FEDERAL TRADE COMMISSION

HORIZONTAL MERGER GUIDELINES REVIEW PROJECT

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FEDERAL TRADE COMMISSION

I N D E X

P R O C E E D I N G S

MR. FARRELL: Good morning. I’m Joe Farrell. You’re going to be welcomed by the Chairman and the Assistant Attorney General in just a moment. I’m doing a pre-welcome which consists of telling you about security. Those of you from outside the agency know all too much about security already this morning, I guess. But I’m asking to read you the following.

First of all, if you go outside the building and you don’t have an FTC badge and you want to get back in, you have to go through security again.

Second, if there’s a fire or evacuation, please leave the building in an orderly fashion. Outside the building, go across the street to the Georgetown Law Center, look to the right front sidewalk -- I’m not sure whether that’s right as looked at from here or from there. That’s our rallying point. So, rally there.

And if it’s perceived to be safer to remain inside, you will be told where to go inside the building. And if you spot suspicious activity, please alert security.

Those are the security briefing. I have two other logistical comments. One is there are cards for questions at the back of the room. If you have questions for panelists, please write them on the cards and pass them up to the moderator.

And, secondly, outside, there are copies of the 1992/1997 Horizontal Merger Guidelines and you might be interested in those. And there's also a little flyer called "Where To Eat Near the FTC Conference Center." I noticed that the Where To Eat list is organized by price bands and, so, if you wondered whether it's legitimate to define a market by price bands, there's your answer.

So, without further ado, let me introduce the FTC Chairman, Jon Leibowitz, to welcome you here.

WELCOMING REMARKS BY CHAIRMAN JON LEIBOWITZ

CHAIRMAN LEIBOWITZ: I love it when economists make jokes to start off a meeting.

On behalf of Christine Varney and myself, let me welcome you to our scheduled workshop on updating the horizontal merger guidelines. When Christine and I started talking about this during the summer, we thought it was going to be a good time to think about updating the guidelines. But timing is everything, and given the announcement of Comcast/NBC Universal this morning, it’s a truly propitious time to start updating the guidelines.

Let me commend the FTC and DOJ team that’s been working to put this together. On the FTC side, that would be Joe Farrell, who you’re acquainted with, Rich Feinstein and Howard Shelanski. And for the Justice Department, that would be Molly Boast, Phil Weiser and Carl Shapiro. By all accounts, this group has worked together extremely well, which shouldn’t be a great surprise -- and I see Gene Kelman here, also an integral part of any policy-related matter. And it shouldn’t be a surprise that they have worked really well together because several of them have now worked for both agencies and, also, because I think Phil lived in Howard’s house for a time and, of course, Carl and Joe are the virtual Chang and Eng of the antitrust economist community.

We are really a far cry from the bad old days of the Schering brief, the Section 2 Report, and ugly clearance battles, I think stretching on for months. It's really been the approach, I believe since Christine and I started in our current jobs, to work together collaboratively. I know it can be fun to talk about conflict between the FTC and the Antitrust Division rather than talking about our similarly held enforcement priorities and policies, but the reality is we play really, really well together, as this project demonstrates.

Many of you know that I've been a critic of the extent to which the Chicago School's -- and by the way, I'm wearing my badge. I just wanted to show that. We all have to wear our badges, particularly because the magnetometer is broken outside, as all of you know.

Many of you know that I've been a critic of the extent to which the Chicago School's optimism about efficiencies and indifference towards oligopoly conduct have affected merger reviews, as well as how it's affected antitrust law generally. But from my perspective, this effort isn't about giving any priority to one antitrust school or another. It's really about good government and making sure that the rules of the road are clear and well understood, especially by those who enforce them.

From my perspective, the current guidelines have actually worked pretty well since the last update in 1992. And I know Jim Rill is right here and he deserves enormous credit for being the leader of that 1992 update -- What? You do. Don't be so self deprecating, you do. Yet, I think they don't explain the process clearly enough to businesses. They don't explain it clearly enough to judges. Probably, if I had to be honest, I would say that has helped us in some instances; it has hurt us in others. And they don't incorporate the latest economic thinking.

So, hopefully, by giving everyone a better idea of how we look at mergers and also how they ought to be examined by the Courts, we can clear up some misconceptions and demystify the process. And if we can do that, I think everybody wins, especially consumers who benefit most from balanced, yet aggressive, antitrust enforcement and businesses which, as you all know, benefit enormously from certainty.

The reason why we need to update our guidelines is pretty clear. Over the past 17 years, since the last revision of the guidelines, merger analysis has developed in important ways. But as our joint commentary noted three years ago -- and where is -- is Tom Barnett here?

He's around here somewhere. Thank you. Tom Barnett and Debbie Majoras were the leaders of that commentary. Guidelines tend to exaggerate the extent to which the agencies follow a single, rigid, step by step broad approach to merger analysis, and we don't always follow that approach when we evaluate mergers. Instead, we set our inquiry on one key question, whether the merger under review is really likely to lessen or substantially lessen competition.

So, the areas we'll be thinking about stem from that inquiry. And among them are, the use of direct evidence of anti-competitive effects as an indication that a merger may harm consumers, whether to clarify how and why the agencies use the hypothetical monopolist test to define markets, whether to update the description of how the agencies use concentration statistics, like HHIs, to understand the impact of the merger on the market -- you know, really, I think the question is really how much should we increase the HHI thresholds in the guidelines to better correspond to how we understand them -- and whether to put remedies in the guidelines as other antitrust jurisdictions have done. And, of course, I'm going to keep an open mind, but I think all of these ideas make a lot of sense.

Today, we're going to have four panels and a veritable cavalcade of antitrust luminaries to help us illuminate these issues. Among those speaking today are Bob Pitofsky, Tim Muris, Jim Rill, Doug Melamed. Is Doug here? Doug is not here. Well, we know why he's busy. All right, that was an antitrust joke. I know it's early in the morning. And Deb Garza and Tom Barnett who's back there, too. And most of those people are just on the first panel.

After their overview on the role of the guidelines, we'll have specific panels on direct evidence of competitive effects, market definition and unilateral effects and, of course, this is just the start of the project. We'll be taking our merger guidelines examination on the road, holding workshops in New York and Chicago next week and in Palo Alto next month, and the final workshop will be back here in Washington, D.C. at the end of January.

These workshops, of course, as you know, are about transparency. But just as importantly, they're about thinking through the merger review process with very smart folks in the antitrust community outside of our occasionally -- I would say often -- occasionally insular, inside the inside of the Beltway/Justice Department/FTC Antitrust axis. So, we really do look forward to hearing from all of you, from incorporating your ideas. You should feel free to challenge us as, of course, my staff does on a minute-by-minute basis to me.

And with that, again, let me thank everyone for coming today and let me turn it over to my very, very good friend and colleague who is doing just a spectacular job at the Antitrust Division, Christine Varney.

(Applause.)

WELCOMING REMARKS BY CHRISTINE VARNEY

MS. VARNEY: Thanks, Jon. Jon did a terrific job laying out why we're all here today and what we're doing in this undertaking and what we're going to be doing today. So, before we turn to our first panel, let me just add my thanks and my welcome.

I know I've gotten a lot of questions, as I'm sure Jon has this morning, about the Comcast/NBC deal that was announced this morning. So, let me share with you what I shared with my staff, and that is, we're not commenting on that today. But we're hopeful that this kind of undertaking can help us understand the emerging complex deals that we face, such as that one. So, good morning, welcome and have a good day. Thank you.

PANEL ONE: OVERVIEW, HISTORICAL PERSPECTIVES, ROLE OF THE GUIDELINES

MR. SHAPIRO: So, if the people on the first panel will come up, we're five minutes early because our leaders are so efficient, as opposed to security.

Take your spot. We may just take a couple minutes to assemble here so we're not starting ahead of time. We're still waiting for Bob it looks like.

(Brief pause in the proceedings.)

MR. SHAPIRO: All right, let us get started. It's now actually 9:30, so we're on time. I thought I had all my panelists, but they're a slippery crew. I lost one again. Okay.

Welcome. I'm Carl Shapiro. I'm one of the members of the working group at the DOJ and the FTC for the review project here. Thank you all for coming, those of you who are here physically and others who may be watching from elsewhere.

As already indicated, we have a really distinguished panel. I'm very grateful for everybody here on the panel for joining me. Everybody on the panel has extensive high-level experience in the antitrust agencies and considerable experience in private practice, in the private sector as well. Those are dual perspectives are extremely valuable. This panel is our first panel of the five workshops, the first of four panels today.

And, so, particularly given the distinguished group, this is an overview panel to really put the guidelines in historical perspective, talk about their role, their function and what types of things should be in the guidelines and what things shouldn't be in the guidelines, as well as, more specifically, where updating and revisions might be most valuable and where they should not be done. So to frame some of that.

We already indicated in our questions for public comment, we see two general reasons why we're undertaking this project at this time. One is to see if a gap has developed between the guidelines as written and actual practice, and good government would call for closing that gap. And the other is the learning and experiences developed in the intervening 17 or 18 years that could be reflected. Those are not just joint concepts, but they're overlapping interests here, and we'll be addressing those on the panel.

In getting ready for this morning, I went back and looked at the 1968 merger guidelines. I think we may hear a little bit about them from some of our panelists. We've got historical perspective. I can not resist pointing out that the 1968 guidelines themselves are 17 pages in total and they cover horizontal, vertical and conglomerate mergers; eight pages on the horizontal mergers and they are very structuralist. And so, in a market that is highly concentrated with the top four firms having at least 75 percent of the market, if the acquiring firm has a 10 percent and the acquired firm has 2 percent or more of the market, this would be ordinarily challenged at the time and it goes from there.

We've come a long way and the question is what the next step might be. One of the backdrops for this, I think, is the decline of the structural presumption over the decades and how that affects merger enforcement and how it should be reflected in the guidelines.

I've asked each of the panelists to give some introductory remarks for five to ten minutes a piece. I will be tough and cut them off, their distinguished nature notwithstanding. And I'd like to start with Bob Pitofsky as one of the deans of the antitrust community.

Bob, please start, and all of you all have been instructed to speak into the mic.

MR. PITOFSKY: Thank you, Carl. Good morning, everybody.

I'm going to do two things. I am going to talk about the historical role of the guidelines with respect to American antitrust and then I'm going to talk a bit about, if there is going to be another iteration, some of the things that ought to be included, excluded, clarified, amplified and so forth.

Let me start with the guidelines. In my view, the guideline process, in many ways, has had the most important influence on American antitrust policy in the last 50 years. Now, you say, wait, wait, wait, there's the Supreme Court, isn't there? And there's scholarship and there's speeches and statements by the enforcement people. Yeah. Wait, wait, wait, there's the Supreme Court. What have they done? How many Supreme Court antitrust cases did they take? The last horizontal merger Supreme Court case was 35 years ago in General Dynamics. It's not exactly an unimportant sector of the economy, but the Court just isn't interested.

Academics are very powerful influences, but they work their way into the guidelines. And, of course, the enforcement people make speeches and statements and bring cases, but it's a little hard to tell compared to the guidelines what it is they have in mind and which way they were going.

The first guidelines were issued in 1968 by the Department of Justice. In those days, it was the style of the Federal Trade Commission to sit out projects like this and they sat this one out and did not join these guidelines. Although later on, I think under Miles Kirkpatrick, they joined the DOJ in later iterations of the guidelines.

The dominant influence by far was Donald Turner. Not only because he conceived of the concept of guidelines, but he drew into those guidelines the beginnings of sophisticated economic analysis and we have progressed from there. It wasn't exactly a non-controversial process. Don's view was enforcement people had an obligation to tell the private sector what their enforcement intentions were. I think that's right. I thought it was right at the time. The problem is that a lot of the lawyers at the DOJ said, what do you mean you're going to give them a blueprint of what we think is okay and what we think isn't? How are we going to win any cases? All they'll do is wave the guidelines in front of the judge and say, see, we followed the guidelines.

It hasn't worked out that way. It hasn't worked out that way at all. The Department of Justice continues to win cases when it is forced to go to court. The FTC, during my six and a half years, won 12 out of 14 cases when it was forced to go to court. So, Don stuck to his guns and, in fact, the guidelines have survived.

Indeed, each iteration gets better and better.

Although, I will say two things about them. Each iteration makes it somewhat more difficult for the plaintiff, for the government, to win and, more importantly, each iteration has far more sophisticated economic analysis incorporated.

My dominant point today -- I hope I'll have more than one or two chances to talk about it -- is the following: An aim of the people who are revising these guidelines is that they should incorporate, not exclusively, but should incorporate the idea of making these guidelines simpler, and clearer and, in some particular areas, so as to give people a better idea of what is intended. Simpler.

My example would be barriers to entry. It used to run on about six or eight or nine pages in the guidelines and introduced concepts like committed and uncommitted entrants, sunk costs, viable minimum scale. I mean, in a way, it's a brilliant piece of analysis. And the lawyers in New York and the lawyers in Washington, they get it, they're on board. But there are a lot of lawyers and business people who find it very difficult to know what minimum viable scale would be in a year that hasn't happened yet.

What do I think ought to be introduced into the guidelines that is not there now? Innovation markets.

It seems to me that as you look around the world, the action has to do with innovation. The guidelines, from the very beginning, have been preoccupied with price. But price is not the only anti-competitive consequence of various kinds of transactions. If two companies are both working on the same improvement in a pharmaceutical or widget or gidget or whatever they're working on and they propose to merge, that could have a negative consumer welfare consequence.

Now, the usual argument is, but you can't measure market share in innovation markets. That's fairly common reaction and it is very difficult. But I think the answer is that you can. I want to know how many patents these two companies obtained in the last several years, how large is their staff, how qualified is their staff, what kind of machinery do they have. Judge Bork, among many others, has said, look, it is extremely difficult, but it can be and it should be done. And market shares can be measured in those areas.

A couple of final points, very briefly. I have been writing for a long time and I'm very cranky about the failing company defense. I think it's too stringent. I think Congress didn't have in mind all those qualifications before you could assert a failing company defense and I don't even think it's good economics. But we're going to talk about that on the panel later on, so I'll hold my comments until a later point.

A few other changes, HHI, 100/1,800 and so forth, is it really only a safe harbor if you're under 1,000? Nobody's brought a case -- actually, we brought two cases. I can't say nobody. But both oil companies, they were marketers and they were in around the 1,500, 1,600 range. But that's once in a blue moon. And if, in fact, government's intention is not to bring cases unless the HHI is over 2,000 or 2,500, we ought to say so.

Many people think the SSNIP test is 5 percent, and maybe it is. Many other people would say it's 10 percent and everybody in the know knows it. Maybe that's true. I don't know it one way or the other. What I do think is it ought to be clearly stated in the guidelines as to what the SSNIP test is and if it's changed. It ought to be changed, as Don Turner would put it, to tell people what the enforcement intentions are of the enforcement agencies.

And, finally, this is just a pet peeve on my part, but I'm sure all of you recognize that even though trend to concentration was the principal concern of Congress when they amended the Celler-Kefauver Act in 1950, the principal concern, trend to concentration has never been regarded as a factor in deciding whether or not there had been or will be anti-competitive effects. All I ask is that the people who are working on revising the guidelines take a look at that and see if it belongs in the next version of the guidelines. Thank you.

MR. SHAPIRO: Thanks, Bob. Next, I'd like to ask Jim Rill to speak to us. Jim was Assistant Attorney General when the current guidelines in chief were drafted in '92. I think he has great insights about that process and the results and how they've held up.

Jim?

MR. RILL: Thanks very much, Carl. It's really an honor to be here with such a guest panel and it's rare that I am not the oldest person on the panel. I'll give that honor to Bob Pitofsky.

Let's take a look at what guidelines are supposed to do and at the '92 guidelines themselves. I think, they set forth an explication which makes a lot of sense. The guidelines -- quoting now from the guidelines, "The guidelines have the dual purpose of leading to appropriate enforcement decisions on horizontal mergers and providing the bar and the business community with reasonably clear guidance with which to access to antitrust enforcement risks of proposed transactions."

Good so far as it goes. There's another

player, though, that's not mentioned in that statement and another player which I think is of importance in considering revision of the guidelines and, in fact, has played a major role in the revision of the guidelines that took place in 1982 and again in 1992 and again, I think, in 1997, and that is, of course, the Courts.

So, the guidelines have an intellectual -- an analytical path, hopefully an intellectual path, too, but an analytical path, but it's not a cookbook. The guidelines are not a cookbook. They're not a nice, articulate, well defined recipe to follow in designing every aspect of merger enforcement, but rather a broad, but clear, analytical path. I have a personal vendetta against anyone who talks to me about something called a guideline violation. I submit there is no such thing as a guideline violation.

So, how does one achieve those purposes? It seems to me there are three principles, and I owe this thought to an interesting paper that was prepared by Tim Muris in New Institutional Economics. Any principle, and I think this applies to guidelines -- needs to be: one, based on sound law and economics; two, and of great importance, needs to be readily understandable and practical by counsel, by firms and by courts; and three, needs to be sufficiently flexible to adapt to new learning in law and economics. Those three principles should, I submit, guide the process that's going on right now.

I endorse the process that's going on right now. It's been 17 years since the 1992 guidelines. The 1992 guidelines were 10 years after the 1982 guidelines, which were 14 years after the 1968 guidelines. I have just given you my total knowledge of econometrics.

I agree with Bob that the Turner guidelines were revolutionary in 1968, not only because of the infusion of some economic learning into the guidelines, but the Assistant Attorney General had the fortitude to do that which I would never have done. He told the Supreme Court of the United States that it was full of baloney and that he certainly wouldn't bring cases that would fit under the rubric of the Vonns case or the Papst Blatz case. If you look at the Turner guidelines, the guideline levels are well above the learning of those two cases.

But the Turner guidelines went so far as they went. And by 1982, economic learning and court decisions, particularly General Dynamics, had begun to expose the error of reliance on rigid market or tests. Thus, the Baxter guidelines undertook to raise the thresholds and identify factors such as entry, in particular, that went beyond market shares.

The 1982 guidelines were a massive step forward, I think a sea change, a seismic change in antitrust, and for that reason, I think Bill Baxter was one of the truly great Assistant Attorneys General to serve in that post. But, they remain largely structural and the flawed market share paradigm was put in terms of likelihood of challenge, which I think went much too far.

A second problem with the 1982 guidelines is that they were only as -- with the '68 guidelines, only Justice Department guidelines. And when the 1982 guidelines came out, the Federal Trade Commission, several days later, put out a very general statement that they weren't necessarily following the '82 guidelines but were going to look at the law and facts of each case.

During the next decade, court decisions and economic literature put further doubt in the structural approach, even of the '82 guidelines, and we had cases like Baker Hughes which called into serious question the market share paradigm and dwelt, to a great extent, on entry.

At the same time, the entry issue was being rather superficially handled when you look at cases like waste management in the Second Circuit where entry was sophisticatedly analyzed on the basis, well, it must be cheap to buy a trash truck. Entry, obviously, was not properly being defined either in the guidelines or certainly by the courts, and the Calder decision a year later was to the same effect, not with trash trucks, but hose nozzles.

Advanced economic thinking, moreover -- my particular favorite is Bobby Willig's article in Brookings, produced a reliance on unilateral effects analysis which had not been incorporated in the '82 guidelines, particularly in the area of differentiated products. The '92 guidelines in that area were somewhat actually anticipated in enforcement decisions, such as the Procter and Gamble/Rorer case, finding within a broad stomach remedy market, unilateral effects by the acquisition of Maalox by Pepto Bismol.

Thus, there was a need to accommodate new learning and replace some of the gaps, to use Carl's term, that existed in the guidelines versus the courts and economic learning.

In the '92 guidelines, the notion of a presumption on the market share paradigm replaced the notion of a likelihood of challenge. The competitive effects provisions of the guidelines were greatly expanded into a separate and rather long section. There was a much more comprehensive approach to entry and, as

Bob indicated, a somewhat intricate approach to entry. There was, I think, most importantly, the infusion of the notion of unilateral effects, particularly in differentiated markets, but also in commodity markets, apart from the analysis of coordinated effects. And, yes, they were the first ever joint guidelines issued by the Federal Trade Commission as well as the Department of Justice. And there are stories there I could tell you, but won't in this panel.

So, let's go back to the desirability of revision now. Is there new learning to be reflected? Yes. Certainly, with respect to the market share paradigm and presumptions. Do we accurately explain in the guidelines what the agencies are doing now? No. If one looks at the FTC's reports on when challenges are made and in what particular industry, at what market share level, at what level of customer complaints and other factors, they bear little relationship to the 1,800/100 formula that's set forth in the guidelines, even as a presumption.

Is the presumption right or is simply the market share paradigm a trigger to further analysis, which it seems to be in many of the court decisions? And we need to wonder whether the guidelines currently provide an explanation of what the agencies are doing and what the courts are doing in a concise and understandable manner. There I go to the issue of unilateral effects, which I think does cry out for further explanation, but not necessarily radical change.

I think that we want to keep the -- I would urge the drafters to keep the market definition and hypothetical monopolist tests. These are tests that have stood the weather-beating winds of time. They have widely been adopted by the courts, and I could cite all the cases from Swedish Match to Oracle as a starting paradigm. The question is, does it have to be a starting paradigm or can there be a holistic approach? I think a holistic approach is fine if it doesn't become mush. But Oracle, Country Lakes Food, Sunguard, Swedish Match, all of these cases adopt the market definition paradigm and it seems to me that's appropriate.

The courts raised question of the HHI levels, in fact, in the Arch Coal decision. The District Court not only looked at the guidelines, but then looked at the FTC report which indicated the FTC, itself, doesn't follow the rigid principles of the guidelines. I think one reads Oracle and would have to say that the arguments or the positions taken by Judge Vaughn Walker, in that case, illuminate some of the areas where unilateral effects can be addressed in guideline form. But I would urge the drafters not to, even in the unilateral effects differentiated product area, to abandon the market definition principle.

Bob mentioned the SSNIP test. I agree with him. I think there needs to be an explanation of when a 5 percent SSNIP test is deviated from and then what reasons and why, because it's not spelled out in the guidelines, but it happens. If you look at the paper we submitted, it happens a lot in energy and in the retail food industry.

Finally, I think the power buyer point needs to be looked at, if there is such a principle to be considered. It came up in not only Country Lake Foods, but also in the ADM Synthetic Sweetener business.

So, after 17 years, this adolescent, I think, is ready to grow into somewhat more maturity. I would say radical change is not appropriate. Some commentary is quite probably appropriate, but I don't think a treatise is appropriate because if you start writing a treatise, you get into big formulas, and you lose both comprehensibility and flexibility.

Overall, I think the project is timely, excellent and certainly led by competent people who should be leading a project of this sort and, again, I'm honored to be able to participate. Thanks, Carl and Joe.

MR. SHAPIRO: Thank you so much, Jim. That's very gracious. We're going to return to some of these questions you've posed in the discussion for sure.

Next, I'd like to ask Doug Melamed to speak. Doug was Deputy Assistant Attorney General and Acting Assistant Attorney General in the Antitrust Division in the late nineties and I'm sure will put that hat on and not his new hat as Intel's General Counsel as he speaks.

MR. MELAMED: I'm always thinking of the public interest, Carl, and the happy news is that the interests of Intel and the interests of the public are always aligned.

(Laughter).

MR. MELAMED: So, there's no tension there.

Let me just say at the outset I think guidelines in the merger area are especially important because, unlike the Sherman Act where 99 percent of the law and the guidance that is given to the business community arises out of the case law, sort of the common law process, in the merger context, it's largely a regulatory process. Obviously, one constrained by the case law and one in which the case law is influenced by the regulatory actions. But it is largely a regulatory process in terms of its most immediate and significant impact on the business community.

And, so, it’s critical that the regulators -- I don’t like that word, but it’s not about shorthand -- articulate with as much clarity as possible the way that they think, and they think the private parties and courts ought to think, about mergers. So, I think guidelines are important. And, that being the case, I think after 17 years, it is very desirable to bring them up to date to reflect contemporary learning.

In the introductory comments, I want to make two points, one a broad one and one a narrow one. The broad one is this. I actually haven’t read the guidelines for a long time or hadn’t until a couple days ago when I read them in anticipation of this panel. I guess maybe I had gone back to look for little passages to cite in briefs or something, but not really looked at them in any comprehensive way.

Rereading them, I was struck by how formalistic they are. They have all sorts of definitions and categories of abstractions, committed versus uncommitted entry, the definition of a market, notion of HHIs, and most importantly, the five-step analysis -- which although there’s some lip service paid to, well, this is only an aid in answering the question of competitive effects -- is really presented almost as a decision tree kind of process.

Now, the various analytical tools that are described in the guidelines, whether they're the SSNIP test or diversion ratios or minimum viable scale and so forth, are important analytical tools, and I think it would be very valuable for the agencies to update the description of those tools and how they are used to reflect current practice and current economic thinking.

But they're not ends in themselves. This isn't kind of an exercise -- merger review is not an exercise of applying these various analytical tools. They are simply tools, means of shedding light on the ultimate question, which is whether the contemplated merger is going to injure competition and disadvantage some segment of the community that we want to protect.

So, I think while the analytical tools of the sort described in the guidelines are very valuable, I don't think the guidelines actually describe, taken as a whole, the process that practitioners of the agencies actually go through in reviewing a merger. And I think in that respect they are somewhat -- I don't want to say misleading because I think at least the regular practitioners know that, but they ought to be updated, I think, starting from perhaps that preface.

Roughly speaking, here's what I do, and I think a lot of people do something like this, in analyzing a horizontal merger. You have companies A and B. You represent A and if you're in practice or if you're in the agency, you're looking at contemplated merger. And so you say, okay, do A and B compete? And if so, where? Who are the consumers or the suppliers if you're concerned about buy side markets? For whose patronage do they compete? And then you ask, well, who else do they compete with? Who else constrains their behavior vis-a-vis those trading partners?

And then you ask, okay, if we eliminate rivalry between A and B, what's going to happen? Are there going to be other extant competitors to constrain it? Is it likely that people on the fringes will enter or readjust their competitive behavior? Are these rivals close substitutes for one another or are they not so close? You know, are we dealing with homogeneous products? Do we have concerns about coordinated effects? Are we dealing with a unilateral effects story?

But the analysis starts, at least to my likes, by asking who are the merging parties, where do they compete, what's the affected area of commerce and now how do I analyze the question, or answer the question, what happens if we eliminate rivalry between these two merging parties?

In the course of thinking of it, building up from the facts that way, at various times, one might think, gee, there are certain analytical tools that might be helpful here. It might be helpful to know what is the market. It might be helpful to know whether there are likely entrants. And I don't know committed, non-committed, I don't think that's part of most people's active vocabulary. But you do ask how likely is it that they're going to enter. And you look at the factors that go into that dichotomy and the guidelines and so forth.

The problem, I think, with starting sort of from the abstractions and working down is that, it not only doesn't describe I think what, in fact, happens, which reflects that it's a problem, but that it can lead to some erroneous conclusions. For example, firms outside the market can be important constraints on behavior of firms in the market. If you imagine, for example, a monopolist merging with the closest, albeit distant, substitute who's outside the market, you might be very concerned about the competitive impact of losing the constraint of that outside the market, closest substitute. If you focus just on the market and the HHIs, you know, you're obviously going to lose sight of that.

Committed, uncommitted is really a matter of degree. I think the dichotomy doesn't make a lot of sense. Market shares matter sometimes and sometimes more than others. And, of course, the problem with market shares is that we don't really care about historical market shares, we only care about future market shares. And, so, we might want to say -- if we want to make a prediction, what will the market shares be in some relevant time horizon, we might start with historical market shares on a kind of past is prologue notion, but always asking the question, is this a prologue or do we have a General Dynamics kind of situation here?

One big suggestion is that I'd like to see the guidelines focus more on how one actually builds up a competitive analysis starting from the facts, how one uses the analytical tools that are presently in the guidelines and I assume will be enriched by this revision, rather than by coming up with a nice conceptual framework of how one might employ all these tools in some stylized merger analysis.

The second and narrower suggestion I would have has to do with efficiencies. Efficiencies are really important, obviously. Innovation is really important. All the studies we all know show that innovation contributes a great deal more to economic welfare than avoiding dead weight loss and so forth. So, we really have to keep an eye on efficiencies.

Now, I understand probably a fraction as much as others in this room, but to some extent at least, efficiencies are commonly over-predicted in mergers not just for agency consumption but probably for Board of Director consumption and we have all the studies about mergers that fail and so forth. But it is still very important, it seems to me, that the agencies and the practitioners and, ultimately, the courts have a clear idea of how to think about efficiencies, how to assess them recognizing the uncertainty of prediction, and then how to evaluate them, how to compare them against what might look like games of market power by the merging firms.

I'm particularly interested in an issue that was treated in the '97 update as a footnote item and I think is really a very important question that I don't know the answer to. I don't know what the agencies or the courts would say in response to this question. What do you do if you have significant efficiencies in market -- I'll use that term -- market A and what apparently looks like a moderate and competitive concern in market B? A lot of people I think would say, well, the courts are clear, you can't weigh the benefits in market A against the harms in market B, that's an anti-competitive transaction. I don't think that would be the right policy result and I would hope the new guidelines would explicitly grapple with that issue and give us some guidance as to how that comparison, that trade-off could be handled.

MR. SHAPIRO: Thank you, Doug. Again, lots of food for thought later. A number of people have brought up innovation and I think it’s something we really want to return to. There’s not much on the guidelines on that. So, everybody put your thinking caps on.

Next, I’d like to ask Tim Muris to speak. Tim has experience going back to the eighties in the time of the ‘82 guidelines and, more recently, of course, Chairman of the Federal Trade Commission. So, Tim, tell us.

MR. MURIS: Thank you, Carl. It’s a pleasure to be here at old timer’s day, except for Carl who’s a recidivist, I guess, as others of us are.

Let me try to discuss three principles for revising the guidelines. To begin, the guidelines have succeeded in significant part because they do not try to do too much. Rather than complex, lengthy regulations, they provide a flexible and durable framework that reflects the antitrust community’s consensus. This focus on consensus should underlie any potential changes to the guidelines.

The lack of such consensus doomed the recent attempt to provide a one-size-fits-all test for analyzing unilateral conduct under Section 2. The long-held consensus regarding the relative insignificance of simple concentration tests, which we've heard about already, justifies reflection of that view in any revisions to the current guidelines. Major changes that lack such consensus, however, risk the fate of last year's Section 2 report.

My second point is that the guidelines should reflect agency practice. When I was Chairman, I pushed this in two ways, the data release, which I'll discuss momentarily, and the merger commentary, which we began as well. In terms of practice, the agency should adjust the HHI thresholds and no longer characterize certain mergers as presumptively anti-competitive. Jim Rill's 1992 revision stated that the numbers are only the starting point, and I agree with that.

Nevertheless, the numbers can provide useful screens, and let me suggest three. First, when there's a post-merger HHI below 1,800, there's unlikely to be competitive concerns. It sounds like Bob had an idea of 2,000, but I'll talk about the data release in more detail in a second.

Second, post-merger HHIs between 1,800 and

2,400 are unlikely to have adverse competitive effects when the delta is below 300. Mergers in this tier with a delta of 300 or more are likely to require detailed investigation into their likely competitive effects. And, third, post-merger HHIs of 2,400 or greater are unlikely to have adverse competitive effects when the delta is below 150. Mergers in this tier with deltas above 150 or more require detailed investigation into their likely competitive effects.

Now, these numbers don’t come from any theory, these numbers, I believe, come from the agency’s data releases. Now, because the data releases were in ranges, it’s possible -- and the agencies have the actual numbers in hand -- it’s possible that these numbers aren’t precisely correct and there should be some adjustments. But I do believe that the experience would provide a very useful screen and the numbers reflect hundreds of merger investigations. Indeed, because the merger wave occurred in the late nineties, most of the numbers are still from the Clinton Administration.

Another topic on which the guidelines and practice diverge involves fixed cost. I think the commentary makes it clear that fixed costs count, under certain circumstances, and any revisions should reflect that.

Moreover, the guidelines should confirm that the burden on the parties to demonstrate efficiencies is no greater than the agency's burden to show anti-competitive effects. Now, my experience is that agency leaders accept the statement that I just made, although there are some on the staff that I don't think agree. If agency practice is to apply different burdens, then I think any revisions should justify such an extraordinary position.

My third and final point is that evaluation of individual mergers is heavily fact specific and that, therefore, any changes to the guidelines should highlight those facts that are particularly probative. And let me suggest five examples.

The first is that the best evidence for determining efficiencies involves actual experience. Just as the agencies rightly dismiss unsubstantiated claims, they should accept as presumptively valid, those claims based on the best possible evidence, which is the resulting efficiencies or lack thereof in recent mergers involving one of the merging companies or others in a relevant industry. And, of course, such evidence can include improvements in product quality, not just reductions in cost.

Second, the guidelines should not assume the form of competition among firms offering differentiated products. Any revision to the guidelines that assumes a certain form of competition, for example, that firms compete by simply setting price, would make it more difficult for the guidelines to characterize existing competition accurately and to predict any loss of competition following a merger.

The guidelines' framework searches for ways in which market power may be exercised successfully and that analysis depends heavily on the particular industry setting and the form the competition takes. Specifying the form of competition, independent of the industry particulars, risks serious error.

And I associate here myself with an article by Werden, Froeb and Scheffman, who noted that after 15 years of using various models, we all have a greater appreciation on the complexity and variety of competitive processes and clearer understanding that differing modeling assumptions can amplify or attenuate merger price increases. As the guidelines move away from structural presumptions, they should not incorporate models that do not reflect real world competition.

The third highly probative fact any revision should recognize is that merging firms have an incentive to pass on marginal cost savings, regardless of the number of remaining competitors, which is a proposition that simply follows from the fact that almost everyone faces a downward sloping demand curve.

Fourth, the guidelines should reflect the importance of customer views in determining the likelihood of anti-competitive effects. The data release showed that strong, consistent complaints almost always lead to a challenge. In my experience, I think most people's experience is that when you've got strong, consistent support, the agencies will not challenge.

Unfortunately, in <u>Heinz</u>, <u>Arch Coal</u> and <u>Oracle</u>, Courts were dismissive of customer opinions. In assessing customer testimony, the Courts and the agencies should recognize the policy judgment that underlies the business judgment rule so prominent in corporate law. This rule essentially requires judicial abstention from second guessing corporate decisions based in part on the relative experience of businesses versus judges and courts. The business judgment rule creates the presumption that corporate directors and officers act on an informed basis, in good faith, and in the best interests of the corporation.

This rationale applies to customer testimony. Once the agencies or courts have screened customers to ensure their testimony is reasonably informed, in good faith and not based on conflicting or anti-competitive incentives, the decision makers should give great weight to customers' views on mergers likely effects. Customers will most directly experience the effects of a merger. Their self-interest, combined with their knowledge of the industry, ensures that their views will provide crucial evidence.

Most antitrust lawyers, on both sides of the table, agree that customers remain the most objective marketplace participants. The decisions they make frequently provide a better window on how the merger actually functions than an economist's model or the court's intuition.

Finally, my final probative fact involves the importance of post-merger evidence in consummated mergers. Here the agencies have something fundamentally different than typically is the case in the normal HSR process -- or they can have it anyway -- that's evidence of the merger's actual competitive impact. When reliable evidence of that impact is available, it should trump the predictive analysis used in the standard HSR process. The relevant analogy is to judicial decisions regarding the superiority of direct evidence of competitive impact in Section 1 decisions.

Now, of course, the post-merger evidence has to be reliable and the agencies have to be confident that their measurements are accurate and merger-specific. In at least two instances, reliable measurements of the merger's impact will likely be impossible. The first involves cases in which too little time has passed post-merger to measure the effect. I think Chicago Bridge was a good example of that. And the second occurs when the merging parties have manipulated the post-acquisition evidence.

Thank you and I look forward to our discussion.

MR. SHAPIRO: Okay, thank you very much, Tim.

Our last speaker, Deb Garza, like Doug, was a Deputy Assistant Attorney General and then Acting Assistant Attorney General in the Antitrust Division, a bit more recently. Deb, please go ahead.

MS. GARZA: Thank you. It really is an honor to join this panel of colleagues, each of whom has contributed significantly to antitrust scholarship and the development of competition policy, both within and outside the United States. Jim, particularly, with respect to the ICN, which you're responsible for.

My comments today will draw largely on the work of the Antitrust Modernization Commission, as well as on my experience in both private practice and in government, using the merger guidelines, explaining them to clients, merging parties and persons affected by mergers. I've also had a bit of experience working on guidelines, including the 1984 revisions to the 1982 Justice Department merger guidelines. So, I'm very sympathetic to the challenges that the agencies are facing.

I'm also very sympathetic to the notion of why it's an important thing to be engaged in review and potential revision of the guidelines. The guidelines serve several important purposes. Educating the public about the goals and substance of competition policy is one. Ensuring the transparency and fairness of enforcement is another. Providing certainty that is needed for the free flow of capital in well functioning markets, facilitating voluntary compliance with the law and sometimes also advancing the development of the law in the courts.

I think the '68 guidelines, the '82, the '84, all the subsequent guideline revisions have actually done a remarkable job of helping to forge the development of merger law in the United States and abroad. On the other hand, and we may discuss this later, I don't think it should be the primary purpose of the guidelines to try to advance the law.

I also think that even the process of developing, reviewing and updating guidelines serves a very important purpose of fostering dialogue and understanding, forcing the agencies to examine the efficacy of current policy and their articulation of that policy and ensuring that enforcement policy remains valid. Even if no significant changes are made to the guidelines, there is a real value, I think, to confirming the consensus support for them.

Of course, it's important to ensure that the guidelines remain current, that they accurately reflect both the agencies' actual enforcement policy and practices and recent developments in the law. A material gap between what the guidelines say and what the agencies do actually could undermine public confidence and legitimacy of government enforcement.

I want to quickly go to the AMC recommendations, and I note, too, going last gives me the opportunity to see that, just as at the AMC, there was a substantial amount of bipartisan consensus about a number of things I think that I've seen developing up here already, while there are some differences, some substantial consensus on a number of matters.

Let me go quickly through the AMC recommendations that I think are relevant to the current exercise for those of you who don't carry the AMC report around with you.

UNIDENTIFIED MALE: It's big.

MS. GARZA: It is big, yeah. I should get a nice little abridged version of it.

First, the AMC concludes that there was a general consensus that the basic framework for analyzing mergers followed by the U.S. enforcement agencies and courts is sound, and I think that's an important starting point.

Second, the AMC concluded that no major changes to merger enforcement policy are needed to address issues in industries characterized by technological change and innovation because current law, including the merger guidelines, are sufficiently flexible to address those aspects of competition. At the same time, the AMC did make several recommendations specifically related to the review of innovation-related aspects of mergers.

The AMC recommended that the merger guidelines should be updated to explain more extensively how the agencies evaluate the potential impact of a merger on innovation. The ability to innovate is a significant reason for some mergers and innovation is extremely important to economic welfare, yet the current guidelines mention innovation only in passing in footnote six, which they said sellers with market power also may lessen competition on dimensions other than price, such as product, quality, service and innovation.

The Commission recognized that there remains a need for additional learning regarding innovation competition, but concluded that the agencies have sufficiently considered the issues involved to provide some more useful guidance than what we see in that footnote.

Next, the AMC recommended that the merger guidelines should be updated to include an explanation of how the agencies evaluate non-horizontal mergers. Now, I realize that this exercise is specifically designed to think about the horizontal merger guidelines, but let me tilt at some windmills here and represent the AMC by suggesting that it would be very worthwhile for the agencies to revisit their treatment and articulation of their treatment by vertical guidelines.

The ‘82 and ‘84 merger guidelines, which were only the DOJ, contained a section addressing non-horizontal mergers, including vertical mergers and mergers raising potential competition concerns. Although that section of the ‘82 and ‘84 guidelines addressing non-horizontal mergers was never formally abandoned, the ‘92 merger guidelines and the ‘97 revisions did not include that section and the FTC has never, to my knowledge, issued any sort of guidelines or statements about their treatment of vertical mergers.

Although significant thinking has occurred regarding vertical mergers since 1984, the guidelines haven’t been updated. The AMC concluded that the horizontal merger guidelines have brought significant transparency on how the agencies evaluate horizontal mergers. The business community has benefitted, petitioners have benefitted and we think they would benefit greatly from some updated articulation of the competitive effects of vertical mergers.

I’ll note that Chairman Leibowitz mentioned today the Comcast/NBC Universal merger, which I don’t know, but I suspect may have some vertical aspects to it. Just another illustration, the agencies do look at vertical aspects of transactions in important transactions and it seems to me a real mess not to do something to address the fact that the last time that they spoke to this issue was in 1982.

The AMC recommended that the agencies should increase the weight given to fixed cost efficiencies, such as research and development expenses in dynamic innovation-driven industries where marginal costs are low relative to typical prices. The current merger guidelines appears to weigh most heavily efficiencies that will reduce price to consumers in the short run.

Reductions in total costs, including fixed costs, such as improving upon the rate and quality of innovation, have less, if any, effect on pricing in the short run, obviously. In the longer run, however, some, if not all, such efficiencies could also likely benefit consumers in the form of lower prices, increased choice and improved quality.

Although the current merger guidelines do recognize that R&D efficiencies should be considered, they appear to treat them with particular skepticism. While the AMC recognized the difficulty of measuring efficiencies and balancing the value of future benefits that may result from innovation against the current costs to consumers, given the importance of innovation and the centrality of innovation-based industries to our current economy, the Commission urged the agencies to, in effect, give the highest priority to the appropriate treatment and articulation of how it looks at innovation issues in merger analysis.

The AMC recommended that the agencies should give substantial weight to demonstrating that a merger will enhance consumer welfare by enabling the companies to increase innovation, recommended that that agency should be flexible in adjusting the two-year time horizon for entry where appropriate to account for innovation that may change competitive conditions. The Commission expressed concern that the current merger guidelines do not clearly acknowledge the possibility of dynamic change over a longer period of time than two years.

Innovation may result in entry beyond the two-year time horizon. While we recognize that the guidelines do not purport to present a hard and fast rule, the Commission recommended that the agencies increase their flexibility in this regard to ensure that innovation that will change competitive conditions more than two years out receive the proper consideration.

And, finally, the AMC recommended further study of merger policies. Specifically, the Commission recommended that the agencies seek to heighten understanding of the basis for U.S. merger enforcement policy, including through study of the relationship between concentration and other market characteristics and market performance to provide a better basis for assessing the efficacy of current merger policy. Thank you.

MR. SHAPIRO: Well, thank you very much, Deb.

Before we turn to discussion, I wanted to have a brief advertisement for our next panel. So, a word from our sponsor. We're particularly fortunate to have Judge Doug Ginsburg here on the next panel. We're very honored that he accepted our invitation to come and speak. So, stay tuned for that.

Now, back to our regularly scheduled programming. I have a number of questions and I want to kind of move it along, and I'll look for each of you to indicate when you want to weigh in here.

The innovation topic, almost every one of you has mentioned it, okay? So, let's stipulate that innovation is really important. Let's even stipulate it's more important than small price changes, okay? The AMC says that we should factor that more in. There's virtually nothing in the guidelines on innovation effects.

How might we do that while maintaining flexibility and while recognizing that it may be very hard for the agencies to peer into the future far enough to really discern innovation effects? What kind of markers could we look to if we want to add some material on that in the guidelines?

Tim, I know you're interested in this topic.

MR. MURIS: Sure. I think you should give more guidance. I'm not sure you're ready to do guidelines. There are three particular issues that make this particularly difficult. One is the economics doesn't point in any uniform way. We know, I think with great confidence, and the statistics show this, that mergers to monopoly and mergers to duopoly normally are bad and should be challenged.

The economic models and limited evidence on the innovation point -- and some of the best summary is still in a report Bob did in that first set of hearings that he had. About the best that you can say is that in so-called mergers to monopoly situations, sometimes it's anti-competitive, but not always. So, you've got a fundamentally different meaning of numbers than you have in product market cases. That's the first problem.

The second problem is the benefits from successful innovation, in many cases, are just overwhelming. Take the drug situation. We did the Genzyme case. It was one of the few cases when I was Chairman that was controversial and we allowed what was a two-to-one merger to go through, and they succeeded in a drug to deal with a horrible disease called Pompe's Disease. Those kind of benefits, you know, dwarf the benefits in the typical product merger of, you know, 5 to 7 percent lower cost. And that's more true generally with innovation, I think people believe.

The third problem is our experience -- I still say our, I guess I can't get over that -- the experience of being the government when the analysis of innovation is mostly at the FTC and mostly with drug mergers. There’s nothing wrong with that, but they have -- there’s a particular regulatory process that makes the whole innovation issue more tractable.

So, what I would suggest is rather than do guidelines is that you offer more guidance, beginning with someone writing a nice paper about just exactly what the FTC has done in all those drugs cases, you know, why they’ve done it, how they’ve done it, the arguments that have occurred. Try to make it relatively neutral, at least in part.

So, again, more guidance for sure. I’m not sure we’re ready for guidelines.

MR. SHAPIRO: Bob?

MR. PITOFSKY: I agree entirely that defining an innovation market and the measuring market share is much more difficult than other efforts that we’ve engaged in because so many innovation markets suggest ideas, and after spending a hundred million dollars, it turns out the idea isn’t going to go anywhere. So, I agree that as a preliminary, the people who are going to revise the next set of guidelines should take a look at what happened over the last 20 years in terms of innovation, get some statistics together.

But then to opt out and not give as much direction as we can to the public sector about market definition and market share, I talked about market share in my initial remarks. I know how difficult it is. But people have been working on it. There are articles on it. RAP (phonetic) has an article on it. Judge Bork wrote a little bit on it. It's not easily done the way price analysis is done. But that doesn't mean that it can't be done, or you do as much as you can, give as much hint to the public sector as you can and move on from there.

MR. SHAPIRO: Deb?

MS. GARZA: Yes. The AMC appreciated that -- directly in its recommendations and report that there is an issue, about whether or not the agencies' thinking has matured sufficiently to get guidelines, as Tim suggested. And it is important, I think, that the guidelines represent a consensus document and don't sort of represent the flavor of the month club in terms of economic thinking.

But what we saw with AMC was that the public -- the non-experts that looked at the -- the policymakers that looked at the guidelines that seemed to be looking at a static world and seemed to be really focused more highly on price effects and didn't seem to, frankly, give enough weight and consideration to innovation issues. I don’t think that’s a true assessment of what actually happens at the agencies. I think when the agencies do their analysis, they are thinking of competition in a dynamic sense.

It’s just that the nature of the guidelines because of the way they were written, they were really more focused on a sort of static competition world and more on the price effects. I think the concern is that they don’t adequately leave room for consideration of the effects on innovation, which, as Tim has said, can really swamp any other effects or concerns.

So, even while you may not be able to specify much in the guidelines about how you’re going to look at innovation issues, the AMC thought it was important to make sure and clear that innovation is an issue and then, frankly, urge that through this process of looking at the guidelines and potentially revising them that there should be a lot more work and thinking and articulation, whether or not it’s in the guidelines, but a lot more articulation of the issues that are relevant to innovation and merger analysis. So, whatever is in the guidelines or outside the guidelines, you are pushing forward the thinking in that area and articulating the issue clearly, even if it’s not in sort of the strict structural guideline sense.

MR. SHAPIRO: Doug and then Jim.

MR. MELAMED: Just a couple of modest thoughts. I don't claim any great expertise here, but here are my thoughts.

One, I think, first of all, innovation has two potential roles here. One is are we worried about harm to some innovation in what some people would call the innovation market? And the other is the prospective future innovation and kind of efficiency benefit that one might imagine from the merger. I think the analysis might be different.

As to the former, my sense is to have great skepticism about the value of defining innovation markets, trying to figure out how to measure shares in them and so forth. I think the whole premise of that doesn't really apply. The whole premise of defining shares is to figure out, you know, sort of whether there's a likelihood of anybody being able to price off a marginal revenue curve rather than a demand curve and create some dead weight loss. But for innovation, the issue is how are you going to be able to -- how you're likely to shift the demand curve.

There's a tremendous incentive often, even for a monopolist, to shift the demand curve. So, I'm not sure that even if we could define an innovation market and measure shares would tell us an awful lot about the likelihood that incentives for innovation would be affected. That's one thought.

The second thought is maybe the way to look at innovation on either of these questions, the plus and the minus, is to go directly to the question of whether we think the transaction affects incentives to innovate? Often, two big potential innovators might get together precisely because they see potential synergies or, you know, they can -- whether it's just spreading their fixed cost of R&D or putting together two nutty geniuses in the same room or whatever it is. But if they have incentives to innovate, one ought to be worried about that.

On the other hand, obviously, there are situations, I suppose, where an incumbent monopolist might buy up a potentially disruptive innovator in order to shut it down. But it seems to me that relevant focus on the formality of market definition and shares, we ought to be asking simply the question of, what do you think this transaction does to incentives? Maybe that ought to be a prime driver of the analysis.

MR. RILL: Doug picked up on a point, also, that I was concerned about in thinking about innovation and its inclusion in the guidelines. I think I agree with Tim that it's probably not quite ready for prime time if the guidelines are indeed considered to be prime time because the learning is still on the way.

One has to look not only at, from the parties' standpoint, the plus side of including innovation analysis and the calculation of efficiencies, but also the minus side of looking at the possible anti-competitive effect analysis that will result from over-inclusion of innovation output functions, innovation firms in a merger case.

There's literature that pointed out -- a good bit of literature out there, but some of the literature is, I think, a little bit terrifying in the sense of looking at the very broad-based possible inclusion in a "market" of R&D functions that may be only functioning in very distant, but nonetheless, theoretically related end product categories with end products that became, for example, treatment of a particular condition, or even a related condition.

Some of the literature would include that in looking at the possible anti-competitive effect of a transaction between firms whose R&D capacity seemed to be, at least on first analysis, going on quite different tracks would put them in the same market and look to a possible challenge to the merger on that basis.

So, I think great care has to be taken to distill some of the literature and see how fundamentally sound it is and how it would play in court and go back to the principle of, is this an understandable standard that would be tractable and flexible enough to make sense in the guidelines? I think more has to be done with the literature and possibly with the cases, certainly on the competitive effects side and possibly not so much so on the efficiencies side.

MR. SHAPIRO: We have two panelists who want a second bite here. Bob?

MR. PITOFSKY: Very briefly. The implication seems to be if you had an innovation market, the result would be findings of anti-competitive effect and, therefore, a decline in innovation. The guidelines should also incorporate the notion that quite often, mergers between firms that are engaged in innovation are going to be very efficient, that they're going to be able to combine technologies. That's the history that we had with a related area which is R&D joint ventures. Not one was found illegal for the first hundred years.

It seems to me that the guidelines ought to set out the pros and the cons of consumer effects of innovation markets.

MR. SHAPIRO: Briefly.

MS. GARZA: Very briefly. The AMC had not actually recommended that there be focus on innovation markets in the guidelines. But notwithstanding what Jim and Tim have said, it seems to me that there's -- about the state of the learning, it seems to me that there is a sufficient consensus and, in fact, the agencies do look at things like the effect of a transaction on incentives to innovate.

Our proposal would be that in the competitive effects discussion, one should at least articulate that when you have a merger that is being driven by or involves significant issues of innovation, here's the way we're going to look at it. Here's the kinds of things that we're going to be concerned about, like how it's going to affect an incentive to innovate. And then the flip side, indicating that the agencies will recognize innovation-related efficiencies and how so, and to make clear that two years is not a hard and fast rule and that fixed cost efficiencies related to research and development may have a real role to play.

MR. SHAPIRO: Well, let me push this a little bit further before we move to another topic. So, it strikes me as -- if we focus on incentive and ability to engage in innovation, there's a pretty clear trade-off such as we get in unilateral effects, which is if the merging firms are -- if one firm's success would take a lot of business away from the other, we have some rivalry there that might be diminished by the merger that could retard innovation.

On the other hand, they might be able to get synergies or efficiencies. That could be articulated without invoking any notion of innovation market and simply explain the same type of analysis you would do, perhaps with a longer time frame, that we do, to some degree, for innovation and do routinely for other dimensions of competition. Reactions to that? Doug?

MR. MELAMED: Very briefly. I think that makes sense, but it does seem to me and those who know the literature better than I, correct me if I'm wrong, that the trade-off between diminished rivalry and diminished incentive to innovate is a lot less direct than is the trade-off between diminished rivalry and higher prices. If I'm right about that, it seems to me that the agencies -- the guidelines ought to note that rather than just lead people to believe that, well, gee, a three-to-two must be anti-competitive.

MR. SHAPIRO: Okay. So, your homework assignment is to submit supplemental comments on why it's less direct. He's pulling the microphone away from you to agree.

MR. MURIS: It's not just a lot less direct.

It's that when you look at the literature, there are lots of models that say it's better to have fewer firms because you can capture the benefits to innovation. Now, I think there's a very good paper by Katz and Shelanski which I think does a good job. There are people who have taken the insight that I've just said and said, therefore, all mergers ought to be approved and innovation is king and I think the Katz and Shelanski paper does a good job of debunking that view.

It doesn't mean that we're dealing with the same kind of insights that we have in product markets. What it means is that if you are going to write anything that reflects a consensus, it's going to be awfully short. But, I think there would be great value to looking -- just as we did with that data release, I mean, I was surprised, I think everybody was surprised a little bit where the numbers came out. Let's look -- the FTC's got enough experience now in this area with the drug mergers that I think it would be useful to collect it and publish it.

MR. SHAPIRO: So, if we noted the importance of appropriability, which is underlying, I think, your point as part of incentives, would that assuage your concerns or do you still think it's just too murky?

MR. MURIS: Well, fine, you add that, you've got a few sentences. I don't mind saying that. But I don't think it tells us a lot and it's not on a par with what Jim said, you know, in terms of the prime time. And you still haven't addressed the issue that, I mean, outside of the drug mergers, it's a real murky issue -- unbelievably murky about trying to even identify who the relevant parties are.

MR. SHAPIRO: Okay. Let me move to a different topic that's also been brought up by a number of you, which is, I would say, the decline of the structural presumption, Jim, you referred to the flawed market share paradigm. Tim, you mentioned adjusting HHI thresholds, which, you know, is still using the paradigm, of course, and we've already signaled that we're not departing -- planning to depart, if we do update the guidelines, from the use of market definition and HHIs.

But given that there's -- it's not a consensus, a lot of voices saying structural measures should get less weight and we should do a more holistic approach, if we move in that direction, which downplays the role of market concentration as an indicator of competitive effects and focus more on other ways of assessing the facts, how can this be done without weakening merger enforcement? To the extent that the structural presumption is an important tool that the agencies use in court, how do we do that?

MR. PITOFSKY: I don't think we can do it. I agree that some structural presumption is not everything. I know I've described it as a launching pad. It gets you started and then you look at a lot of other factors. But to say that 20 percent market share and 80 percent market share are pretty much the same thing is going to diminish the ability to enforce the antitrust laws.

MR. RILL: I think there's a lesson to be learned from Europe here. There's not many, but certainly one. The European 2004 guidelines in dealing with market structure levels indicate that they're a starting point for further analysis. I think as it has developed in the United States, that's probably what they are now, a starting point for further analysis. I think the notion of presumption in the '92 guidelines is, at most, a very weak presumption. I think the court decisions very obviously bear that out, certainly at levels other than, for example, two-to-one.

But does it weaken antitrust enforcement that one needs to go on and look at competitive effects, other measures of competitive effects, other empirical evidence that would indicate that a merger might have adverse competitive effects once a certain threshold for further analysis has been cleared? I don't think the evidence will bear that out.

I think that commensurate with the decline of the power of the structural presumption, if you will, there has not been a decline in merger analysis and merger review. At certain levels, the presumption remains in effect. I think there were flaws in the H. J. Heinz decision, but it seems to me that if one accepts the analysis of the decision, one can't argue with the notion that if the facts were as stated, that there would have been a very high level of proof shown to overcome the fact that they allege this is a three-to-two merger.

You could argue with that finding, but nonetheless, I think that shows there was not particular a weakening of merger enforcement and a whole range of decisions, such as Swedish Match and others, show that I don't think there's been a weakening in either the enforcement vitality of the agencies or of the courts' decisions properly designed. So, I don't think the presumption is there to necessarily add vitality to antitrust enforcement in the merger area.

MR. SHAPIRO: Tim?

MR. MURIS: Well, two points. The success or failure of the government in court I don't think has turned one way or the other on the structural presumption and, indeed, parties are so reluctant to take the agencies to court, it happens very infrequently.

Second, and this is a point when I was Chairman, I thought, do we want to redo the merger guidelines? And I said, “no”, because I believed in consensus, but I believed we ought to lay the groundwork for future visions by doing two things. Any revisions have to address the numbers, but what are the numbers? So, we did the data release and then the commentary on actual agency practice.

Obviously, you’re going to need to confront the data and either accept it or explain it away in revising the numbers.

MR. MELAMED: Just a brief final thought. You know, the guidelines are not a statute. You can write all the guidelines you want describing how the agencies go about merger analysis. They could be reconciled with a world in which the law says that there’s a structural presumption that we, the prosecutors, are going to tell you how we’re going to exercise our prosecutorial discretion and you could have a world in which you don’t undermine the structural presumption except by the force of an analysis that suggests that maybe courts, in their wisdom, shouldn’t give too much weight to the presumption. But I think there are two separate questions on what the law is and what the agencies’ preface ought to be.

MR. RILL: I'd just respond one second to that point. True, the guidelines are not statutory. In fact, I think Judge Thomas Penfield Jackson once described them as an admission against interest by the government. But the courts increasingly and you can cite cases, myriad cases, where the courts have treated the guidelines, noting that they're not law, but nonetheless enormously persuasive by the expert agencies and follow the guidelines as though they were almost stare decisis precedent.

MR. SHAPIRO: So, it seems to me that the reality is that to the extent the guidelines continue to downplay the importance of market shares or Herfindahls and say it's a starting point, but you don't get much from that, it's very hard, isn't it, for the agencies if they go to court than to put a lot more weight on that measure?

Doug, were you saying otherwise?

MR. MELAMED: No, no, no, I'm saying you could write around this problem if you were worried about it. I actually think, in the spirit of what Jim was saying, that if you articulate a tractable and sensible way to analyze mergers at the agency, you shouldn't be worried about the fact that it will weaken your litigation hand.

You ought to assume courts can apply it, too. But if you wanted to draft around that, you know, you could try to do it.

MR. MURIS: This is full rule of reason analysis, especially in court. And I think that might be a damning admission in some ways. After all these years of doing mergers and studying mergers, you could think maybe we could come up with some better shortcuts. The reason I mention the facts is I think there are occasional factual shortcuts. But the reality is is that when in Section 1 cases they're always talking about nobody does full rule of reason analysis. Well, mergers are full rule of reason analysis and that's reality. I'm happy with that myself.

MR. SHAPIRO: Well, the guidelines right now, they have a disclaimer saying this is how we do things, but it's not necessarily how we'll conduct litigation. Should we drop that disclaimer and encourage the courts exclusively to rely on the guidelines or just keep it the way it is?

MR. MURIS: I don't think that --

MR. MELAMED: Option A.

MR. SHAPIRO: Drop it?

MR. MELAMED: Yeah, Option A, drop it.

MR. MURIS: I agree with that.

MR. PITOFSKY: I'm sorry, what is the consequence of dropping it, that the courts are told not to pay any attention to it?

MR. RILL: No, it's a gratuitous footnote that was trying to get away from actually trying to align burdens of proof and other technical litigation strategies in the guidelines. I don't think it's for any useful purpose now. I don't think the effect is to weaken or strengthen the force of the guidelines.

MR. PITOFSKY: Vis-a-vis the courts.

MR. RILL: Right.

MR. PITOFSKY: I'll go back to the original here. I think the guidelines tell you what the enforcement intentions of the enforcement agencies were. I don't believe the courts should be bound by them. Maybe a little interest, but very little interest. Much more bound by precedent, although there isn't an awful lot of precedent.

MR. RILL: But the fact of the matter is that the courts are feeling very much influenced by the guidelines. Read the cases.

MR. PITOFSKY: A few of them have. Not that many.

MR. RILL: There aren't that many cases.

MR. PITOFSKY: I stick by what I say, still not that many. But you’re right, that’s the reason.

I think the judges should do their jobs. The guidelines are for the purpose originally intended, to give people an idea of what the enforcement agencies are likely to do.

MS. GARZA: Carl, can I just -- I don’t know about dropping the footnote, keeping it. The fact of the matter is what the agencies will look at and how they assess a merger is one thing and how courts try merger cases is another, and I don’t think the guidelines should worry about things like the allocation of burdens and the various tools that the courts will use to help them assess the evidence and, frankly, I know that there is always a concern and has been a concern by the agencies about how the guidelines might affect their litigation success. But to be frank, I think it’s incumbent on the government to make its case in court under the rule of reason. And, frankly, if the judge is reaching for the merger guidelines to rule against you, chances are you’ve already lost him or her on the merits of the case.

MR. SHAPIRO: Tim, you mentioned the commentary that was released in 2006 and there’s a lot of good stuff in there. We asked in our public questions whether there were parts of it that might be incorporated into the guidelines themselves. I guess I want to ask you not so much to mention specific parts of the commentary, any of you, but what is the role of these adjunct documents and should we take parts where there is a consensus, for example, and move it into the guidelines? How should we view that commentary which is the latest, you know, systematic statement as we undertake this project?

MR. MURIS: Sure. Well, when we -- at least for myself, I envisioned the commentary as the purpose of it was to reflect the actual practice. Multi purpose for when somebody sat down to revise the guidelines.

Also, I think the commentary does something that's quite useful and probably wouldn't work in the guidelines. All the case examples. And I think, you know, occasionally doing that in whatever form is helpful. Although the people who worked on the commentary will agree with this, is cooperation between the two agencies can sometimes be strenuous. I'm looking for a delicate word here. I guess that wasn't one. I think that something like the commentary can be done more frequently with relative ease than revising the guidelines. So, I think they're complements as opposed to substitutes, although partly again I think any revision should reflect some of the consensus that's in there.

MR. SHAPIRO: Doug?

MR. MELAMED: I'm not sure I disagree with Tim, but just a note of concern about the last point he made. It's precisely because the commentary can be published with less angst that one has to wonder whether if we get too accustomed to commentary, we don't simply have the whim of the current, you know, senior staff at an agency, rather than something that is more considered and more of an enduring reflection hopefully both agencies use.

MR. SHAPIRO: Okay. Tim, again, you mentioned there are a lot of examples in the commentary. We posed the question whether or not -- let's say not real world, but hypothetical examples might be valuable in the guidelines. They're in the IP licensing guidelines, about ten of them. There's about ten in the collaboration guidelines. As a professor, I find them rather helpful as a pedagogical tool. That would be a change for the merger guidelines. A good change or perhaps note? Comments?

MR. RILL: I'll try. There are, to be sure, one or two examples in the 1992 guidelines. I don't think they're very happy examples. I will only say that there's some merit to what Tim suggested and that is that joint effort is very strenuous. You can read into that what you'd like.

In the merger area -- and I've read the IP guidelines and the international guidelines carefully and I think the examples are quite good. I think the merger area and its companion rule of reason analysis makes it much less amenable to examples that are particularly useful because the rule of reason analysis is so specific that a slight change in some of the underlying and factual basis, empirical basis for the analysis could change the outcome of the answer to the question that might be posed in the examples.

I think examples are much more appropriate for speeches and possibly commentary than they are in the guidelines because there are too many variables that could go into the production of the example that could make a slight change in the variables so that you come out with a different answer.

MR. SHAPIRO: Okay. Do others want to comment?

MR. MURIS: Well, as an academic, I generally like examples, but examples here seem odd given the hundreds of actual examples of cases you've got. If you want to pull an example, you do what the commentary did. People don't want to do that to protect the innocent or whatever.

Second, it would fundamentally change the nature of the guidelines in the sense that given so many different points in the guidelines, I don't think you could just sprinkle them through. You'd have to have a lot. It would change the document significantly. I mean, maybe that's a good thing. I think inertia and precedent probably say it's not, but I suppose I could be persuaded otherwise.

MR. MELAMED: Let me try to start persuading you otherwise or at least suggest this. I thought Tim's comment about there are so many mergers and how can you have examples is odd because there are examples in the non-merger guidelines where there are vastly more actual transactions and litigated cases and, nevertheless, examples were workable there. That's thought one.

Thought two, yes, if the agencies can't agree on a set of examples, then you shouldn't scuttle the whole project, just get rid of the examples. But I'm not sure it would be a bad idea or definitely I think it might be a good idea only if you only had a handful of examples rather than an example illustrating every important analytical point.

To put into the guidelines examples drawn upon some very illuminating things the agencies have done in years, such as the explanation of the Genzyme and cruise line cases, which are extremely valuable, and perhaps could be brought in at a key point when you're talking about certain kinds of data or incentives in innovation or whatever. Even if you didn't have 40 examples, you actually only had a half a dozen, I think it might be illuminating.

MR. SHAPIRO: Okay. Let me just give each of you a chance for a minute or two if there's some last remark you want to make, having heard this discussion. I'm surprising you with this perhaps, but reactions overall.

MR. RILL: Well, I will simply start and say that the entire process that you're undergoing right now provides an enormously beneficial perspective and it seems to me that panels such as this, and perhaps even more so the panels which will be following on, are going to, in themselves, I think, add significantly to the learning that's going to be evolving around the discussions that are taking place, regardless of whether there's a revision or not. And I think that, as I've indicated and the other panelists have indicated, there are areas that are ripe for revision.

I look particularly towards the unilateral effects panel at the close of the day. So, I applaud the process. I think it's worthwhile in and of itself even if nothing more comes out of it than the learning that could be extracted from the panels.

MR. SHAPIRO: Thank you, Jim. Tim?

MR. MURIS: Well, maybe you've already done this or have a sense of doing it, but the questions that you've asked are very open-ended and could lead to a fairly wholesale revision. At some stage, I think you should communicate publicly, you know, before you actually write whatever you're going to write that you've decided for X, Y, Z reasons to focus on, you know, A, B and C. You have embarked on an effort that is praiseworthy, but immense and, to use the word again, potentially strenuous.

MS. GARZA: Just echo what others have said. I think as you go forward, I think it's going to be important not to try to make the guidelines carry too big a load. You can't make them do more than they should do. I think that what they should do is mainly to communicate to those who are subject to government enforcement what the rules of the road are to the extent possible, provide certainty, provide transparency. Don't worry so much about trying to move the courts and, so therefore, don't load too much into the guidelines. Remember, as others have said here, it's not regulation; it's really just an articulation of the general way in which the agency will look at certain factors and what factors it will look at.

MR. SHAPIRO: Well, thank you all. Let me just set up a little bit of what's to come the rest of the day in the context of what we just heard. We sort of consciously steered clear of some of the more specific issues, such as, how are we going to deal with unilateral effects or the market definition, the algorithm and the SSNIP test because those are going to be treated later today and some of the other topics we didn't have time for, such as much on efficiencies will be addressed in other workshops.

The very next panel is on direct evidence. I think that fits very nicely with one of the themes -- I attempted to say consensus here -- that as we put less weight on market shares alone and do the more full analysis, perhaps starting the way Doug described it, that there are a variety of different types of evidence we look to and the guidelines, while sound in structure, don't say much about how we do that.

So, please stick around to hear that and other panels. We're going to take a 15-minute break. Please join me in thanking this panel.

(Applause.)

(Panel 1 concluded.)

PANEL TWO: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

COMMISSIONER KOVACIC: Welcome back. We're going to turn now to the topic that was touched upon in the first session and that is the use of direct evidence of competitive effects in merger analysis. We're all familiar with the much quoted line in many a judicial opinion that says, almost invariably, that the starting place for analysis in a Clayton Act Section 7 merger case is the definition of a relevant market and the measurements of market shares.

A great deal of theory and applied work, certainly in the last 20 years or so, has turned back to the possibility, recognized in principle from the very beginning of experience with the Sherman Act, that it would be ideal, instead of using proxies, to directly assess the likelihood or the fact of anti-competitive effects. And that possibility has been recognized in a number of cases outside of the Section 7 area and touched upon in the FTC's administrative proceedings and in Evanston, and we're going to look in more detail at the use of direct effect evidence of competitive effects as a way to assess mergers.

We're going to have basically 10-minute presentations by each of our panelists and then time for discussion. We have a terrific mix of folks who have not only had opportunities as academics and practitioners to deal with these issues, but have done so inside of the public enforcement community as well.

Judge Doug Ginsburg, the Judge on the U.S. Court of Appeals for the District of Columbia and formerly the head of the Antitrust Division; Leslie Marx from the Duke Business School at Fuqua and also with Bates White; Leslie, formerly Chief Economist of the Federal Communications Commission; Rich Parker with O'Melveny and Myers, a partner there, also formerly the Director of the Bureau of Competition at the Federal Trade Commission; Mark Popofsky, now a partner at Ropes and Gray, but also past holder of several key management positions at the Department of Justice Antitrust Division; and Bobby Willig, Professor at the Wilson School at Princeton, Principal of Compass Lexecon and also formerly the head of the Economic Analysis Group at the Department of Justice, who had a little bit to do with the 1992 guidelines as well.

So, a fantastic combination of not simply enforcement experience, but also practice outside the agencies. They've looked at the merger guidelines from both sides and will be addressing this dimension of it. And if I could ask Doug please to get us started.

JUDGE GINSBURG: Thank you, Bill. I'm pleased to be here and to know that the Division and the Commission are proceeding in such an openly, scholarly, informed way to the question of whether and how to revise the guidelines.

I am here in my capacity, as Bill said, as a Judge, not at all as an economist. So, I ask you to forgive any misstatements that may be made. I make this disclaimer whenever there’s a real economist in the room. And, also, in my capacity as a collector of tidbits in films that lampoon government agencies. So, if anyone has suggestions, I hope they’ll let me know later on. Perhaps my favorite relevant to this morning is from Ghostbusters. Toward the end, Bill Murray finds himself in the bedroom with -- was it Susan Sarandon? Sigourney Weaver, pardon me. Sigourney Weaver, and putting aside the context, which some of you will know, says, The EPA has a rule against sleeping with the possessed. Actually, it’s just a guideline.

(Laughter).

JUDGE GINSBURG: Now, I haven’t yet seen The Informant, but having read the book, I trust that some of us in the room may have been lampooned in that effort. So, I look forward to that.

I have a couple of messages and I hope they’re clear and simple. The first is this, in talking about, thinking about direct evidence of competitive effects in a merger context at least, the order of the day should be, in my view, simplicity. That is to say, in thinking about this with an eye to how it's going to be played out in court, which often it won't be, but that seems to be the failsafe assumption, the best direct evidence is empirical, historical evidence from which you can readily extrapolate.

Darren Tucker, who I think is here at the FTC, right?

COMMISSIONER KOVACIC: Yes.

JUDGE GINSBURG: And may be here today, I don't know. In a recent article said, examples of direct evidence include a natural experiment showing the effect of a change in concentration or number of competitors, documentary or other evidence showing an acquiring company's post-merger plans and changes in prices are output from a consummated merger. Now, these are all desiderata, of course, much to be desired, but going to be available only in select cases. So, it's often going to be necessary to do something well beyond that.

One such case, of course, was mentioned earlier, I think was Evanston Hospital. But that happened to be a consummated case and, so, there was price experience about which the Commission and the parties could argue in light of the elapsed time, I think four years, between the consummation of the deal and the challenge. But the question there was whether the Commission could define the market based on econometric evidence, but the econometric evidence was, in turn, an analysis of empirical price data.

In the recent airline filings, the Continental request for immunity from the Department of Transportation in switching from Sky Team to Star Alliance, the data suggested that nonstop service is a separate product market and the Department, using cross-sectional analysis of fare data, showed that fares paid by nonstop passengers increased typically, on average, 15 percent in two-to-one transactions and 6 and two-thirds percent when nonstop carriers went from three-to-two.

As for whether the nonstop trans-Atlantic market is a separate market, I can hardly imagine that there's much of a market for service that stops while going across the Atlantic. I'm not sure what it would entail.

(Laughter).

JUDGE GINSBURG: Maybe just as you've described elsewhere, departures without arrivals.

(Laughter).

JUDGE GINSBURG: Staples is, in a way, the prime example, especially since it's been ventilated in the District Court, where, of course, there were excellent data available. The parties could argue over the quality and meaning of the data, but the cash register data were, I thought, compelling and showed the effect of whether Staples was facing two or one other similar office supermarkets.

Now, when this kind of data are available, it seems to me quite clear that one ought to avoid the more laborious methods of defining a market and try to do so in this rather more analytical data intensive way when it's possible. To the extent that there are limitations, and even when you have data, you're going to be drawn into using econometric models, and that's where the difficulties really start to ensue.

I don't know if Greg came back after the break. He did. But Greg Werden and Luke Froeb and David Schefman had an excellent piece called a Daubert Discipline for Merger Simulation in one of the antitrust journals recently and I'm just going to quote a few sentences. They're not connected on the page as they are when I read them.

"The basic economic theory underlying unilateral effects from horizontal mergers is deceptively simple, but behind this simple story is a complex game theoretic model replete with assumptions about how consumers, retailers and manufacturers behave and especially about how competing manufacturers interact with each other and with retailers. By specifying a particular model, it is possible to make quantitative predictions of the price effects of branded product mergers. It is important to assess the reliability of these predictions, yet there is scarce empirical evidence on their accuracy in predicting actual price effects of mergers."

Now, what the authors have done is approached this all through the lens of Daubert and what constitutes admissible expert testimony, which I think is a very sensible perspective, one of several that one should take in thinking about guidelines along these lines. And the important point that they make is, "Any model used to predict the effects of a merger must fit the facts of the industry in the sense that the model explains past market outcomes reasonably well."

Now, of course that's all going to be subject to adversarial testing. So, it's all the more important that that criterion be met.

There are at least two cases in which courts have essentially rejected expert opinion based on the kinds of models that we're talking about here, both in the Eighth Circuit. In Concord, “The expert opinion should not have been admitted because it did not incorporate all aspects of the economic reality of the sterndrive engine market and because it did not separate lawful from unlawful conduct.”

And from California Northern in the American Booksellers case, “The expert’s model contains entirely too many assumptions and simplifications that are not supported by real world evidence.”

I think these are fair indications of the threshold that Daubert sets for this kind of evidence in court.

Now, something that may be less obvious is, it seems to me, that there’s some utility to be derived. I have not done this, I leave it to the agencies’ concern. But I think there’s some utility to be derived from looking at the experience of the courts, and I’m familiar with some of the cases in the D.C. Circuit, in accepting and rejecting conclusions based on models other than in antitrust cases, sometimes other than economic models. A lot of these come up, both economic and other models, in environmental cases. And you see arguments about attacking the results by attacking the model on the ground that some allegedly important phenomenon was not factored in.

There are a number of cases in which proceedings have gone for years through the Environmental Protection Agency, and have been, at the end of the process, thrown out because of this kind of flaw in the model, and other cases in which the tolerance of the courts for the fact that a model is inherently a simplification, inherently is going to disregard certain data as inessential, is also accepted before the courts. So, trying to do a typology of those cases I think would inform one’s judgment on approaching anything to put into the guidelines on direct evidence.

Finally, a couple of procedure comments. As I said, I think these workshops are an excellent way to begin, considering whether to and how to revise the guidelines. I think it’s also important before making those revisions to solicit comment on proposed changes. I’m not sure whether that’s been done in the past in revisions of our guidelines. It’s been done in other jurisdictions, most recently perhaps in China, which went through several rounds, both in statutory drafting and then in drafting regulations of soliciting and analyzing public comment.

I think I should leave it at that.

COMMISSIONER KOVACIC: Thanks for getting us off to a great start, Doug, both with respect to suggestions about the substantive approach, but how to go about this as well as a matter of process.

If I could turn now to Leslie, please.

MS. MARX: I appreciate the opportunity to participate in the panel and thank the organizers, Carl Shapiro and Rich Feinstein, for putting together today's workshop, and I commend the FTC and DOJ for opening the debate about possible revisions to the horizontal merger guidelines.

The questions for public comment that were issued by the FTC and DOJ raise issues related to the unilateral effects portion of the guidelines, and the last panel today is devoted to unilateral effects.

Although coordinated effects do not get much play in the request for comment, I believe coordinated effects require and deserve attention. In fact, it may be that coordinated effects are the more significant concern, particularly if coordination involves a suppression of rivalry among a much larger group of firms than simply those involved in a merger. It certainly does not make sense for competition authorities to emphasize their success in cartel enforcement, while at the same time ignoring coordinated effects in merger reviews.

The FTC lost a case based on coordinated effects arguments in Arch Coal in 2004 and, to the best of my knowledge, has not gone to trial with another case based on concerns about coordinated effects since then.

The FTC needs to be secure in its ability to take action against mergers where coordinated effects are a concern. Otherwise, firms that think there would be gains for a merger due to coordinated effects are going to pursue those mergers to the detriment of consumers and competition.

Coordinated effects were included in the horizontal merger guidelines because they were believed to be an important issue. But, overall, there appears to be a disparity between the analytical thinking that is expected from a unilateral effects analysis and what goes into the typical coordinated effects analysis.

The guidelines ask for arguments about the likelihood of post-merger coordination. I view this as a deficiency in the current guidelines. I would propose a revision to the guidelines approach to coordinated effects that focuses on how merger affects the pay-offs to coordination. Pay-offs can be quantified using standard economic techniques and give us an indirect measure of likelihood given the presumed positive relation between the two.

How can we quantify a merger's effect on the pay-offs to coordination? This is a research problem that I've worked on and I have published work with coauthors that supports my comments today.

Merger analysis tends to focus on unilateral effects, so presumably there would be a model of competition allowing the measurement of the unilateral effect of a merger. Generally speaking, whatever techniques are used to measure the effect of a merger between two firms in an industry can be extended to measure the effects of additional or alternative consolidation involving the other firms in the industry. Thus, we can use standard unilateral effects models to quantify the change in pay-offs to coordination that results from a merger.

This type of measurement would give you the pay-off associated with coordination that is sufficiently well organized to be tantamount to a merger. In that sense, this type of quantification provides an upper bound on the pay-off from coordination.

One could argue that it does not provide a quantification of the merger's effect on the pay-off from say a slight increase in tacit cooperation or something else falling short of perfect explicit collusion. But it's more informative than what's done now. If the upper bound on the merger's effect when the pay-off from coordination is small, then there's no need to worry about the merger's effect on incentives for tacit cooperation. If that bound is large, then there's a lot more room for thinking about other contributors.

The machinery for this line of analysis is immediately available to any economist who has conducted a unilateral effects study. The analysis would only augment whatever's currently being done and could be done at relatively low cost because it just extends analyses already conducted.

Let me give a quick simple example. Suppose there are four firms in an industry cleverly labeled A, B, C and D, and we can let D be small. Suppose A proposes to acquire B, but there are concerns about coordinated effects involving C. First, we can calculate a bound on the incremental pay-off from coordination prior to the merger by contrasting the pay-offs in the pre-merger market with those predicted by the unilateral effects model applied to a merger of A and C.

Next, we can calculate a bound on the incremental pay-off from the coordination after the merger by using the unilateral effects model for the merger of A and B and contrasting that with the unilateral effects model applied to the merger of A, B and C. Comparing these two bounds, we have a quantification of the change in the incremental pay-off from coordination as a result of the merger.

The questions for public comment ask about the possible role of evidence of head-to-head competition. This would be pertinent to, for example, the recent JBS-National Beef and CSL-Talecris cases, and any merger involving a so-called maverick firm. The current guidelines raise the notion of a maverick firm saying coordinated interaction can be effectively prevented or limited by maverick firms, firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals.

The guidelines seem to view a firm's status as a maverick as some exogenously given and unchangeable characteristic of a firm. But so-called maverick behavior is a strategic decision of a firm, not an exogenous characteristic. The guidelines are written as if a maverick's behavior is that of a wild animal.

(Laughter).

MS. MARX: Rather than the behavior of a profit-maximizing firm in the marketplace. We must remember that maverick-like behavior might be a strategic decision by a firm designed to improve its position in a post-merger cartel.

By using the approach of extending a unilateral effects analysis, no additional data or information is required, assuming the unilateral effects analysis has the flexibility to be extended to other potential mergers. We would expect this to be true unless there's something special about the model used for unilateral effects that means it can only be used to examine a merger between the two firms being considered and cannot be extended to consider other potential mergers.

Furthermore, the approach I discussed can incorporate an array of different aspects of a merger and post-merger coordination. For example, it allows the quantification of pay-offs associated with the inclusion or exclusion of various firms in the post-merger cartel, allowing the identification of the profit maximizing cartel membership, which would be of most concern to the agencies.

It allows the quantification of the pay-offs associated with deviations for inclusive behavior, providing information about the stability of various post-merger cartels. It allows the calculation of the efficiency gains that would be required to offset the potential loss in consumer surplus from coordinated effects. And it allows the quantification of how required divestitures might mitigate a merger's effect on the pay-offs from coordination.

I’m not alone in advocating for more rigorous coordinated effects analysis. For example, Andrew Dick, in a 2003 law review article, argues in favor of more rigor. But his focus is on the constraints that prevent coordination in an industry, and it’s not clear what analytic tool one would bring to bear in this case.

I propose a different guiding question. Instead, I would ask, how does the merger change firms’ incentives to overcome whatever constraints on coordination might exist, including how the merger changes incentives for an apparent maverick to behave as a maverick?

In recent articles by Davis, and Sabatini, and Davis and Hughes, authors have proposed quantifications using a particular model of tacit collusion. That’s another approach that also provides valuable information. It’s a different approach in that it produces an estimate of the pay-offs associated with a particular type of cooperation where one might argue about whether or not it is feasible or likely for that type of arrangement to be implemented.

Our approach avoids the issue of likelihood completely and focuses on what level of profits are available to the firms should they find a way to overcome whatever obstacles they face in organizing coordinated behavior. The greater the available pay-offs, the greater should be our concern that creative minds focused on profit maximization will find a way to achieve those profits.

The opposition to the merger in Arch Coal, based on coordinated effects, may well have been correct, but the arguments presented in that case were not compelling to the courts. Yet, since Arch Coal, U.S. authorities and the European Commission have successfully pursued many price fixing conspiracies. In other words, the agencies remain vigorous enforcers of Section 1 of the Sherman Act, recognizing the ongoing threat to the competitive process from cartels and collusion. It’s important that the agencies be able to map this concern into merger reviews.

To conclude, I think it would be valuable to recognize in the guidelines that the discipline of economics has much to say about post-merger pay-offs from coordinated conduct and that thus we have much to say indirectly about likelihood since it is reasonable to believe that likelihood of post-merger coordination increases with the pay-off from such conduct.

COMMISSIONER KOVACIC: Thank you, Leslie. In many ways, when we think about the topic of direct proof, it often comes up in the context of unilateral effects analysis and your presentation very usefully focuses on the possibilities of thinking about coordinated effects as well and that's a very valuable part of the session.

Rich?

MR. PARKER: I want to thank everyone for inviting me, the organizers, and I'm certainly going to try to say something from my own perspective and experience that I hope will be helpful.

I think it is very important that the merger guidelines reflect actual agency investigational practice. Actual agency investigational practice, in turn, has to be calibrated to turn out cases that can be tried successfully because we all know that only a federal judge in the United States can stop a merger from closing and, ultimately, these cases have to be presented. And I think what's important is that there be agency practice that makes a winnable case and that the guidelines set forth what that practice is.

My experience in trying cases in Federal District Court, merger cases both for and against the government, is that the district judges are concerned about effects. They are concerned about whether customers are going to be hurt and they are concerned about the mechanism by which they're going to be hurt. And the government has to explain that, whether there's going to be coordination or whether it's going to be some form of a unilateral price increase simply because they're so big or because they have some close substitute type issue. The government has to explain that.

The best evidence of that is direct evidence. And what I call direct evidence is anything other than a presumption for market shares. The best evidence, of course, in my opinion, is a natural experiment. And generals always fight the last war. So, I mean, in Cardinal Health, which I tried back in 1998 with Mike Antallics and others, we had a couple of instances that showed what happened when the merging parties entered California and we saw prices go down. And now that merging party is going to be out. It's pretty obvious what's going to happen when that merger closes.

Staples is probably the best example where we have evidence of what happens where two stores are across the street from one another and what happens when they're not. Pretty obvious, it seems to me to a federal judge, almost all of whom are not antitrusters, as to what's going to happen. That's the most important evidence.

I think party documents are extremely important. Those of us who represent large companies know that they spend a lot of energy with a lot of very bright people trying to figure out what's going to happen when this merger closes before they invest a gazillion dollars of their shareholders' money in this, and so, those documents can be very instructive. And by the way, many of them, obviously, are not going to help the government. They're going to help the parties. But I think those are very important expressions of what is likely, under the standard, to occur after it closes.

There are also other kinds of documents. Many of you may remember that I once had a document where a senior executive said that would-be pricing synergies of this merger we should be able to get an immediate 15 percent price increase. I think that is very bad for the party, very good for the government, but pretty doggone good evidence as to what is going to happen. And I think that is what is important in trying a case.

I want to talk about two things and where does the structural presumption fit in and where do all the economics fit in. Starting with the structural presumption, I think it's very important for the government that it have that because it gets you off to a good start. But I don't believe, for one minute, that a federal judge is going to be moved by the structural presumption alone. They're going to want to know whether, in reality, somebody is going to get hurt. The defense always has the argument -- and trust me, I've made it before -- that the government, they’re talking presumptions and they can have every presumption under the sun, but I’ve got the facts.

And when trying a case for the government, you ought to say, you know, Your Honor, we do have this presumption. That’s what the Supreme Court says. Absolutely. But I’ll tell you something, let’s pretend like it’s not there. I’m going to show you what’s going to happen to these people. I’m going to show you why there’s something the matter with this merger and why people, the customers, who we’re supposed to protect, are going to get hurt.

So, I think you want the presumption just because it’s in the law and because it’s modestly helpful, but don’t anybody think that it’s all that helpful to the government and that you somehow need it to win a case. I don’t think the judges are all that impressed with it.

The economics. I respect the economics profession, I respect the scholarship that goes into all these tests. But I’ve never been in a case where I didn’t have PhD on my side say that other side’s test isn’t any good or the data isn’t any good or something and there’s a better test that should have been applied and it comes the other way.

Of course that ought to be part of a case, but in my opinion, if I'm the government, the way I want to end my case is I want to say, I have presented direct evidence, I've presented natural experiments, I've looked at the parties' documents, I've looked at this, that and the other thing, I've got customers who say how they benefit from the competition among these parties, and by the way, we've done the best economics can do with some tests and they corroborate the direct evidence. Now, that's a case that's going to win. And on the defense, obviously, I'd make the same point. The direct evidence is on my side and this test we've run corroborates it. But I think that's where they fit in.

All right, this is an exercise in revising the guidelines. What are the practical implications of this? I find myself agreeing with a speech that Commissioner Tom Rosch gave a few weeks ago -- I think it was last month -- where he said that market shares and HHIs and whatever and however you revise them should not be set up as a gating issue the way they are in the guidelines now because I don't think they are, in practice. Anybody who deals with the agency knows they're not. The commentary says they're not. They shouldn't be set up that way.

I would set up and I would start the guidelines off by saying the fundamental question -- they say it fancier than this -- but the fundamental question is whether customers are going to get hurt and we're looking for evidence about whether or not they're going to get hurt and here are some examples of the kind of stuff we look for.

Next point, markets, yes, we define markets. Yes, we look at concentration. But please note they're going to be more important in some cases, that is coordinated cases, than in other cases. And, so, that would be the way that -- that would be my own practical suggestion as to how to deal with the guidelines. I mean, it's not a huge revision. I think a lot of this work was already done in the commentary.

You simply talk about we're looking first and foremost about direct effects and talk about the kinds of things that -- the kinds of evidence, maybe examples or something, of what you want and then talk about where market concentration comes in. Not as a gating issue, but as basically another form of analysis that I said is going to be more important in some cases or other.

I think if you do that, you would have some output that would be helpful to parties trying to understand what happens down here and, frankly, would be at least helpful to courts in understanding basic antitrust analysis.

COMMISSIONER KOVACIC: Thank you. Thank you very much, Rich, for, again, tying together your own experience in the courtroom, but also thinking about how things went when you were bringing the cases yourself and how that might actually affect the recasting of the guidelines themselves.

I'd turn to Mark, please.

MR. POPOFSKY: Thanks, Commissioner, and thanks to the organizers and it's a pleasure to be here.

I start from the same position as Brother Parker to the left, that direct evidence covers a broad array of stuff. I mean, it's essentially anything other than the structural presumption in establishing a prima facie case of illegality. This is a vast topic and it's really the heart of the merger guidelines. Several panels later today, we're going to explore particular facets of it, but this is a great bio-diversity of antitrust here.

We had Professor Marx talk about a model as part of direct evidence. We had Judge Ginsburg talk about the sort of evidence in Evanston and Staples/Office Depot as part of direct evidence. We had Litigator Parker here talk about how it's really everything you're going to persuade a federal judge with. This is a vast topic.

And what I want to suggest in linking that vast topic to practical revisions to the guidelines and something that's going to persuade generalist judges, which I think is a very important point here, that the agencies should proceed with some caution.

With that said, let's talk about how direct evidence can be relevant to merger analysis generally, and I approach this in part as a litigator and counselor, in part as a poor part-time academic. But, nonetheless, this is how I'm approaching it.

It's uncontroversial, direct evidence, putting aside market definition and the structural presumption can make a case for a merger being illegal. The Supreme Court has said that market share and market definition are mere surrogates for anti-competitive effects for Section 1, a little weaker proposition along those lines for Section 2. We've had no other authority than Judge Posner tell us that the tests substantively under Section 1 of the Sherman Act and Section 7 have converged. That being the case, why can't direct evidence, one asks, create a presumption itself of illegality in certain circumstances in place potentially of an analysis of market share and concentration. That's sort of a starting point.

And then one thinks about the different types of settings where that could arise. The most obvious analogy for that, I believe, is a case like Evanston where you have a consummated merger and there's where the analogy to what the Supreme Court said in Indiana Federation of Dentists about market share and market power being mere proxies is more powerful. You have conduct. You're trying to look at its actual past effects.

What would be the more logical thing to ask than what the merger did? Assuming you can create a persuasive case of showing what it did. An important question of proof. Parker has talked about how you might play that out in a court. It wouldn't just be some fancy econometric analysis isolating all the variables except the change in number of players. But intuitively, at least, a consummated merger is where the idea of using direct evidence in lieu of the structural presumption is most powerful.

And then the question is, how you deal with the diversity of evidence. Trickier. And I think this is the real key question for revising the merger guidelines, is what one does in the case of unconsummated mergers. And here's the $64,000 question I submit, it's not where direct evidence can be relevant, but where it tentatively can be dispositive.

You can think about how day-to-day direct evidence is used by the agencies in analyzing mergers. One way that certainly fits within the more general inherited legal landscape we have in Section 7 is exculpatory direct evidence.

In a unilateral case, the parties are not close competitors. There's been a history of entry. In a coordinated case, the nature of the products, marketing, pricing, et cetera, is such that coordination is just implausible. You can see how from a law enforcement perspective of trying to decide which mergers one is going to take into a second request or even to court, exculpatory direct evidence is clearly important and something that the merger guidelines should, I think, discuss how it is being used.

The question of what granular level to do it, given the diversity, is a question I'll leave for the discussion. So, that's the exculpatory side.

I think the hardest question at all -- and I'll be brief so we can get to Professor Willig and leave plenty of time for discussions -- is when direct evidence can be inculpatory, and not just that, can itself substitute for the structural presumption and basically create a prima facie case of illegality by itself.

Of course, there have been noted efforts to suggest frameworks for doing that. Of course, the Director of the Bureau of Economics at the FTC and the current and one-time again Deputy Assistant Attorney General for Economics have proposed such a test. What I want to suggest here is that one should proceed with caution in suggesting and revising the guidelines, that direct evidence, by itself, can carry today in the sort of simple level that I think Judge Ginsburg laudably says we would like to have in litigation.

The reason for that is that it's not clear to me at all that the simple test of direct evidence is inculpatory or going to tell enough of the story to be persuasive to the courts. The courts have inherited a legal landscape that says we want to look at what the definition of the market is, not just because the Supreme Court in Philadelphia National Bank told us it's useful, but there's an intuition behind that. We want to know more about that -- more than just the relationship between these particular parties. We want to know what's likely to happen with repositioning. We want to have an intuitive sense for how much price might rise to the extent you're saying look at just these insiders. We want to look at a lot of things.

And I think if you say there's a simple category of direct evidence that's going to be a humdinger, that's enough to establish illegality, whether it's the price increase in Staples, which I think, interestingly enough, was cleverly used by the government to establish the relevant market, or some of the tests for unilateral effects that are going to be proposed, you're risking three dangerous things.

One is you're going to risk having a method for how the agencies operate that's out of step potentially with what generalist judges will accept. And I know that was a subject of earlier panels today. I'm sure it will be a subject of later panels. I think there's a danger of an intra-agency analysis that is not going to be persuasive to the courts. It may be a few transactions to get there, but, of course, those decisions that get written are influential. It creates the incentives by which the parties act and the agency acts in the merger review process. It's important.

The second, if these tests for direct evidence are relatively weak, it's enough to have evidence like Staples/Office Depot, it's enough to have diversion ratio times margins, that's enough, rebut it. I think you're going to be potentially risking some false positives that might outweigh false negatives. I suggest that might be a possibility.

And if you believe that in that you're

basically saying, okay, we can split the burden, the parties now have to rebut something. Now that we've put this simple test forward, I suggest that it might not be good not just for merger enforcement but for the role merger enforcement plays in the economy.

Finally, and this links back to the diversity point, tests for establishing a prima facie case with direct evidence we might want to be simple, but the rebuttal is going to be diverse, the point I started with, and complex.

So, I think the challenge in revising the guidelines is to mediate between those positions. Add clarity potentially to the factors to go into this great space of what do you do beyond a structural presumption, but recognize that a simple answer may not always be there. And although the Supreme Court in Sylvania said that antitrust divorced from economic principles were the last sound moorings, we should also remember that antitrust is part of the legal system where parties must be able to predict their conduct and we must have transparency and a rule of law as well.

Thanks.

COMMISSIONER KOVACIC: Thanks, Mark. You and Rich, again, drawing on your experience from both sides of the enforcement process have done a nice job here, I think, of laying out the menu of possibilities, different types of proof that can be brought to bear and we can come back on that in a moment.

Bobby, please.

MR. WILLIG: Thank you. You know, direct proof of competitive effects sounds so powerful. It sounds like such a marvel. What a great thing to skip all this nasty work that we always do under the guidelines or any other analytic frame.

It's my bottom line view that direct evidence is almost never a magic bullet that obviates the need to do a real competitive effects analysis. Direct evidence is not, and I've hardly ever seen it be, a bypass of competitive effects analysis, but it can be a terrific and powerful source of data for a competitive effects analysis.

I'm hedging my language here because Rich is on the panel. I say almost never -- almost never due to the occasional board document that Rich will have uncovered in his old role, which asserts to the board that the merger will enable prices to rise almost surely and significantly due to the taming of our most powerful competitor. And I know some of us seek those documents and maybe that means, with a smoking gun in hand, there's no need to do anything else. I'm not one to say that

that's not right or not occasionally the truth of the case. But, more usually, there is no magic bullet.

Jim, you'll recall 20 years ago we were sitting in the front office looking at the evidence, talking about direct evidence. The merging parties were clearly directly bidding against each other for the business of their many customers. Directly bidding against each other. It's one of the examples on the set-up list of elements of direct evidence that maybe should be incorporated in the new guidelines. The direct evidence showed them directly bidding.

But still more direct evidence that you instructed the staff to look for indicated that the customers chose two or three rivals to go head-to-head and bid directly against each other out of the five players in the marketplace and the customers did not really care very much which two or three they drew out of the five in the marketplace. So, if the five became four through a merger, there would be no diminution of competition.

Direct evidence first said, oh, my god, they're bidding against each other, stop all analysis. But under the guidance of Mr. Rill -- I hope I'm not mischaracterizing, too, my memory is rosy -- of course, you get more direct evidence from a search in competitive analysis showing that that first direct evidence would have been misleading if it had been viewed as a magic bullet.

On the other hand, I've seen firms making commodities that were very close substitutes to each other and they never bid against each other. We've looked and looked and there's no evidence of them bidding against each other. And you say, oh, magic bullet, exculpatory. I think if we're going to change the guidelines, we've got to keep that language out. What does exculpatory mean?

MR. POPOFSKY: You had to look it up, Bobby, you told me.

MR. WILLIG: I did and I sort of remember, but I didn't see inculpatory in the other hand.

So, maybe that's exculpatory or something, but a deeper analysis, a more complete analysis showed that when one of those two firms that never bid against the other had an output cutback, it raised prices in the industry for everybody, including the other proposed merging party. It's not necessarily about bidding against each other. Sometimes it's about total output in the market. Direct evidence without a competitive analysis, full of pitfalls for the foolish looking for magic bullets, I would say.

How about a proposed merger of retail category superstores, not Office Depot/Staples, but some others that I've encountered in my life as a consultant and an analyst and a simple data analysis showed, absolutely, prices are higher in areas where there are fewer of the outlets of the big three chains in this marketplace. So, higher prices correlated with fewer players among these big superstore chains.

Is this a natural experiment which we all crave? Does this prove competitive effects from a merger that would shrink the three down to two in some areas or the two down to one? Well, maybe in some circumstances, yes, but only a fool would reach that conclusion without a deeper competitive analysis. We ran those data in this particular instance and we found that the company's own guidelines for where to enter local markets keyed on certain market factors, the desirability of the local market. If the market stank from their point of view, they weren't going in and, likewise, their rivals weren't much either.

And those same competitive factors that made entry stink also raised the cost of doing business on average and intended to raise prices. So, a spurious correlation between concentration and price which "direct evidence," the marvelous natural experiments that we all crave would have misled us into finding.

Of course, in Office Depot/Staples, the evidence turned out to be right of that kind, not econometrically, but because the smoking gun documents showed that. Right, Rich?

So, I think it was that that ultimately persuaded the court. The company said, yeah, we charge higher prices when there’s no competition around. It wasn’t the econometric standoff that led to the conclusion.

MR. PARKER: I don’t think the econometrics have won any case in the world.

MR. WILLIG: Well, how about prosecutorial decision-making? So, sometimes that direct evidence is actually indicative and sometimes it’s not.

I’ve looked at a situation where the transaction cost had risen for futures contracts on LIBOR interest rates. These are futures contracts on those kinds of interest rates, whatever they are, I’ll tell you later. And when the transaction cost went up, volume fell off. Sure enough, the data are collected daily, hourly, minute-by-minute. It’s easy to see tracks like that in the data. But at the same time, when one looked to see a corresponding volume rise on futures contracts at another exchange, based on treasury bond interest rates, there was no corresponding rise in volume there, as volume fell off on the contracts on LIBOR interest rate scored futures contracts. Evidently, no substitution in the data.

Well, I think I'm with you about this exculpatory stuff because sometimes the absence of a finding of substitution actually requires less analysis than the opposite finding where there could be all kinds of confusing factors. And, so, we reached the conclusion, and ultimately the merger went through, that at least in this particular area of possible market definition, there was no relevant market that included both of those futures contracts and, therefore, no competitive concerns.

MR. POPOFSKY: See, you used exculpatory perfectly, Professor.

MR. WILLIG: I'm getting there. It's so good being educated by you, Mark. Lawyers and economists should be friends.

(Laughter).

MR. WILLIG: I've seen natural experiments showing impact of market ups and downs on the demand side leading the episodes of entry and exit. Definitely providing all kinds of fruitful evidence about the character and height of entry barriers, exit barriers, the timing of entry, how long would it take for entry or exit to react to changes in the market. But the connection between entry and exit from evidence like that, to the real issue of whether entry should alleviate competitive concerns over a merger in that same space, as we all know, would require deep competitive analysis.

The natural experiment is the beginning of the evidence, it's not the end. It actually doesn't provide the answer, but it provides enormously valuable evidence for an ordinary competitive effects analysis.

So, with all of these examples, and there's tons more that will be coming to your minds, I'm sure, I come back to my conclusion. That direct evidence can aid competitive analysis, it should be part of it, but it can't supplant it. Direct evidence is often a provider of central data and input into a true competitive analysis of mergers.

So, those of you who are rewriting the guidelines, please have the guidelines say this. There's nothing like some good direct evidence to help inform a proper competitive analysis. And the commentary that goes along with the guidelines can have endless examples of the kind that I was just recalling for the sake of this presentation. Sometimes the examples say, yes, direct evidence can be quite persuasive, and a lot of examples say, caution, caution, you've got to go on and ask further questions before you regard that direct evidence as a magic bullet.

In other words, showing both the power of direct evidence and the need for caution in interpreting it should be part of, if not the guidelines, the commentary, and that will bring the state of the art of any such analysis along in a beneficial way. And I think you can do that with part of this revision. But magic bullet, no.

COMMISSIONER KOVACIC: Thanks, Bobby. And your comments draw attention back, as all of you have, to what specific kinds of approaches might be built into the guidelines. I'd like to take one theme that all of you have addressed and pose a question based on that.

In thinking of casting the guidelines, do you think it is either wise or necessary to have at least some attempt in the presentation of the case, to sketch out what the boundaries, using a traditional approach of a relevant market would be? To think of it another way, can you imagine the time would come, or should come, when you would see a complaint that would not include the words "relevant market" or "market share" at all?

MR. PARKER: I can see a time when that is part of a complaint, that is a theory in a complaint. But somewhere you've got to have -- maybe in a different count -- you got to have a market because that's what's called for under the case law. Note that under the Sherman Act, and I think this is an antitrust crowd, the Republic Tobacco Case and Indiana Federation of Dentists have started to talk about pulling away from actual market analysis in the Sherman Act cases. And, it seems to me, in some cases, nudging the courts in that direction is not a bad idea and I think there's a lot to it. But you got to nudge them.

Right now, you can't go into Federal Court or Part 3, in my opinion, without defining the relevant market. How important that becomes in the litigation, I think I talked about previously.

MR. WILLIG: I would like to see relevant market remain a critical part of the court case, I suppose. But, to me, even more importantly, of the discipline exercised by the agencies in making enforcement decisions.

However, I would also like the agencies to articulate publicly the current practice, which is to make inferences about relevant market and delineations of relevant market based on the best available evidence, and that evidence may arise from the kinds of analyses that we've been talking about or so-called direct evidence or more inferentially from consumer interviews or from marketing studies, whatever is the best evidence. An assortment of lines of evidence, obviously, is complementary, one part to the next. But still the discipline should be part of the agency's review process to articulate at the end of the day what is the inferred but chosen definition of the relevant market.

MR. PARKER: Can I just make one point?

COMMISSIONER KOVACIC: Sure.

MR. PARKER: Somebody ought to go back and look at the complaint that the agency filed -- and I wish Molly Boast was still here because she was handling it -- in the BP/Amoco/Arco deal where we were saying that there was a problem in Alaska, and I think we had two theories there. One, there was a price discrimination market involving sales to California refineries. But I also think we had a count based simply on direct evidence that one of the parties was already exercising monopoly power there and that the party they were buying was the only potential anecdote. I think that may actually have been in that complaint because that's the theory we were going to proceed on.

It was never tried because the transaction was abandoned. But somebody ought to look at that in the course of this because it goes directly to your point, Bill.

COMMISSIONER KOVACIC: Doug?

JUDGE GINSBURG: It may be hard to imagine the complaint that doesn't have it, but one can more readily perhaps imagine the proceeding that doesn't get to it.

I think, Bill, Jim Rill will know, 35, 40 years ago, didn't William Schwartzer write an article on the efficiency sequencing of questions in trying an antitrust case? I think people aren't familiar with it now because what he said is so much the practice in terms of motions to dismiss and summary judgment starting with basically the least evidence intensive questions, although he didn't put it quite that way.

So, I can imagine it being in the complaint, but I can readily imagine cases in which that's just not necessary to litigate it to death.

UNIDENTIFIED MALE: That's a good point.

COMMISSIONER KOVACIC: One debate that comes up in the discussions about direct proof is that some have said that it's a juris prudential prerequisite coming out of the language of Section 7 of the Clayton Act, the discussion of effects in a line of commerce, that it's indispensable. Others have said that the courts ultimately might be willing to import the approach that's been developed in Section 1 and Section 2 cases that suggest that certain types of direct proof of effects by itself might be sufficient.

But I gather, in part, that what -- at least a comment that’s been mentioned a couple of times here is that at least by way of providing a familiar frame of reference for an approach to beginning to think about actual likely effects, that some discussion of a relevant market is a useful internal analytical discipline and a good element of guidance and a good element of the presentation of the case in court.

MR. POPOFSKY: Yes, I would agree with that entirely.

JUDGE GINSBURG: Would you say that equally with respect to the geographic market?

COMMISSIONER KOVACIC: I suppose that’s a fair question to pose in that --

JUDGE GINSBURG: I think it’s a test of --

COMMISSIONER KOVACIC: Yes, yes.

JUDGE GINSBURG: You would?

COMMISSIONER KOVACIC: Yes.

MR. PARKER: I agree with that.

COMMISSIONER KOVACIC: Yes?

MR. PARKER: But what I was saying was that that ought to be in the guidelines, that discipline to go through. I think you can simply say it’s not a gating issue. You can simply say that it is probably more important in some cases than in others, the market analysis.

COMMISSIONER KOVACIC: One basic question is, again, to think of who the audience for the guidelines is and what their purpose is. Is it principally to reveal the internal decision-making calculus of the agency and its approach? And by making that evident, to enable parties to come forward with arguments that will assist in the assessment of the case? Are they designed on their own terms to guide the courts towards the acceptance of certain analytical techniques and methodologies?

Is there ultimately expected to be what the agencies will do inside the house and what they do in the courtroom and that the guidelines might make clear that there are certain things we are explaining to you for the purpose of saying, here are analytical approaches we will use on the inside, but we won’t necessarily try cases this way? We’ll use another vocabulary, we’ll use another approach. We will welcome the more detailed econometric analysis inside because we have the capacity to do it, we have experience doing it and we welcome that. But when it comes time to try the case, maybe in the way that Rich was just saying, we won't do that.

There's the famous interview that Judge Hogan gave after the Staples case in which he was asked in Ken Auletta's book on Microsoft, how much did the econometrics matter to you, and he said, not at all; that is, I relied on the documentary evidence. Who is the audience for this document? And is the document really taking -- is it to take two approaches, one to say for parties who come before us, this is evidence we'll use to decide to prosecute, but when we go to actually proceed to bring a case and lay it out, we won't necessarily use the same techniques or methodologies that led us to decide to go ahead.

MS. MARX: I mean, I view the guidelines as giving some structure for how the agencies are going to go about figuring out whether a particular -- a quantification of whether a particular merger is going to increase or decrease consumer surplus and whether it will affect the nature of competition. Economists have a lot to say about quantifying whether a merger might increase or decrease consumer surplus, but essentially nothing to say about proper legal strategy.

So, I could imagine a guidelines that were geared toward analysis that's going to guide you toward the correct policy decision and might be quite divorced from what you would expect the agencies to go forward with as their legal strategy.

MR. PARKER: Can I say one point about the audience here? I don't overlook the client. You got somebody who wants to do a billion dollar transaction and cannot understand why he or she has to wait all this time in Washington. As counsel, it is really helpful to -- I mean, I always tell them, I say, look, we may disagree with how the agency comes out, but I always say, these are good people who know what they're doing. For example, take home the merger guidelines and you will see exactly what they're going to look at and you will see that it makes sense.

So, I think that a document that lays out what you're going to do in terms and that holds together and is coherent actually is very good for the agency's role in the broader economy and, most certainly, helps outside counsel who are trying to explain why it is they can't close their deal for ten months and they may have to go to court to do it or whatever.

I just think the business community -- you know, it's important to communicate that you folks know what you're doing. You do know what you're doing, but it's important to communicate that. I think the merger guidelines are one way to do that, in my opinion.

MR. POPOFSKY: Let me pile onto that for just a second.

COMMISSIONER KOVACIC: Mark and then Bobby.

MR. POPOFSKY: Because I could not disagree more strongly with Professor Marx here. You know, I don't think anyone said it better than Judge Breyer in Barry Wright and again in his Leegin dissent. Antitrust is not a mere applied economic exercise. It is a system of law enforcement. It is something that very much, as Rich said, affects businesses in the real world. And the weaker the link between the methodology the guidelines lay out and the principles that are applied in court and the principles by which primary actors, you know, are guided in their conduct, I think the more disastrous it is. The link should be tight and it should be strong.

COMMISSIONER KOVACIC: Bobby?

MR. WILLIG: Defend yourself, Leslie.

MS. MARX: No, my point is that the type of procedures that you would expect an agency to go at in evaluating the effects of a merger are not necessarily in the order or of the presentation you would want to make in a legal case.

MR. POPOFSKY: I'm making even a deeper point, I guess than that. I don't think that what the agency should do should be a mere applied economic exercise to calculate consumer surplus. I think, as Professor Willig said, it's a competitive effects analysis. As Jonathon Baker once wonderfully wrote, when a piano drops on a sidewalk and hits someone, you don't ask was there negligence, you ask who was negligent. You know, in going through everything we do as a disciplining matter, you know, market definition, calculating shares, all the things the guidelines lay out as a way of thinking about is wonderful for that because it structures the analysis of deciding who dropped the piano.

But I think when you get farther away from that and say, you know, let's engage in some mathematical modeling exercise of how the piano got dropped, I think there's a danger in many respects. It's just where I come from on this.

MR. WILLIG: Okay, let's imagine a common sort of thing, assume a can opener. Let's imagine an agency whose leadership is really integrated and works well as a team, and I think this is sometimes a reasonable approximation of reality, not always to be sure. So, the agency --

COMMISSIONER KOVACIC: It's been known to happen.

MR. WILLIG: So, the agency decides to bring a case against the merger and suppose that the econometric analysis, call it that or call it the piano tuning if you like, but the deeper analysis, call it econometrics, was actually necessary for the agency to make up its collective mind. Now, I'm not in an environment where the lawyers say, oh, that's crap, and the economists say, you're full of crap, not that sort of agency, but where the parties -- the leadership actually listen to one another.

Judge, you mentioned the airlines case, the alliance situation. That may be a situation where there's obviously competing considerations and maybe we actually do need to look at the data to find out whether the efficiencies or the anti-competitive effects are stronger. Maybe. And maybe those econometrics that you saw weren't really the right ones. I'll send you some that are different.

(Laughter).

MR. WILLIG: So, the agency decides to bring the case. The econometrics were crucial to the agency's decision. That won't always be the case. Sometimes it just amuses the economists. Sometimes it tends to lead to a search for evidence that will be persuasive to everybody, covering the same ground, but is not econometric. And maybe that was the case in Staples/ Office Depot, I don't know. But imagine the econometrics were really salient to the agency. Now, are you all really saying that when you go to court, you shouldn’t use those econometrics because you’re going to run into a well informed other side that will rebut all of your evidence, and the same way that the agency wasn’t persuaded, why should the court be persuaded unless the trump card of the econometrics is played in an understandable way in court? I just don’t get it.

MR. POPOFSKY: Well, I certainly wasn’t advancing that proposition. I can’t say it any better than Brother Parker. It’s confirmatory, it’s consistent with, it’s a piece of the whole analysis.

MR. WILLIG: You’re saying it’s not needed.

MR. POPOFSKY: I’m not -- it may not be needed.

MR. WILLIG: Okay. But what if it is needed?

MR. POPOFSKY: You were posing a hypothetical where for a decision to be made, it was needed.

MR. WILLIG: Yes, exactly. That’s the catch.

MR. POPOFSKY: You know, and that is how the decision maker was acting.

MR. WILLIG: So, what do you do with that case, sir?

MR. POPOFSKY: What you do with that case is it’s important and it’s a tipping factor, sure. What I don’t --

MR. WILLIG: Then do you show it in court?

MR. POPOFSKY: I don't think you would bring a merger case without my Bobby Willig by my side, putting up my calculations, my data, my equations. I would be negligent to my client.

MR. WILLIG: And we'll beat the pants off the other side, believe me.

MR. POPOFSKY: We would.

MR. WILLIG: Okay.

MR. PARKER: This is getting good, guys.

MR. WILLIG: As long as we have it on the record, we're fine.

MR. POPOFSKY: What I object to is the notion that merger analysis is a quest for econometric truth.

MR. WILLIG: Yes.

MR. POPOFSKY: That is what I was objecting to.

MR. WILLIG: That's true.

MS. MARX: Certainly, my proposition is that it is a quest for the truth, and if the truth comes to us in a board memo, that's one thing. But I think we need to -- the whole nature of what we're worried about here are competitive effects in mergers. That's economics. That's how the market is going to be affected by the merger. We need to be looking at economic evidence. I think the economic evidence ought to be primary in these cases.

Maybe once in the presentation of the legal case, maybe it’s easier for your audience to understand a board memo, but I think the fundamental quest of the agencies should be the economic truth.

COMMISSIONER KOVACIC: Doug?

JUDGE GINSBURG: Well, I just want to point out that this whole discussion takes place in the context for which we’ve convened, of thinking about merger cases. So, there’s no occasion in any imaginable merger case for worrying about direct evidence as an economizing device, all right? So, it’s not like a Polygram situation.

The government’s going to bring this case that’s going to use whatever resources it has. It’s worth challenging, it’s worth defending. It’s not something where economizing on the proceedings is an important value. However, the handling of direct evidence may well spill over into private non-merger cases. So, it’s a concern that ought to be in the background as revision goes forward.

There have been two articles in the last year, one by Professor Stuckey’s that’s been published, questioning or arguing that merger law in the United States does not meet rule of law standards because of problems of predictability and transparency. There’s a more recent manuscript, I think on SSRN that has not yet been published, very recent, taking a similar view of the law of the European Commission on mergers.

I think that is an important concern. If that becomes a widespread perspective, I think it's very deleterious to the agencies and, to a lesser degree, the world of law itself.

So, I think the answer to the question I think you posed at one point, Bill, about whether the guidelines should reflect whatever they can about the agencies' internal process has to be yes, even if it doesn't always carry over into the presentation of evidence.

MR. PARKER: There's a sense of which -- I mean, that is extremely important. Just think about it, folks. I mean, I don't do just mergers. I mean, I'm spending most of my time right now trying to figure out whether prices were fixed at a meeting that occurred three years ago in a certain place at a time. You're in a merger case, you're not doing that. You're trying to figure out what's going to happen in the future.

So, I can't think of any other kind of case that I've ever been involved in, maybe there is somewhere in the law where you're trying to predict the future and nobody really knows. What I'm suggesting -- I'm not suggesting you just look at board memos or anything else. I'm suggesting that things from the past like that, natural experience, other kinds of things, are really going to be the most persuasive. That does not mean that the agency goes to court without doing the econometrics or doing the best it possibly can given the current economic capabilities of the day. You do both.

MR. POPOFSKY: Just one further comment on that. I think mergers is actually an area where the agencies have a particular responsibility to think about the link between how they are approaching transactions and what the legal principles are. Putting aside the sequencing issues, I know another panel will probably address whether one starts with, as I said, maybe exculpatory evidence or very inculpatory evidence. I'm not talking about sequencing. I'm talking about the ultimate analysis.

And the reason for that is the reality that very few cases, of course, get to Judge Ginsburg. It's rare they go to District Court. It's even rarer they go to the Court of Appeals. And it's, of course, not been since General Dynamics or Citizens, whichever you want to believe is really a merger case, that they've been the Supreme Court. It's an area, given the realities of both business, how the legal system works and other factors, that the agencies really are acting in a law enforcement role where, in some sense, they're both judge and jury, and I think that creates a special responsibility for that type market.

COMMISSIONER KOVACIC: We're just about the end of the session and to close up, I wondered if I could go back to the panelists, if you had a thought that you'd like to close with for a minute or so. Why don't we pick something maybe that you haven't drawn on or another point you want to drive home. And maybe we'll start with Bobby and come back this way.

MR. WILLIG: Thank you. One question mark in my mind, and I call it a question mark, but I think I have a leaning, is in view of the plethora of kinds of direct evidence, and I agree with all of us when we make the point that there's tons of different kinds, when we think about different kinds of analytics that are necessary to handle different kinds of direct evidence to test their salience and their veracity, whether their superficial look is actually sufficient to be taken seriously, should we really put all that stuff in the guidelines?

Because, in a way, we're worried about checklists on the coordinated side. This will be an infinitely long checklist of different kinds of direct evidence and ways to test different kinds of direct evidence. What a burden for the reader, for the user of the guidelines, as opposed to having laundry lists like that and examples off in the commentary and keeping just the principles in the guidelines, to which we hope direct evidence may go once that direct evidence is properly tested through the analytics.

It’s a question, but I think I know my answer to it, yeah.

MS. MARX: One of the other things that was raised in some of the questions for comments is whether the presence of buyers with significant market power should be viewed as something that might deter fears about coordinated effects in a merger. I would want to be cautious about putting something like that into the merger guidelines because there are a number of examples like in vitamin C where Coca Cola was an important buyer of vitamin C and the cartel, although that made them pay attention, they had to have special meetings to deal with Coca Cola, the presence of the buyer -- the significant buyer there did not deter the cartel.

In food flavor enhancers, -- that’s a cartel where there were four cartel members and only three large buyers in Europe -- it’s a problem for the cartel to divide up those buyers, but they used counter-purchasing agreements and managed to work things out where cartel members would buy a requirement from each other.

So, I would be cautious about including language in the guidelines that suggests that significant buyers necessarily reduce the threat of coordinated effects.

COMMISSIONER KOVACIC: Thanks, Leslie. Mark?

MR. POPOFSKY: Since Bobby spoke and it’s safe to speak, but I’m going to echo his theme. You know, there’s a tension between what businesses would like, which is something of a checklist -- I mean, how many clients, Rich, come to you and me and say, we’d like to know can we do this, can we not do this, show us where they say can we do this or not. On the other hand, there’s virtues in being modest, virtues in keeping one’s options open.

I suggest in this quest for finding nice, neat answers that help make the law predictable in the merger area, in finding potential substitutes for the Philadelphia National Bank presumption, that the agencies be relatively modest and recognize there’s a lot that one still doesn’t know. And then when one is using direct evidence as a surrogate for that, there’s a lot of trouble one can get into if one wants to basically flip the burden to the other side.

COMMISSIONER KOVACIC: Rich?

MR. PARKER: Those of you who know me as somebody who talks often and a lot are going to be surprised, but I think I've already said what I think. I hope it was clear and unambiguous and I most certainly hope it was helpful.

JUDGE GINSBURG: Just following up on Professor Willig's last observation, principles only in the guidelines, illustration, checklists and so on on the commentary, that's probably a good organizing principle. I'm not sure of a practical difference it makes because I don't -- unless things have changed, the commentary isn't amended any more frequently than the guidelines. Has that changed?

COMMISSIONER KOVACIC: The commentaries were the first of the type.

JUDGE GINSBURG: Okay.

COMMISSIONER KOVACIC: So, they were sometimes called guidelines on the guidelines.

JUDGE GINSBURG: I think it's worth -- this is a perennial, but I hope you might find occasion to revisit it at the agencies in connection with this project, and that is doing something more by way of closing statements when cases are not brought, that would supplement the guidelines in a meaningful way. And something that can be very brief and suggestive rather than detailed and then, certainly, you have to be concerned with trade secrets and so on. But that would give some ongoing guidance.

In my far outdated experience, every potential merger case involved a story or two stories and parties came in and told us their story and the staff came in and told us why that story was not right or why, in fact, it checked out later on. And a lot of those stories are totally unique, but like common law cases, the cumulation of unique cases enables people to triangulate their position and to steer accordingly.

COMMISSIONER KOVACIC: I want to thank everyone for addressing what will be a fundamental focus of concern for the revision process as it takes place. There is, again, a traditional framework that everyone is familiar with. If you plug in the relevant language, you get the countless number of cases that begin by saying we always begin the Section 7 case inevitably by defining a relevant market, measuring market shares and going on from there. Yet, there’s been another literature body of experience that says, in a number of instances, that’s not strictly necessary and it can even be a source of confusion.

I think today there’s been an excellent

discussion of how those two views might be reconciled in a new drafting effort here. I'm grateful for all of you helping us see theory meet practice in talking about the topic. Let me ask you to thank our panel.

(Applause.)

COMMISSIONER KOVACIC: And I think the Panel 3 on market definition starts at 2:00.

(Panel 2 concluded.)

(Luncheon recess taken.)

PANEL THREE: MARKET DEFINITION

MR. FEINSTEIN: Why don't we get started with the next session. For those of you who don't know me, I'm Rich Feinstein. I'm privileged to serve as the Director of the Bureau of Competition. One thing that I've already learned just from coming up to this table is that the Bureau of Competition has these very cool pens, which I didn't know about until this morning. So, I will have gotten something out of today.

In any event, the first two panels this morning, I think, set the bar pretty high. But we have a very distinguished group which we hope will not disappoint the afternoon audience. I don't think we will. We've got an interesting topic, which is market definition. And the way we're going to organize this is pretty much the same as it was done this morning, which is to say that I've asked each of the participants in the panel to make an opening statement of five to ten minutes, and I will enforce that. And after that, we will be kicking around some questions.

If any members of the audience have questions, the same rules apply. Please write them down on a card and get them up to me and then we will see if we can get into those.

I also want to mention that Larry White has brought a handout. There are copies of it, I believe, on the table in the back of the room, as well as on the table in the hallway outside the room. It’s a one-page outline.

MR. WHITE: A one-page outline that you’ll be hearing.

MR. FEINSTEIN: So, let me just very briefly introduce our four speakers and then we’ll get started.

To my immediate left is Eduardo Perez Motta, and we are very, very pleased to have him with us today. He, since 2004, has served as the Chairman of Mexico’s Federal Commission on Competition. We’re honored to have him participating in today’s workshop. Eduardo has a long and distinguished career in public service in Mexico and also has a background in economics and we’re looking forward to hearing his remarks today.

To Eduardo’s left is Jonathan Baker who is well known to many people in this room, I’m sure. He is currently a Professor at American University’s Washington College of Law and was formerly a Director of the Bureau of Economics at the FTC.

To Jonathan’s left is Larry White who is currently a Professor of Economics at the Stern School of Business at NYU where he’s also the Deputy Chair of the Economics Department, and Larry served as the Director of what was then known as the Economic Policy Office in the Antitrust Division back in the early eighties when I was actually working there as a staff attorney and assistant section chief. And we're delighted to have Larry here.

And then I'm not sure Joe has ever been to the left of anyone, but at the far end of this table is Joe Simons who is well known to many people here. Joe, of course, served as the Director of the Bureau of Competition from 2001 to 2003, is a very accomplished antitrust counselor and litigator, and is currently the co-Chair of the Antitrust Group at Paul, Weiss.

So, with that, let's begin the presentations and we'll begin with Eduardo.

MR. PEREZ MOTTA: Well, thank you very much. It is a privilege for me to be here with you in this discussion. Let me start by saying that I find this -- the idea to organize these hearings as something quite positive and this is something that we should do, frankly speaking, we should do in Mexico as soon as possible.

The Mexican law specifies and the rulings specify how we have to do this, but it's always quite useful to put an outline or guidelines publicly so that all the operators and the -- the economic operators or economic agents and lawyers and economists can understand what's the methodology, the methodology that is used by the authority to take these decisions.

So, first of all, I think it's a very good idea to have these guidelines. I know that your guidelines come from 1992. There -- more recent commentary on the guidelines, but I think it's always a good idea to have a check and to have this review publicly in these kind of hearings. I think it's a good idea.

So, let me thank you for inviting me and also recognize that this is a very important exercise, and this is an exercise that we are going to -- actually, we are going to follow very soon in Mexico.

This topic, the topic that we are discussing in this panel, is market definition. From the years that I have been in the competition authority in Mexico, I frankly find that this might be one of the most contentious and maybe one of the most difficult issues always. What's the relevant market? How do you define the relevant market? This is a major issue and it goes not only for mergers, but also for investigations on abuse of dominance. So, I think this is a major problem and it's always important to give a discussion on this concept.

I'm going to use less than my ten minutes. Let me explain to you, very briefly, how we work on merger analysis and what's the basic element that we use in

Mexico, according to our law and our rulings. Our law is -- let's put it this way, the Competition Commission, the Mexican Competition Commission, the Federal Competition Commission is basically empowered by the federal law of economic competition and also has its regulations that are the ones that allow us to challenge something and to impose sanctions on any merger whose aim or effect -- this is the important point -- the aim or effect is to reduce, lessen or prevent competition and free market access to products and services that are equal, similar or substantially related. This is exactly what the law says.

So, the competition is going to sanction those measures that lessen, harm or impede competition basically when they approach one of these three elements. We consider that they lessen or harm or impede competition when they first confer the ability -- the ability to the company or to the companies that is going to come out from the merger to unilaterally set prices. That is the first point, the first element.

The second is to unduly displace or restrict access to competitors or the third element, which is to facilitate anti-competitive conduct and anti-competitive conduct could be either a collusion or a unilateral anti-competitive conduct. So, those are the elements that could allow us to sanction a merger.

Now, the elements that we consider for a merger analysis are basically five elements. The first is the definition of the relevant market. That’s the main issue. The second is the market concentration and the market power which is basically the market share or the ability to set prices, to restrict input by (inaudible), position, conduct, access to inputs and imports. So, in this case, what we basically use is the Herfindahl-Hirschman Index and another index that we have developed that we call the dominance index. We have published in the Official Gazette basically how we handle those measures and this is information that is very public.

The third element is the merger effect on competitors, clients, related markets or agents. The fourth element is basically cross ownership. And the fifth and last element is something that was introduced recently in the reform of the law three years ago, is an efficiency defense. So, the companies that are notifying a merger basically have to or they can justify, on efficiency grounds, the impact that this merger is going to have.

So, this is basically our legal framework. That’s how we make these analysis. And I would like to stop here just to start this discussion. Thank you very much, Richard.

MR. FEINSTEIN: Jonathan?

MR. BAKER: Thank you. I want to thank Rich and Carl for inviting me, and I'm delighted to be back to the FTC. And I think I probably ought to add that, you didn't put it in your introduction, but I'm actually right now at the Federal Communications Commission, but I'm not speaking for them, just for me.

I have two points I'd like to make about market definition. The first is that market definition is more important for analyzing coordinated effects than for unilateral effects. So, let me explain that first and then I'll go on to my second point.

In a coordinated effects case, the key question is whether the merger changes the nature of the rivalry among the firms. Now, we need to define the market in order to figure out what firms to think about. Who are the market participants? And we also need to define the market to compute market shares, which we might want to use to determine how market concentration changes or if we're not going to use that route for identifying coordinated effects, we still might want to know market shares perhaps to identify who the maverick is. So, the reasons and the nature of the coordinated effects analysis that would lead us to want to define the market.

In a unilateral effects case -- and here I'm going to talk about unilateral effects involving localized competition among sellers of differentiated products, which is the most common setting -- the key question is different. The key question is whether a substantial fraction of the customers of one of the merging firms views a product of the other firm as their second choice. And unilateral affects cases, in other words, turn most importantly on the nature of the buyer substitution between the products of the merging firms, not on the way sellers interact.

Now, you know, it's not that you wouldn't get into how sellers interact. But the key initial core question has to do with buyer substitution and, in particular, buyer second choices from the buyers of one product, what their second choice is and whether it's the product of the merging firm, the partner -- the merging firm's partner. Market shares and market concentration often contain very little information about buyer's second choices. So, they don't help much in identifying unilateral effects.

There's other kinds of evidence that might be more probative, you know, for example, how price varies with market structure, like we did in Staples, or diversion ratios or other things that one would want to look at that would be more probative than market shares.

And, also, it may be hard to determine market shares reliably in differentiated product industries where market boundaries can be difficult to draw, with a densely packed space, that kind of thing.

So, that's my first point. Market definition is more important for analyzing coordinated effects than unilateral effects.

My second is that market definition needs to focus on one economic force only, namely buyer substitution. If you ask market definition to do too much, it's easy to get confused. So, this is not quite an economic proposition; this is a how to make it work in practice proposition. And that's why the guidelines don't ask this analytical step to account for supply substitution as well as demand substitution or least why it makes sense for them not to. In contrast, some courts will account for supply substitution in defining markets in -- at least in monopolization and other exclusionary conduct cases.

And it's also why it's a bad idea to try to account for the significance of demand complementarities, including those associated with two-sided platforms, which is, you know, a topical issue in the market definition step of the analytical process. By all means, we have to think about that and think about the significance of complementarities in order to evaluate the competitive effects of the merger, but let’s do it in the step of analyzing competitive effects, not market definition.

In fact, if you think about the structure of the merger guidelines, they sensibly allocate the economic forces to different steps of the analysis. So, buyer substitution analysis is what we’re talking about, but supply substitution is mainly handled in the entry step, although there’s also some aspects of it that are taken into account in figuring out who the market participants are. That would be the uncommitted entrants and, in the context of unilateral effects, repositioning. And the rivalry among sellers is addressed in the competitive effects analysis and some other things are addressed there as well.

Now, this allocation breaks down in unilateral effects cases, though. Because the guidelines ask us to analyze buyer substitution twice in a unilateral effects case. First, in defining the market and then, once again later, in determining diversion ratios or whatever we’re going to do in the competitive effects analysis.

Now, there are technical differences between the two analyses. So, for example, if we thought that the merged firm would raise price but not by as much as the SSNIP, say only by 4 percent, we might catch the problem in the competitive effects SSNIP, but not catch it when defining the market. But, in general, it may well make more sense to analyze buyer substitution only once in unilateral effects cases. And if we're only going to do that, I would do it in competitive analysis rather than the market definition step. Thanks.

MR. FEINSTEIN: Thank you. And my apologies for leaving out your current duties at the FCC in the introduction.

MR. BAKER: Oh, that's fine.

MR. FEINSTEIN: Larry?

MR. WHITE: Okay. Again, my thanks to Rich and Carl for inviting me and shepherding this whole operation. I think it's a very, very valuable effort.

I do want to talk about the hypothetical monopolist market definition paradigm. It has stood the test of time. It's now been 27 years since 1982 when it was first enunciated. And I think there are good reasons why it has stood the test of time.

First, it's a conservative approach. It basically asks, as a general matter, although there are exceptions, what is the smallest group of producers that if they colluded; i.e., acted as a hypothetical monopolist, could succeed in exercising or enhancing market power? Or equivalently, and this really goes to the heart of the matter, a relevant market is, in essence, one that can be monopolized. I think that's a very useful framework, a useful just world view of thinking, you know, what are we trying to find here?

And then, of course, the remainder of the guidelines, as John just indicated, provide the means for determining the likelihood that either market power will arise initially or any existing market power could be enhanced because of the structural and/or behavioral characteristics of the market.

There's another very important aspect of the paradigm, its flexible use. First, whether the participants in the market are already exercising market power is irrelevant. That hung up a lot of people for a while, but it's irrelevant because the paradigm is basically asking, could this merger make things worse? And that's really the relevant question. Could this merger make things worse?

Further, though the paradigm focuses on producers, and properly so because it's producers that might collude post-merger and, so, you want to be focusing your attention on them. But in the case of price discrimination markets, you've also got to identify relevant consumers. And, so, there's that flexibility there.

Further aspect of flexibility. The paradigm was developed in the context of a world view that was basically all about coordinated effects. In 1982, that's the way the men and women of the Antitrust Division of the U.S. Department of Justice thought about what were the problems for mergers. It was a coordinated effects view. However, the paradigm is applicable for unilateral effects, has been used in these kinds of cases. But I want to ask the question -- John has addressed it to some extent, I'll address it in just a minute -- is it really necessary for unilateral effects cases?

So, as I think about the strengths of the paradigm, why it has stood the test of time, it's a relatively conservative approach, and I think that's a healthy approach. And it's got these nice aspects of flexibility.

All right, what are the limitations? Well, now I'm going to come back to the unilateral effects analysis. As Joe Farrell's sharp eye noticed in my one-page handout that's available, I screwed it up and mistakenly wrote coordinated effects where I really meant unilateral effects in this part of my outline.

The market definition -- I'm going to go more strongly than John on this point -- I think it's potentially confusing, a confusing afterthought in a unilateral effects analysis. And if you want a good example of that, I urge you to read Vaughn Walker's decision in the Oracle case.

I have increasingly come around to the view that basically says if you have found significant unilateral effects, you've got a market. That's got to be a market because you found something where there are going to be post-merger significant price increases. That's what we're concerned about. That's got to be a market.

Now, how that gets phrased, I don't really care. But you don't want the market definition confusing the issue. You want it in unilateral effects cases basically saying, you know, hey, we found the effect, that must mean there is a market here.

The other thing I want to point out -- and this is not strictly a merger guidelines issue, but I'm going to be using the inspiration of Rahm Emanuel, as you know, his maxim is never let a good crisis go to waste. Well, never let a good opportunity go to waste.

And the other thing I want to mention about the hypothetical monopolist market definition paradigm is that its application to monopolization cases is severely limited. It can only be used for prospective monopolization actions. Every once in a while that may come up, but that's not the typical monopolization case. The typical monopolization case is where the defendant is being accused of bad acts and an essential feature is to argue that the defendant already has market power. And if that's so, you cannot use the hypothetical monopolization market definition paradigm, because trying to use it in that context really is committing the cellophane fallacy. So, let me stop there.

MR. FEINSTEIN: Thanks, Larry. Go ahead, Joe.

MR. SIMONS: All right. Thanks, Rich. Good afternoon, everyone. I want to thank Rich for inviting me and I guess Joe and Carl as well. You and your colleagues are to be highly commended, I think, for initiating this enterprise. I think no matter how it comes out, it's going to be extremely beneficial to the antitrust community.

So, let me start out by echoing some of the things that Larry said and what some of the folks this morning said as well, which is, that the existing guidelines are very, very good, have very deep bipartisan support and have clearly withstood the test of time. As a result of that, my own view would be that I would be very cautious in making major changes, and I think if it were up to me, I'm not sure that I would change very much at all.

But having said that, I'd like to cover four points today, one kind of a general comment on the guidelines and then three points about market definition.

On the overall point, as currently drafted, the guidelines are very general in nature. They don't go into a huge amount of detail trying to anticipate every factual situation that might come up in a merger. And I think that's the right approach. I think it would be a mistake to inject a lot of detail into the guidelines rather than having them focus on broad principles, which Larry did a terrific job of laying out in terms of the market definition.

So, my sense would be let's focus on the broader principles and let's have the applications to the specific facts flushed out over time through experience. That flushing out process has been and can continue to be made transparent to those outside the agencies through speeches, closing statements, commentaries and the like. I think the method of applying the guidelines has developed very substantially over time in different ways with respect to different parts of it, and I just think it's not possible to account for every factual situation. So, my sense would be to kind of stick with the broad principles along the lines of the current form.

So, since our panel is discussing market definition, let me try to make three points on that score. First, something very basic, which is that I think market definition needs to remain as a key part of the analytic framework for the merger guidelines. The statute and case law require it. And I think that, at least my sense is certainly among the lawyers, getting rid of the market definition in the guidelines would not have a lot of support. I understand, you know, just from talking to economists and certainly from what Larry and John have said just moments ago, that that type of approach is much more popular with the antitrust economists. And, you know, I think you can understand why.

A lot of that is based on -- the unilateral effects analysis is based on economic modeling and simulations. That’s much easier for the economists to get their arms around, much less so for the lawyers. I think the lawyers are going to have some concern as to if you really rely on that, how it’s going to play out in court.

I think there is one circumstance, in particular, I think it’s pretty rare, where you’re going to be able to prove direct effects of a merger, and in that case, the market definition pretty much falls out of your proof of direct effects. This is consistent with what Larry was just saying. So, if you prove that the merger caused the prices to go up -- an example of that was FTC's case involving Evanston Hospital -- then pretty much there has to be a market there someplace.

In fact, a kind of interesting sidelight, I was at the Bureau when that case was being developed. And the economics -- econometrics actually drove that investigation because that showed that there was a price effect. The intuition of the lawyers was, gee, it's kind of hard to define a market here. You had geographic issues. You had issues about one hospital was a community hospital; one hospital was a teaching hospital. And, so, there was a little bit of confusion about how should they approach the market definition.

And what really drove that for the staff, I think, and for me was the economics, showing that there was an effect. So, if we knew there was an effect, then there should be a market there. But I think that's a pretty rare case and to kind of take the market definition out of the guidelines based on that I think would be a mistake.

Second, I'd like to address a couple of points relating to critical loss and diversion analysis. I would not recommend putting the details of how to do critical loss into the merger guidelines. I think critical loss or something like it is going to, oftentimes, be necessary when you're defining a market under the merger guidelines. So, unless the market is really obvious and it doesn't take a brain surgeon or any kind of serious analysis to figure out what the market is, you're going to have to get some sense of how much volume is necessary to make the price increase unprofitable.

Now, you can do that through critical loss and maybe there are other ways to do that, too. But one way or another, you've got to get some sense of what that number is, what the range is. Is it 10 or 20 percent? Is it 70 or 80 percent? I think if you asked most folks today, they would tell you it was kind of towards the lower end. But if you went back 20 years before critical loss was done in any kind of serious way, you look at the NAAG merger guidelines, for example, who say the number should be 75 percent. So, one way or another, you're going to have to do that.

The details are going to vary depending on the factual circumstances. I think if you try to put that into the guidelines, you're going to create more problems than you're solving. Similarly, I wouldn't want to put anything in the guidelines that discussed estimating what I refer to as the actual loss from the margin data via the Lerner Index or the inverse elasticity rule, however you want to characterize it. At least among lawyers and I think some economists as well, this would be highly controversial. As far as I'm aware, it hasn't been done successfully in court. I think it's been tried a couple times and not done very well.

And then the other thing is the necessary implication of using the Lerner Index to underlie your analysis is, at least from what I know, virtually all horizontal mergers raise price and that is something that I think the lawyers will have an issue with.

Regarding diversion analysis, I think that that's something that is much more relevant for unilateral effects, and really if you're going to discuss it, it should be in the unilateral effects section. And I don't really think that's really useful for the guidelines and the market definition.

And the third point I wanted to make relates to what type of SSNIP we should talk about or use in the guidelines. Based on my own experience, talking to folks at the FTC and talking to folks at the DOJ, I have never seen -- and the folks I've talked to can only think of once or twice -- where a merger was investigated using something other than an across the board SSNIP. The guidelines, as they're written currently, would allow a market to be defined based on a SSNIP relating to just one firm. So, you have five firms in the market, one firm raises the price and you can define a SSNIP on that basis. I think that's not done in practice. I think it's misleading to do it that way and my recommendation would be to take it out.

And then the final thought I have is just to recommend adherence to the Hippocratic Oath, Rich, which is particularly appropriate for him since he was head of the health care shop. You've got a very well respected set of guidelines here with a huge bipartisan consensus behind them. And, so, in that circumstance, I think it becomes really important, you know, above all else, do no harm. Thanks.

MR. FEINSTEIN: Well, I think I can probably speak for all six of us who are working diligently in this effort that that is our goal, to do no harm. Thank you very much, Joe.

What I'd like to do first, I guess, for those of you who were here this morning, there was a very lively debate, particularly I guess on the second panel, relating to the use of direct evidence on anti-competitive effects or competitive effects, not necessarily anti-competitive effects. They touched, to some degree, on how the availability of direct effects might bear on market definition. What I'd like to do is approach it from -- you know, sort of the same question from a little bit different perspective.

And, Joe, you eluded to a circumstance where we had a consummated merger and it appeared, based on the econometrics, that the direct effects were fairly clear. That may not always be the case. Even in a consummated merger that may not always be the case. It's probably even less likely to be the case directly, as opposed to by analogy or by example, in an unconsummated merger where you're trying to make a prediction.

So, the first question I'd like to solicit the group's thinking on is, given the fact that the purpose of market definition is to identify the context in which likely or actual competitive effects are to be assessed, are there circumstances where the existence of direct evidence of competitive effects reduces the need for a precise market definition? And if so, what are they and should they be specifically addressed in the guidelines?

MR. WHITE: All right, I'll leap out. Yes, yes, yes. I'll say it again, if you found direct effects in a unilateral effects case, you have a market and you don't need to go any further. Anything more risks confusing Vaughn Walker. I guess that's -- I don't know how to say it more directly. And so, I would just stop there.

MR. FEINSTEIN: John, why don't you go. Since Joe's had the floor more recently, let's give John a chance.

MR. BAKER: That's fine. Although I'm going to agree with Larry. Joe might come out the other way. So, there are two different kinds of direct evidence that are worth talking about. One is direct evidence of the ultimate question of anti-competitive effects which I think of as let's say a price market structure kind of study like we did in Staples. But there's also direct evidence of something from which you then infer that there's harm to competition. Like, for example, direct evidence about demand elasticities and diversion ratios and things like that.

And if you are using market shares as the basis for proving harm to competition, you are making an inference, also. It's just based on market shares. So, all kinds of evidence might be probative in different kinds of settings. And there will be cases where the direct evidence that the merger is going to raise price is totally convincing and the other evidence won't help you much. Even if it came out the other way, you wouldn’t believe it. And there will be cases where you’ll have some of the other kinds of evidence and the market shares and market concentration will help you. And so, in the first setting, you don’t need to worry about market definition as much. And I guess I talked early about how that’s more likely to be so in the unilateral context than in the coordinated effects context.

I do want to say something since Larry brought up Vaughn Walker twice. I don’t view that as a confused judge. I think that Judge Walker knew exactly what he was doing. He just didn’t want to find unilateral effects in that case. And to be honest, I think it would be a mistake to rewrite the merger guidelines purely in response to what Judge Walker had to say because he’s very different from most judges. He’s an antitrust expert who had a strong point of view is my take. And most federal judges are not antitrust experts who are trying to sell us on their perspective on unilateral effects and merger analysis, and so wouldn’t respond in the same way as he did.

MR. FEINSTEIN: Joe?

MR. SIMONS: Right. So, following up on that point from Jonathan, I couldn’t agree more on the Vaughn Walker point, which leads right into the point I was going to make, which is that I think for most, at least for me, a good case is one in which all the evidence points in the same direction. And if it really is a good case, the odds are good that the evidence is all going to flow in that one way. So, even though you might have evidence of a direct effect, I would want to look at the other evidence as well. I think in terms of a judge, the judge you're most likely to get in front of is not going to be the Vaughn Walker type of judge. The judge you're most likely to get in front of doesn't know anything about antitrust. And the way to convince that judge is, you know, the more stuff you've got going in the same direction, the more likely you are to convince him.

MR. WHITE: I'd like to leap back in because I've been really chewing on something that Joe said in his earlier remarks and I think is relevant here. He talked, at the very end, what type of SSNIP. And he said, suppose you have a market with five firms but only one firm raises its price. Am I --

MR. SIMONS: Yes.

MR. WHITE: Okay. I assume you're talking post-merger.

MR. SIMONS: Yes, it was the hypothetical monopolist controls the five firms and the hypothetical monopolist only raises the price of firm one.

MR. WHITE: And I would say you've been led astray by market definition that really -- if you've got the one firm that's going to be able to raise its price, you know, there is a market right there. And stop, don't go any further. You're going to confuse somebody.

And so, think in terms of what's the goal here. It's to prevent the raising of price either in a coordinated manner, in which case market definition is terrifically important, echoing what John said earlier. Or unilaterally, in which case, stop, don't go any further. You're going to confuse somebody.

MR. SIMONS: Can I follow up on that point?

MR. FEINSTEIN: Sure.

MR. SIMONS: So, I probably was not clear in the example I was trying to -- at least I had in my mind. So, here's what I had in my mind. If you think of a situation where there are ten equally situated firms and you have a merger of firms one and two and we assume for the example that they can't raise the price of both their products or either one of them. We further assume that firms one through five, if they're monopolized, they can't profitably impose an across the board SSNIP either.

But let's suppose we then assume that if the hypothetical monopolist of firms one through five could impose a profitable SSNIP by just raising the price of firm one’s product. And under the guidelines as currently written, you could define a market that way, except that wouldn’t tell you very much. Because by hypothetical, we’ve assumed that you can’t have a unilateral effect. The only way you can have a coordinated effect, the only way that the compliant firm raises price is to get a side payment from firms three, four and five. So, if that’s the only way can you have a problem, then why are we looking at that? That’s what I had on my mind.

MR. BAKER: Well, there’s sort of an answer to that, which is maybe that you think -- well, you sort of say side payment. What you’re trying to do when you say that is you want to rule out tacit collusion, too.

MR. SIMONS: No, no, no.

MR. BAKER: But in the market you describe, in principle, there could be a coordinated effects problem. Maybe this particular merger, you know, changed the market structure in a way that made it possible for the post-merger firms to raise price and the other firms would kind of go along and permit it in a way they wouldn’t before. I mean, it’s all kind of hypothetical. I’m not sure this is a real, real thing. But in principle, it’s exactly right. And the guidelines are conceptually correct, I believe, in saying what you're referring to, that, the hypothetical monopolist could raise the price of any or all of the additional products under its control.

If you insist on what you want to insist on, the way it was in the '84 guidelines before -- this got changed in the '92 guidelines. If you insist on going back to the way it was in the '84 guidelines at this point, you run a different risk that there's going to be a situation -- think about your example where there really is a unilateral effects problem. You want to prove a market in your view of how to write the guidelines. You could get at the unilateral effects problems and sell it to the court, let's say, in a market that has five firms in it. But if you had to do an across the board SSNIP, you would add an additional 20 firms, there's no way you'd convince anybody that there's a problem.

So, I think it's correct to keep this in and sensible besides. It's rarely used, but it's appropriate.

MR. SIMONS: See, my view is, and I think -- I think Whole Foods had this problem. You start to look like you're gerrymandering a market so you don't have to prove a competitive effect and you're going to rely on a presumption. So I would rather -- let's define the market the way it's originally been done. And when you want to prove a unilateral effects, you prove that. And if you do that sufficiently, you win. Otherwise, you're going to be defining very narrow markets.

MR. BAKER: Okay. But you're running against the usual litigation dilemma in unilateral effects cases when you say that, which is that maybe the -- you know, if the market shares aren't particularly meaningful and the two merging firms have products that are fairly close substitutes, but they are sort of in a little corner of a bigger market, but you don't want to define a narrow market, well, then you have low shares and it's hard to convince anybody that there's a problem.

But then if you want to go the other route and define the narrow market and say it's merger to monopoly or near monopoly, then you run into the people who say, well, narrow markets are gerrymandered and they're those evil sub-markets and they're just -- they've got too many adjectives. You end up missing the problem because of this trouble.

MR. SIMONS: Well, no, you're trying to fit your case into a structural presumption when you really have a different case. I think the guidelines would be benefitted if they would actually say something about this circumstance where you can have a unilateral effect in a broad market.

Because what tends to happen is -- and I think it has something to do with the way it’s litigated, usually, is you go in and you try to say the market is narrow and then you run into a problem when you lose on the market definition. Whereas, if you just kind of said, okay, here’s the market, it’s defined the normal way it’s defined and we have a unilateral effect and here’s the evidence we have for that, I think you might have a different situation. If you clarified in the guidelines that that’s what you’re doing and that’s appropriate to do, maybe you do better.

MR. BAKER: Well, I kind of agree with you because the real problem in the story is that you’re trying to create a presumption of harm to competition in this unilateral case based on market shares when they’re not particularly good indicators of anything in most unilateral effects cases. And it would be very useful to have an alternative basis for creating a presumption of competition that a court could get its arms around that would be based on something else that would be more probative and then that would take the pressure off the market definition in just the way you described and, also, have the benefit of having a framework for describing the harm to competition that you can explain to the court that connects up to the source of the evidence you’re using to try and get that presumption. So, it’s --

MR. WHITE: John, I thought you were an ally and you’ve just given into the devil.

UNIDENTIFIED MALE: We’ve got you surrounded, Larry.

MR. WHITE: You know, come back to the basic idea of relevant market is something that can be monopolized, something where the price can go up if some structural things change. And narrow, small. It doesn’t bother me in saying that’s a market. You know, at some point, it’s de minimis. I understand that. But beyond de minimis, small, narrow? Hey, if there’s an effect, there’s an effect. Why confuse it by saying there’s this bigger market, but, oh, there’s something going on here, but we’re not going to call this a market. Again, a relevant market is something that can be monopolized.

MR. BAKER: That’s not what I was arguing. I agree with you. It’s perfectly fine to have a narrow market.

MR. WHITE: Well, both of you are the devil.

MR. BAKER: Neither one of you is the devil.

(Laughter).

MR. BAKER: No devils over there. My boss is really an angel here. If we're forced into the market definition paradigm for analyzing unilateral effects and are going to have to argue it that way in court, there are advantages to both approaches. I have no trouble with narrow markets. I don't have trouble with sub-markets when I can define them.

But what we were talking about before was what's the best way of creating a presumption of anti-competitive effects? Maybe you even want to do it without market definition entirely in unilateral effects cases or at least downplay it. The less you care about market definition in unilateral effects cases, the more you want to look for something else than market shares to base your presumption on, the more important it is to have some alternative and, frankly, the more sensible it is because market shares are often not very good predictors of harm in unilateral effects cases.

So, what I was saying before about the presumptions was essentially independent of market definition, not buying into either the large market or the small market.

MR. FEINSTEIN: So, just to follow up real quickly, if you don't define the market in a way that allows you to estimate shares, if you focus on competitive effects and don't get to the point where there are presumptions, I suppose, what implication does that have for the safe harbor analysis that currently exists given certain HHI levels? What happens to it? Anybody?

MR. SIMONS: It's not clear to me that there is really a safe harbor. In real life, everything depends on the market definition. So, if the market is defined one way, okay, you're safe. If the market is defined another way, you're not.

UNIDENTIFIED MALE: (Off microphone) Does that mean if the market's defined very broadly, you shouldn't be safe? You said even if the market had been all sales of office consumables so that Office Depot and Staples would have had 5 percent of the market, you're perfectly comfortable saying that that merger is anti-competitive and you think that's the way it should be litigated.

MR. SIMONS: No, here's what I'm trying to say. What I'm trying to say is that the market definition under the way it's currently structured comes with a presumption if you get the shares high enough. Right?

UNIDENTIFIED MALE: (Off microphone) (Inaudible).

MR. FEINSTEIN: I was focusing more on where the shares were low enough. But go ahead.

MR. SIMONS: Usually people rely on a presumption to prove a case and then you lose on the shares. Right? And your story about competitive effects.

MR. FEINSTEIN: John wants to say one more thing and then I want to move on to a different issue.

MR. BAKER: This little conversation is related to a point that I think Joe made before, Joe did it in the context of talking about the Lerner Index. But the unilateral effects analysis involving differentiated products, if you're just looking at the substitution across the firms and you're not thinking about other aspects of the analysis, it will look like all mergers will, at least initially, have a tendency to raise price. And this was -- you know, we knew this in 1992 when we put that section in the guidelines.

But the answer is that's not true, I mean, in the sense that there's more to merger analysis than just -- the full competitive effects analysis goes beyond the buyer substitution and the first and second choice products. And when you get to the -- beyond the presumption, you can rebut it. You can think about repositioning and you can think about efficiencies.

Now, when Carl and Joe wrote their recent paper about how to use diversion ratios and margins to create something that could be sort of like the basis of a presumption, they built in an efficiencies assumption in there. So, essentially the price has to rise more than a certain amount or after a standard deduction, I think was the phrase that came -- or was it Larry, maybe? I don't know. That's one way to handle it.

So, going down this route of proving unilateral effects without a market definition or at least building in a presumption through a route that doesn't require market shares and market concentration isn't the same thing as saying all mergers are going to lead to higher prices, because you can set it up in a way that incorporates some assumption about efficiencies or repositioning that would limit the cases to the ones where the concern is the greatest about a price rise.

MR. SIMONS: But that strikes me as kind of artificial because you then recognize that the underlying process produces a price increase for every horizontal merger and you realize that's not right. So, you're kind of using the efficiencies as a standard deduction to calibrate it down. But how do we know that that's even close to being properly calibrated?

MR. BAKER: Well, we have to do better than the 35 percent safe harbor in the current guidelines or even the low HHI safe harbor in the current guidelines when it comes to unilateral effects because the market shares aren't very helpful in analyzing unilateral effects in a lot of cases. So, this has got to be a better route.

MR. SIMONS: Well, the problem is if you use this, though, you're going to end up challenging mergers at much lower concentration levels than you're -- you know, you're going to be challenging lots of mergers you never would have challenged before.

MR. BAKER: Would you view the Staples/Office Depot merger as a merger at a lower concentration level or do you view it as a merger at a high concentration level? The concentration level that you get depends on the market definition, and that may or may not be helpful here.

MR. SIMONS: Well, I guess it depends on which market definition you have in mind. Whether you're going to do the variable SSNIP or whether you're going to do across the board SSNIP.

MR. FEINSTEIN: Let me shift slightly, although we're going to stay on the topic of SSNIP for a minute. I think there's a fairly broad consensus that that's a useful tool in the market definition process. But in connection with the possibility of revising the guidelines, I'd be interested in hearing the panel's views on the question of whether the level of the SSNIP should either be revised to the general proposition or should be made more variable depending upon particular circumstances. How, if at all, would you address that issue? That is the possibility of selecting what level of SSNIP ought to be used and when. Yes?

MR. PEREZ MOTTA: Actually, my impression is that this should have some flexibility. In our case, our Commission does not apply this formally. But we normally consider a range between 5 to 10 percent that follow basically the U.S. and the E.U. parameters. But you could have some cases, for instance, when the size may be substantially smaller in markets with low price cost margins, for instance. So, I think flexibility should be there.

MR. FEINSTEIN: Anyone else want to comment on that?

MR. SIMONS: I would go back to Larry’s kind of first principle on market definition, certainly for the unilateral cases. And that is, you’re worried about you want to identify a market that is being cartelized. So, you might have a situation where probably on average, 5 to 10 percent is probably good. But there might be cases in which, you know, a 5 to 10 percent price increase won’t work, but a 20 percent price increase might. And if you come across that, well, you should use it.

On the lower end, my view is a little more ambiguous, I guess, because I'm not really sure that once you start to get down to 1 or 2 percent, whether that's really something that you can really apply with any kind of confidence just because there's so much noise at that level.

MR. FEINSTEIN: Yes, John?

MR. BAKER: Well, I have no objection to a variable SSNIP and it might make sense, but I want to take a step back, also, in sort of the way Joe and Larry were doing. I think there are all sorts of markets in which transactions can be analyzed. There are markets that are overlapping with each other. That is to say, if there's any market in the sense that Larry was emphasizing, that would be one that would be profitable monopolizing, which this particular merger presents a problem, the agency ought to challenge it.

And if it doesn't look like you get one with a small SSNIP, but you get a different market with a larger one, that's one where it looks like there's a problem or vice versa, you ought to challenge it in either one of those that you see. But the real problem is not with SSNIP -- that's really only an imperfect substitute for getting rid of the smallest market principle which is the real underlying problem. Because there's no reason to tie yourself to some smallest market when, you know, if there's a competitive problem in a larger one, why not analyze it in that? The goal is to figure out where there's a problem and challenge bad mergers, not to have finality to an arbitrary smallest market that can get in the way of doing that.

MR. FEINSTEIN: You've anticipated what I was coming to next, which is the smallest market principle and the methodology which adds products in the order of next best substitutes. Are those areas that the panel would agree with, John, are good candidates for modification or are as they should be now?

MR. WHITE: Well, the way I read the guidelines is there's enough generality there, that it's sort of generally the smallest, but it encompasses the kinds of possibilities that John just described. So, I don't see any need for big change there. Unless there's just too much confusion and so there needs to be a little bit of clarifying language.

MR. FEINSTEIN: Joe?

MR. SIMONS: Yeah, just to me it's not really clear why that was ever put in there. So, I mean, if it could get clarified, maybe that would be helpful and keep it in, or if it can't, then maybe take it out.

MR. FEINSTEIN: So far our entire discussion has been, at least implicitly, focused on product market issues. I'd like to solicit the thoughts of this panel on the general topic of geographic market. The notion of a relevant market obviously includes both components, but we've really been, at least implicitly, focusing on identifying the products. Does the current treatment of geographic market in the guidelines call for modification in your opinion or your opinions?

MR. WHITE: I don't think so. You're right, especially in unilateral effects, we tend to be thinking in terms of -- the phrase I use, you know, customers trapped between two -- their first and second choice products, but you can think of customers trapped geographically just as well. So, I tend to generally in both dimensions, both product space and geographic space, I don't see any need for greater clarification there.

MR. FEINSTEIN: Joe, John, Eduardo?

MR. SIMONS: The only thing that occurred to me was that if the product is being sold on a deliberate basis, then you might have a geographic price discrimination and then maybe you want to define it by the customers.

MR. BAKER: Well, I gather the context of this question is the way that the geographic market definition section talks about the hypothetical model says the only present or future producer of the relevant product at locations, and that the issue is when you think about buyer substitution, the buyers aren't substituting to the location where the producer produces; it's the location where the producer sells. And I think that would be the right thing to do would be to -- I think that must be what's meant and to change it from producer to seller. But it's really the -- I think everyone does it that way in practice.

MR. FEINSTEIN: We've got three economists and two lawyers on this panel, the second lawyer being the moderator. But I want to ask a question about the use of non-economic evidence. It ties in a little bit, I think, with the point that was made earlier about dealing -- you know, judges are typically generalists and may not be as conversant in some of the topics that we've been talking about. I'd be interested in hearing from each of you your views on the role of non-economic evidence, in particular, things like customer statements or internal documents which reflect business people's assessment of the competitive landscape. What role should that kind of evidence play in the market definition exercise that we've been discussing? Eduardo?

MR. PEREZ MOTTA: I think you should use it. Not only to use the non-economic evidence, but also when

-- I'm just looking at this problem on the authority side. You have to understand that in the end, the person that is going to judge your resolution is a non-economist. So, the problem, I think, is a little bit more general. It's not only the use or the possibility to be open to use non-economic elements. In this case, we are -- in Mexico, we are pragmatic in that sense, especially when you find a merger with direct evidence -- this goes to your first question as well. With the direct evidence, you don't see a problem.

If it's clear that there is not a problem with that case, you have to stop there. You don't have to go further. And there you include non-economic or direct evidence on markets, which is important.

Now, if you have to go to the economic analysis and you have to define the relevant market and then to follow all the five steps that I was describing at the beginning, I think the challenge that you have as an agency, a competition agency, is something that is fairly obvious. But sometimes it's not easy to do. It's how you can explain all the sophisticated analyses that you are using in very simple terms, strong and very well articulated, but simple so that judges could understand easily your analysis and could evaluate and judge not only your procedures, but the substance of what you are doing.

MR. FEINSTEIN: John.

MR. BAKER: Well, so I approach this question this way. We're interested in the economic force of buyer substitution in defining markets and, more precisely, the way the question has been refined in the context of the guidelines, how buyers would substitute in response to a price increase.

I think of the evidence that one might bring to bear in answering that question as falling into five different categories. The first is, how have buyers responded to changes in the relative prices in the past? It's something one could think about. The second is, what do buyers say -- you know, you survey them or whatever -- about how they would likely respond today if prices were to change?

The third is inferring something about likely buyer responses to changes in prices from characteristics of the products and locations that are known to matter to buyers. So, what I have in mind there, for example, might be you work out the engineering study of the switching costs in geographic market definition and would it be profitable to go a little bit further in the amount of price rise to get your product or not? But we could do this on the product side as well.

The fourth category is inference about buyer substitution from the conduct of sellers. Sellers are experts on their buyers. So, if the sellers are monitoring price changes at certain rival firms, certain rival products and responding to them, then you're learning actually about buyer substitution from that because you're making an inference -- you're learning what these experts think about buyer substitution.

Then the fifth category is the views of other industry experts, you know, more broadly than the sellers. So, consultants or former executives or trade association folks or sellers of complementary products who know about the market they sell into or buy from.

So, there are five categories of evidence. Each of those categories you could have evidence that is systematic and quantitative or that's anecdotal or qualitative. So, even for the response of buyers to price changes in the past, you might think, well, you're talking about measuring demand elasticities. Well, maybe I am, but you might also just be asking the firms' executives who have -- I remember a consulting thing I worked once where the company said, well, yeah, we tried raising price in Milwaukee, you know, on our product and we got hammered. Well, that's evidence about the response of buyers to changes in prices in the past. And all of these types of evidence can, in different cases, be probative.

And, so, what you are really looking for is the type of evidence and the style, the form, you know, the qualitative, quantitative, whatever, that happens to be most probative in the particular facts of the case. And you rely on that or you put it all together. So, I don't think there is any general preference for any type of evidence or any form in which it comes.

MR. WHITE: Okay, I'm really intrigued with what John just said. I was going to stop with just his categories one and two, which I would paraphrase what did consumers do in the past in response to price changes of which the sophisticated version is working out demand elasticities and diversion ratios, et cetera, versus a consumer survey, what would they do in the future in response?

Now, empirical economists' bias is to trust more the category one rather than category two because, gee, you know, can they really imagine all the full circumstances? The "would" feels much weaker than the "did" so long as can you do the appropriate controlling for other things, et cetera, et cetera, et cetera.

I started thinking about, though, his third category. All right, you get engineering studies inferring switching costs. But where did those data come from? Either they came from “what did” or “what would.” You know, where else have the engineers come up with the parameters for that estimate?

Now, category four, gee, that’s pretty strong. I mean, I absolutely endorse John’s insight here that the sellers revealed behavior here telling you something about “what did.” I mean, sort of strong, strong information about “what did.”

And then category five, use of other industry experts. Well, again, you’re back to where did they get their information? It’s either from “what did” or “what would.” So, I think it’s really useful to focus on the two categories. “What did,” “what would.”

As an economist, I like “what did” better. And I like John’s extra insight, look at, whenever you can, past seller’s behavior, but it’s going to be based on “what did.”

MR. FEINSTEIN: Joe.

MR. SIMONS: So, the funny thing about the discussion so far, at least from my lawyer’s perspective, is that if you looked at the guidelines, those things are kind of listed in the guidelines already. But the thing that’s not listed in the guidelines is econometrics. So, I don’t know, maybe you want to put that in there. Maybe not.

But the only point I would make is that it's -- this non-economic evidence is the most important because you can win a case, you can have a case without the econometric evidence. If you just have the econometric evidence, I don't think you're going to win a case if that's all you have. Like I said, the best case is everything points in the same direction.

MR. FEINSTEIN: We are right at our end point, but I'm going to ask the audience's indulgence to give us two more minutes. There are four of us. If any of you would like, in 30 seconds, to offer a final observation, now's your opportunity. Let's start with Joe and work our way back.

MR. SIMONS: I think I've said everything I would say, so I don't need to take up your time.

MR. FEINSTEIN: Okay, not required.

MR. WHITE: Okay, I want to make two points. One, I didn't add --

MR. FEINSTEIN: You can take Joe's time.

MR. WHITE: Okay. Which was, you know, there may be times when you don't have any "what did" evidence and, so, the best you can do is use the survey "what would" and you just do the best you can with it. So, I don't want to rule out "what would", but you have to understand its limitation.

The other thing, I'm really glad you mentioned econometrics, Joe. Econometrics gets a bad rap. It's just statistics, guys. And you understand means okay? And you can understand the idea that, you know, means might be different. Well, econometrics is just a slightly more complicated version of that where you've got to try to start controlling other things.

The fact that you may not have a lot of training in econometrics, if you were dealing with a traffic accident case, you might have engineers coming in to try to tell you about whether the brakes failed or didn't fail or the skid properties of asphalt when it's wet to this degree and maybe you need to bring a meteorologist in. And there's going to be all kinds of expertise that you may not have. Sorry, econometrics is, again, it's just another set of expertise. It's like dealing with means and averages, only a little more complicated.

MR. FEINSTEIN: John.

MR. BAKER: I just thought I'd add that my engineer has another source of expertise, too.

MR. FEINSTEIN: Eduardo.

MR. PEREZ MOTTA: Let me just touch on the econometrics discussion. I think in the end the challenge that we have is how to explain the econometric results in such a way that you can make something that is easy to understand. So, I think both things go in -- you can make them work in the same direction. Sometimes you need a sophisticated econometric analysis to protect your decision and you have to use it, and I think it's better to use it.

But the challenge is how you can put that you in words that could be understandable for a person that is going to judge your decision, that is going to be a lawyer.

MR. FEINSTEIN: I guess the final observation I would make -- maybe the first observation I would offer is picking up on Larry's distinction between "what did" happen and "what would" happen. Unless you're talking about a consummated transaction, at the end of the day, we are always trying to figure out what will happen. And, therefore, I think both "what did" and "what would" are probative.

Please join me in thanking this panel, and we'll reconvene at 3:30 for the final panel of the day which will address unilateral effects. Thank you very much.

(Applause.)

(Panel 3 concluded.)

PANEL FOUR: UNILATERAL EFFECTS

MR. SHAPIRO: Let us resume here for our last panel of the day. I'm Carl Shapiro, Chief Economist over at the Justice Department, one of the people on the working group. Thank you, guys, for being here and for sticking around until the last panel. I appreciate the interest.

Before I introduce the panel, I came with my copy of the merger guidelines; I never go anywhere without the canary yellow merger guidelines. The blue one doesn't have the '97 revisions. See, this is the '92 guidelines. See, this is why you need to learn more about efficiencies, okay? We'll talk about that. Your clients could benefit from that, I'm sure. Yellow is '97, okay?

But little did I realize the FTC version with the beautiful picture of the FTC that was going to be available for everybody today -- now, I suppose I'll have to assign some of my staff to make sure there's no additional things here that are not in the joint version. So, everybody, this is a big opportunity to get your own copy of the guidelines with the -- get them while they're still in force.

Okay, let me very briefly introduce the panelists. The topic is unilateral effects. We've touched on that and it's come up a number of times earlier today, probably, in fact, on all the panels to some degree. So, on the right-hand side, from my perspective, Alison Oldale is a Chief Economist at the UK Competition Commissioner. We’re especially appreciative to her for coming so far to speak with us today, particularly given the UK’s experience with their own merger guidelines and unilateral effects analysis. So, thank you, Alison.

Next to her is Renata Hesse, a partner at Wilson Sonsini. Renata has quite a bit of experience in the Antitrust Division -- in fact, that’s when we first met -- as well as now in private practice. So, I look forward to that dual perspective.

The same thing could be said of M. J. Moltenbrey, who is a partner at Howrey, also many years of experience in the Antitrust Division and now in private practice. So, that’s extremely valuable.

On my left, Steve Salop, my longtime friend. We were consultants together at Charles River. He’s a Professor of Economics and Law at Georgetown University Law Center across the street and a senior consultant at Charles River Associates.

And at the end, Marius Schwartz, Professor of Economics at Georgetown University, Senior Academic Affiliate of Bates White, also a great friend of the

Antitrust Division. Thank you, both.

As we've been doing in the other panels today, I want to give each of the panelists five to ten minutes to make some opening statements and then we'll have discussion.

Let me just very quickly frame what I see as one of our goals. We had one detailed question in our questions for public comment on unilateral effects. It happens to be question number ten, where we pointed out that unilateral effects were introduced in the guidelines in '92. There's been a lot of experience gained since then. The overall question here, I think, is -- we put it there -- should the guidelines be updated to reflect this experience and the learning that's taken place in the intervening 17 and 18 years, and we list the number of ways in which that might happen.

It's pretty clear from earlier panels today, there are a set of issues around how unilateral effects interacts with the market definition. We heard, for example, Larry White, and I think perhaps Jonathan Baker as well, in the previous panel saying, well, if you've identified an effect, maybe a unilateral effect, raising of the prices of the products sold by the merging firms, that there must be market around that and that maybe you could short-circuit or back out market definition.

So, there's an intersection with market definition. There's clearly an intersection as well with what generally we're calling direct evidence; that is to say, evidence that's not based on inferences from market structure. And earlier we heard, for example, Bobby Willig say, well, you should look at a variety of evidence, maybe you don't want to have particular pieces of it and get carried away about that. But we'd want to talk about what would be the most probative and convincing evidence regarding unilateral effects and could the guidelines say more about that because they don't get into any detail on what lines of inquiry are followed. I mean, they explain the basic logic of unilateral effects, but don't go beyond that. It's a question. Would it benefit if they did so?

So, with that framing, let's start with Alison.

MS. OLDALE: Hi. I want to start by thanking the FTC and the DOJ for inviting me here to participate in the debate about the U.S. guidelines. As Carl mentioned, in the UK, we are in the middle of revising our own merger guidelines. So, I know how challenging it can be to look back over recent practice and learning and to try to capture all of that in a clear way in guidelines and how much more challenging it is to take on board the often passionately expressed views of commentators, practitioners and others. Challenging, but hopefully leading to better guidelines. And I commend the FTC and the DOJ for organizing these workshops.

I'm going to make some opening remarks about the UK's experience of unilateral effects analysis in merger controls, focusing on differentiated products markets. In one very important sense, there's nothing unusual at all about the UK experience. If we're looking at the case where we think there might be unilateral effects, we will be focusing very much on trying to work out what effect the merger has on the pricing incentives of the parties, we'll be trying to understand how they compete with each other, what other constraints there are that might effect what their behavior will be after the merger and generally how the market operates.

We do think about market definition, but it doesn't dominate or determine or drive our analysis. And I understand that's pretty much the way the agencies here in the States actually do their cases. Perhaps what's unusual in the UK is how explicit we are that this is what we're doing. And that comes through in a number of ways.

Our existing guidelines stress that market definition and unilateral effect analysis interact. It's not just a sequential process of doing one and then the other and that both of them often rest on very similar analysis on a very similar fact base.

If you look through our decisions, it’s very rare that you will see a huge amount of emphasis on concentration measures and it’s very unusual that we will put a huge amount of weight on them. In particular, recent decisions are becoming quite explicit that high margins and high diversion ratios are pretty good evidence that a merger will lead to a big change in the pricing incentives of the merging parties. And this is often captured in a measure of -- some measure of the pricing pressure, the upward pricing pressure that a merger creates. The version we use we call additive price rise. And we are currently revising our guidelines to make all this even more explicit.

So, the draft that was put out for consultation in the summer also notes the evidential value of high margin and high diversion ratios for thinking about the change in pricing incentives of merging parties when we’re looking at unilateral effects and differentiated products markets.

It’s also worth noting in the context of some of the debates that have been going on earlier our existing guidelines. We already mentioned critical loss analysis as a framework for thinking about how to apply the hypothetical monopolist test. In the new guidelines, we're a bit more explicit that margins can tell you something about elasticities and you might want to use that in your critical loss.

How have parties and practitioners responded to all of this? Well, there have been three main comments. The first comment is, come on, guys, this is all too easy for yourselves, all you're doing is looking at the relationship between the two parties. What about all of those other constraints that market definition process highlights and forces upon you? We do need to address this perception, I think. And we are trying to do that in some of the decisions.

So, the points I think that we're trying to make is to stress that unilateral effects analysis uses all of the information about all of the other constraints. There's no lack of discipline involved in looking at unilateral effects. For example, the diversion ratio is a ratio. On the top, you may have just the diversion between the merging parties. But on the bottom, you've got the whole world. So, you've got the diversion to everything else that might be acting as a constraint. They don't get lost in the analysis.

And, also, in order to implement some sort of unilateral effects analysis, you really do need to know quite a lot about the nature of competition and the intensity of competition on the market. That's where the margins and the elasticities come in.

You still have to think about entry, repositioning and buyer power once you've done your initial analysis of whether there's the upward pressure on pricing, just as you do if you start with market definition and concentration measures.

So, we're hoping to stress that nothing gets lost in what we're doing. Again, in some very recent decisions we are more explicit that high margins and high diversion ratios not only suggest a big change in the pricing incentives of the merging parties, but also suggest that the merging parties form a big part of the defined market, if not a market unto themselves.

To use a phrase that one of my colleagues at the OFT, Chris Walters, who's been injecting a lot of energy into the process of getting these things into our practice, he uses the phrase "back into market definition from the unilateral effects analysis," which I think Carl mentioned earlier as well.

So, that's the first comment. The first comment is, guys, you're making life too easy for yourselves, you're losing discipline. The second comment is, hang on, this is all too difficult and onerous and requires far too much information. Well, again, I do think we need to address this. And the way to do it, I believe, is to stress in our decisions the commonality between market definition and unilateral effects, as I've just mentioned. But in particular in this case, how similar the question is. It is a really similar question.

So, the question for the -- the unilateral effects question is, would a hypothetical monopoly supplier of the party's products raise their prices? And the question for the market definition exercise is, would a hypothetical monopoly supplier of the party's products, plus a bunch of other stuff, raise prices? So, it's a very, very similar question. There's no particular reasons for thinking that either of them is more or less difficult than the other.

So, that's the first question. It's all too easy. The second question, it's all too difficult. But to be honest, the most common comment that we get is, okay, if you're going to do it, please tell me how. Lots of these cases are in retail mergers where the parties just want to know where they've got to make divestments. Most of the debate that we have with parties and their practitioners is about the details of how to do it, rather than the principles. And I confess, this is all a work in progress. There are quote a lot of practical questions that we are working on through our casework, but they're not closed yet.

A biggie, margins and how to measure them. It's going to be increasingly important that we really understand how to do that. Diversion ratios and where to get them from. Can we rely on surveys and so on? What is the measure of upward pricing pressure that we should use? I said that we have been using a particular one, but there are questions, what to do when you have multi-product firms. Do you use the same sort of model? How do you deal with asymmetry? Again, do you use the same model or should you see some variance? What about all of the sensitivity to the demand function? We need to continue looking at these things.

And then, finally, materiality. If we're going to start getting indications of some sort of upward pressure on prices, then how much is too much? I really like the approach of trying to link this pricing pressure to some sort of measure of required offsetting efficiencies, following Werden, Farrell and Shapiro. And to me, it's the end game of a clearer focus on unilateral effects, it's a clearer focus of thinking about efficiencies and materiality, then I, for one, would think that was a good thing. Thank you.

MR. SHAPIRO: Thank you very much, Alison. Before I go to our next speaker, I may put you on the spot a little bit and could you just take another minute to tell us where you are in your process? I know you had a bunch of comments filed on your own proposed merger guidelines review. What's the next step?

MS. OLDALE: The next step will be to revise the draft guidelines in light of those comments and then put them out there, hopefully the beginning of next year.

MR. SHAPIRO: Okay, well, good luck.

MS. OLDALE: Thank you.

MR. SHAPIRO: And thank you. Next, M. J. Moltenbrey.

MS. MOLTENBREY: Let me start with what I think is probably, at least on this panel and perhaps in general, a relatively noncontroversial position that, yes, the unilateral effects section of the current guidelines should be revised. There may be a little more disagreement about exactly how that should be done.

As many people have mentioned and Carl mentioned in his introduction, the unilateral effects portion of the guidelines, as a separate and distinct analytical exercise in merger review, was introduced in the '92 revisions of the guidelines. And at the time, I was a staff attorney at the Department of Justice. And I can say that those guidelines and the introduction of those guidelines did have a significant impact on the way I and my colleagues looked at mergers and thought about competitive effects analysis when looking at a merger. Not that no unilateral effects analysis had been done prior to the guidelines, but it really did kind of institutionalize and discipline the process quite a bit.

I don't have any statistics. I haven't tried to do this statistically, but if you do a kind of cursory review of recent cases brought by both the FTC and the DOJ, it's clear that unilateral effects theories of competitive harm have been increasingly important and prevalent, and more and more, there is a unilateral effects theory pled either on its own or in addition to a coordinated effects theory, which, again, is something that is fairly different from when I first started practicing antitrust law.

If you're an antitrust lawyer or an economist, unless have you been in the cave for the past couple of years, you're going to be familiar with some of the work that Carl and Joe Farrell have done on trying to develop models for measuring unilateral effects in mergers, looking at division ratios and margins and trying to develop an index to measure the effects of a merger and, basically, abandoning reliance on concentration as an indicator of likely competitive effects.

I recognize this is done in their private capacity not in their capacities as the heads of the economic teams at the two agencies. And that's only one example of some of the thinking that's going on and some of the more sophisticated economic analysis that is out there and available to people to use when looking at unilateral effects -- potential unilateral effects cases.

Another observation I will make, though, is that while the agencies seem to be looking at unilateral effects and people are thinking a lot about unilateral effects, it seems that the courts have not been quite as enthusiastic in terms of adopting or following or accepting the theories that had been posited by the agencies, certainly not in some of the litigated cases.

Just a couple of examples, I would point to the baby foods case, the Whole Foods/Wild Oats merger and Oracle/PeopleSoft, examples where, at least at the trial court level, the court seemed to struggle with the agency's use of a unilateral effects theory and the evidence that the agencies were relying on.

And then even at the appellate court level, where the government has prevailed, for example, in the Wild Oats case, whether you agree with the outcome of the decision or not, it's hard not to see some significant flaws in the reasoning of the court and the court's ability to take some pretty complicated economic concepts and apply them, again, dealing with a court that was very much a generalist judge and not an antitrust specialist.

And, so, it seems to be that there's a clear need or a clear potential benefit of clarifying and expanding the merger guidelines to incorporate some of the agency's learning, to explain better what the agencies are doing. I am going to leave, I guess, for the discussion period because I don't want to take up too much time, some of the more detailed suggestions that I might make, but I do want to make a couple of observations where I think changes might be warranted.

It has come up several times today and Carl mentioned it again in his introduction, that it's hard to talk about unilateral effects analysis and not talk about market definition issues. But in the current guidelines as written, there's a lot of clumsiness in the way the unilateral effects portion of the guidelines talks about market definition and tries to incorporate it. At the time they were written, I'm sure there were a lot of efforts to kind of make this seem like not such a dramatic departure from what had been going on and what had happened under the prior guidelines. So, the unilateral effects section references things like the safe harbors of the HHI numbers and references 35 percent market share. In a lot of cases, not all, but in a lot of cases, when you actually try and apply, there's just really a logical disconnect.

If you are dealing with a merger involving two companies that are their closest substitutes and you apply product market definition, so you start with product A and you add the next best substitute, by definition it's product B and the merging party's product, and ask whether a hypothetical monopolist could raise price. Well, if you have a unilateral effects case, the answer is, yes, they could raise price and, therefore, that is your product market.

To then turn around and say, and then we look at whether or not you are above the HHI thresholds or whether or not you have a 35 percent market share is a bit tautological because almost by definition you have just decided that you have 100 percent combined market share for those two combined products.

In other circumstances, let's take a market where you have products A, products B, and products C, and in the event of a price rise of 5 percent or more in product A, most customers would shift to B but a significant number would shift to product C. As a consequence of this merger, you believe that when A can capture those increased sales that would shift to C, suddenly a price increase that would not have been profitable beforehand, would become profitable.

If you actually do the merger guidelines' current product market definition exercise, you start with A, you add B, because that's the next best substitute. Most people would switch to B. You ask whether the monopolist could or would raise price profitably. The answer is yes. You have defined your market. C is not even in your market. Although, clearly, we know that there is a competitive effect when A merges with C.

So, in both of those examples, it's clear there's really not a good fit between what the agencies are doing and how the current guidelines suggest that you go about market definition. This just gets confused even further when you start talking about whether or not you are within or outside the safe harbors of HHI thresholds or whether or not you have a combined share of 35 percent. So, at a minimum, I think, one of the exercises in the revision should be to clarify some of that confusion.

There are cases where you're going to find a unilateral effect with a merger, but you're not going to define it as a complete market. One example might be that you decide that if A and B combine, A could raise prices by 3 percent, but not by 5 percent. So, okay, maybe you don't meet the SSNIP test. So, you're going to start adding more products in. So, maybe there are some cases where you're going to have a properly defined product market under the existing market definition principles that doesn't just consist of the two merging companies. But that's only one of the many possibilities that might come about. So, I think that's an area that clearly could benefit from greater clarity and elucidation.

I could talk about that for a while, but I know others on the panel can probably talk about it in more detail than I will. So, I'll just mention one other area that I think might benefit from clarification. Section 2.212 of the current guidelines suggests that --

MR. SHAPIRO: Get your copies out. Come on.

MS. MOLTENBREY: If other participants -- I'm not going to say in the market because I'm not sure that makes sense, but other participants in the industry might reposition so that they would capture more of the lost sales of the merging companies, that you would not likely have an anti-competitive effect and that should be taken into account.

But both in the merger guidelines commentary and I would suggest even in the agency practice, what was given with one hand seems to be taken away with the other. In the commentary, the agencies have said that they rarely find that repositioning would be sufficient to overcome a unilateral effect and, in fact, it is hard to find cases where it appears that the agencies accepted a repositioning argument. I think that is an area that, again, warrants maybe more than the very brief attention that's given to it in the existing guidelines and ought to either be revised -- depending on who you ask, either the guidelines or the agency practice might need revisions.

And I will stop there and save the rest for question and answer.

MR. SHAPIRO: Okay, thanks, M. J., Marius Schwartz next.

MR. SCHWARTZ: Okay, thanks, Carl.

You all posed 20 great questions and question 10 has eight parts and I'm only going to deal with one part of question 10, which is the relationship between market definition and unilateral effects and only one aspect of that, and that is what type of evidence should we use in merger review and why? Direct or structural? And the quick answer, of course, is you use both. The order shouldn't matter, as has been mentioned. And you should iterate between these two types of evidence.

None of this is remarkable, of course, but I hope to flush out the reasons for doing that and illustrate with an example from a merger challenge that was brought by the Department of Justice where I was an expert.

So, go back to what a horizontal merger does. It consolidates the ownership of assets used by the firms to compete in supplying their overlap product or services. So, a necessary condition for there to be the risk of substantial harm to consumers, is that the requisite assets very broadly defined tangible, intangible, whatever it takes to supply this stuff, are in sufficiently scarce supply to other firms, at least over the relevant time frame. That seems like a no-brainer. That’s a necessary, not sufficient, condition because there could still be efficiencies.

So, a fundamental question -- maybe the fundamental question is, do the merged firms possess some unique assets? That’s the question. And relatively important unique assets. Of course, the operational challenge is, how do you get at this from the kind of evidence you have in practice?

There are two ways to start the inquiry which starts off with different types of information. I’m going to call one bottom up, which is start by trying to identify the fundamental assets that are needed and who might have them, and the other one is top down. Start with evidence about competitive outcomes, who seems to be competing with who, what are the results, and then try to understand the why, the drivers.

The bottom up approach starts by trying to identify the key attributes of the competing products, the physical dimensions, the geography, and so on. And then asking which other firms have or could easily get these things to get the assets needed to generate those attributes. It’s a structural analysis corresponding to the same kind of questions that we ask when we do market definition. You say, what is the relevant product? Well, you need to know what matters. And that all seems reasonable except that, oftentimes, when we try to do the market definition formally, it’s hard to pin down the exact dimensions of the product market of the geography because it’s not always obvious. If products are differentiated in many dimensions, it’s not always obvious the relative importance of various dimensions.

So, if you try to come up with a market definition, you may well get stuck right there, unable to show that there’s a narrow enough market in which concentration is high enough to warrant concern. And you get knocked out of stage one before you even get to first base. So, that’s a problem.

Now, at the same time, in such cases, you may well have suggestive direct evidence that those firms do seem to compete pretty strong directly with each other and lesser with other parties. That’s sometimes information that’s called evidence of competitive effects. I like to actually distinguish that. It’s the type of information -- you know, we see that they seem to be bidding against each other a fair bit as compared to others, but that doesn’t quite tell us that there will be competitive effects. We have a few more things to cross before we get there.

But it’s a different kind of information. Enough to suggest that even though we may not be able to define the market with any precision, which would have tripped us up in stage one, we really ought to take a hard look. So, in other words, the thing about it is, we may not know why it is that Steve and I are strong competitors, but there may be good evidence that we are, at least good suggestive evidence. So, that’s how I think of this, too.

So, it makes sense to start there and say, well, are there some fundamental underlying structural factors, fundamental assets that do, in fact, validate that these two firms are especially close and that other firms couldn't step into the mix? It's important to not stop with this suggestive evidence. It's important because, one, there could be a lot of data problems with win-loss and these kind of measures. And there's other reasons that we could talk about later. And, so, I view these as very complementary approaches. You look at the suggestive evidence and then you try to understand is there something fundamental that validates that? And that second step requires basically the kind of stuff we do when we do a market definition of concentration, I think.

Now, let me just illustrate all of this -- like I said, it sounds pretty obvious. Let me illustrate it with a case study where I submitted a declaration. This involved a proposed merger of two amphitheaters in Southern California that -- these are open-air venues that were mainly used to stage rock concerts in the summer. So, this is the division trying to get the youth vote. And we showed our hipness when we referred to Mr. Rickie Lee Jones.

(Laughter).

MR. SCHWARTZ: For those who remember that. Now, when I first looked at this case, there are so many dots on the map of Southern California that were potential venues, you had no idea what to do with this stuff. How can there possibly be a case here? Well, what's the relevant geography? Is it Orange County or is it also Los Angeles? Not obvious a priori. Product market. Concert venues are differentiated -- I've written down dimensions -- by location, proximity to freeways, availability of parking, noise restrictions, size, outdoor versus indoor, general ambience. Lots of stuff.

If you tried to define the market from first principles, you would have been killed, right? There's just not enough information there to get a strong market presumption of a market definition and high concentration. At the same time, picking up on what John Baker says, let's see how they view each other, who do they think they're competing with? There was just a document that showed of all of the times when one facility bid to attract an act, 90 percent of the time they lost to the other guy. Well, that's interesting. You could say there's something going on.

There were also documents suggesting that price competition between those two was responsible for rock groups getting a bigger percentage of the gate revenue there than in other markets. So, all of this was interesting and forced us to try and understand the why.

Look at the documents, talk to promoters, talk to industry participants and pretty soon you got some insight into this. It turns out that these venues were very close. That mattered. Twenty miles as opposed to 40 miles matters in Southern California. They were comparable size. Stadiums, for example, which were 50,000, are fine for the Rolling Stones but are not fine for Mr. Rickie Lee Jones.

(Laughter).

MR. SCHWARTZ: The open-air nature mattered. Furthermore, those attributes, once you understood why it is these firms are uniquely close competitors are not things that competitors could easily replicate. Try getting a zoning variances in Southern California. All of which gave me a fair bit of confidence that you've got something.

Now, to supplement this and to put the market definition concentration overlay, I actually did a robustness check. Let's suppose that we include in the geography also Los Angeles, what happens? Let's suppose we include also closed-air facilities and under 5,000, what happens? The concentration still remained quite high. Now, if you included the stadium and you measured your shares by -- when I say concentration, I meant by revenues, how we measured it. When you use your capacity as you measure, number of seats, well, yeah, it’s diluted because a couple of stadiums wipe out the concentration, but that’s not relevant because these are differentiated products and just counting seats is not the right metric.

So, I give that as an example of how when we think of unilateral effects and market definition, there’s an aspect to this, which is, there’s different kinds of information we tend to put under those buckets and I think both of those are useful and they should both be used.

So, let me just stop there and leave the rest for Q and A.

MR. SHAPIRO: Thank you so much. That’s a very good example. Even a little dated, I think. But those very issues come up all the time. So, thank you.

Next, I would like to turn to Renata Hesse.

MS. HESSE: So, I was going to actually try to talk about Oracle without really talking about Oracle because I think everybody’s probably sick of hearing about it, but it is something that both -- because I was involved with it at the Division and also because I work for technology companies a lot now, is a case I’ve given a lot of thought to. And I have tried to figure out precisely why it is that Judge Walker ended up where he was, given that we thought it was pretty clear that these two companies were very close competitors and that we had a lot of evidence suggesting that that was the case.

So, I don’t mean exactly how he got to the end result because there’s been a lot of discussion about how, in some ways, that might have been a foregone conclusion. But what I really mean is what, to me, is problematic about the decision is this inherent tension in it that he felt between how you define markets -- and there’s a lot in the decision that you can read about how he was struggling with this idea of defining markets too narrowly -- and the assessment of competitive effects in the context of differentiated product markets where what you’re trying to focus on is figuring out whether or not the products of the two merging firms are really next best substitutes. In a sense, whether or not it’s a merger to monopoly for these two products. And I think, in my view, Judge Walker ended up in a place that’s not particularly helpful because he defined a very narrow set of cases where you could find a problem.

But what does that really have to do with the guidelines? So, I think one of the things you can give him credit for -- and obviously as a losing party, I’m willing to give him credit for very few things -- but he really was struggling for guidance. He was looking for help with unilateral effects. And you can see, if you read the opinion, that he read all kinds of economic articles. The economists in the room might think he didn't quite get them right, but he did look for information.

And I don't think the guidelines gave him very much help because they really don't say very much about how to look at market definition and unilateral effects in the context of differentiated product markets and they really don't address the unique issues associated with these two pieces that you're looking at, market definition and competitive effects. And I think everybody so far who's spoken has basically agreed in the context of at least differentiated products, the analyses really aren't very different. But the guidelines don't really say very much about that. And, so, I think it would be helpful to have more explication of how it really works.

I guess in my view there are kind of two things you can do. And I guess there's a third thing, which I will start with, which is basically saying you don't need you to define markets when you're looking at unilateral effects in differentiated product markets. I think given that the Supreme Court has basically said you have to define markets, that's pretty much off the table. So, despite the fact that that might be economically the right thing to do, I'm not sure you can just mandate through guidelines that you don't have to define markets. I think people are going to continue until case law changes.

So, once you're in the world of defining markets, I think you've got two choices. And one is to really understand and make more transparent that in the context of differentiated product mergers and unilateral -- I always get tongue-tied around this, unilateral effects cases involving differentiated products, that the market definition analysis is going to tend to lead to much smaller and narrow markets and in many, many cases may, in fact, lead to just two firm markets and that you shouldn't be afraid of that. It's okay.

You can look at -- I think it's the Staples decision where you sort of get the feeling that Judge Hogan is like, I can't define this narrowly as a market, I'll call it a sub-market and that will be okay. It's a market. I mean, if you want to think about that as a market in terms of competitive effects, it's a market and we should let the world know that's all right, judges, you can do that.

The other option I think is to continue to do what I'll call sort of traditional market definition, which will tell you, I think, something about market dynamics, but it won’t really give you very much insight and it certainly won’t tell you enough about what’s going on so that you can get into the world where you’re talking about presumptions. And if you go that route, I think there has to be some explicit statement that that’s also okay.

By that, I think what I’m really talking about is sort of a recalibration of how we think about market definition in this context. So, if you define markets narrowly, it may not be appropriate to label a firm dominant, as Judge Walker said in Oracle. In a traditionally defined market, the firm may have very low market shares. In fact, that was what Judge Walker thought was the case in Oracle.

Conversely, if you continue to define markets more broadly, but then, in terms of thinking about competitive effects, focus more uniquely on the competitive interaction between the two firms, it may be similarly inappropriate to say that the plaintiff, in many cases the agency, that you failed to meet a presumption and you don’t have a prima facie case because you don’t have a structural case and the market is not concentrated and, therefore, you can’t go forward. And I think there just has to be some acknowledgment that these two similar, but different ways of thinking about market definition in the context of unilateral effects cases are different than what you're going to do in a coordinated effects case, for example, but they really are okay. They may seem a little bizarre at the beginning, but they're actually, from an economic perspective, correct and that courts and practitioners shouldn't shy away from them.

So, there's a lot more to say about these things, but I will pass the mic back to Carl.

MR. SHAPIRO: Thank you, Renata. We are going to follow up on that, I promise you that. But not before we hear from our last panelist, Steve Salop.

MR. SALOP: Thank you. I just want to say, as I begin, this represents joint work that I'm doing with my colleague, Serge Moresi, at CRA.

What I want to focus on today is really two issues and a third if I've got time. The first is downgrading the importance of market shares and concentration in unilateral effects cases. I don't think there's anything wrong with defining a market in unilateral effects cases, though Mark Popofsky told us this morning that both he and Judge Posner think that Section 7 of the Clayton Act don't actually require that. But rather whether or not we define a market, the issue is the importance that we're going to place on market share and concentration.

The second thing I want to talk about is alternative presumptions, alternative evidence that we can use in unilateral effects cases if we do downgrade the role of market shares and concentration.

And then, third, if there's time, I want to talk a little bit about deterrence and the role of deterrence in the merger guidelines because it's something I found that was left out of the questions and is something that's really very important.

In the previous panel, with respect to market definition, they talked about, gee, there's really a lot of consensus about the SSNIP test, and I don't think that's true. I think that there's not much consensus -- well, there may be a lot of consensus, but there's not consensus on the SSNIP test, which implies unanimity. I think there are real problems with the hypothetical monopolist SSNIP test in the guidelines and I think that it requires a lot of renovation that also indicates why we should be downgrading the role of market shares.

The SSNIP test is really very elegant methodology, but it's both complicated and very imperfect. And as a result, it often leads to very ambiguous results. Noisy evidence at best. You often can't tell what market is most appropriate. And I think the revised guidelines should explicitly concede this point. It was made very nicely in a paper by Katz and Shelanski. And it implies that the role of concentration of market shares should be downgraded.

Now, we already know from Baker Hughes and other cases that the Philadelphia National Bank presumption has been weakened over the last 40 years, and I think a key reason for that are the flaws in market share and concentration as indicating competitive effects. But, of course, it should be recognized, I would say sort of it's interesting the ABA's comments to the questions ignored the fact that if you weaken the presumption, the Philadelphia National Bank presumption, which they wanted to do, that implies that you would also weaken the safe harbor presumption. And that door swings both ways.

If market shares and concentration are an unreliable measure of the likelihood of anti-competitive harm so that they can't be used to create an anti-competitive presumption, well, then they're flawed with respect to the safe harbor presumption as well. And I was quite taken by the fact on the previous panel that Joe Simons, who is usually associated with the conservative wing, is someone who thinks that that safe harbor also should be downgraded.

With respect to market definition, I think there are several areas in which the implementation of the SSNIP test is very problematical. The first is the smallest market principle, which I think should be deleted. Most importantly, as a matter of policy, as many other people have said, the fact there may not be a problem in the narrowest market does not mean that there's not a competitive problem in a broader market. So, you simply can't stop with the smallest market.

Secondly, it can lead to a very distorted view of competition by using this next best substitute algorithm. I think the current guidelines fall for the cellophane fallacy, despite the fact they recognize its existence. This use of the prevailing price, unless there's evidence strongly suggesting passive coordination, I know of virtually no cases in which the agencies have used a lower price. But tacit coordination is pretty common and one should be very cognizant of the potential for falling for the cellophane fallacy. And in our comments, we suggest a way around it.

Third, margins may be high not because of tacit coordinated but because of differentiated products. And when products are differentiated, we think we should use the Katz and Shapiro, and O'Brien, and Wickelgren methodology that uses margins as an indicator of elasticities, like the OFT is doing in their merger guidelines.

Fourth, the SSNIP test is very complicated when there are multi-product firms, either substitutes or complements; very complicated when there are dynamic effects and one cannot count on the simple-minded SSNIP test to give a reliable answer. And to put multi-product firms and dynamic competition into account in the SSNIP test, you essentially have to do a simulation model that simply eliminates efficiencies. Very complicated analysis.

So, the point I want to make here is that these are all reasons why the market definition process is necessarily complex, imperfect and error prone. Sometimes it's virtually intractable. While we may want to define a market, because market definition is very useful for getting an understanding of who the close substitutes are, it says that we should be downgrading the role of market shares and concentration. You don't want to put too much weight on that.

So, what should we do in unilateral effects? Well, I start from the idea that there's lots of evidence that's relevant for unilateral effects besides market shares. There's direct evidence from natural experiments, such as Staples, you know, the kind of evidence in Staples and Whole Foods. Sometimes there's direct evidence of pricing interaction. Sometimes the firms claim pricing interaction as did documents in both Whole Foods and Staples. There's also circumstantial evidence available of the closeness of substitution from consumer switching evidence, from entry studies. A whole variety of evidence that could be used to throw light on closeness of substitutes.

I want to focus here on one particular type of circumstantial evidence, these upward price pressure indices of the sort that Alison was talking about and that we talked about in detail in our comments, price pressure indexes or PPIs. And they can be either gross upward price pressure indexes or net ones. Upward price pressure and unilateral effects depends on the closeness of substitution, which I think you can proxy by the diversion ratio and the margin, as well as other factors.

But the particular measure that looks at the diversion ratio in the margin is very useful. It's generally pretty simple to calculate and it can be used as a presumption. It could be used to replace the HHI that is the product of the market shares or the combined market share.

There was a lot of anxiety expressed in the

ABA's comments about this upward price pressure index. And it's funny for two reasons. One, I started consulting around 1982 and clients were willing to pay me a great deal of great money to calculate HHIs in 1982. Lawyers were very uptight about the HHIs. But, now, that's considered old hat. Anybody can do an HHI.

MR. SCHWARTZ: Those were the days.

MR. SALOP: Those were the days, yeah. But the same thing with respect to the upward price pressure index. In fact, it's not alien at all. The merger guidelines -- I don't have the section. Maybe Carl can find it. Talk about the next best substitute as defined by the value of diversion. Well, I think the best measure of the value of diversion is the diversion ratio times the margin. That would be the proper analytic measure. So, really in order to carry out the SSNIP test in the merger guidelines, you already need to know this upward price pressure index.

It's also not alien because diversion ratios are basically the ratio of the cross elasticity rather to the own elasticity and those elasticities have been around in merger analysis since the DuPont and Brown Shoe cases. Indeed, this upward price pressure index, the gross price pressure index that Serge and I focused on in our comments is a very close cousin to the market definition test in Katz and Shapiro, and O'Brien, and Wickelgren.

So, we think it's a really very useful bit of circumstantial evidence. It's not direct evidence; it's circumstantial evidence. But it's better circumstantial evidence than looking at market shares. And it can be used to form the presumption, either the safe harbor presumption or the anti-competitive effects presumption. In fact, it's very interesting because this index that we use, the diversion ratio times the margin, in fact, it is the market definition test if the hypothetical SSNIP is a SSNIP for just a single product.

If it's a uniform SSNIP, then it's a little more complicated. It's the diversion ratio times the margin divided by one minus the diversion ratio, at least in the simple form where everything's symmetric. So, it is very closely related and it's a good way to think about the presumption. I mean, suppose you propose a market just of the products of the merging firms and you find that an increase in the price of one of the products would be profitable, so that those two products would define a market.

Well, that seems like a pretty defensible presumption of anti-competitive harm. Not a nonrebuttable presumption because this is only using part of the information, but it is a rebuttable presumption as good as the HHI, as good as the combined market share, it really seems much better. And then you can go with that fairly simple presumption and then you can move on from there and gather the additional evidence that you'd need in order to evaluate the likelihood of anti-competitive effect.

Do I have one more minute to talk about deterrence?

MR. SHAPIRO: One minute.

MR. SALOP: One minute. You know, the guidelines are really all about deterrence. They're not all just about analyzing a single merger. The goal of merger enforcement goes beyond analysis of the particular mergers that happen to come before you. They also have to take into account deterrence. We know there are false positives and false negatives in merger analysis as in anything else but deterrence goes beyond the false positives and false negatives for the deals you have, but also the effect on the deals that are being proposed. And false negatives include insufficient remedies.

So, I think it's important in setting these presumptions and working through the guidelines that you figure out the impact on deterrence. Section 7 talks about incipiency. In 1960, that was about a trend to concentration, but in the world of decision theory that we're in now, what incipiency must mean is a greater concern about false negatives and under-deterrence, than about out false positives and over-deterrence.

So, I hope that the agencies, in thinking through the guidelines and in particular in deciding what cases that you're willing to go to court over, that you take the deterrence effects into account.

There's been a lot of talk in the last few years about won/lost records. One, economics makes it very clear that there's selection bias, that won/lost records tell you virtually nothing about the litigation because of settlement rates. And it seems to me, in looking at sort of what people have been writing about the last few years, that the agencies are paying too close attention to won/lost rates and possibly are being too risk adverse with respect to the cases they bring.

So, thank you.

MR. SHAPIRO: Thank you, Steve. Thank you, all, for your comments.

There's a lot more to talk about and not that much time. Let me frame, at least, my first set of questions around the relevant section in the guidelines that deals with lessening of competition through unilateral effects and, in particular, differentiated products which I have to say, in my experience, at least the last eight months at being back at DOJ, that’s a lot of the cases. I can’t give you a count, but it’s a lot of the cases, particularly intermediate goods where we’re seeing if suppliers are bidding for patroNAAGe of their downstream business customers.

So, there’s about two pages on this in the guidelines, a page and a half. And I want to read -- bear with me -- after describing unilateral effects generally what they are. And here’s, I think, the main guidance and, so, I want to push on where we would go beyond that. It says, “Substantial unilateral price elevation in the market for differentiated products requires that there be a significant share of sales in the market accounted for by consumers who regard the products of the merging firms as their first and second choices.”

So, our staff is often looking at that question, first and second choices, that’s very closely related to diversion ratios. But notice that it’s framed in terms of share of sales in the market. Okay?

Now, I want to set that in contrast -- now, you can imagine some modifications there that wouldn’t necessarily refer to the market when doing that part of the test. And I want to then bring in your example, Marius, where you said you don't know what the market is, you don't know what the boundaries are, you could look at a win/loss record, you could look at bidding, you could look at some other measures of how often the two firms bump against each other. So, if you do that, and then -- but then Bobby Willig warned us this morning. He says, well, careful, if you just look at the win/loss records, you might be missing the fact that there's other firms, let's say other venues in your case, that are almost as good substitutes to the two merging venues and if you ignore them and just looked at the direct competition, you'd get a false positive.

So, Marius, starting with you, could we do modest revisions here, for example, that would reflect your iterative process, not assume you've figured out the market yet to give guidance about how this actual investigative process would work?

MR. SCHWARTZ: Okay. Can you make the question a little more precise?

MR. SHAPIRO: What do you do next? After you look and you see that the two -- they're often bidding against each other, what do you do next to make sure that you've paid enough attention to surrounding competition even if you haven't defined the market?

MR. SCHWARTZ: I'll tell you what we did and I think it’s a good general lesson, is you try to understand why it is that you’re seeing this seemingly close competition. So, you talk to people, you read documents, decision documents, and try to pin down what are those fundamental assets that might be driving this. And it’s important -- I agree with Bobby there, that if there’s no fundamental assets or anything that is explaining this pattern, you ought to worry a little bit because --

MR. SHAPIRO: You’ve got, obviously, your locations and venue, physical properties in your case. That’s often the case. You have some pretty well defined product attributes.

MR. SCHWARTZ: You have that, but if you don’t know how important those are -- somebody says, oh, consumers would, at the drop of a hat, drive 30 more miles. That blows me out of the water.

So, you need to try to get information on how important these things are. And with that information, you can come back and try to craft maybe a range of candidate markets, all of which would show you if you’ve done it right, that there’s pretty high concentration.

Back to the point that if you’re confident there’s a unilateral effect, there ought to be a market there.

MR. SHAPIRO: I'm trying to get confident, I guess, is the problem. I think M.J. said, well, if you've figured out the unilateral effects, you can back out the market. But how do we figure that out? If we're not going to do it based on market shares, does that mean we're doing the full competitive effects analysis? What if we look at the bidding and maybe margins, is that good enough or do I back out the margin from that or is that too easy? Others?

MR. SALOP: This is a drafting issue, Carl. It seems to me that the share of the sales accounted for you should just interpret as the diversion ratio. The importance of the other substitutes, as Alison pointed out, they're all in the denominator. They're already taken into account. You need to take the margin into account.

It seems to me that Bobby's -- you know, Bobby's example came from some testimony that Bobby gave at the Antitrust Modernization Commission that said if you've got two gas stations on a traffic circle that are perfect substitutes and then you've got some other more distant gas stations that are a little more distant substitutes, I suppose the relevant market would be all the gas stations, not just the ones on the circle, but the merger involves the two gas stations on the circle.

So, if you raise the price at one of the stations on the circle, all the sales would be diverted to the other station. So, it would seem like there's a unilateral problem, but, in fact, if they'd really try to raise the price, people would go to the other stations. And the conclusion is problematical because his example doesn't hold together. If the two stations on the circle were perfect substitutes, like he assumed, and if they weren't colluding -- you definitely don't want to allow the merger, if they were colluding. But if they weren't colluding and they're perfect substitutes, they can keep the price down to costs, the margin would be zero. So, there would be no unilateral effects concern. So, the example just doesn't work.

If you fix the example so they're differentiated products, then this upward price pressure index works just fine. If you'd raise the price at one of the stations, some people would go to the other stations and they would be protected, but the people that didn't go to the other stations, they would get hammered from the merger. So, you need to deal with unilateral effect that could occur from raising only a single price.

It seems to me that the people that are worried about the more distant substitutes -- I mean, clearly, they need to come into account of a full analysis. But the people that want us to say that trumps, they're ignoring the fact that a unilateral effect can involve a subset of the product's prices being raised, not a uniform price increase. And that's the flaw in their reasoning.

MR. SHAPIRO: So, let me pick up on that and materiality. Alison, I know you mentioned this, but you don't have to respond if you don't feel like it.

One notion of materiality would be there's going to be a significant price increase and how do we know about that? Another would be, well, it's maybe not just a product or two, does that really count? If there's two guys that sell two different brands of breakfast cereal, but there are a whole different set of cereals that are offered and we think the price of one or both of those brands will go up a bit, but they're just two of many, is that enough under -- you know, should that be enough? What might we say about that materiality, either magnitude or scope of the price increase?

My sense is some judges might say, look, that's a sub-market or that's a narrow part of a market. That's not enough. Reaction? Alison?

MS. OLDALE: I have to say I don't have an answer at all. I've got more questions on materiality.

I’m really not sure what I have to say about it. I think probably the best characterization of the way that we’ve tended to think about it in the UK is in terms of the size of the price increase rather than the volume of products that are affected in relation to the size of the market. But it’s not clear to me that either of those are right. Should we care more about bigger markets? Is there some notion of materiality being related to this size of the consumer detriment arising? I think it’s an important and under-explored area.

MR. SHAPIRO: Go ahead.

MR. SALOP: Well, if you take this gas station example, if the only people that would be hurt would be the people that stayed and you only thought a small portion of the consumers would stay with the first gas station, but there are efficiencies that apply to, you know, large efficiencies that apply to all the customers, then you might say it’s immaterial. That’s because, okay, if 10 percent of the consumers that buy the two products are going to be harmed, but the other 90 percent are going to benefit, then you might say that’s not material. So, I’d say it’s always relative to the efficiency benefits that you expect in the market.

MR. SHAPIRO: Renata, this is sort of directed at you, but, again, I’m not trying to put anybody on the spot too much. You said we should say it's okay to have narrow markets. But there's certainly a sense that if the markets seem narrower than courts are likely to be comfortable with that they'll, at least, raise eyebrows, and I'm sure you experienced that when you were at DOJ.

And you mentioned Oracle and since many of us know that, maybe it's good for illustrative purposes. I mean, strictly speaking, if you said, okay, if there's a unilateral effect between Oracle and PeopleSoft, then they could be a market, the two of them, without even including SAP. That would be somehow the logical conclusion, at least if they were next closest substitutes, which is kind of an artifact anyhow. So it seems -- and I should add, the commentary gives a lot of language about how these markets that we get could exclude a lot of products that are substitutes for some customers. It's the same idea.

Should we import in language from the commentary? If we're going to go that route, of course, if we're convinced that's right as a matter of analysis, we'd like to make the argument for the courts either in the guidelines or case by case. Are you just telling us to be brave or what?

MS. HESSE: Maybe so. I mean, I think, obviously, the challenge is that you have these cases sitting out there and so you now have to do something about them. And, so, in my view, one of the biggest priorities that you all should have is actually finding a good differentiated products case where you can try to fix what's wrong in Oracle. And that's not an easy thing to do. But I think the guidelines, at the very least, could give --

MR. SHAPIRO: Are some of your clients going to offer us a good opportunity?

MS. HESSE: I'm hoping not. Could offer some more explanation for how this really works and why the narrow market isn't something that you should be afraid of. For me, personally, I think actually the other route is preferable because I think it's a more true reflection of what the overall market dynamic is.

MR. SHAPIRO: What do you mean by that?

MS. HESSE: Meaning that you look at the market and you don't define it as just Oracle and PeopleSoft, you define it as Oracle, PeopleSoft and SAP and the shares of Oracle and PeopleSoft are lower, they don't meet the structural market concentration Philadelphia National Bank presumptions.

But you could say, okay, this is what the market looks like. But if you look at the competitive interaction between these two parties, we've identified a significant number of customers who account for a significant proportion of the sales in the market who will be harmed. And we can show that to you in a variety of different ways, merger simulation, customer testimony, documents from the parties, et cetera.

MR. SHAPIRO: What about the other way to go, I imagine, would be to say even if the SSNIP markets are fairly narrow and aligned with unilateral effects, as you said, we could plead broader markets either by abandoning the smallest market principle, using a bigger SSNIP or whatever, and then we might have relatively small market shares and argue, well, these market shares understate the effect because the two firms are selling products that are very close and we see them against each other a lot. Then we'd be up against arguments, oh, the market shares are so small, you guys are wrong, okay, and that's sort of a safe harbor.

Were you going to pick up on that?

MS. MOLTENBREY: Yes.

MR. SHAPIRO: I thought you were.

MS. MOLTENBREY: I think it's difficult, I guess, to think about this partly the way an economist, I think, would think about it and the way a lawyer would think about it, which are not necessarily identical, especially if you're not a lawyer who was raised as an antitrust lawyer.

I think all of us, all of the lawyers in this room who do this every day, are relatively comfortable with economic models and looking at econometrics as a way to define markets and to say it doesn't matter that in an industry where the firms identify one another as -- you know, maybe identify five or six firms as their big competitors, look at them, respond to them. Nevertheless, there is a market that consists of only two of those firms. In fact, you know, when we think about it accurately we may say there are probably multiple markets within that industry, all of which are relevant for antitrust purposes and all of which could be appropriate.

But as lawyers when we think about how we're going to present a case and you think about case law, the precedents you're going to be looking at and the fact that you may well be in front of a judge who maybe does two or three difficult antitrust cases in their entire career, that's not really a very attractive way to think about markets. The challenge, I think, in the guidelines, is going to be to find a way to explain why this localized competition is what you're going to be focused on, but not in a way that makes it seem as though everything else that's happening out there is irrelevant.

If you sit there and say, a merger between -- and I'm not suggesting agreement or disagreement with any of these particular cases, but if you look at the Whole Foods/Wild Oats case, for example, and you say competition between Whole Foods and Wild Oats is very important and this merger is going to eliminate this localized competition and prices are going to go up, it doesn't follow from that that the other supermarkets in the relevant geographies are irrelevant. It doesn't mean that the importance of another supermarket is basically no different than the importance of the dry cleaner down the road. Obviously, that's not how the agencies are thinking about it.

So, I think the challenge is to find a way to reconcile those two things. Some of it may be about language. When I started at the Antitrust Division back in the mid-eighties, to date myself, it was a time period when if you actually used the word "sub-market" when talking about things, you were immediately chastised and ridiculed and kind of sent back to your office to write 1,000 times, there is no such thing as a sub-market. And that comes out of the misuse of the concept of sub-markets in the courts and in some older cases.

But I'm not sure that that isn't possibly a useful way to talk to a non-antitrust specialist about why we care about a merger between two firms, even though there are other competitors in a market. Maybe there are other ways, if people are too afraid of reintroducing some of the abuses that you have from sub-markets and the notion of talking about localized competition or something. But, to me, that's really an expositional problem; it's not an analytical problem.

But it is an important part of what the guidelines do, is to help courts understand exactly what it is and, frankly, lawyers and practitioners who may not be as facile with some of the economic concepts to have this make sense to them.

MR. SHAPIRO: We're --

MR. SALOP: Can I just make a comment about that? I think that what M.J.'s saying that's really very wise is that Philadelphia National Bank and sub-markets were crutches and they're crutches that have turned out now, you know, 40 years later, to get in the way of getting the right result.

And, so, if you'd go back and abandon Philadelphia National Bank and just take a competitive effects approach, a first principles approach and come up with credible evidence that there's harm, irrespective of the presumptions, and then bring in the presumptions in a secondary way, we win even if there are no presumptions, but by the way, there ought to be a presumption, maybe not based on market share, maybe based on a price index, then that's the way to do it.

MR. SHAPIRO: Let me pick up on that with that last question and we will go just a few more minutes. So, we heard earlier today from the first panel -- the first two panels, actually, this morning that presumption isn't so strong anyhow and agencies need to tell a convincing story of effects to convince a judge that customers will be harmed. That was the way Rich Parker put it, for example.

So, in unilateral effects cases, the guidelines don't really get into what categories of evidence are convincing or probative or we look to. There's a bunch of ones that I can list. I just want to very quickly have people say, do you think the guidelines should get into talking about some of these categories of evidence or is that too much detail, for example? So, there's win/loss reports, bidding episodes, other indicia of head-to-head competition. One can look at margins. You can look at shares of some collection of products, customer surveys, company documents, merger simulation at the high end, it's more sophisticated, hard to understand maybe.

What about listing some of these and how we look at them and what role they play, would that be helpful or too much detail? Let's go down sort of very quickly each person.

MR. SCHWARTZ: I think without being taxonomic, listing a few and saying that, yeah, we take them seriously, especially because they give a window to how the participants view the competition, that would be helpful. That's how I'd approach things. So, why not list it?

MR. SHAPIRO: Yeah, Steve.

MR. SALOP: I think some categories would be useful. In fact, there are categories -- in the market definition section, there's a categorization of types of evidence. I think you certainly should have in that list natural experiments because that's really key.

MR. SHAPIRO: M.J., just going down.

MS. MOLTENBREY: Yeah, I agree.

MS. HESSE: I'm against listing actually. In part because I think there are some markets and some industries where some of these tools don't work very well, and, so, if you list them out, people are going to feel like, oh, my god, what if I can't do a merger simulation and I don't have win/loss?

From the outside, people look at these lists and they think, okay, I can check off these boxes. And the other reason is that I actually think that it's always some combination of these things. And they're informative and I guess you can list them in a win and say these kinds of things can be informative.

MR. SHAPIRO: So, if we said -- and I think this is the way it's done in other parts of the government -- here are the types of things that we look at, each case is different, you might have none of these or some of them, it all depends, these are just instructive, would you still be pretty uneasy with that, Renata?

MS. HESSE: I think what you're going to end up doing is driving people towards specific kinds of evidence.

MR. SHAPIRO: And that's bad?

MS. HESSE: Yes, I mean, I think because it could be -- yes.

MR. SHAPIRO: Alison, do you want to weigh in on this or not?

MS. OLDALE: A couple of things. I think there's possibly a difference between listing types of evidence and types of tools. So, evidence may be a bit more durable than tools. I have the impression that our tools are evolving all the time as we get better at what we do and they may not last 20 years or however long it is between revisions of guidelines in quite the same way.

I have to say, our guidelines do contain quite a lot of lists. But I've heard quite a lot of arguments today that maybe the guidelines ought to focus on the more durable bits and some of the lists should be perhaps in commentary, which I'm going to take away and think about.

MR. SHAPIRO: Well, your draft is quite a bit longer than our guidelines, for example.

MS. OLDALE: Yes. Yeah, it is much longer.

MR. SHAPIRO: For better or worse. Okay, I know I'm imposing on you a little bit. We are slightly past time, but let me give each panelist up to a minute, if they want, to leave us with a last pearl of wisdom.

MR. SCHWARTZ: I'll take less than a minute. I just suggest to Carl, it may be a good idea if the agencies released a draft of the proposed guidelines so we can look at the actual language and maybe have a second round, at the risk of creating more work.

MR. SALOP: I just think you should put a page limit on the guidelines.

(Laughter).

MS. MOLTENBREY: I think you should do

everything you can to avoid putting any Greek letters into the guidelines, but other than that...

MS. HESSE: So, as my prior comment indicated, I think I am in favor of more general but explanatory information, use of hypotheticals, maybe along the lines of the merger commentary, but not a lot of real detailed, specific information.

MS. OLDALE: And I just think that you have a challenge. There seems to be quite a common view about what we actually do and what we ought to be doing for unilateral effects, but also a very common view that trying to express this in the existing framework for the way that we do market definition is quite difficult.

MR. SHAPIRO: Well, thank you all. Join me in thanking the panel.

(Applause).

MR. SHAPIRO: So, we’re going to adjourn until Tuesday when we’re in New York.

(Panel 4 concluded.)

(The workshop was adjourned.)

C E R T I F I C A T I O N   O F   R E P O R T E R

MATTER NUMBER: P092900

CASE TITLE: HMG Review Project

DATE: DECEMBER 3, 2009

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: DECEMBER 10, 2009

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ROBIN BOGGESS

C E R T I F I C A T I O N   O F   P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

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ELIZABETH M. FARRELL