Dissenting Statement of Commissioner Joshua D. Wright

In the Matter of ZF Friedrichshafen AG and TRW Automotive Holdings Corp.
FTC File Number 141-0235

May 8, 2015

The Commission has voted to issue a Complaint and Decision & Order against ZF Friedrichshafen AG ("ZF") to remedy the allegedly anticompetitive effects of ZF's proposed acquisition of TRW Automotive Holdings Corp. ("TRW"). I respectfully dissent because the evidence is insufficient to provide reason to believe ZF's acquisition will substantially lessen competition for heavy vehicle tie rods sold in North America. In particular, I believe the Commission has not met its burden to show that the acquisition will result in an increased likelihood of harm from coordinated effects or from unilateral effects. As a consequence, the Commission should close the investigation and allow the parties to complete the proposed transaction without imposing a remedy.

I write separately today to explain my vote and to discuss the quality and quantity of evidence necessary to support a coordinated and unilateral effects challenge under the 2010 *Horizontal Merger Guidelines* ("*Merger Guidelines*").

The Complaint alleges the proposed transaction increases the likelihood of coordinated effects and unilateral effects in the market for heavy vehicle tie rods sold in North America.[1] After the proposed transaction, ZF and TRW would have a combined 41% share. The remaining competitor, Urresko, has a 58% share. Fringe suppliers have a 1% share.

I. Coordinated Effects Are Unlikely in the Relevant Market

The Complaint implicates an important question with regard to coordinated effects: what evidence is necessary to establish reason to believe a proposed transaction may substantially lessen competition by "enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers."[2]

The *Merger Guidelines* offer three conditions that, if satisfied, suggest the agency is likely to challenge a merger upon the basis that it will result in an increased

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[1] Compl. ¶ 12, ZF Friedrichshafen AG, FTC File No. 141-0235 (May 5, 2015).
[2] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 7 (2010) [hereinafter MERGER GUIDELINES].

likelihood of competitive harm from coordination. The *Merger Guidelines* specify that the agencies are likely to challenge a merger if: (1) "the merger would significantly increase concentration and lead to a moderately or highly concentrated market;"[3] (2) the "market shows signs of vulnerability to coordinated conduct;"[4] and (3) "the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability."[5]

The second and third conditions are at issue here and worthy of further discussion.

The record evidence is mixed with respect to the second condition, whether the market shows signs of vulnerability to coordinated conduct. Evidence that the market is generally conducive to coordinated interaction includes the fact that heavy vehicle tie rods are fairly homogeneous goods and are purchased using relatively short-term contracts.

Also potentially germane to assessing the vulnerability of the relevant market to coordinated conduct are previous episodes of coordination by the same players in different markets. In 2012, a German subsidiary of TRW Automotive, TRW Deutschland Holding GmbH, pled guilty to a conspiracy to fix prices of seatbelts, airbags, and steering wheels sold to two German automobile customers for vehicles manufactured or sold in the United States.[6] While this prior episode does not involve the same relevant product or geographic markets as the current matter, it might suggest some vulnerability to coordination.[7]

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[3] *Id.* § 7.1.

[4] *Id.*

[5] *Id.*

[6] Plea Agreement ¶ 4(e)-(f), United States v. TRW Deutschland Holding GmbH, No. 2:12-cr-20491-GCS-PJK (E.D. Mich. Sept. 25, 2012).

[7] The *Merger Guidelines* state that "The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market," but that prior "express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market," and that prior collusion "in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market." MERGER GUIDELINES, *supra* note 2, § 7.2. Thus, I am comfortable with concluding the prior TRW Deutschland price-fixing case is material to our investigation, and that this evidence increases the likelihood of coordination, all things equal. However, without a more detailed assessment of any logical connection between the markets where collusion actually took place and the relevant market here, I am hesitant to give this factor alone substantial weight given observable differences between the markets. For instance, in the markets at issue in that case, the bidding process appeared to be more formal with longer

There are other considerations, however, that indicate the market for heavy vehicle tie rods is not particularly vulnerable to coordination. First, while the product might be fairly homogeneous, there are significant switching costs including the time and cost involved with validation testing of the new supplier's tie rods. All else equal, significant switching costs make markets less vulnerable to coordination because they diminish firms' ability to punish effectively deviations from the coordinated price. Second, cost and demand fluctuations appear to be relatively frequent and large, which increase the information costs needed to detect accurately deviations.[8] Third, Urresko is a relatively recent entrant and has become the largest supplier in the market. These types of disruptive market events are generally not conducive to successful coordinated interactions. Finally, there are a number of large buyers, which can result in dramatic market share swings if a supplier loses the majority of a buyer's business. While the record evidence with respect to vulnerability of the relevant market is certainly mixed at best, it would not be unreasonable to find the second prong in the *Merger Guidelines* satisfied.

Ultimately, however, I do not have reason to believe the proposed transaction is likely to result in coordinated effects because the record evidence does not satisfy the third condition – that is, there is no "credible basis on which to conclude that the merger may *enhance*" any pre-merger vulnerability to coordination.

The *Merger Guidelines* provide the acquisition of a maverick firm as one illustrative example of the type of evidence that would satisfy this third condition. There is no evidence that either ZF or TRW is a maverick firm as contemplated by the *Merger Guidelines*.

The sole evidence offered in favor of the proposition that the proposed transaction will *enhance* the market's vulnerability to coordination is that the merger will reduce the number of firms in the relevant market from three to two. I do not agree that a reduction of firms from three to two, without more, is enough to provide "a credible basis to conclude that the merger may *enhance* that vulnerability." The

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commitments. *See* Information ¶ 8, United States v. TRW Deutschland Holding GmbH, No. 2:12-cr-20491-GCS-PJK (E.D. Mich. July 30, 2012).

[8] For instance, the primary input to produce heavy vehicle tie rods is steel. Looking at the producer price index for steel mill products, the average annual price change over the past ten years is 1.6% with a standard deviation of 6.6%. Some of the specific yearly changes are substantial, e.g., -8.6%, 7.5%, 9.1%, 12.8%. *Producer Price Index - Metals and Metal Products*, U.S. BUREAU OF LABOR STATISTICS, http://www.bls.gov/regions/mid-atlantic/data/ProducerPriceIndexMetals_US_Table.htm (last visited May 8, 2015).

observation that a market with N firms will, after the merger, have N-1 firms, is simply insufficient without more to establish the required credible basis under the *Merger Guidelines*. This is true even when a merger reduces the number of firms from three to two. The Commission offers no explanation as to why the *Merger Guidelines* would go through the trouble of requiring a credible basis to believe a merger will change the market's competitive dynamics that *enhances* the market's vulnerability to coordinated conduct, *in addition to* an increase in market concentration, in order to substantiate a coordinated effects merger challenge if the latter were considered sufficient to satisfy both elements.[9]

As I have stated previously, "there is no basis in modern economics to conclude with any modicum of reliability that increased concentration—without more—will increase post-merger incentives to coordinate. Thus, the *Merger Guidelines* require the federal antitrust agencies to develop additional evidence that supports the theory of coordination and, in particular, an inference that the merger increases incentives to coordinate."[10] Janusz Ordover, in a leading treatment of the economics of coordinated effects, similarly explains that "It is now well understood that it is not sufficient when gauging the likelihood of coordinated effects from a merger to simply observe that because the merger reduces the number of firms, it automatically lessens the coordination problem facing the firms and enhances their incentives to engage in tacit collusion; far from it."[11] The required additional evidence needed to satisfy the third condition is absent in this case.

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[9] The Commission cites Carl Shapiro to support the proposition that market concentration is relevant to coordinated effects analysis. *See* Statement of the Federal Trade Commission 2 n.4, ZF Friedrichshafen AG, FTC File No. 141-0235 (May 8, 2015) (quoting Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 701, 708 (2010) ("In particular, as the revised Guidelines explain, the Agencies place considerable weight on HHI measures in cases involving coordinated effects.")). I agree. The 2010 *Merger Guidelines* establish market concentration as one of three conditions that must be satisfied to find coordinated effects. What Shapiro does not state, and the proposition the Commission does not otherwise substantiate, is that evidence of changes in market concentration is sufficient to satisfy the third condition along with the first.

[10] Dissenting Statement of Commissioner Joshua D. Wright 3, Fidelity National Financial, Inc., FTC File No. 131-0159 (Dec. 23, 2013).

[11] Janusz A. Ordover, *Coordinated Effects*, *in* 2 ISSUES IN COMPETITION LAW AND POLICY 1359, 1367 (ABA Section of Antitrust Law 2008) ("It is quite clear . . . that a reduction in the number of firms and concomitant increases in concentration do not necessarily make collusion inevitable or even more likely, stable, or complete.").

II. Unilateral Effects Are Unlikely in the Relevant Market

The sole evidence offered in favor of the Commission's allegation that the merger will render unilateral price effects likely is that some customers have used the competition between ZF and TRW to obtain better pricing and some customers have switched between the two suppliers.[12] While this is certainly material to our inquiry, this is a thin reed, without more, upon which to base a unilateral price effects case. There is no information on price effects. Moreover, there is no substantial evidence on the record with respect to the role the market leader, Urresko, plays in disciplining prices. The fact that Urresko is a recent entrant and has become the market leader in a relatively short period of time also renders dubious the proposition that barriers to entry in the relevant market are adequate to sustain a post-merger price increase. Additionally, even with sufficient barriers, Urresko's rapid growth undermines significantly any unilateral effects argument and suggests a post-merger price increase from a merged ZF-TRW would be fragile and potentially unsuccessful. The *Merger Guidelines* contemplate the possibility of intense competition in markets with small numbers of firms, observing that "Even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings."[13]

Moreover, unilateral effects in a homogeneous goods market principally involve reductions in output.[14] In order to be profitable, the reduction in output must not be met by a sufficient supply response by rivals. Thus, absent meaningful capacity constraints, unilateral effects are less likely in homogeneous goods markets. I have seen no evidence that Urresko is capacity constrained.

III. Conclusion

The Commission insists that a different "lens" should be used to evaluate evidence in markets where the number of firms is reduced by merger to three or two.[15] The Commission cites in support of its structural theory and presumption three academic articles written by economists.[16] Only two offer economic evidence and the proffered substantiation fails to support the claim. The first is an important early entrant into the static entry literature examining the relationship between market size

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[12] *See* Analysis of Agreement Containing Consent Order to Aid Public Comment 2, ZF Friedrichshafen AG, FTC File No. 141-0235 (May 5, 2015).
[13] MERGER GUIDELINES § 5.3, *supra* note 2.
[14] *See id.* § 6.3.
[15] *See* Statement of the Federal Trade Commission, *supra* note 9, at 2.
[16] *Id.* at 2 n.5.

and the number of entrants in a market, focusing upon isolated rural markets.[17] It strains credulity to argue that Bresnahan and Reiss's important analysis of the impact of entry in markets involving doctors, dentists, druggists, plumbers, and tire dealers in local and isolated areas, where they find the competitive benefits of a second competitor are especially important, apply with generality sufficient to support a widely applicable presumption of harm based upon the number of firms. Indeed, the authors warn against precisely this interpretation of their work.[18]

The second is a laboratory experiment and does not involve the behavior of actual firms and certainly cannot provide sufficient economic evidence to support a presumption that four-to-three and three-to-two mergers in real-world markets will result in anticompetitive coordination.[19] Once again, the authors warn against such an interpretation.[20]

Finally, the Commission cites a draft article, authored by Steve Salop, in support of its view that economic evidence supports a presumption that four-to-three and three-to-two mergers are competitively suspect.[21] The article does not purport to study or provide new economic evidence on the relationship between market structure and

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[17] Timothy F. Bresnahan & Peter C. Reiss, *Entry and Competition in Concentrated Markets*, 99 J. POL. ECON. 977 (1991). While Bresnahan and Reiss is an important early contribution to the static entry literature, it cannot possibly bear the burden the Commission wishes to place upon it. Abstracting from the complexities of market definition was necessary for the researchers to isolate entry decisions. This is possible when studying the effects of entry by a second dentist in a town with a population of less than 1,000, but not in most real-world antitrust applications. The authors of the study make this point themselves, noting that "whether this pattern appears in other industries remains an open question." *Id.* at 1007.

[18] In earlier research using similar empirical techniques and data – namely, small rural markets – Bresnahan and Reiss plainly reject the notion that the findings should inform views of market structure and competition generally: "We do not believe that these markets 'stand in' for highly concentrated industries in the sectors of the economy where competition is national or global." Timothy F. Bresnahan & Peter C. Reiss, *Do Entry Conditions Vary Across Markets*, 3 BROOKINGS PAPERS ECON. ACTIVITY 833, 868 (1987).

[19] Steffen Huck et al., *Two Are Few and Four Are Many: Number Effects from Experimental Oligopolies*, 53 J. ECON. BEHAVIOR & ORG. 435 (2004).

[20] *Id*. at 436 ("The number of firms is not the only factor affecting competition in experimental markets. This implies that there exists no unique number of firms that determines a definite borderline between non-cooperative and collusive markets irrespective of all institutional and structural details of the experimental markets.").

[21] Steven C. Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach* (Georgetown Law Faculty Publications and Other Works, Working Paper No. 1304, 2014), *available at* http://scholarship.law.georgetown.edu/facpub/1304/.

competition. Thus, it cannot support the Commission's proposition.[22] In sum, there is simply no empirical economic evidence sufficient to warrant a *presumption* that anticompetitive coordination is likely to result from four-to-three or three-to-two mergers.

It is important to note that the Commission and I have no disagreement over the proposition that the number of competitors within a market is a relevant fact to assess the likely competitive effects of a transaction. The relevant question is not whether the number of firms matters but how much it matters—and in particular, whether a movement to three or two firms warrants a generally applicable presumption that a transaction is more likely than not to harm competition. I do not believe it does. The Commission disagrees.

The *Merger Guidelines* make clear that the purpose of market concentration and market shares associated thresholds "is not to provide a rigid screen to separate competitive benign mergers from anticompetitive ones, although high levels of concentration do raise concerns."[23] Rather concentration is but one aspect of the inquiry aimed at better understanding post-merger incentives to compete. The predictive power of market share and market concentration data is informed by economic theory and available empirical evidence. There is no empirical evidence sufficient to establish a generally applicable presumption that mergers that reduce the number of firms to three or two are likely to harm competition.[24] Further, the Commission's reliance upon such shorthand structural presumptions untethered from empirical evidence subsidize a shift away from the more rigorous and reliable economic tools embraced by the *Merger Guidelines* in favor of convenient but obsolete and less reliable economic analysis.

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[22] Nevertheless, to the extent Salop argues in favor of legal presumptions in merger analysis, he clarifies that they "obviously should be based on valid economic analysis, that is, proper economic presumptions," which should be updated "based on new or additional economic factors besides market shares and concentration." *Id.* at 37, 48. I agree. Additionally, Salop explains that "[c]ontemporary economic learning suggests that concentration be considered when undertaking competitive effects analysis – in conjunction with other factors suggested by the competitive effects theory – but not treated as the sole determinant of post-merger pricing." *Id.* at 13-14. Notably, Salop does not endorse a distinction between four-to-three mergers or three-to-two mergers and mergers in less concentrated markets that justifies a presumption that the former are anticompetitive; rather, he merely observes that empirical evidence and economic theory do not warrant "*ignoring* market shares and concentration in merger analysis." *Id.* at 12 (emphasis in original).

[23] MERGER GUIDELINES, *supra* note 2, § 5.3.

[24] *See* Statement of Commissioner Joshua D. Wright 3-5, Holcim Ltd., FTC File No. 141-0129 (May 8, 2015).

This is not to say that evidence of changes in market structure cannot ever warrant such a presumption. It does when the evidence warrants as much. The Commission has in certain contexts found reason to believe competition would be substantially lessened based simply upon a reduction of firms in the relevant market. See *Actavis plc-Forest Laboratories*[25] and also *Akorn-Hi-Tech Pharmacal*,[26] which both involve generic pharmaceutical markets. The Commission was able to draw conclusions about the relationship between price and the number of firms in generic pharmaceutical markets because substantial research has been done to establish that such a relationship exists.[27] Indeed, the cases in the pharmaceutical industry are the exceptions that prove the rule that the Commission needs to do more than count the number of firms in a market to have reason to believe a substantial lessening of competition is likely. No such research has been done in this market. Accordingly, unlike in generic pharmaceutical markets, we have no evidence to conclude that a simple reduction in the number of firms in this market is likely to lead to higher prices and lower output. Simply assuming such a relationship exists in this market without any evidence to suggest that it does harkens back to the bad old days of the first half of the 20th century, when the structure-conduct-performance paradigm was in vogue.

To summarize, there are three-to-two mergers that give rise to unilateral effects, and three-to-two mergers that give rise to coordinated effects. It is our burden to show that *this* three-to-two merger is likely anticompetitive. The Commission must find sufficient evidence to support an inference of likely economic harm to consumers. The heavy degree of reliance upon a structural presumption in this case is not sufficient to do so.

Finally, the Commission and Commissioner Ohlhausen each claim that the quantity, and presumably the quality, of the evidence is not the same for investigations truncated by remedy proposals compared to cases where a full phase investigation is

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[25] Analysis of Agreement Containing Consent Orders to Aid Public Comment 2, Actavis plc, FTC File No. 141-0098 (June 30, 2014) ("In generic pharmaceutical product markets, price generally decreases as the number of generic competitors increases. Accordingly, the reduction in the number of suppliers within each relevant market would likely have a direct and substantial anticompetitive effect on pricing.").
[26] Analysis of Agreement Containing Consent Orders to Aid Public Comment 3, Akorn Enterprises, Inc., FTC File No. 131-0221 (Apr. 14, 2014) ("In generic pharmaceuticals markets, price is heavily influenced by the number of participants with sufficient supply.").
[27] *See* David Reiffen & Michael R. Ward, *Generic Drug Industry Dynamics*, 87 REV. ECON. & STAT. 37 (2005). As an aside, given that we are now ten years removed from the publication of this important study and over twenty years removed from the sample period, it might be worth revisiting this question with fresher data if the Commission intends to continue relying upon inferences of competitive harm from market structure in the generic pharmaceutical market.

completed or compared to a completed trial, respectively.[28] While this observation is an accurate description of the pragmatic reality of conducting law enforcement investigations, I do not agree with the implication that the quantum and quality of evidence needed to satisfy the "reason to believe" standard should turn on whether and when a remedy proposal is offered during an investigation. The idea is that we should "take into account the need for predictability and fairness for merging parties in these circumstances"[29] and considerations whether it is "appropriate to subject the parties to the added expense and delay of a full phase investigation."[30] I fully support the agency identifying opportunities to lower the administrative costs of antitrust investigations and believe there to be ample opportunity to do so. But attempts to operate a more efficient law enforcement system must satisfy the constraint, required by law, that there is reason to believe a transaction violates Section 7 of the Clayton Act. That standard sets a relatively low bar for the minimum level of evidence required to substantiate a merger challenge. I reject the view that it should be a standard that should be relaxed because the merging parties offer a remedy.[31] The Commission is primarily a law enforcement agency, albeit one that largely conducts it business by entering into consents with merging parties. Making the consent process more efficient and predictable is a laudable goal; but we must not allow pursuit of a more efficient consent process to distort our evaluation of the substantive merits. To do so, as in my view we have here, risks in the long run reducing the institutional capital of the agency in magnitudes far greater than any potential cost savings from truncating an investigation.

For these reasons, I cannot join my colleagues in supporting the consent order because I do not have reason to believe the transaction violates Section 7 of the Clayton Act nor that a consent ordering divestiture is in the public interest.

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[28] *See* Statement of the Federal Trade Commission, *supra* note 9, at 3 n.7; *see also* Separate Statement of Commissioner Maureen K. Ohlhausen 1, ZF Friedrichshafen AG, FTC File No. 141-0235 (May 8, 2015).
[29] Separate Statement of Commissioner Maureen K. Ohlhausen, *supra* note 28, at 2.
[30] Statement of the Federal Trade Commission, *supra* note 9, at 3 n.7.
[31] That said, as I stated in *Holcim Ltd.*, I am not suggesting the "reason to believe" standard "requires access to every piece of relevant information and a full and complete economic analysis of a proposed transaction, regardless of whether the parties wish to propose divestitures before complying with a Second Request." *See* Statement of Commissioner Joshua D. Wright, *supra* note 24, at 11.