Litigating Merger Challenges: Lessons Learned

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The decisions in Arch Coal² and Oracle³ in 2004, and Whole Foods⁴ and Foster⁵ this past year, has led to some sober reflection both inside and outside of the agencies. Indeed, the Federal Trade Commission held a one day workshop on merger litigation and unilateral effects theories this past February.⁶ The day was spent reflecting on the agencies’ recent merger litigation experiences and debating whether the agencies should consider changes to its approach – specifically its approach to unilateral effects cases like Oracle and Whole Foods. I thought I would share some of my thoughts on the issue in light of both my experience as a member of the

¹ The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor Kyle Andeer for his invaluable assistance in preparing this paper.


⁵ FTC v. Foster, 2007-1 Trade Cas. (CCH) ¶ 75,725 (D.N.M. 2007).

Commission and my experience as a member of Oracle’s litigation team that prevailed against the Department of Justice in 2004. I believe that there are lessons to be learned from these experiences – both from the cases we lost but also from the cases we won.

I. Market Definition versus Competitive Effects: A Matter of Emphasis?

According to the conventional wisdom, the first step of the merger analysis begins with market definition. It has become the “gating issue” in the minds of many – both inside and outside the agencies. Judges have also often focused on market definition as a “threshold issue” in merger litigation. I would suggest this is a mistake. A focus on market definition risks obscuring the ultimate question under Section 7 of the Clayton Act, which is whether the transaction is likely to substantially lessen competition. The answer to that ultimate question may turn on market definition but it doesn’t have to in all cases. I do not mean to suggest that one could eschew market definition altogether but rather that it should not be the focus of the analysis.

To be sure, there is support for the argument that market definition is the threshold issue in any merger analysis. For example, there is ample case law that embraces that conventional wisdom. But much of that case law can be distinguished. First, the Supreme Court decisions

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were prospective merger cases pre-dating enactment of the Hart Scott Rodino Pre-Merger Notification Act in 1976. Competitive effects evidence is often more difficult to come by when the merger challenge is prospective. The government may have a greater ability to develop this evidence in a consummated merger challenge where the transaction can be assessed retrospectively. That was particularly true before the enactment of the HSR Act when the government had very little, if any, pre-complaint discovery. A structural analysis that begins with market definition and then moves on to assess market shares can be a useful predictive tool when the merger is prospective. Markets are defined so that when one calculates the share that a firm (or group of firms) comprise, one can assess whether that firm has significant “market power”.

Second, the older cases that emphasize upfront market definition were concerned with whether the merger would facilitate coordination among the remaining market participants (i.e., coordinated effects). In such cases, upfront market definition is arguably more important than a challenge based on a unilateral effects theory. A coordinated effects challenge requires an assessment of who is “in” and “out” of a market. Only once the market participants have been identified, can one assess the likelihood that a merger will facilitate the coordination of pricing or output decisions and thus substantially lessen competition.

Finally, in most, if not all, of their recent merger challenges the agencies have

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2d 34, 45 (D.D.C. 1998) (“Defining the relevant market is the starting point for any merger analysis.”).

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emphasized market definition. They have tried to define the relevant markets with precision in their pleadings. They have told district courts that the fundamental issue in their cases is market definition. And they have made that issue front and center in appeals from those district court decisions. The goal appears to have been to take advantage of the presumptions articulated in Philadelphia National Bank. Those presumptions are based on market shares and thus the agencies must define the relevant markets in order to avail themselves of the presumptions.

It is not simply the case law that suggests that market definition should be the threshold or first step in merger analysis. The framework of the agencies’ own guidelines appear to embrace that approach as well. The order of the 1992 Horizontal Merger Guidelines suggests that one must first define the relevant market before one can then assess the competitive effects of a particular transaction. Section 1 of the Guidelines lays out the steps the Agencies will take in defining a market over 14 pages and suggests that the exercise must be precise. The specific provisions dealing with unilateral effects (which are contained in Section 2.2) reinforce the suggestion that market definition is a “critical” first step when it describes a safe harbor based on post-transaction “market share.”

I respectfully suggest that this emphasis on market definition and market shares in merger litigation is wrong as a matter of law and as a matter of economics. Courts and scholars


13 Id. at § 2.211.
have repeatedly recognized that market definition is not an end in itself but rather an indirect means to assist in determining the presence or the likelihood of market power.\textsuperscript{14} It may be helpful in some cases, but it should not be treated as a threshold requirement. Market definition is a tool for analyzing market power, but it is not the only tool, either as a matter of law or economics. Direct evidence as to the likely competitive effects of a transaction is another tool, and one that seems to me to be far more probative. The purpose of market definition and the direct analysis of anticompetitive effects are consistent – both techniques seek to determine whether a planned agreement by competitors is likely to facilitate the exercise of market power.

The fundamental issue in antitrust is whether the challenged practice constitutes or facilitates an exercise of market power such that it substantially injures competition.\textsuperscript{15} Indeed, in cases brought under the Sherman Act, the courts are increasingly focused on direct evidence of competitive effects to determine the lawfulness of completed or ongoing conduct.\textsuperscript{16} To be sure,  

\textsuperscript{14} Toys “R” Us, Inc. v. FTC, 221 F.3d 928, 937 (7th Cir. 2000) (“The share a firm has in a properly defined relevant market is only a way of estimating market power, which is the ultimate consideration.”); Ball Mem’l Hosp., Inc. v. Mutual Hosp. Ins., 784 F.2d 1325, 1336 (7th Cir. 1986) (“Market share is just a way of estimating market power, which is the ultimate consideration, and . . . [w]hen there are better ways to estimate market power, the court should use them.”); 2A Phillip E. Areeda & Herbert Hovenkamp, \textit{Antitrust Law}, ¶ 531a, at 156 (2002) (stating that a relevant market definition simply serves as a surrogate for market power); Dennis Carlton, \textit{Market Definition: Use and Abuse}, \textit{Competition Policy International} (2007) (“[M]arket definition, together with the calculation of market shares, is a crude methodology”).

\textsuperscript{15} U.S. Dep’t of Justice & Federal Trade Comm’n, Horizontal Merger Guidelines at § 0.1 (“The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise.”)

\textsuperscript{16} FTC v. Indiana Federation of Dentists, 476 U.S. 447 (1986) (“IFD”); Conwood Co., L.P. v. United States Tobacco Co., 290 F.3d 768, 783 n.2 (6th Cir. 2002) (“Whether a company has monopoly or market power ‘may be proven directly by evidence of the control of prices or the exclusion of competition ... ’”); United States v. Microsoft Corp., 253 F.3d 34, 51 (D.C. Cir. 2001) (stating that in a Section 2 case, if “evidence indicates that a firm has in fact [profitably raised prices substantially above the competitive level], the existence of monopoly
some would argue that the case law embracing direct evidence of competitive effects should be
distinguished from the typical prospective merger challenge under Section 7 because of the
nature of the inquiry. In a case arising under either section of the Sherman Act, the analysis is
generally retrospective – the practice has already occurred and predictions about its effects are
unnecessary. But that may be a distinction without any meaningful difference. Direct evidence
bearing on competition will support a reliable prediction about the merger’s likely impact on
competition – and that is all that Section 7 requires.

There is Clayton Act case law that supports an increased focus on likely competitive
effects. For example, in United States v. Baker Hughes, Judge (now Justice) Thomas explicitly
recognized that the ultimate issue in merger cases is whether the merger is likely to create or
facilitate the exercise of market power, and he observed that while proof of a high market share
was one way to prove that, where there were other kinds of evidence supporting that prediction,
they could and should be used.17 Thus, at least in the D.C. Circuit, it is apparent that the ultimate
question in a merger challenge is whether the merger is likely to result in the exercise of market
power, and direct proof that a merger is likely to have that result is probative on that issue.

Additionally, the Fifth Circuit recently recognized that the reality of a merger trial is that
the Commission, as the plaintiff bearing the ultimate burden of persuasion of illegality, presents
all evidence supportive of its position at the same time responding to the respondent’s evidence

when the burden of production has shifted to the respondent.\textsuperscript{18} Thus, the Commission’s direct evidence of competitive effects may be offered not only to prove that ultimate issue but to define the relevant markets – i.e. the markets in which the merger is likely to result in the exercise of market power.

All of this is not to say that the agencies can eschew market definition altogether. For example, as the Seventh Circuit held in a Sherman Act case, the plaintiff must at least identify the “rough contours” of the relevant markets.\textsuperscript{19} That makes sense. It is implausible to argue (or conclude) that a merger is likely to have competitive effects without describing at least roughly those who are likely to be adversely affected by it. But I would contend that the proof of relevant markets can be defined by direct proof of likely competitive effects. I have described this as “backing into” the market definition.\textsuperscript{20} Others have described the competitive effects evidence and the market definition evidence as “two sides of the same coin.”\textsuperscript{21} Both mean the same thing to me: the relevant markets need not be defined in the order or in the fashion set forth the Merger Guidelines.\textsuperscript{22}

I also think a focus on competitive effects is an easier story for the government to tell and

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\textsuperscript{18} Chicago Bridge & Iron v. FTC, 515 F.3d 447 (5th Cir. 2008).

\textsuperscript{19} Republic Tobacco Co. v. North Atlantic Trading Co., 381 F.3d 717, 736 (7th Cir. 2002).


\textsuperscript{22} Gregory J. Werden, \textit{Market Delineation under the Merger Guidelines: A Tenth Anniversary Retrospective}, 48 \textit{THE ANTITRUST BULLETIN} 517, 535 (1993)(the merger guidelines are not meant to serve as a “cookbook consisting of specific directions to be followed in precise order.”).
for a court to understand. A case focused on market definition risks getting bogged down in esoteric fights over the SSNIP test. Asking a customer witness whether they would have switched to an alternative in the face of a 5% price increase is arguably not a persuasive line of questioning. Indeed, it was these sorts of questions that caused trouble for the government in Oracle.

This raises the question of whether it is time to revisit the guidelines particularly if the Agencies want to focus more directly on the ultimate question of competitive effects. As Susan Creighton suggested at the recent FTC workshop, it may be sufficient for the agencies to make themselves heard on this subject in their merger challenges. The emphasis on market definition and market shares in the Clayton Act cases may be a product of the positions taken by the Agencies. Others have suggested that changes in the Guidelines are needed if the agencies are going to focus directly on the competitive effects of a particular transaction rather than relying on old structural presumptions. For example, Oracle’s lead trial counsel, Dan Wall, asserted at the FTC workshop that unless and until the Merger Guidelines were changed, the Guidelines would lock the agencies into the structural approach because courts generally adopt the Merger Guidelines’ analytical framework. The 1992 Guidelines were the first to introduce a separate section on competitive effects and it may be time to revise them.

One way or another, however, I believe the agencies should make it clear that they

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23 Marc Schildkraut, *Oracle* and the Future of Unilateral Effects, 19 ABA ANTITRUST 20 (Spring 2005) (“[T]o have a better chance of prevailing in cases like Oracle, the antitrust agencies first need to modify the Merger Guidelines to permit direct effects to trump prima facie analysis and then they need to educate the antitrust community on the importance of this change.”).

believe that direct evidence of competitive effects will suffice to define the markets that are relevant to their merger decisions and challenges.

II. Trial Presentation: “Telling a Story”

To me, the trial advocacy in a merger challenge is all about telling a compelling story about what the competitive effects of the merger are likely to be and how likely they are to occur. In my judgment (and experience) if the court subscribes to the agencies’ story, the agencies are likely to win. If the court does not, the agencies are likely to lose. It’s as simple as that. All of the possible evidence that the agencies may consider presenting should be evaluated in terms of whether and to what extent the evidence will help to tell their story.

A. The Role of Economics At Trial

Economic evidence can take many forms – price elasticity studies, diversion ratio studies, critical loss analyses, simulation analyses, and natural experiments to name a few. Personally, I think simulation analyses and indeed any kind of economic analyses that require the use of mathematical formulae are of little persuasive value in the courtroom setting. When I see an economic formula my eyes start to glaze over, and if the formula uses Greek letters I tend to think “it's all Greek to me.” I think that’s the way that courts view this evidence too.

Simulation analyses and the like were presented in the Oracle, Swedish Match and Staples trials, and in all three instances the courts (including some pretty sophisticated judges) virtually ignored them.25

Critical loss analyses are easier to understand (and for economists to explain). However, I view them as an implementation of Section 1 of the Merger Guidelines. If, as I advocate, the

agencies intend to prove the merit of their merger challenges primarily through direct evidence of competitive effects rather than in the fashion described in Section 1 it is arguably a big mistake for them to rely on critical loss analysis as a major part of their case. This is not to say that such an analysis has no value at all. It can support more direct evidence of competitive effects. But I don’t believe it can or should be a substitute for such evidence in most cases.

Price elasticity analyses and natural experiments are another matter. If properly and simply explained by an economist who is a good teacher and an experienced and attractive witness, they can be used very effectively to help tell the agencies’ story. For example, where the merging parties enjoy prices that are substantially above the prices of other players selling similar products or services, and either entry has not occurred or the entry that has occurred has not materially eroded the prices of the merging parties, a compelling competitive effects story can be told. Most economists, however well prepared, will not have the industry experience to serve as the primary “storytellers.” However, they can play an important complementary role and reinforce the testimony of those witnesses by presenting data respecting prices, entry, diversion and/or price erosion.

A note of caution about such analyses and experiments should be sounded. They must be “well-controlled” so as to eliminate or at least minimize the possibility of other explanatory variables. As I say, an experienced and attractive economist who is a good teacher can be a significant contributor to the story line. However, if and to the extent that his or her direct testimony can be impeached on cross-examination by, for example, demonstrating that other explanatory variables were not ruled out or that they were ruled out when they should not have been, that kind of expert testimony can severely hurt, rather than contribute to, the story line.
B. Case Presentation: A Modest Proposal

The overriding consideration for non-economic evidence is the same as it is for economic evidence: does it tell the agencies’ story effectively? In terms of the order of proof, I have already indicated that my bias is that the burden in that respect be carried primarily by the non-economic evidence. The economic evidence may be important to reinforce the non-economic evidence, but it can rarely, if ever, carry the day by itself. Hence I think of the economist as a complementary player rather than the headliner.

The merging parties’ (and/or their consultants) documents, the testimony of the merging parties (and/or their consultants), customer testimony (and/or end users if they are different from direct customers), competitor testimony, and “industry expert” testimony are alternatives. There is no “one size fits all” rule when it comes to the presentation of these various kinds of evidence. Much depends on the nature of the documentary evidence and the perceived attractiveness of the witnesses. However, I will state my own preferences and the reasons for those preferences.

First, I would prefer to lead off with the most senior knowledgeable representatives of the merging parties themselves (or their consultants). The reasons for that are primarily twofold. First, they can be examined as adverse witnesses. That means the agencies’ can use leading questions to tell their story. As one wise federal district judge once observed, “direct examination of a witness is much more difficult than cross-examination” in telling a story because leading the witness is not allowed on direct examination. That also means that merging party cannot tell their story (at least for the first time) through direct examination. It must be told instead through the lens of cross-examination, and if the examiner is skilled, that can be a very cruel lens.

Second, the story-telling documents of the merging parties (and their consultants)
frequently can best be presented during that examination. One of the best cross examinations I have seen was one in which the examiner did not really care what the witness said. The witness was asked to authenticate document after document and those documents told the examiner’s story (or disproved his opponent’s story) extraordinarily well. All the examiner had to do was asked the witness a question that the document answered: if the witness gave an answer consistent with the document, the examiner just asked the witness to authenticate the document and then displayed it on the screen; if the witness answered contrary to the document, the examiner just asked the witness to examine the document and then displayed it on the screen as an impeachment document. Either way, the examiner’s story seemed to be told through the party’s own mouth.

Customer testimony is trickier for several reasons. First, customer witnesses are not easy to control. Customers are not adverse witnesses and thus leading questions are a no-no. Generally, it is anyone’s guess as to how they will testify that way on direct examination, let alone cross-examination. If the Agencies work with them on their direct that can be a legitimate subject for impeachment on cross-examination.

Second, courts tend to perceive customers as having a built-in bias against a merger because customers generally favor lower prices and are inclined to think that mergers lead to higher prices. This is reflected in the Oracle decision, where Judge Walker expressed reservations about the foundation for the customer testimony.26 However, before Oracle, it was

Oracle, 331 F.Supp. 2d at 1131 (“[t]he issue is not what solutions the customers would like or prefer for their data processing needs; the issue is what they could do in the event of an anticompetitive price increase by a post-merger Oracle. Although these witnesses speculated on that subject, their speculation was not backed up by serious analysis that they had themselves performed or evidence they presented. There was little, if any, testimony by these witnesses about what they would or could do or not do to avoid a price increase from a post-merger Oracle.”); see also Arch Coal, 329 F.Supp. 2d at 145-146 (“In many contexts, however,
reflected in the decisions of several courts in hospital merger cases where payor testimony was described as self-serving.\textsuperscript{27}

Third, it is very hard to present customer testimony in a fashion that is not cumulative, on the one hand, and is representative, on the other hand. In Oracle, for example, the agency presented more than a dozen customers witnesses, and the district court obviously got bored with hearing the same thing over and over again (e.g., whether the customer would change its buying practices if confronted with a small but significant price increase). On the other hand, in Sungard, the district court concluded that the witnesses presented by the agency were not sufficiently representative.\textsuperscript{28}

Fourth, customer witnesses can very rarely be used to present documentary evidence. They are generally not knowledgeable enough to authenticate or testify about party documents. And, because they cannot be treated as adverse witnesses, courts are reluctant to permit introduction of their own documents through them, and even when that is permitted, the documents are often perceived as being self-serving and the product of selection.

Nearly all of these same considerations militate against the use of competitors as primary story-tellers. They are ‘wild cards’ who are not adverse witnesses and therefore cannot be led.

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antitrust authorities do not accord great weight to the subjective views of customers in the market. (Citations omitted). Furthermore, while the court does not doubt the sincerity of the anxiety expressed by SPRB customers, the substance of the concern articulated by the customers is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market.’’).\end{flushleft}

\textsuperscript{27} FTC v. Freeman Hosp., 69 F.3d 260, 272 (8th Cir. 1995); but see Thomas O. Barnett, Substantial Lessening of Competition - The Section 7 Standard, 2005 Colum. Bus. L. Rev. 293, 309 (arguing that while customers are sometimes biased, customer interests tend to be in line with the goals of the antitrust laws).

\textsuperscript{28} Sungard, 172 F.Supp 2d at 191-192; United States v. Engelhard Corp., 126 F.3d 1302, 1306 (11th Cir. 1997).
Those who oppose the transaction may be perceived as having axes to grind, and their testimony and documents may be treated accordingly. And they must be both non-cumulative and representative at the same time, which is hard to accomplish. Nor, I would suggest, can that feat be accomplished through the use of declarations or affidavits instead of live testimony. Live witnesses (and their documents) alone can tell a story effectively. Affidavits and declarations are apt to end up in the court file (and then the circular file).

This is not to say that customer and competitor testimony can never be useful in buttressing the story told by the principal storytellers. Their testimony can be helpful for that purpose. In fact, the most convincing story is one that is told by the principal storyteller or storytellers and supported by virtually everyone else in the industry, customers and competitors alike.

Indeed, it may sometimes be useful to help support that story through an industry consultant (though my own experience tells me that a paid industry consultant is often not nearly as credible as the industry participants themselves. In fact, his or her testimony will simply duplicate theirs and consequently looked canned).

Or, it may be useful to support that story by visits to the stores or plants of the merging parties. That was apparently effective in the Staples case as a means of reinforcing the central story the merging parties’ store were unique as competitors to each other.29 The problem is that those visits are uncontrolled. They can backfire if the court concludes the opposite of the story that is being told.

C. Litigation and the Press

Finally, the importance of dealing effectively with the media cannot be omitted in any

29 Staples, 970 F.Supp. 1066.
discussion about what constitutes effective trial strategy in a merger case, whether the theory be one of unilateral effects or coordinated effects. Courts do not decide these cases in a vacuum, especially if it is a high profile merger and the trial is lengthy. They read the papers, watch television and surf the net the way the rest of us do. It is important that they not get the impression that the case they are deciding is either a slam dunk or a lost cause. The merging parties and their public relations people spend a lot of money making sure that a case of this kind is fairly reported. Part of the agencies’ job during trial is to try to make sure that that reporting is fair and balance. It certainly helps if that effort is amusing too. Frankly, I'm not very good at that. Dan Wall and Joseph L. Alioto are masters at it. They would stroll out of the courtroom each day and tell the media in colloquial terms what had just happened and what it meant. I don’t know how much it helped (although they both won). But it sure didn’t hurt.