be hard to measure. Two quick examples.

In grocery retailing, there is an enormous amount of competition on consumer convenience. Grocery retailing chains are spending enormous amounts of money to try and appeal to people who have got expensive time, to try to make it convenient. What's one of the ways they do that?

They do that with store layout. They spend lots of money researching how to lay out the shelves in the store, so as to make it more convenient. It's even important, according to their research, how you arrange the items on particular shelves. And my question is, how you are you going to quantify that? How are you going to quantify, across firms, store layout and stocking on
shelves? Maybe somebody is imaginative and can do it; I think it would be hard.

The second little incident is an example that applies to Staples. Apparently, according to an article in Fortune magazine recently, up until recently the managers of Staples -- the very top managers of Staples -- did not have a very good understanding of their costs. And if I went to them and asked them, I say, "What drives your costs," apparently they weren't going to be able to tell me -- at least completely accurately.

They used to devote a lot of floor space to furniture and computers, and they were very happy with that. They said, "Oh, these things make us high-gross margins." Well, a couple of years back, the vice-president of finance put in a new software program that looked at a variety of factors and their costs, and -- lo and behold -- she discovered -- those file cabinets and those desks and those personal computers really aren't that profitable. By the time you allow for storage and insurance and transportation and damage -- in fact, you probably need more sales help with some of those things -- they actually weren't that attractive. They now devote more space to legal pads and pens.

So, the top management of an otherwise well-run firm did not have a very good handle on the factors that
were driving their costs, which tends to make me question, at least, that if I went to them and interviewed them, and said, "What should I have in this equation," that the answers might -- at least in some cases -- not be accurate.

A second related point is -- at retail, at least -- a lot of products are jointly demanded and jointly supplied. This has been noted in some of the literature, but at least as far as I'm aware, hasn't been resolved.

So, for example, I care something about one of the items in my grocery cart. But what I really care about is the cost of the entire cart, along with the services and amenities that are provided. If I am an airline traveler, I am interested in, for one thing, the number of flights I can get, where they go to, and I care, obviously, about the price I pay on any individual point-to-point trip.

That second dimension, where they fly, how often they fly is important. And how does the airline provide it? They provide it with a hub. I also might want a place where I can drink nicely, so they provide that, too, with a frequent flyer bar.

And the problem that creates is, therefore, if you view any item or any small number of items in
isolation, you don't necessarily pick up the entire 
economic decision-making that the firm and the consumers 
are confirming.

Those drearily provided items that require 
cost, somebody has to pay for them. Somebody has to pay 
the price for the hubs, somebody has to pay the price for 
all the research that goes into laying out the stores 
better. And therefore, any individual item or sets of 
items is going to have trouble reflecting that jointness 
in supply and demand.

But third and last -- and probably the most 
serious problem -- why can't I put these costs and 
quality variables in the equation to control for them, is 
if you do, you once again get an interpretation problem. 
The firms control things, obviously, that affect their 
costs and their quality. If I have those on the right-
hand side of a regression equation, I am implicitly 
measuring a price-cost margin. I am implicitly measuring 
something like profits. That's the problem we had in the 
old literature, that's the problem why we started doing 
price concentration studies.

You have an interpretational problem.

Starbucks coffee, with the cost of their beans, 
the cost of training those nice young workers, even the 
cost of their rents, Starbucks earns a higher margin on
their costs. We come back to the same problem, though.
Why are they earning that higher margin? It's a good
argument it's at least possible that they are earning it
not through any kind of consumer-harming behavior, but
they are earning it because they are competitively
superior. They are offering consumers a better product
that, even at a higher price, is attractive to them and
beneficial to them.

So, this problem of non-price competition,
which is acknowledged, and it has been recognized, but
there is usually a qualification, "Well, if we have got
good econometricians, we get good data, we can control
for that problem," I am very skeptical of.

Therefore, most price-concentration studies
that I am aware of have an interpretation problem. They
don't offer an good evidence that higher concentration or
higher market share is damaging consumers.

I will concede my time. Let me just mention
briefly at the end, Staples is the leading example of
such a case. Staples, there is an extra dimension. In
Staples, you have data over time, as well as across
cities. So the Staples research potentially offers some
gains that is not available to the standard price-
concentration study, but I will simply add that there are
problems with doing it over time, as well.
MR. SIBLEY: Do you want to start off the response?

MR. KWOKA: I think Craig's comments really are quite useful. He has made them elsewhere and previously. And I think they're good reminders to the profession about some things that one needs to be mindful of.

Real question is what should one conclude from this. I said in my opening remarks -- but I have said it a thousand times -- is that there is no such thing as a perfect empirical study. I once told someone that I could deconstruct any empirical study ever written, there is always something that one has not measured perfectly, or has left out, and I think that one could walk through the 100 price concentration studies and find some limitation on every one of them.

The question becomes whether those factors are, on their face, important, or whether what we know of their quantitative importance can account for the effects that we observe.

I notice that when he first enumerated the studies, he mentioned -- groceries, gasoline, and banking, I think, were the three you mentioned, Craig -- my colleague at Northeastern, Steve Morrison, has co-authored a large number of studies of airlines.

Airline studies that they have done typically
have examined quality issues -- scheduling convenience, frequent flyer miles -- and has monetized these through very careful modeling of consumer evaluation of some of these attendant, or corollary companions to the seat.

To the best of my knowledge, they never monetized the frequent flyer bar, but the question you have to ask is is that quantitatively important enough to refute the proposition that they find? Since I recently taught this, I happen to recall that in May of 1990 in the AER they have an article summarizes part of a larger study that shows that using quality-adjusted prices as the variable, that every increase in the number of effective competitors -- say, moving from five to four -- increases price by anywhere from 4 to 12 percent.

And that's typical of the quite careful studies that they have done. Once again, you can find limitations of these, it's an unsustainable burden for those limitations, to negate the collective effects of the most carefully done studies -- not the least carefully done, but the most carefully done studies.

MR. RULE: I definitely enjoyed Craig's remarks. It plays to something of a pet peeve that I have always had, which is I think that, if you go to the agencies, there is a recognition that HHIs, concentration numbers, in and of themselves, are not all together

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But if you have an econometric study of some sort that some economist trots out, there is a tendency -- I think on behalf of the lawyers, because I have always believed that the incentives generally for staff -- I think they want to do the right thing, but all things being equal, they would rather bring a case than not bring a case.

So, if somebody can give them a hard and fast number that makes it look like I can predict this is a problem, they will use it. And there is a tendency, if you are a lawyer, you know, gazing at all this Greek on a page, to say, "God, it must be right, because I can't understand it at all." And so, it lends a sort of degree of certainty that is often hard to refute.

It has created, although this is good for the economic profession -- it's created sort of this cottage industry for always doing studies. And even though you may think that they are dangerous, and it's a bad idea, it's kind of like the old story about a lawyer who is the only lawyer in town going broke, but as soon as another lawyer moves in, they're both fat and happy.

And so, you have got to hire an economist to go out and do your own study so that you can refute why, "Gee, you know, whatever study you're looking at -- DOJ
or FTC -- is really not very reliable."

But I think it is always important for folks to remind themselves that economics is not really completely a science, it's more of an art, and that ultimately, when agencies make decisions, they have to be careful and they have to understand that inevitably there is some subjectivity and inherently some degree of uncertainty, because they're trying to predict the future, which is, in almost any endeavor, a dangerous one.

MR. NEWBORN: I agree with much of what Rick says, but I have got to tell you I disagree with your comment that lawyers look at these studies and they inherently say it must be right.

I have got to tell you I think almost every lawyer I have ever met who has been at the Agency -- and I worked there for 20 years -- looked at these studies with an incredible amount of skepticism. If it helps them, they will use it; if it doesn't help them, they will ignore it. And I don't believe they have a lot of faith in those studies. I believe they believe it can be designed to create any result that is wanted by the outside parties, in which I find myself now. And I believe that internal studies are much more fair. They are trying to be fair. They are not trying to get to a particular answer, they are trying to
get to the right answer.

I don't believe that the staff has much faith
in those internal economic studies, either.

MR. RULE: This is one of the reasons that, if
I had my druthers in most deals, I would never do a
study, because it never helps you, it only hurts you.

MR. NEWBORN: It almost never helps you.

MR. RULE: But you end up often having to do it
because you think it's going to be done internally by the
staff.

MR. NEWBORN: I agree with that 100 percent.

MR. RULE: And the problem is for lawyers -- I
don't mean to suggest that the lawyers are going to buy
whatever the study is, I'm just saying that if there is a
study that they can do internally, and their economists
are willing to swear by, that basically is a
justification for bringing in a case. They will jump on
it pretty quickly.

MR. NEWBORN: I have got to tell you, Rick, the
reasons for bringing a case come down to what the FTC
report said they are. They come down to -- the two most
important things -- they come down to hot documents and
they come down to customer complaints.

If you don't have customer complaints, you are
almost never going to bring that case. If you have hot
documents, you're looking for other ways to bring that case. But you really need the customer complaints. And those industries where you have customers who might be complaining -- other than supermarkets --

MR. RULE: Yes.

MR. NEWBORN: But let me just say -- and you can respond to that in a second -- I want to say I love that kind of talk, I think that stuff is very interesting, and I think it's very useful for all practitioners to know all those things.

But I kind of agree with John, and maybe everybody, that no study can survive a good cross-examination. Just can't do it. It's impossible. There are so many assumptions in the study, and so many other counter-assumptions one could make, whether it's the internal rate of return, or the cost-of-living index, or whatever the heck you're using in that study, there is another one that someone could equally use that's going to change the study in some minor way -- occasionally in some major way.

So, I'm not sure about the studies you're referring to. I still believe in Bain, so what am I doing talking here?

MR. KWOKA: This is where we should ask David to comment on what value the Division -- or some
representative of the FTC may wish to comment on what
value you put on the economic studies you receive.

MR. SIBLEY: Well, let's see. We have had
three complaints filed since I came to the Division. And
in fact, at least our witness for one of those cases is
here in the room; the other may be, for all I know.

One was a coordinated effect story where, there
was some talk about market shares and capacity
constraints, but a lot of it had to do with a hot
document where somebody said to somebody else, "Come on,
let's collude." I'm sure that didn't help the merging
parties.

Another one we had, which we have decided to
put in our "win" column, anyway, we did a lot of sort of
sophisticated analysis, none of which gave us much of
anything.

In the end, I think one reason things came out
the way we kind of like them, was that we had a bunch of
customers saying that they didn't like it for reasons we
could sort of understand, but we never actually modeled
much. And so I think the other side decided it wasn't
going to be officious, government regulators with too
much time on their hands getting in the way of progress,
it was going to be, "My God, are we going to litigate
against our biggest customers?"
Then, in the third case that I'm thinking of, there actually is some econometric stuff. Fortunately, the data is very disaggregated. We know tons, even apart from the econometrics, about what was going on. And I have a lot of confidence in the results there.

I was going to try to smoke Craig out a little bit more, and I will just give myself a minute or two, and then we will go to what the EU has to say.

Suppose that we didn't have any Merger Guidelines, but we did have all this literature that you discussed here, and let's apply the Steve Newborn test, which is you're not going to have anything in the Guidelines which are not fully accepted over at least two administrations by economists, the administrations, and I guess their barbers, or something.

MR. NEWBORN: And you have to eat your children; that's part of my --

MR. SIBLEY: If that's the test, and I were to say to you, "I, David Sibley, am charged with drafting the world's first merger guidelines," and I want the first sentence to be, "All things equal, increases in concentration are likely to lead to bad things, although I don't know where they do that," would that statement pass the Steve Newborn test, based on your understanding of the literature?
MR. NEWMARK: Steve Newborn test, in the sense that that's agreed to?

MR. SIBLEY: That's right, and that it's really solid.

MR. NEWMARK: Agreed to, theoretically. We have lots of theory that says that. But what I am asserting -- at least for the price-concentration literature; we could get into the other forms of empirical evidence -- that the price-concentration literature does not support that statement. It's just a big question mark.

I can't support that statement based on this particular branch of empirical research. There are other forms of empirical research that have been done that antitrust authority people would say supports that statement, too. But I won't comment on those.

But I would say based on my impression of price-concentration studies, they don't offer you any evidence. What you see is higher prices. But we don't know that that is a bad thing. It could be a good thing. It could be Starbucks.

MR. SIBLEY: Okay. All right. And our last formal presentation is Vincent Verouden, who is going to talk to us about the -- shall I say EU guidelines or EC guidelines?
MR. VEROUDEN: Both are fine, I think. We normally say the EU guidelines, yes.

MR. SIBLEY: Now, I have actually met a couple of times with folks from the Commission, and sooner or later the word "modalities," whose definition I am unsure of, gets used. I hope you don't say it.

(Laughter.)

MR. VEROUDEN: I don't think I will.

MR. SIBLEY: Thank you.

MR. VEROUDEN: I have prepared a few slides. I would like to use these final minutes to talk about the use of concentration and the market shares in the EU merger guidelines.

As you may know, actually these guidelines are very recent. We published them about three weeks ago, on the 30th of January, and they are actually part of a wider package. They complement the new EC merger regulation, which was also adopted in January of this year. And actually, both texts will become applicable as of the first of May 2004.

A brief word about the background of this merger regulation, because, in fact, as you will see, the market shares and concentration that are in our guidelines are also linked to what is the new substantive standard in our new merger regulation.
The background of this new package, the new merger regulation, is that there were a couple of issues. There were, on the substantive side, two issues that kind of influenced the debate in Europe as to the merger control test.

As you know -- or as you may know -- this test has always been the so-called dominance test in article two of the merger regulation. And there was some debate as to how this compares to the substantial lessening of competition test that is used in the U.S. Is it the same, or are there differences? The second substantive issue that I will just mention is actually the role of efficiencies in merger analysis.

The existing test is whether a merger creates or strengthens a dominant position as a result of which effective competition would be significantly impeded. Now, and the main question here was, what if a merger involves of two significant companies, and together they will have market power, significant market power, but nonetheless they are not, let's say, dominant in the usual meaning of the word -- for example, being the largest company in the market?

What if you have a concentrated market and the merger results in only the new number two in the market? Can our existing dominance test still capture, if need
be, such cases?

Now, there was some uncertainty as to the scope of this test, and to remove this uncertainty which was out there, it was finally decided by the members of the European Union that a rewording of our merger test was appropriate. And it now reads, actually, that a merger must be prohibited when it would “significantly impeded effective competition, in particular, as a result of the creation of a dominant position."

So this kind of singles out creation or strengthening of a dominant position as a primary form of competitive harm. But perhaps not the only one. So, this is the test with which we had to work, and for which the guidelines have been written.

The guidelines, as I said, complement the change in the test, and set out, of course, the analytical approach that the Commission intends to take in reviewing individual mergers. And the central question is probably familiar to you: Will the merger enhance the level of market power in the market for one or more firms? And increased market power means increased prices or other harm to consumers.

The guidelines make the distinction which is also familiar to you, mainly that between unilateral effects and coordinated effects, those are the two main
ways in which a merger can cause harm to competition, to consumers.

And it is indicated that -- I'm coming now to the test -- unilateral effects may arise, in particular, when the merger leads to a dominant position. This comes a little bit back to the general idea that while -- the larger the companies involved, the higher everything else being equal -- the anti-competitive effects that one could expect to take place in the markets.

We have two sets of indicators in our guidelines, market share indicators and indicators based on HHI. Let's start with the first, the market share indicators.

Historically, since we always had this dominance test, the research question in any merger investigation was often, "Well, will the new entity have a new dominant position post-merger?" And this leads one, naturally, to look at what is their likely market share, for example, what is their likely market position in the future?

And so, a lot of experience has been built and case law has been established on the notion of dominance, and what we have done is to adopt two indications by the court. The first is that when a merger produces a company with more than 50 percent market share post-
merger, then this, in itself, could be evidence of the existence of a dominant market position. And this is something that the European Court of Justice has established in a number of cases. It may also be below this 50 percent if other factors are present, as well.

The second indicator is that when, the merged entity will have a rather small market share, so to speak, a limited market share, then there is unlikely to be any anti-competitive effect. And according to case law, when the combined market share is less than 25 percent, there are unlikely to be problems.

The exception is, however, for coordinated effects, where this 25 percent market share indicator does not apply.

On HHI -- like I said, with our traditional test, which was the dominance test, we have often focused on only the market share of the companies and their combined market share post-merger. We didn't kind of routinely look at HHI levels in our previous cases.

But still, we thought it was useful to have them. And, to get some insight into the levels that were implicitly applied in previous cases, we did a study and we looked at implicit levels in previous cases. And this led us to come up with the following system and levels for the HHI indicators.
That is that the commission is unlikely to identify competition concerns when either the HHI is below 1,000 and in such cases it's not even really necessary to do further analysis.

For intermediate levels of HHI -- that is, between 1,000 and 2,000, and a delta below 250 -- it is equally unlikely to identify competition concerns. And the third range -- that is, the higher HHI levels above 2,000, but where the delta is below 150 -- the merger is also not likely to produce negative effects.

So, this structure, in terms of intervals of HHI and then a delta which goes with it is, of course, familiar to you. It's also in the U.S. guidelines, so we took it as an example.

Where, however, we decided to take a different approach is that the message that we kind of connect to these levels is different. It follows what we could call a soft safe harbor approach. So it distinguishes it a little bit from the hard and fast safe harbor. It's not hard and fast, but it does give a very decent -- hopefully -- indication.

A further difference is the following. When we looked at our previous cases, in trying to find a level below which, let's say, there would be no problems from a competition point of view, it was, of course, very
difficult to really get such a level, which in a clear
and informative way, would separate cases that are
unlikely to give problems from other cases.

But we also found that quite often there were
specific circumstances which meant that actually the HHI,
which was present in that case, was not very informative.
Now, not very informative, of course, that sounds like a
very broad thing. We actually have opted to list the
special circumstances in our guidelines.

It's not necessarily exhaustive, but it's
informative in its own right. And I must say that on
this part, we actually followed the merger guidelines
which also had a similar approach.

Anyway, so we say, "Well, if your HHI levels
are below the levels indicated, then you are fine."
That's basically the message, except when there are
objective or reasonably objective circumstances, and I
have listed all six of them here. Some of them are
actually quite obvious, and I don't think they are giving
rise to much debate, in the sense that -- at least that's
what I think -- if a merger involves a recent or
potential entrant, then, you know, that's a special case.

The same we say may indicate when merging
parties are innovators, for example, with pipeline
products, or when there are significant cost share
holdings between the players in the market.

Then we have two which are related to possible coordinated effect scenarios, so that's indications of past collusion. We thought we could single out that one also as a specific circumstance.

And the final one, actually, has to do with our test -- I mean still the dominance part of our test -- and that is when a party has more than 50 percent market share pre-merger. Well, then, we don't really want to give any indication, in any case, and it's all about looking into the effects of the case themselves.

The idea here is simply to actually single out these cases, and by singling them out, it somehow becomes more feasible to get levels of the HHI below which, generally, the Commission is unlikely to find any problems. And so we thought this is informative in its own right, and it proves a little bit, hopefully, the predictability.

Of course, it is not certain it will match the Newborn test and so on, but we think it's an informative approach, and one that is hopefully proving valuable in the coming years.

One final remark, I think, on the levels themselves. You know, you can always ask yourself, or you can always say there are cases that are above the
levels, which obviously don't create problems. So why
don't you further increase the levels? Or why don't you
increase the levels, let's put it like that.

And here, I think we should say that it doesn't
really matter that there are many cases above the
thresholds that are giving rise to problems. What does
matter, really, is whether by increasing the levels you
kind of start missing cases that actually do give rise to
concerns. So this is the consideration that we have made
in putting the levels at the -- at where they are now.

Okay, thank you.

MR. SIBLEY: Getting close to the end. Any
quick comments or questions on --

MS. MCDAVID: I am reminded by these fine
slides about one of the issues that we really didn't talk
about, which is the issue of innovation, and what market
share and concentration statistics may tell us about
competition to innovate and its importance in all of
this.

And it's not something we can cover in four
minutes, but it certainly is an interesting and important
issue, and one that the FTC grappled with recently in the
opinion that Chairman Muris wrote back in January.

MR. SIBLEY: Well, actually, the two other
economists here are much more empirically oriented than I
am, but in my dim memory is that people who have tried to
relate concentration, however defined, to innovation
haven't had much luck. Is that correct?

MR. KWOKA: Not much luck. I think that's
right. If you're not happy with the relationship between
concentration and price, you're definitely not going to
like the one between --

(Laughter.)

MR. NEWBORN: Well, there is another panel
tomorrow on them, so we can defer to them.

MS. MCDAVID: That's right.

MR. SIBLEY: Any other questions for Vincent?
(No response.)

MR. SIBLEY: Okay. Now, you will notice Greg
Werden is here. Greg being in the audience is generally
a reliable signal that someone is going to be corrected.

(Laughter.)

MR. SIBLEY: And in fact, today's lucky winner
is Rick Rule. So, Greg, what did Rick do wrong?

MR. WERDEN: Well, he should have known better
than to talk about history he didn't live through.

MR. RULE: That's right. I learned it all from
you.

MR. WERDEN: Not from me.

MR. SIBLEY: This is what you call a coup, by
the way.

(Laughter.)

MS. WERDEN: Turner's guidelines, which took three years to write, were meant to pull back significantly from where the case law was going. And clearly did, in relation to Pabst and Von’s, and cases like that, for which Turner was roundly criticized, mostly from within. And interesting for the discussion today, he was criticized even more for creating predictability in enforcement.

Staff hated that. They loved the effect of random merger enforcement. They loved the in terrorem effect.

(Laughter.)

MR. WERDEN: 1982 -- Baxter came to the division on March 1st of 1981, already knowing that a 1,000 HHI was the magic number, and basing that, it seems mostly on the kind of studies criticized here, or an earlier generation of those studies, but it wasn't entirely clear.

The rest of the numbers in the guidelines he kind of made up as he went along. 1,600 was the higher-up number he had in mind, originally, but that got changed to 1,800 because there was 1,600 in one section of the guidelines and 2,000 in another section, and the
FTC came up with the brilliant remark that we should split the difference, and we did. You can't say we didn't take any of their comments.

(Laughter.)

MR. WERDEN: The 1982 guidelines were meant to be a pull-back from the 1968 guidelines. There very much was a significant difference. There was an effort to compare how the HHI numbers matched up with four-firm concentration ratio numbers, and they showed that, assuming that we really enforce at the levels of the 1982 guidelines, and we had really enforced at the levels of the 1968 guidelines, that enforcement was becoming less strict, because that was the thinking of the day, that enforcement was a little too strict.

But on the other hand, in 1982, 1983, and 1984, we enforced at the levels of the guidelines. And as you do know from firsthand experience, that changed during the second Reagan administration quite a bit, and that's where we started to depart, in some people's estimation, from what the guidelines say.

But that, in fact, isn't true, because the guidelines were revised in 1984 to slightly change the wording associated with the numbers in a very crucial way. It only says these numbers mean something unless we decide that they don't. It says, "Unless all of the
other factors listed in the rest of the guidelines lead to the conclusion that the merger really isn't the problem." Well, oftentimes that happens.

So, I think that's enough of a history lesson.

MR. RULE: I distinctly recall there was an analysis, somebody wrote a paper that compared the 1968 guidelines to the 1982. And I don't think there was much of a difference.

MR. WERDEN: There are several. Not a huge difference, but a difference and a difference that was on purpose.

MR. RULE: But not very significant.

MR. WERDEN: Not huge. History is very inaccurately misrepresenting where Baxter was, vis a vis where Shenefield was. They weren't dramatically far apart on merger enforcement. The guidelines weren't dramatically far apart on merger enforcement. The second Reagan administration versus the first Reagan administration, that was huge.

MR. SIBLEY: All right. In the zero seconds left, any questions? I'm sure most of these folks wouldn't mind sticking around for a couple of minutes more. Go ahead, Alden.

MR. ABBOTT: David, I just wanted to make sure the announcement got out that all the materials from the
candidates will be posted on the FTC's website as soon as
they're available to us from the authors, and presumably
on DOJ's website, as well.

MR. SIBLEY: Okay. Anything else? Yes, Eric?

MR. GRANNON: What are your concerns about
consumer welfare?

MR. SIBLEY: Well, it sort of depends on what
your priorities are. I guess I will have to be Steve
Newborn for a while. He would say that, you know, that
taking a swift justice is better than rough justice
approach. Consumers are probably well served, because at
least efficiency-enhancing mergers will know where they
stand, and they won't be held up in deals ruined because
of the time it takes to investigate and litigate things.
I would say something like that.

Admittedly, he wasn't real clear about that.

Rick, you're sort of a bright-lines person.

MR. RULE: One of the interesting things about,
for example, the Trinko case is the notion of, type one
and type two errors and that sort of thing.

And my sense is that, in order to catch an
occasional almost random event that potentially threatens
consumer harm, you have to invest a lot in resources in
terms of lawyer time and uncertainty about deals, and
certain deals not going through at the margin.
Then you would say that overall, the impact on consumer welfare of having safe harbors that allow most of what are not going to be problematic deals to go forward, even though you have a few false negatives, is worth it at the end. And I have always felt that, in terms of particularly looking at guidelines, it's important to build in the sort of cost of enforcement in deciding what are appropriate rules.

And I think, to some extent, at least subconsciously, that's what we were doing in the 1980s. But again, I think that is more relevant when you're talking about creating safe harbors, as opposed to trying to come up with a precise number that divides legality from illegality.

MR. SIBLEY: Well, let me just close with a speculation here. Actually, this bright line debate is really quite interesting. One of the potential downsides of being transparent and having bright lines is that the easier it is for that process to be manipulated.

It is possible -- I don't know how likely -- that what Greg called the in terrorem policy, which is, "We're kind of random, you never know, we might just say no because we feel like it, or might say yes because it's that kind of day," or whatever, may be in a sort of kind of random but possibly horrifying regime like that, the
only mergers that would get through are ones that are so 
transparently wonderful and good that they can survive 
all that stuff, and there is certainly no manipulation. 

Now, I haven't thought through how a 
transparent process of the sort Rick's probably thinking 
about could be manipulated in public harm, but I wouldn't 
rule it out.

MR. RULE: Well, the one thing I will say is 
that, you know, Greg is absolutely right, because I was 
there for the 1984 guidelines, and those words that came 
back to be important in, you know, 1985 to 1989 were 
hard-fought words that myself and Deb Garza, principally, 
persuaded the AAG to agree to.

But the problem was, the staff didn't like it. 
It's not so much, I don't think, the in ter ro rem effect, 
what they always would say is, "Look, we have got to go 
into court, and we don't want these words coming back to 
haunt us, and we want an out if we decide there is a 
problem."

MR. SIBLEY: I have heard it already.

MR. RULE: Yes, and it's very hard to get 
around that. And essentially, the reason that you have 
to do it is you have to say, "Look, we're trying to give 
people guidance," and you have got to make that trade-
off. And to some extent we're tying our hands, but it's
worthwhile because we're supposed to be doing the public
good. But it's not easy to convince staffs of that.

Mr. Sibley: Okay. One more question, I guess.

Mr. Stargard: Maybe I missed the point here,
but if we separate the U.S. side and the EU side, Mr.
Verouden, your very last comments seem to indicate that
at the EU commission you are worried about false
negatives. That was basically your very last sentence.
"We don't want false negatives."

And on the U.S. American side, I hear, "Oh,
we're worried about false positives. We don't want to
over-enforce it, we want to keep things going." Is there
a huge divider here or am I misinterpreting?

(No response.)

Mr. Rule: The one observation I will make, and
then Vincent should speak to it -- I think the difference
is, with all due respect and humility, the United States
has had a lot longer experience with our guidelines. I
mean, their guidelines, after all, won't go into effect
for a couple of months.

And I think if you look at the data that the
agencies have provided, given the small number of
transactions, for example, that are challenged even
within a certain range, like 1,800 to 2,000, and that
sort of thing suggest that, you know, to me, why they are
as low as they are. Because there is a cost to all those investigations, there is a cost to people, in terms of uncertainty.

So, moving it up suggests to me you're not going to miss very many. So the number of false positives would be small. I can say that with some degree of confidence because of what those numbers look like to me.

For the Commission, this is sort of new ground, I mean, in a lot of ways it's new ground, because it's not just a new set of guidelines, it's a new kind of theory and approach. And based on that, it's understandable that they would be somewhat cautious and worried that, "Gee, maybe we set the number wrong," both on the downside and the upside.

And so, I think what Vincent is saying is he's right. Wherever you set that line, particularly if it's a safe harbor, it means that there are going to be deals above the line that get through.

But you know, that doesn't mean that you ought to raise the line -- I think he's right -- because, to some point, when you raise the line too far, you are getting too many false negatives as compared to false positives, and that's kind of a trick of figuring out where that line is.
MS. MCDAVID: Well, and you have to come back to the fact that this is not where the decision will actually be made, based on these kinds of numbers and statistics. In the end, it will be a much more rigorous and granular analysis than HHIs would suggest.

MR. VEROUDEN: Yes, and in any event I would say that our message is only that below certain levels there are unlikely to be problems. We don't say that, by contrast, if you're above the levels there are likely to be problems.

So, in fact, the only kind of mistakes we have to worry about are the false negatives. We don't have these false positives. So that is a difference between the EU and U.S. guidelines, which is simply related with the choice of having a safe harbor approach versus the bright line approach, which is currently still in the U.S. guidelines.

MR. RULE: I dare say, though, you will probably still make some false positives along the way.

(Laughter.)

MR. SIBLEY: All right. Well, thank you very much.

(Applause.)
MR. HEYER: Okay, so we're ready to begin.

Thank you for attending what I think will be a very interesting session.

One interesting thing to me about having a separate panel on monopsony and mergers is that a number of economists have the view that there really isn't very much difference between monopsony and monopoly. They are the two sides of the transaction, every transaction has a buyer and a seller, and it's the same basic framework that you'd use.

Why special attention to monopsony? Well, there has been a great deal of attention to monopsony, per se, particularly in the agricultural and health care. Two of our panelists are particularly prominent in looking at the agricultural sector.

And there has been discussion of whether the antitrust agencies should be paying more attention than they currently do to mergers that might create greater power on the buying side, rather than just the selling side.

And whether or not one thinks that a different framework needs to be applied to monopsony, it does seem as though there are some interesting questions that are worth considering, and our panelists are going to get
into some of them. And if they don't, I will ask, or you can ask, hopefully, after their presentations.

For example, it does seem to a casual empiricist that a great deal more cases get brought and serious investigations get conducted that involve market power on the selling side relative to on the buying side.

And so, whatever one thinks about whether the same framework is appropriate or not, it does seem an interesting question that a good deal more attention by the agencies seems to have taken place, at least in terms of filed matters, in the monopolization rather than monopsonization area. So we will hear a little bit about that, hopefully.

And there are issues that have come up having to do with vertical integration, particularly in the agricultural area. Economists often think that vertical integration among suppliers of complements is a presumptively good thing. There are certain well-known efficiency properties, reducing double-margins, things of that sort, and yet there continues to be concern, perhaps rightly, over some things that have been going on in the agricultural sphere, and a couple of our panelists will talk about that, as well.

We're lucky to have three very fine panelists here. Let me briefly introduce them before turning the
floor over to them. Bob Taylor is the ALFA Eminent Scholar in Agriculture and Public Policy at the College of Agriculture at Auburn University. He previously held positions teaching at Montana State University, at Texas A&M, and at the University of Illinois.

And among his professional activities, he is on the executive board of the American Agricultural Economics Association. He has authored or co-authored five books, and has literally dozens of refereed journal articles. He is going to be talking a bit about some of the issues that have come up in the agricultural area, in particular, and I found his remarks very interesting.

Peter Carstensen, I think I first came across Peter's name when reading about the testimony he recently gave before Congress on some competition issues involved in the agricultural area. He is the Young-Bascomb professor of law at the University of Wisconsin Law School. He did his undergraduate work at the University of Wisconsin, has a law degree and a master's degree in economics from Yale.

I did not know this, but from 1968 to 1973 he was a trial attorney at the Antitrust Division of the Department of Justice -- prior to even I getting there -- and has been a member of the faculty of the University of Wisconsin Law School since 1973. His research activities
have focused on antitrust and competition law.

He has served as a consultant or expert witness in a number of antitrust proceedings, is currently the chair of a drafting committee for a proposed ABA antitrust section monograph on statutory exemptions from antitrust law, and is a member of that section's newly established task force on antitrust exemptions and immunities.

Finally, Marius Schwartz, currently a professor of economics at Georgetown, where he has taught since 1983. Marius earned his Ph.D. from UCLA, and before that, was at the London School of Economics. He specializes in industrial organization, competition, and regulation.

From September 1998 to April 2000, he served at the Antitrust Division of the United States Department of Justice as the Economics Director of Enforcement and for six months was the Acting Deputy Assistant Attorney General for Economics.

During this period, he oversaw the DOJ's economic analysis of numerous matters, including in particular, the challenges to the Aetna Prudential and Cargill Continental mergers that raised the sorts of buyer power concerns we will be discussing today.

Prior to that, he was a senior economist at the
Council of Economic Advisors, and he has written widely about issues involving, among other things, vertical integration.

I think we have arranged to have Bob speak first. And so, let me turn things over to him.

MR. TAYLOR: Monopsony has been a problem throughout much of the history of agriculture. Sometimes it's severe, and sometimes it isn't. I am going to start with some very general comments about the food system. It's getting to be a global food system.

I suspect that very few of you really have an agricultural background. And these days, when you ask kids where food comes from, they say, "The grocery store," so I take every opportunity to talk a little more about the evolving food system and some concerns I have with it.

The last five or 10 years there has been massive consolidation -- horizontally and vertical -- in the global food system. It's unprecedented in the history of agriculture and the history of man. Most of my comments will pertain to the livestock and poultry industries.

There are monopsony concerns with other commodities, but there is a lot of blood on the floor in the livestock industry, going back to the late 1800s,
when the meat packers -- terminology: packers slaughter
and process beef and pork -- the packers had written
agreements to collude. In 1920, they were broken up.
Before they were broken up, the 5-firm concentration
ratio was 40 percent.

In 1921, we had the Packers and Stockyard Act,
which goes further than antitrust law, and prohibits
unfair, deceptive, discriminatory preferential and anti-
competitive practices. The FTC was involved then, and
again in the 1940s. Since the 1982 merger standards have
come out, the C-4 has gone from 35 percent to 85 percent.

There are many faces of power. There is
nothing new or unique about these. One is from sheer
size, which HHI and CR ratios attempt to estimate. Size
can influence market prices, or in a vertically
integrated system, contract terms, and gives firms
economic power to control or influence legislation.

Size is a problem in some agricultural markets,
but in recent years it's the economic power of ag
business to control or influence legislation that is of
concern to farmers. We have legislation permitting
agricultural cooperatives, which were intended for
farmers to get together horizontally to counter the power
of giant corporations. It really hasn't worked out,
partly because farmers and ranchers are so incredibly
In recent years, the giant agricultural cooperatives turned themselves into vertical supply chains, and were not very successful. In addition, they have been co-opted by private corporations cutting deals with the agricultural cooperatives.

In the poultry industry that I will talk a little bit more about, attempts by contract growers to form associations have been quickly killed, because the organizers have been instantly put out of business by the integrators.

Asymmetric information favoring giant ag business firms over farmers and ranchers, price discrimination, preferential deals, barriers to entry -- because agriculture is vertically and horizontally concentrated, you can't look at a barrier just at one level, you've got to look at it in a vertical chain, and with preferential deals, a firm can control entry or exit.

Also, increasing control of innovation, elements of a threat system, Agency capture -- not Justice or FTC, but possibly others.

(Laughter.)

MR. TAYLOR: Agriculture associations, some of them have been captured by large agribusiness firms.
Possibly land grant capture. This is a way-
oversimplified diagram of the structure of the food
system, starting with agricultural inputs at the bottom,
then farm and ranch production, and coming all the way up
to the food consumer.

But between the farm and ranch gate and the
final consumer, the grocery store, there has been massive
consolidation and integration and a lot of firms have
deals with each other. So it's more of a spider web than
it is any clean delineation, as this diagram suggests.

It's just a general statement. There is
probably an evolving balance of power between ag
processing and food retailing. And I look at things more
in terms of a balance of power than just a number of
firms.

The growing imbalance of power between food
retailing and the food consumer, big imbalance of power
between ag processing and farm and ranch production.
That's where monopsony power comes in. We have also had
tremendous consolidation of agriculture input suppliers
-- seed and chemical companies -- so farmers and ranchers
feel that they're really squeezed from both sides with
monopoly power for ag inputs and with monopsony power in
the markets where they sell their commodities.

I will talk briefly about the poultry industry,
and then I will talk about the cattle industry. They are totally different. And the manifestation of monopoly power differs considerably from one industry to another.

All production is under contract, the industry vertically integrated in the 1950s in a matter of a couple of years. The integrator owns the birds and the feed, and they make essentially all of the decisions about the breed, when the chicks are placed. They mandate equipment. The pay system is called a tournament by economists, but when you really dig into it, it's more of a lottery. And it can be a rigged lottery at the whim of the integrator.

There have been many efforts for legislating contract reform at the state and the federal level, and essentially all of those have been killed.

You become a contract poultry producer by invitation only, which to me is a restriction on economic freedom. Started out the contract producers and the integrators looked out after each other. It was kind of a family deal. But it has evolved to where the contract grower has been squeezed more and more, and down to a poverty level of pay, even though they and their bankers bring over half of the capital to the industry.

The integrator specifies contract terms. There is absolutely no negotiation. The grower is forced to
accept whatever contract terms the integrator offers, and they change that when they see fit. And there are very few opportunities for a grower to change to another integrator because of the pay system. And the fact that an integrator doesn't have to deliver chicks, means that the growers can instantly be made bankrupt.

Economists, as I mentioned, talk about it as a tournament pay system, but it has aspects of a feudal system. And some describe contract poultry production, or contract poultry producers, as serfs. But serfs with a mortgage.

In the cattle market, the -- I'm talking about the slaughter cattle, fed cattle -- in the last 15 years they have partially integrated vertically. And in my opinion, they will never fully integrate, for good reason. They have partially integrated with what's become known as captive supplies. Part of these are owned and part contracted.

Throughout economics, antitrust economics, industrial organization, we talked about buyers and sellers, and a buyer is a distinct entity from a seller. And in a sense, there is a fence between the buyers and the sellers.

In this market, the packer can be both buyer and seller at the same time, because of the contract and
supplies. And this makes analysis very, very difficult, because they go back and forth. And it's not just one market, you've got beef packers that have captive supplies that they own or control.

They are also out there in the cash market, generally buying but they may decide to sell some cattle. But they are also over in the futures market as both buyers and sellers. And there is a lot of room there for mischief, and for big meat packers to exert power and influence prices.

The captive supplies are running about 50 percent, about 5 percent through direct ownership, 5 percent forward contracts tied to the futures market, and then marketing agreements tied to a cash market price, which dominate captive supplies.

These captive supplies vary considerably from week to week. It's also international captive supplies. We're really in a world market. And if you look at CR-3 ratios for the major trade, the actual flow of agricultural commodities throughout the world, the CR-3 ratios are going to be very, very high, and much higher than CR-3, 4, or 5 ratios just based on domestic production. We don't know much about international captive supplies.

This has an effect on incentives. Marketing
agreements account for most of the captive supplies. The
base price on a typical marketing agreement is tied to
the cash price in which the packer is an active
participant, primarily as a buyer but every once in a
while as a seller.

This gives the packer a multiplier incentive to
manipulate the market and all of the three major packers
have extensive captive supplies like this. If you have
one pen of cattle that you own, and you can go out and
buy another pen of cattle on the cash market -- it's
basically a weekly market -- and you, the packer, expect
price to be going down that week, whose cattle are you
going to slaughter? You are going to slaughter what you
own and wait for price to go down, so you wait to enter
the cash market and it affects price.

Sweetheart deals for the chosen ones, the
chosen packers. Supply response, cash price goes down,
also allows them to control entry and exit. And it's not
really any one of these factors I have mentioned, but all
of them taken together can result in a significant and
more than additive effect on a cash market, and it makes
analysis very difficult.

Before I go to this, eight years ago cattlemen
filed suit against Iowa beef packers alleging
manipulation of the cash market with captive supplies.
Similar suits have been filed against the two other beef packers: ConAgra, now owned largely by Swift, and Excel, owned by Cargill.

The case went on trial January 12th, in federal court in Montgomery, Alabama. Plaintiffs took three weeks to present their case. Defense took one week to present their case. It was given to the jury a week ago right about now, and at 12:31 today the jury found Tyson IBP -- Tyson bought IBP -- guilty of manipulating the cash market price.

Article in today's New York Times about it, "The Cattle Showdown in Alabama," says some time next week the jury will decide -- they didn't. They did today. And if you're interested, I have the questions the judge gave the jury. There are five questions they had to answer. All 12 jurors had to answer yes on all five questions to find Tyson guilty.

Now, I am an economist, not an attorney, but to me, these go far beyond the test of the Packers and Stockyard Act. Really tight requirement, and we will see how that goes out.

Now, for this workshop, I was asked to look at, you know, was there any reason for treating monopsony different from monopoly, and no, I don't have any philosophical or theoretical or conceptual reason to
think we should treat monopsony any different than we treat monopoly, but the characteristics of buyer power may differ considerably from seller power -- the characteristics or manifestation, however you want to use it -- and may differ considerably from industry to industry, even beef compared to poultry.

The issues, the characteristics, the way in which power can be exerted varies considerably. And I think the growing economic power is something that needs to be looked at.

I know this probably goes beyond the authority of Justice and the Federal Trade Commission, but it's clear that in the last few years, when farmers and ranchers have tried to get state or federal legislation to balance out power, that it has not happened, probably because of the economic and political power of the giant ag business.

I would say the five percent rule can be a problem on the monopsony side because in some industries like farming and ranching, the margins are really, really thin. And without buyer power being exerted, they may be making a small profit. But five percent would take them from a small profit to a huge loss. And so that is a problem.

CR-4 and HHI indices are not very predictive,
in my opinion, as you go from one agricultural commodity or one market to another.

And another issue in agricultural markets -- in the poultry industry, and even with the captive supplies in the beef and pork industry -- is that the buyer can dictate not only price but quantity and force producers, the sellers, into an all or nothing decision, and offer them just enough that they will elect to stay in business rather than go out, and with preferential treatment may not offer enough and force some out.

But with quantity and price being dictated by a monopolist, it can be shown that from a social standpoint, the outcome is efficient, unlike the textbook monopsony, which just looks at price. So it can be efficient.

Then the problem is one of fairness, not efficiency. And that's what farmers and ranchers worldwide -- the independent ones -- have been alleging for some time, that this is not fair. It's not so much the efficiency side. Thank you.

(Appause.)

MR. HEYER: Peter is going to talk next.

Similar issues, broader prospective?

MR. CARSTENSEN: We hope a little broader perspective. We will see. It certainly is an honor to

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be included in these discussions, and a special privilege
to be in a panel with these distinguished scholars.

As was mentioned, about 30 years ago I left the
Antitrust Division Evaluation section to go and become an
academic. On my way out the door, I said, "Hey, guys,
ever need any help with any new and novel theories, give
me a ring." I guess my number has finally come up after
30 years.

(Laughter.)

MR. CARSTENSEN: Well, just be patient, be
patient. My interest in the problems of monopsony and
buyer power comes from my interest in agricultural issues
and the problems that farmers and ranchers faced in
marketing their products, but I have come to see it in a
broader context where I think the issues lurk in a number
of other situations, even though we have not readily
identified those.

And certainly in the ag area, and I think in
other areas, many, or at least some of the problems can
only be addressed through reform of the legal structure
that constitutes and governs the markets in which these
transactions take place.

As Bob's reference to the Packers and
Stockyards Act indicates, there is a set of other
statutes in agriculture that really need some serious re-
Bob didn't put the dollar number on what the jury found, but it's a $1.28 billion verdict that single damage award. I would say the instructions the court gave were Section 2 monopoly instructions, and the questions that were asked were Section 2 questions. So what the heck? I think conform the pleadings to the proof -- and throw in a reasonable attorney's fee.

(Laughter.)

MR. CARSTENSEN: But I've always been a little bit of a bomb thrower, and those are Alabama juries, after all.

Well, I think one of the problems we had, and one I want to kind of focus on a little bit is that anti-trust law lacks at present a kind of robust and fully developed set of economic criteria for determining likely competitive harms that come from increased buyer power.

We do have underground observations that are suggestive of the kinds of concerns that ought to be considered. Moreover -- and this is important -- we have commitment both from the previous administration and the present one that they will look seriously at buyer power issues and how to respond to those.

What I want to do in the next few minutes is to present some of the ways that I think buyer power issues
are different from the general seller side kinds of
evaluations, and therefore, to illustrate and to argue
for my kind of proposition, we need metrics that measure
both power and effects grounded in the economic realities
of the buying side of the market, and some of the points
that Bob has just made, in terms of both of the markets
that he has talked about.

So, for me, the metaphor that we often hear
that monopsony is a mirror image of monopoly stands in
the way of critical thinking about, and thoughtful
evaluation of, transactions where there should be a focus
on the buying side and the public policies that ought to
apply.

Now, this doesn't mean we walk away from our
standard kinds of concerns with exploitation and
exclusion. Those occur on both the buying and the
selling side. Most of the effects that are prominent on
the buying side also can be found with analogs on the
selling side of the market, so it's not like a whole new
vocabulary.

The analysis of buyer power requires many of
the same tools and economic sensitivity to coercion, to
exploitation, to efficiency that affect merger analysis.
But the particulars of the effects to be measured, what
are the likely effects, the more specific typology of
those effects, the kinds of market shares that ought to trigger concerns are the one that, I think, need to be turned to fit the buying side of the market. And that's really where I want to turn.

Now, I should also acknowledge, as Assistant Attorney General Pate did in October, when we were testifying before the Senate Judiciary Committee, we need a lot more work. We need a lot more serious scholarship, serious research in this area.

Turning to, I think, five points that I would make generally, and then turn a little bit more specifically to kinds of Guideline-type statements that I would make, with all due deference to the panel last time, that didn't want any changes made in the Guidelines.

First thing is to think about the incentives, the opportunities, and the barriers to exploiting buyer power. And here, I would point particularly to things like auction theory, where what we're told repeatedly is that better collusion on the buying side in auction-type situations is a substantial risk because of the strong incentives to participate in such conspiracies, to exploit sellers, and potential bidders do not have -- that is, potential entrants into bidding -- do not have the same capacity to disrupt these kinds of cartels that
occurs on the selling side of the market.

And here, this central thing is because this is collusion about the price that will be paid, rather than the price that you're going to be charging to sell your products. And I think that's a fundamental point to think about, in terms of how these markets -- these market situations -- differ when you're looking as a seller at a powerful buyer, as opposed to buyers -- in terms of the other way around.

That is, the buyer wishing to compete on the buying side of the market has to raise the price to the seller. This raises the buyer's cost of doing business, it makes its downstream products more costly.

Now, that means all buyers are going to have a shared interest in keeping the cost of their inputs down, cheating -- which, in this case, involves raising the price you pay for your input -- does not immediately increase either your sales volume or your profits. If anything, it's going to put a squeeze on your profit margin as well, because if you buy more you sell more, and now there is more pressure on the other side.

So, there are some implications from that. First of all, with respect to coordinated effects, it means that it's going to be easier to coordinate larger groups of competitors because cheating is more costly and
difficult, and because there is more of a shared
incentive to engage in this activity.

Secondly, and something that Bob was just
illustrating for you, even in the absence of tacit
collusion, any buyer with any oligopsonistic, or
monopsonistic power is going to have an incentive to try
to push input prices down, to try to increase the spread
between its input and its output market.

So, what that means, again, is that there are
all kinds of incentives. And again, we said some of
those are illustrated in terms of incentives to
manipulate. Whenever you're a volume buyer -- in beef,
for example, where there are some markets out there in
which modest quantities of goods are being transacted
which become the marker for all kinds of other goods --
I'm going to use that to set the price on your captive
supply, my incentives to manipulate, especially as I am
buying larger and larger quantities, my customers have
more difficulty switching, is an enormous kind of
problem.

We have an example of this in the cheese
industry, where Kraft manipulated the price of cheese in
the old Green Bay Cheese exchange, in fact, drove down
the price of cheese there, the biggest buyer of cheese,
about 30 percent effect on dairy farmers because, in
Wisconsin the price of milk is a function of the price of cheese, so that you get that.

The second thing, again illustrated by Bob, is an enormous capacity for price discrimination. And here I am indebted to Professor Schwartz's discussions of price -- of switching costs and the difficulty of making changes on the supply side of the market so that it becomes much easier to engage in a variety of discriminatory unilateral practices, and we have seen that in the livestock markets.

There is a second area of this problem that I see as a recurring one, and that's what I think of as high volume buyers. And I illustrated that a little bit with cheese and other examples where you can manipulate a public market price for your commodity, which is a low-volume commodity markets. This is true in butter as well as -- and cheese. Those are the two examples that most readily come to my mind, but I'm from Wisconsin and so that would be my natural orientation, I suppose.

But there is also the large volume retailer that buys in substantial quantities from the high-volume producer. And here, it seems to me at Toys R Us and other examples, we can see a 20 percent national market share can have -- gives you enormous leverage over your supplier.
Think about it this way. You are selling, you need to sell through lots of outlets. Suddenly 20 percent of your outlets are going to go away? What are you going to do about that? You're going to start doing whatever that 20 percent tells you to do over a wide range of choices.

And so, what we see is volume buyers forcing the prices down in order to get an economic advantage. They exercise their buyer power on the upstream supplier, which may then try to pass it off on to further players up the field.

The other thing we see recurrently from Interstate Circuit and through to Toys R Us is the use of that buying power to disadvantage competitors, and sometimes more efficient competitors.

So, again, we have these kinds of effects that exist. Another one that I reference here is the spheres of influence, the kind of conduct that we would think of on the buying side -- on the selling side, rather -- where you have two goods that are particularly good substitutes for each other, and then you have others that are in the broader market but are not nearly as good substitutes, that kind of cross-elasticity.

Well, on the buying side of the market in oligopolistic markets, there is a strong incentive to
carve up. You look at poultry, you look at beef, you see where those facilities are located. Everybody tries to get their sphere of influence. When you start looking at the interactions there, you get a variety of opportunities, again, both to discriminate and to create your own little domain where you have significant influence over your suppliers.

Another point -- and it's what I illustrated a second ago with the cheese example -- why more of the impacts of monopsony power get reflected up a chain to some more distant point. And again, Bob's diagram of farm to processor to retailer. The retailer puts the screws to Tyson on poultry. Tyson doesn't sit there and eat it, he passes it back to the folks that are raising the chickens on their farms. Put the screws to Tyson as a beef producer, that gets reflected back up the stream.

And so, to understand where we're going with some of this stuff in terms of effects, you need to look not just at the most immediate party and can they take it, does this look like just creating more efficient transactions at that transactional point, but how do these things play out up the line, if you're going to have a full analysis of these effects.

My final point in terms of the overview situations is -- concerns both allocative and productive
efficiency on the buying side. I am -- and I hear this all the time -- there are all these negatives, "Oh, we deny this merger, the world is going to come to an end."

Well, I have done enough work on the legal history of antitrust to know that that's been said since 1890, and you know, the world hasn't come to an end yet.

So, I am very skeptical of all these mergers that are going to be blocked, and it's going to destroy efficiency. I'm a Maoist on this point. That is, Mao said there were many roads to Socialism; I say there are many roads to efficiency. And if you can't merge, then get there somewhere else if there is a real efficiency to be achieved.

So while I am very skeptical that we are losing very much, if anything, but the other part of it is -- and part of it comes out of what Bob said -- there is a lot of wealth transfer that goes on here. Moreover, there is some work by Sexton and Zhang which suggests that if there is both buyer power and seller power, even if neither is terribly substantial, combine the two and allocative efficiency harms are enormous, relative to any possible modest efficiency gain. You have got to get very, very substantial efficiency gains before you outweigh the costs to allocative efficiency.

Moreover, Bob presumes the problem of wealth
transfer is one of fairness. I look at it in terms of market dynamics as creating enormous long-term dynamic costs for the economy. If you drive down the revenue of farming, then fewer and fewer folks want to go into farming. Then you in Washington are going to find Congress is coming up with some enormously bigger bail-out of farmers, in order to put folks back on the land so that we can actually produce the goods.

There is an enormous kind of problem, then, of what our incentives are to engage in various kinds of activities as you transfer wealth away from the people that are actually creating the initial wealth, their willingness to produce goods and services efficiently and effectively.

What does this mean in terms of our merger guidelines kinds of standards? First of all, I think in terms of market definition, where we have got a public market price, where we have got retailers, we need to take fairly generalized kinds of markets -- cheese. Now, anybody from Wisconsin will tell you it's not "cheese," you have got to say what kind it is. Is it cheddar? Is it Swiss? Is it Gouda?

But cheese, by golly, is the market, toys is the market, look at that in terms of the kinds of leverage that can be created over upstream prices. We're
looking at more direct kinds of buying situations where
you're actually dealing with the basic inputs themselves.
Fairly narrow markets because, again, with this
discrimination potential, switching is hard. Switching
is difficult, unless you really have lots of other
options close at hand.

And here, again, I come back to thinking market
definition needs to focus a lot on the kind of unilateral
effect market analysis when we look at substitutability
or switchability between particular outlets, in terms of
the analysis of specific transactions.

I am going to suggest that we need lower
thresholds for when we start taking critical looks at
mergers where there is a significant buying side factor,
because of the reasons I set forth earlier. That is, the
incentives are high, the barriers, the obstacles to
achieving that are relatively weak, and that, therefore,
we need to be very concerned about combinations that
reduce us to less than five or six major firms in a
market.

We need to take a critical look at that point.
And then I think that means an HHI of around 1,600, a
concentration change of 150 points or so.

Competitive effects analysis, again, remember
the location of competitive effects can be remote.
Unilateral effects, a merger creating buying power creates incentives to manipulate the markets, incentive to engage in discrimination. Creates capacity of buyers to manipulate public markets.

Coordinated effects I have already touched on repeatedly. That is, there are strong incentives to collude, directly less incentive to betray that conspiracy. The buyer may find it attractive to create geographic -- or buyers find it attractive to create geographic spheres of influence which indirectly affects competition.

Fourth, it seems to me the defenses of efficiencies are very limited in most of these cases. Entry barriers -- and again, I am indebted to Bob for this -- is very high in most of these markets, very difficult to enter, and that therefore we need to be very, very concerned about even modest increases in concentration.

I think antitrust law has long recognized that buyer power creates competitive concerns, just as seller power does. However, for too long, a primary focus, especially in mergers, has been on the selling side. It's time to redress that balance, and this session is a step in that direction.

Enforcers, however, need to develop a deeper
understanding of the unique characteristics of the buying side of the market. This calls, in my mind, for appropriate metrics. A mindless transposition of seller-side criteria for market shares or competitive effects will only result in an inadequate analysis of buyer power implications of mergers.

Mergers that create serious competitive risks in one or more buying markets will be ignored because of the failure to employ appropriate market definitions and competitive effects analysis. It is my hope that the FTC and the Antitrust Division will make more sustained efforts to understand the different aspects of buyer markets and buyer market power. Only with that kind of effort can merger enforcement continue to fulfill its assigned responsibility.

(Applause.)

MR. HEYER: Our final presenter is Marius, and I am sure there won't be any mindless extrapolation.

MR. SCHWARTZ: Thank you for your patience. I know that listening at 4:30 in the afternoon is not the most tantalizing prospect, unless I am mistaken, but I doubt it, so thank you for your interest.

One of the questions posed to this panel in the press release was how, if at all, should the agencies assess the creation of buying side market power.

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differently than selling power, and that's the question I am going to address.

And by "assess," I mean two things. Should we analyze it differently? For example, should we use different information or different concentration thresholds for deciding that there may be a price increase or a price decrease -- say a "price change" -- to be neutral?

And secondly, should we employ different criteria when deciding whether to bring a challenge? For example, is a price change as a result of the merger enough to bring a challenge, or do you also need to show that there will be a significant reduction of quantity -- the latter being the metric that is more associated with efficiency.

Now, during my time at the Antitrust Division and outside, I have heard arguments on both sides of this, that on the one hand, we should be less stringent when challenging buyer market power, and on the other hand, as Professor Carstensen would say, that we should be more stringent.

So, my position is going for half a loaf to each side, which means a full loaf to no one, and that's because my position is that I don't know of anything in the economics literature that would justify adopting a
differential treatment of buyer versus seller, per se.

The reasons that I have heard advanced for adopting a differential treatment, on closer reflection, are either present also in the case of seller power, or reflect some other characteristics of the marketplace, not the buyer/seller distinction, per se.

So, let me try to divide these points a little bit, first by taking up arguments that we should have less stringent treatment of buyer power, then turn to arguments that say we should have more stringent treatment. Again, by "buyer power" I mean buyer power as compared to seller power.

One question that I have run up against is whether to justify a challenge of a merger, say, must there be harm to consumers? And that sometimes gets in the way of bringing a challenge to a monopsony merger, because you are saying consumers, the end users, may not suffer. And I will come back to this in a second.

But the threshold issue is when people say antitrust "protects consumers, not competitors," what they really mean is not consumers, literally. What they -- the way I take that to mean -- is trading partners. So the thrust of the statement is that just because a merger is going to hurt competitors of the merging firms, that's not enough reason to bring a challenge. A merger
that's efficient will also harm competitors.

So what you're worried about are trading partners. Trading partners could be the buyers or sellers. And to bring that point home, suppose, hypothetically, that you have a group of consumers large enough -- a large enough percent of consumers -- getting together depressing the price and reducing the amount of output that they buy from farmers.

Well the result is that economic efficiency decreases, and that's because of the reduction in quantity. So that says that gains to the consumers from the lower price are less than the harm that is imposed on the farmers. Should we let that slide, just because it's the consumers that are gaining at the expense of the farmers? I see no reason why, and nothing in economic theory or economic analysis will give you any reasons for why.

So, I think we should be symmetric in our treatment of consumers versus producers, firstly. Second point to make is that most monopsony concerns arise when you have a merger of intermediaries. Not a combination of final consumers, as in my previous example, but a merger of intermediaries.

Well, in that case, those intermediaries are acting as buyers for one side of the market and sellers
to the other side. In that case, a merger that allows
the merged firm to depress price to suppliers, is not
likely to benefit consumers, and in fact, is likely to
harm them.

   It's conceivable that there may be no effect on
consumers, that the effects will be confined to harming
the farmers. That could arise, for example, if the
merging firms are perfectly competitive on the output
side but enjoy monopsony power on the input side.

   That was the case that we encountered in the
Cargill Continental merger. Cargill and Continental were
grain merchants. Grain prices to final users were
determined in the world market, so the Department did not
allege that the merger would increase these grain prices
worldwide. What they did allege is that the merger would
allow the merged firms to reduce prices to farmers in
selected localities because, on the input side, the
markets were more localized.

   So that's a case where farmers would have lost,
consumers would remain unaffected, and yet a challenge
would be justified, and in this case, was brought.

   Outside of this special case, where there is
perfect competition on the selling side, you might, in
fact, expect -- in fact, you would expect -- that a
merger that increases monopsony power will also harm
consumers. And the basic reason is if the merged firm is to bring about a lower price for the input only because it's buying less of it, that's going to translate into less output, which can't benefit, and more likely will harm consumers. Okay.

So, the quick answer to that one -- that took a rather long time to make that perhaps obvious point, but it comes up a fair bit -- is you shouldn't just care about harm to consumers. Trading partners, okay?

Next question is, well, is countervailing power an acceptable defense? So suppose that you have a merger that has actually reduced prices to suppliers. Is it an acceptable defense to argue that the merger, while reducing price, will reduce it towards the competitive level as opposed to below the competitive level? The theory being that there is some pre-existing market power on the seller's side which is keeping the price initially too high, and the merger is correcting that distortion.

Well, there are arguments to be made on both sides of this, whether you should accept countervailing power as a defense, and maybe we can talk about it later. But my second point here is whatever position you take on that, on whether you accept countervailing power as a defense, that issue arises equally in the case of buyer mergers as in the case of seller mergers. There is
nothing unique about buyer-side mergers to raise that as a possible defense.

Next question. Putting aside the countervailing power issue, suppose that initially we have perfectly competitive sellers. The merger, by increasing monopsony power, will depress the price below the competitive level. But it's not predicted to have much of an effect on quantity. And that can come about for at least two reasons. One, the elasticity of supply facing the merged firms may be very low -- at least over the relevant price change -- so you're not going to get much of a quantity reduction.

The second means by which it comes about is one that Professor Taylor emphasized, and that is if the nature of the contracting process is richer than simply prices, but encompasses both the price and the quantity, a two-part tariff, or any other such scheme, then what the merger may well do is depress the total revenue that's being paid to the other side without affecting the quantity.

So we now have no quantity effect, but a significant revenue reduction. Should we oppose such a merger? That question is sometimes framed as, “Are wealth transfers enough to justify an Antitrust challenge?” Well, again, there are two possible answers
to that.

One is you may care about efficiency, per se, or about distribution, per se. The second one was the reaction that Professor Carstensen gave, which is in the long run, reducing the wealth to one side of the market may well reduce the resources that go into that sector. So, even if in the foreseeable future you have no quantity effects, in the long run you probably will.

Whatever the answer to that, again rather tedious point by now is that the question of whether you require a quantity change in order to bring a challenge could be posed equally well in the case of a seller-side merger as in the case of a buyer-side merger.

So, this is part one, and I won't abuse my time. There is no reason to be any less stringent on buying-side mergers than on selling-side mergers. And by buying-side mergers, I mean mergers where the alleged concern is on the buying side of the merging firms.

Now let's turn to the second point, which is should the treatment be more stringent in the case of buyer-power mergers? First point I want to make here, which is one that maybe I should have begun with, but I didn't because it may be a little more abstract and I didn't want to turn people off, is that the designation of which party is the buyer and which party is the
seller, at least from an economic standpoint, is often arbitrary.

Think of any transaction. Who is the buyer, who is the seller? When they're giving things to each other, it's an exchange. So you might say, "Well, okay, fine. The buyer is the one that is giving the cash, or generalized purchasing power, in exchange for a specific commodity."

All right. How about the case of a financial intermediary, like a bank or a savings and loan? It's taking deposits, which means it's taking cash now in exchange for cash tomorrow, and on the lending side its giving up cash now in exchange for cash tomorrow. When is it the buyer and when is it the seller? Well, it's arbitrary.

However, you can easily see that the merger between two financial intermediaries could cause harm on either side of a transaction. So it's unlikely that the competitive analysis or the thresholds or the decision-making criteria should depend on whether you're calling it a buyer or a seller-side transaction.

Now, finally, even in the case where you think that it's obviously the buyer, because he is paying cash, and the other side is giving an object in return, again, a simple reformulation of the transaction can change the
identities of the parties.

So, for example, if a manufacturer is selling this product to a distributor, he is the seller. If that same manufacturer changes the contract a little bit where he retains title to the goods and just lets the distributor keep a percentage of the sales price, you can now think of it as buying distribution services from the distributor.

One would think that a merger between distributors that would increase the distributors' market power is going to have pretty much the same effects on the manufacturer in the first scenario as in the second, okay?

So, the point of these examples is to really stress that it's unlikely that the labels "buyers" or "sellers" can possibly form a basis for different treatment. Now, let me just address two or three of the specific examples that have been brought up.

One is that the anticompetitive harm from a merger in the case of a buyer-side merger may only be felt several layers away. And I agree with that. An example was given, I believe in your testimony, was that if you have a merger of grocery stores in a concentrated market they may pass the price to manufacturers, who in turn pass the price increase all the way up the chain.
Well, that's true, and that -- it does flag an important point, which is antitrust enforcers should not construe the lack of complaints by trading partners at the next level as evidence that there is no problem. I agree with that, because the effects may be passed through.

But exactly that same problem can arise when you're dealing with a seller's merger and that's simply going to pass most of the price increase to one level over. So, again, there is nothing to distinguish this issue as being a buyer-side-specific issue.

Next point, again, one I agree with. Certain buyer-power abuse is not reached by antitrust. So unfairly low prices to farmers, or paying lower prices to farmers that are selling on a market as opposed to so-called captive farmers that were under long-term contracts, you know, some people might think that's unreasonable. I take no position of that because I don't know these industries.

But the simple point is there are practices by sellers that are also out of the reach of the antitrust laws. Charging a monopoly price by a seller, if the monopoly was legitimately acquired and maintained is, again, not unlawful. You may not like it, but it's not a violation of the antitrust laws.
Finally, and maybe the most interesting one, the claim that lower market shares can suffice for buyer-power cases than in seller's cases. And there are two possible points. And it has been noted that low market shares at the national level are consistent with the existence of buyer power.

And one reason that has been put forth is that buying markets are often much more localized. So just because concentration is low measured on a national scale, that's consistent with having fairly high concentration in properly defined local markets.

Absolutely correct. In fact, so correct that exactly the same observation applies on seller side of a merger. That just says you have to be careful about defining the proper geographic and product market. But having done that, I don't see any obvious reasons why there should be a difference in the threshold.

One example that Professor Carstensen gave was the case of a bidding, a bid environment, where buyers are bidding for a product they do have incentives to low-ball the price. If I recall, there was a period in the Antitrust Division where 80 percent -- maybe a little less, maybe, but not much -- of our cases involved bid-rigging in the case of roads and other government contracts, where the violation was that people were
putting in too high a bid for the services they were selling.

So, the fact that we have anticompetitive behavior in auctions possibly more frequently than in other forms of exchange, may say something about the auction process, but it doesn't say anything about buyer versus seller cases, per se.

Fine. Not to belabor this, but when scholars such as Professors Carstensen and Taylor and others argue that we need a more stringent treatment of buyer cases, I think that most often -- I would bet -- that it's driven by familiarity with a particular industry or a particular case where there are other things going on that may well say there is a problem at lower concentration levels, or there is a problem even where you might not normally have thought there would be a problem.

But if we're going to do our job properly of guiding -- putting antitrust enforcement on a sound footing -- then you have to be very sharp about identifying what those factors are, and framing the distinction in terms of those factors, as opposed to arguing there should be different antitrust treatment based on the label "buyer" or "seller." Thank you.

(Applause.)

MR. HEYER: Thank you all very much. We don't
have very much more time. And so, consistent with anti-
trust focus being primarily on the consumer, I wanted to
begin by asking if anyone in the audience who has
bothered to stay around this long and listen to the
remarks had any questions before I ask the panelists if
they want to direct any questions to one another. I see
a hand. That would be you, Sheldon.

MR. KIMMEL: I just wanted to note that the
last two speakers, I think, agreed that there is an
upward sloping supply curve of farmers, and that if you
oppress farmers you are liable to get less output.
And therefore, I wanted to ask the first
speaker, Professor Taylor, about the contract poultry
industry, where he was discussing a very concentrated
market that wasn't free, and where the farmers were like
serfs. But in fact, the production has pretty much
tripled in the last 40 years and that's suggesting that
however bad the industry is treating farmers, it's able
to lure in lots of new farmers.
And so, I am wondering what the problem is
there.

MR. TAYLOR: The poultry industry and per
capita consumption of poultry has been pretty much flat
for 10 or 15 years, and the -- when the industry first
integrated in the 1950s, the producers did well and there
was more sharing and the integrator and the contract
producers were pretty much on equal footing, from a power
standpoint.

But it's really about 10 years ago when the
producers started getting squeezed more and more. They
got squeezed with mandated equipment upgrades and other
large capital outlays.

Poultry houses have a 20 to 30-year economic
life, and there is no salvage value for them. So once
you get in -- and most of them, 95 percent, owe money at
a bank, and it costs about three-quarters of one million
dollars to have five or six high-tech houses, which would
be full-time for one person. So they got into it without
fully understanding, you could say, but being deceived
that they wouldn't have to upgrade.

And just about the time they get a loan paid
off, it comes again and it's just recently that
information has been coming out on the true returns to
contract poultry production. So, moving ahead from here,
I don't think you will see a lot of people standing in
line to become contract producers.

MR. HEYER: Well, let me just ask whether there
is agreement among the panelists -- and then, Sheldon, if
you want to follow up quickly -- that something like an
output test across an appropriate amount of time,
perhaps, would be a way of gauging whether the
arrangements in the marketplace are efficiency-enhancing
versus anticompetitive.

Now, there may be wealth effects on the two
sides of the transaction, but I'm wondering -- Sheldon
seems to be getting largely at the issue of whether
looking at the output of the market is a good test for
whether it's performing well.

MR. SCHWARTZ: Well, in general, if you could
properly measure output, that's certainly the place you
would want to start. There is the comment that I believe
Professor Newmark made earlier, that there is quality-
adjusted output, and so on. But certainly as a first
approximation, if output, properly defined, increases
then something good is happening.

MR. CARSTENSEN: But you would also want to
consider your time period. That is, you have got a 30-
year chicken coop. There is often cost there, and you
stay in that business a long time, and you might actually
be under enormous pressure to increase your output if
you're paid on a per-chicken basis, even if it's chicken
feed, because of the structure of the situation.

So, I would sure want to make sure I got the
right measure of quality, and there are some real
interesting questions about the quality of a lot of the
livestock and chickens that are coming to the market today. And I want to look at that -- maybe 40, 50, 60 years even -- well, that's pushing it too far.

(Laughter.)

MR. CARSTENSEN: But 20 to 30 years we should get those kinds of big investments, but you just can't switch it. I mean, that's all those chicken coops --

MR. KIMMEL: Just a brief follow-up. If you look at the most recent Census of Agriculture, you will see a page on historical statistics, and it will show you that production has tripled from the 1960 census to the most recent census, and that increase had not been slowing down. That's all the data we have.

MR. TAYLOR: Per capita consumption is just about flat recently, but let me give my overall subjective impression, and a lot of this is backed up with fact.

When the industry first integrated in the 1950s, there were tremendous gains in efficiency. They brought a better bird to the market, much more uniform quality, and so forth. The inflation-adjusted price has gone down, but recently that's because feed is cheaper, not because of efficiency gains.

The poultry system is highly efficient, in my opinion, and the issue is not efficiency -- and
theoretically, I can show that when the integrator is putting producers into an all or nothing decision setting.

There is no social welfare loss triangle, though. It is highly efficient, but the integrator is increasingly appropriating returns. And the producer is no longer involved in innovation anyway, and I think it's almost flip-flopped to where now the managers they have out there every week -- and in some cases every day -- know less about raising chickens but they are getting orders from up above.

So, I think a highly efficient system is evolving to where it's less and less efficient. But it's hard to see that from any industry statistics.

MR. HEYER: There was another -- I'm sorry?

MR. SAWYER: It seems to me that there are more enforcement actions taken in mergers to sellers than buyers. And I'm wondering if the panel can share their views on why that might be. Is it because there are different standards or there is less buyer concentration in the economy than selling concentration? I'm wondering what you --

MR. HEYER: Marius, you want to go first? You thought the treatment should be similar.

MR. SCHWARTZ: I knew I shouldn't have said
that. That's a good question. First of all, I don't know what the statistics are. It would be nice to know. And assuming the facts are right -- and economists can assume things -- assuming the facts are right, I guess one -- the natural conjecture would be the concentration may be typically higher on the selling side than on the buying side.

Exactly why that would be I'm not sure. A simple example that would make the point would be at least in the interface between final consumers and whoever they're buying from, you would expect that the market power would really be on the sell side.

So, one factual question would be, suppose you stripped out cases that involve final goods industries. Are the enforcement patterns still as skewed as they appear to be today -- as they would appear to be in the overall sample?

If that's true, I guess the next question would be to take a little closer look at concentration levels on both sides. One exercise that I think would be worth doing would be to put the burden on folks that think that we're being -- "we," the Agency; I still think of myself as an alumnus -- that we're being too soft on buyer power would be to come up with some cases where we fail to bring a buyer power case and point us to cases where we
brought a seller-side case under similar circumstances.

Same concentration, same this, same that. You brought this case, you didn't bring that case. Why?

That would maybe let us better see whether the result -- the failure to bring more buyer power cases -- is just explained by other factors.

MR. CARSTENSEN: I want to chime in on this. I think this is one of the things Professor Schwartz suggested, that there is probably some overlap. If you've got buyer power you're likely to have seller power and so you focus on the seller side.

I think one of the things that's obscured the issue is where there has been local concentration on the selling side. There is also a buying effect. I do think that there -- until the Cargill and the Aetna case, there really was a strong ambiguity, at least, about things that were expressly buyer-side cases.

And I think that I was there when Joel Klein was beat up out in Iowa by the pitchfork waving farmers. That's when I discovered I really wasn't a populist. And he got the message about buyer-side power, and I think that's part of the place where we saw a significant articulation of something that --

MR. SCHWARTZ: Yes.

MR. CARSTENSEN: Even so, I see if I am to
recognize issues and to examine issues -- and I point to the recent FTC decision Wal-Mart's acquisition down in Puerto Rico, where buyer power issues were raised, they got, in effect, the institutional back of the hand, "Oh, we don't care about it, we have thought about it as much as we think needs to be thought about it, and there is no view there," even though there soon could be, given the quantities that one sells. There seems to me to be some question about local product markets there.

Another case where -- in the turkey world, where two turkey companies were -- they could be shipped anywhere. The market share is on the seller side, the customer side, zippo. Prices to the farmers I dealt with in the Midwest suddenly went from $3 to $2 for turkeys. And there is an example of where the institutional investigation failed to identify the problem.

MR. HEYER: That was the FTC.

(Laughter.)

MR. CARSTENSEN: I'm sure. But the Justice Department --

MR. HEYER: Bob, did you have any remarks? I was going to throw it open to one last question. I know all of you had your hand up.

MR. RAMADHANI: I was wondering, given that on the agricultural side we see a number of laws that may
protect sellers -- is there a sound economic reason to
not allow the agriculture market operate on a free-market
basis as we see in other segments of the economy?

MR. TAYLOR: That's a tough question. I can't
give a simple or a short answer, but I will just take a
couple of minutes to say that in some ways food is
different. There are food security issues, rather than
just opening the market up completely.

A fundamental problem, a fundamental economic
trade-off, problematic trade-off, is that we want to make
sure we have enough food around. That means high stocks.
Any time you have high stocks that means low price. So
there is that trade-off.

Another complicating factor is we now have a
farm bill that can best be described as a mess. It is a
farm bill written by and for giant ag business to
maximize volume with a lot of money, taxpayer money,
thrown at farmers. But because of the big volume,
consumers pay less for food, so they pay more in taxes
and less for food. There are many, many complications
there.

There is also the issue of preserving some ag
land for the future. And if we just let all of the ag
land go to strip malls, it's not irreversible, but there
is a high cost of bringing that back into agricultural
production if we should need it in the future. So there
are a lot of problems.

Inelastic demands, some of the -- you know, the
checklist on things you -- that make price fixing or
manipulation profitable, if you go down the checklist
many of those are met in the agricultural sector and not
in a lot of non-ag sectors.

MR. HEYER: Last, Peter, you want to --

MR. CARSTENSEN: Just -- well, we move closer
to market. What I have been -- need a legal constitution
for markets. One of the other peculiarities is that a
final decision on what crops to plant is made three
months or more before he harvests and finds out what the
market price is. There are market-specific things and
you need market-specific regulations that facilitate the
market -- securities laws, and things like that for other
specialized markets.

And here I do agree with Professor Schwartz.
What's motivating me is a concern for what's going on in
particular markets and the kinds of market structures
that will be most apt there.

I think we could do an awful lot to improve
market performance for the benefit of farmers and
consumers if we had a better regime that came closer to
actually running an actual open, fair, transparent,
efficient market, and we're thinking -- a lot of those
government subsidies and other distortions that are out
there that we tend to ignore.

MR. HEYER: Okay. Thank all of you for staying
as long as you have. I want to thank our panelists and
also announce that tomorrow morning, bright and early at
9:00, day two begins in the workshop: Non-price
Competition and Innovation. And I will see you all back
here then. Thank you.

(Applause.)

(Whereupon, at 5:10 p.m., the
conference was adjourned to be
continued at 9:00 a.m. on
Wednesday, February 18, 2004.)
CERTIFICATE OF REPORTER

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