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FEDERAL TRADE COMMISSION

HORIZONTAL MERGER GUIDELINES REVIEW PROJECT

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Northwestern University School of Law

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APPEARANCES

WELCOME

Mr. Henry Butler
Ms. Molly Boast
Mr. Richard Feinstein

PANEL 1: ENTRY

Mr. Dennis K. Carlton	Mr. Robert Pratt
Mr. Spencer Weber Waller	Mr. Robert Gertner

PANEL 2: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

Ms. Deborah Platt Majoras	Ms. Monica Noether
Mr. Michael D. Whinston	Mr. James Langenfeld

PANEL 3: UNILATERAL EFFECTS

Mr. Kevin M. Murphy	Ms. Roxane Busey
Ms. Mary T. Coleman	Mr. Paul T. Denis

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INTRODUCTION AND WELCOMING REMARKS

MR. BUTLER: Good morning. It's, like, too cold to talk. My name is Henry Butler. I'm the executive director of The Searle Center on Law, Regulation and Economic Growth, which is a unit at the law school.

We fund faculty research. We engage in some large-scale empirical studies, the State Consumer Protection Study that we just released. We run judicial education programs, education programs for state attorneys generals and their staff. We've been in business since the summer of 2007.

We have worked with the FTC on a number of programs, which has been very enjoyable for us. We had Bill Kovacic was doing some hearings on the FTC at 100. That was about a year ago we had a hearing here at the law school.

We also have established an annual conference with the economists at the FTC. The second one was just last month. It's the FTC/Northwestern Economics, Microeconomics

Conference. We worked on that with the Center for Study of Industrial Organization out in Evanston as well. And so we look forward to continuing that relationship.

So when we were approached about hosting this workshop, we were very happy to do that and glad to have all of you here. So welcome to the law school.

We're actually in a Kellogg building. We use this building for a lot of our programs because it's primarily here for classes that are taught in the evening. So there's always a lot of space availability here, and it works well for us.

There are refreshments down the hallway. Lunch will be at the law school across the way. That's during exams, so we'll ask you to be quiet as we walk over during that. But it's great to have you here and look forward to a productive day.

MS. BOAST: Thank you, Henry. I can't keep my nametag on. I'm Molly Boast from the Department of Justice, and I want to thank you for hosting this.

We decided we couldn't leave the

Midwest out of our worldwide tour of Merger Guidelines Workshop, but in particular we couldn't leave out Chicago in all their variations.

I'd like to welcome all of you on behalf of both the Department of Justice and the Federal Trade Commission.

Rich Feinstein, the bureau director, Bureau of Competition, will be hosting. He and I will host alternate panels today. And special thanks to Liz Callison, who's sitting here in the front row, from the FTC's Bureau of Economics, who has been truly the one person without whom none of this would have been possible. She's steadfastly helped us organized each of these.

These workshops, as you know, grew out of an initiative by the two agencies to take a look at the existing Horizontal Merger Guidelines, which have been place in large measure since 1992, but not substantially revised with the exception of the Efficiencies Division since then.

We came into this project without any pre-designs; and in contrast to past efforts when the guidelines had been revised, we decided we would do well to see whether there was a consensus around making any changes, and if so, what those changes ought to be and then what parts of the guidelines.

I think our public statements have suggested that we're not committed to making revisions. We are also not at this point contemplating a major overhaul.

That said, at least based on the first couple of workshops we've conducted thus far, there have been a number of different points raised that would suggest that there ought to be some changes made.

And so again, we're continuing to try to work for areas where there's consensus so that we bring together the best legal and economic scholarship in this effort.

No one workshop covers all of the topics. Some of you may know that the agency has published a list of questions to help frame the discussion, although they're by no means meant to be limiting. We have different topics at different workshops just because there's no time in one day to do justice to all of them.

Our first panel, which I will moderate this morning, is on entry issues, which seems like a small part of the guidelines; but when I get back to my notes, I'll tell you why I think it matters.

I asked someone to go back and look at the reported merger cases. There's, of course, discussion of entry in other kinds of antitrust litigation.

And it seems that the Baker Hughes decision in 1990 was part of what prompted the merger guidelines revisions in 1992.

Since then, we did not find any case where a prima facie case had been established by the government and then was rebutted by the likelihood of entry.

There are a couple of decisions that give very extensive discussion to entry issues. Most recently and probably most notably, because of their thoroughness, both FTC cases, more power to them. One was the Chicago Bridge and Iron case in 2008, and most recently the CCC Holdings case in 2009. Both those courts talk about entry a great deal.

The Chicago Bridge and Iron case, you may remember, was a case where one of the principal issues that the Commission was litigating was whether in a consummated transaction it was fair to assume that the parties had sort of gamed the system and the entry analysis might not look like what it might in a different situation.

In CCC Holdings it was a much more straightforward, very detailed rundown of all the various kinds of evidence that could be responsive to an entry inquiry.

Let me tell you a little about how we're going to proceed. I'll introduce our eminent panelists. Each of them have been asked to speak on the topic of entry but without any pre-designs on what they say about it for five to seven minutes.

They're invited to comment on each other's presentations; and I will say we have a reporter here, so we want to be clear, but we're happy to take questions from the audience as well.

After their presentations and any commentary that they have on them, we'll go through a series of questions that we've put together that hopefully will help elicit some of the things we want to have discussed in the course of this session.

PANEL 1: ENTRY

MS. BOAST: So let me introduce in no particular order our panelists. Sitting immediately to my right is Dennis Carlton, Katherine Dusak Miller Professor of Economics at that other school down on the South Side, specifically the U of C School of Business.

Sitting to my left is Bob Pratt, who joins us from the Illinois Attorney General's office. Thank you very much. It's wonderful to have State participation.

Continuing over, playing the tennis game, we'll go to Spencer Weber Waller, who comes from the Loyola University School of Law and is also the Director of the Institute for Consumer Antitrust Studies, as probably many of you get his mailings, which are wonderful.

And last, but certainly not least, Rob Gertner, who is the Joel Gemunder Professor of Strategy and Finance, also at that other school in Hyde Park, the Chicago Booth School of Business, and also principal with Chicago Partners.

Rob has been interested in this

project pretty much from the day it was announced, so I'm especially pleased that he's here.

And we'll start with comments by Spencer Weber Waller.

MR. WEBER WALLER: Molly, you'd like us to speak from the table?

MS. BOAST: Whatever you wish, are comfortable with.

MR. WEBER WALLER: This is fine.

Hi. Thank you so much for including me in the hearings, and I appreciate a chance to come over here. I happened to have gone to law school at Northwestern; and while I didn't have a lot of classes in this building, at the time our career center was here and I had almost all my job interviews. So this is a nice change, although it's maybe similar, where I'm going to be grilled to the same level as when I was seeking jobs in the market.

My comments this morning, and I want stay very brief and do more in the Q and A, my comments are part of a larger project that I'm involved in on the role of brands in intellectual property and antitrust.

And obviously my specific comments are going to be limited to mergers and as much as possible entry in that connection. But in that larger project, and my coauthor is here today, his name is Deven Desai, I'm arguing that brand, brand management, brand strategy is one of the most important aspects of modern business management. Equally delighted to be able to say those things at the Kellogg School.

Through all the different and varied techniques of brand management, businesses strive to differentiate their products and services, create and enhance customer loyalty, facilitate price discrimination, reduce price elasticity, and create price premiums.

Now, here today and in the larger project, I'm not arguing that any of these things are necessarily bad or that a successful brand is an antitrust violation.

However, we are arguing that neither intellectual property law nor antitrust law has truly accounted very well for the true nature and importance of brands, and as a result has formulated a variety of seemingly disparate rules, many in the merging area, a little bit in a vacuum, which doesn't take into account the nature and importance of brands and brand management.

When you think about these doctrines in the law, whether they are market definition, market power, entry, which we're here to talk about today, and many, many other issues, in particular antitrust as it relates to vertical distribution of products and services, when you use a brand lens, a lot of issues that don't seem to be related suddenly come into focus and make a little bit more sense.

And I want to suggest that only if you understand and appreciate the role of brands and apply them to antitrust analysis can you have a meaningful discussion of whether the trends in the law are appropriate.

And so first and foremost, I want to suggest that this requires government agencies, legal scholars, practitioners, policymakers, judges, others to be as conversant in the law of marketing and brand management as they are industrial economic analysis, indeed untraditional market analysis.

So I'm going to get into the specifics I think more when we get into the questions and answers that Molly has for us; but I want to suggest that oftentimes you get some surprising results, things cut both ways.

Thinking about brand issues, just bringing them more to the forefront doesn't automatically suggest that you have more enforcement or less enforcement or that individual parties would have a harder time getting a merger cleared or an easier time.

But I do think it sheds a lot of light, and for example, my point of entry with respect to the issues of entry, when I was thinking about brands, some of these comments are in the written submissions that are up on the Web site, some are in the paper as it's continuing to evolve.

One of the merger guidelines and commentary talks about brand repositioning as either sort of a form of entry or as an alternative of entry that the agencies will reconsider.

I'll be discussing in greater

detail as we get into that kind of specifics why when you look at the marketing literature that marketing people for a variety of reasons believe that, in their words, it's virtually impossible.

So when you bring those kinds of insight to bear, it just sort of suggests at both microlevels and at larger levels ways of bumping up to the forefront, theories, research, people, literature that's in the business community.

We just don't tend to talk about it as much in law and economics. So that's why I'm here and why I'm grateful to be able to add those perspectives.

MS. BOAST: Thank you, Spencer.

Let me just plant a question with you now that you don't have to answer now since I promised no surprises. And that is just because I read these cases recently preparing for this, in the Chicago Bridge decision, the court made a distinction between a general reputation, perhaps not quite the same as brand but close enough for this discussion I think, which the court did not think was of entry variant and a reputation for industry-specific trades.

And I want to think a little bit about how reputation and brand actually should play into the entry analysis, so maybe we can come back to that.

Rob Gertner, I think you were going to be our next commenter.

MR. GERTNER: Great. Thank you to the FTC and DOJ for organizing these workshops and including me. It's a pleasure and honor to participate.

If you will indulge me in a brief introductory remark, I will get to entry in under a minute.

The current guidelines have been successful in many ways, but they no longer are an accurate portrayal of agency practice, nor do they fully reflect the richer understanding and frameworks that have developed in the years since they were adopted.

So I welcome a revision, but I do want to note one caveat. Possibly to the chagrin of the agencies, the guidelines are sometimes used and sometimes misused by judges in litigation.

A revision will likely increase their use because the status of the guidelines will be enhanced by a revision whose introduction states that it reflects actual practices and best practices as of 2010.

The mere fact of revising the guidelines raises the stakes; and unless the revision is a substantial improvement, the net result may be worse policy.

I'll now move to discussion of entry; and I will work hard not to turn it into a discussion of market definition, which all roads seem to lead to, maybe for good reason.

Entry basically shows up in two places in the current guidelines, and I would argue that neither is the right place. It is correctly missing from market definition -- whoops, there I go.

It appears with the idea of including uncommitted entrants as market participants as part of HHI calculations in the structural analysis, and as a separate step of the analysis to see if entry considerations should trump a competitive effects analysis, which concluded that there would be a short-run incentive to raise price or a prediction that the merger would raise price.

Instead, I will argue that if entry considerations are important, it should be integrated into a competitive analysis.

In order to discuss this, I would like to use an example based on a generic version of the facts of the Thomson Reuters merger where I served as a consultant to the antitrust division of the DOJ.

The role of the example is just to make my comments tangible. Nothing I say is based on any significant details or direction of the investigation, public or confidential.

Thompson and Reuters each provided software platforms, terminals and data for financial information and analysis. Both customized their products for clients who could choose different software and data elements and would pay accordingly.

Bloomberg also provides these services; and for the purpose of this discussion, I will assume that Bloomberg was vertically differentiated with higher quality and higher prices.

Bloomberg, in contrast to Thomson and Reuters, did not customize its offerings but gives all data and all software to all buyers, approximately.

Bloomberg could easily compete more directly with Thomson and Reuters individually or collectively after merger by taking some of the functionality out of its product and lowering price. But prior to the merger, it chose not to do so.

The question is how do we incorporate Bloomberg in merger review. One note, given my desire to avoid discussing market definition, I will treat repositioning within a broad market and entry into a narrow market as equivalent for the purposes of my remarks.

A key point to note is that the analysis should not depend on whether or not Bloomberg is part of a broad market in which it may reposition itself or a potential entrant in a narrower market.

I know Kevin Murphy will talk more about this issue in another context this afternoon.

So let's begin with a discussion of uncommitted entry, first generally and then in the context of this example. So uncommitted entry is really very similar -- in fact, I think it's almost equivalent -- to the notion of contestability.

And I was an undergrad at Princeton at the time Bobby Willig, who was my adviser, and Bill Baumol, who were working on contestability. So these issues are in my blood.

In fact, I had to futilely struggle to replicate in my notes Bill Baumol's exquisite -- he's an amazing artist -- three-dimensional, multicolored chalk drawing of transray convexity.

I found myself giving up and just listening, so in some ways I think I'm scarred for life by contestability theory.

But from this work we learned a great deal about many things. But contestability is not really an applied concept. It's really theoretical benchmark, much like perfect competition or complete Arrow-Debreu markets. It's not, it's not a market reality.

Like these other paradigmatic models, it focuses our attention on what's missing in the real world, why the assumptions don't hold, and what the implications are. And that way it enhances our understanding.

But just like complete Arrow-Debreu markets, anything approaching contestability or uncommitted entry rarely exists.

The dichotomy of uncommitted entry and committed entry is about as useful as thinking about dividing the world into those economies where there are complete Arrow-Debreu markets and those without, and perfectly competitive industries and those which are not.

So take the Thomson Reuters example. It seems like it ought to be very close to the ideal. Bloomberg entry into that segment seems like it ought to be very close to our concept of uncommitted entry.

It costs us virtually nothing to eliminate functionality from its platform. However, even in this case, entry is not without costs. Many of them sunk.

Bloomberg would need to develop

and implement a fairly significant marketing strategy for a different type of customer, have to train salespeople, et cetera.

Furthermore, and perhaps in some ways more importantly, the opportunity cost of lost sales on the more expensive platform, the potential depreciation of its brand, all would have to be considered.

So the uncommitted entry analysis in the guidelines asks us in this case to determined not only whether or not Bloomberg would enter if a merger of Thomson and Reuters were to yield a small but significant price increase. Note, I do not add non-transitory even though the guidelines do because I don't think Bloomberg would know when it had to make its decision whether or not the price increase was transitory or non-transitory. Small glitch in the guidelines. But also what its resulting share would be.

Then we're supposed to incorporate these revised shares in our HHI calculations to determine anticompetitive presumptions.

I hope this seems like an absurd exercise. It is complex and it mimics the entry analysis we need to do if it is treated as committed entry as part of a competitive effects analysis rather than a structural case, which in this instance would really be an entry analysis with direct evidence really mimicking the structural case.

For these two reasons, the kind of theoretical problem and the practical problem -- I think the distinction of uncommitted entry and committed entry is unnecessary and placement of entry considerations into HHI calculations is misplaced.

Next I want to address sort of a more important issue with respect to entry, which is entry being used as a step after the competitive effects analysis rather than being integrated into the competitive effects analysis.

I will continue using the Thomson Reuters Bloomberg example, although I think it's less perfect for these points.

Here is how an investigation might proceed according to the guidelines, and I think consistent with agency practice.

The agency, maybe outsiders and

the parties, will develop and estimate an econometric model that estimates short-run demand elasticities under an assumption of static differentiated product competition.

Assume for now that this analysis implies the new equilibrium would involve significantly higher prices. Then we will ask whether entry or repositioning by Bloomberg would occur to make the price increase unprofitable. If so, the agencies would not seek to block the merger.

Here is the problem. If entry is an important constraint on competition post-merger, it is likely an important constraint pre-merger as well. If this is the case, the maintained assumption of the econometric model that prices are determined by short-run demand elasticities is incorrect. The model is misspecified and the analysis suspect.

If we accept the premise that entry may constrain prices post-merger, it seems clear that we should at least consider that it may also constrain prices pre-merger. And then it is essential that entry be part of the competitive effects analysis.

I believe that in many industries potential entry and other long-run demand elasticity considerations play a significant and large role in constraining prices.

So the right analysis should incorporate this in the analysis of how a merger affects pricing incentive.

Now, I think it's hard to look at Microsoft and the detailed analysis of Microsoft pricing that occurred in the antitrust litigation and not think that part of an important force in Microsoft's pricing of Windows was thinking about long-term demand elasticities and entry, long-run entry possibilities.

I think we see it as commonly part of managers' discussions with respect to pricing and is present in internal pricing documents that we see.

The conclusion that entry should be integrated into a competitive effects analysis is an example of two broader points Kevin Murphy and I tried to make in our written comments.

First, that a multistep approach to competitive effects analysis is often less effective than an integrated approach that incorporates both entry and efficiencies.

And second, that an important goal of merger review is to develop an understanding of how competition works in the industry pre-merger.

The analysis should be consistent with and explain the key merger facts and then demonstrate how the merger changes competition and pricing incentives.

I think that's all I want to say for now, and I'm sure I'll have much to say in the Q and A.

MS. BOAST: All right. Well, thank you, Rob. That was extremely interesting. Your warning at the very beginning is something that both Rich Feinstein and I take quite seriously since we're both litigators and we worry a lot about guidelines, both as a set of guidance for the parties we see before us but also how courts perceive them. And your comments on entry are quite timely.

One thing for you to think about,

perhaps to comment on later, is whether the juxtaposition of the competitive effects analysis and then entry immediately following in the current guidelines isn't really a way of saying it's all part of the same discussion but the burden shifts.

Our next commentator will be Mr. Pratt from the Illinois Attorney General's office.

MR. PRATT: Thank you, Molly. And I join with the other panelists in thanking DOJ and the FTC for putting on these workshops and for inviting me to be here. It's an honor.

I'll begin with a disclaimer. The views that I will express are my own, not necessarily those of the Attorney General of Illinois, not those of NAAG, and certainly not those of any other attorney general.

I'd like to address two, two points. First, I'll address the only question regarding entry, which is included in the twenty questions for public comment, that is whether there should continue to be a distinction in the guidelines between uncommitted and committed entry.

Dropping the distinction is one change which most commentators seem to support. I haven't read them all but it seems to be a majority view in that direction, and I agree.

There are two basic reasons for my view on this. First is that a separate analysis of uncommitted entrants is not something I've ever seen done. And that's an observation which has also been made by others with broader experience than myself in the merger area.

So the current formulation fails the very basic test of whether it reflects actual practice and, thus, provides meaningful guidance to business and to enforcers.

The second reason for eliminating the distinction is that, as the ABA said in its comments, the distinction is largely artificial and potentially confusing.

Even for antitrust lawyers, some definitional gymnastics are required to nail down the concept that committed is inferior to uncommitted in this context. And I think that confusion is worsened by the guidelines' own conflicting usage of the term committed, which you can find in footnote 27 where it is stated that firms which have committed to entry prior to the merger will be included within the market, much like uncommitted entrants are included within the market, but that only committed or post-merger entry will be considered as possibly counteracting the merger's anticompetitive effects.

So if you are committed as in the first usage, in other words, committed prior to the merger to enter, you are like an uncommitted entrant. Only if you are committed as in the second usage are you committed for purposes of entry analysis. And if you think about it long enough, you will have to be committed.

So to conclude on this point, an uncommitted entrant is just like any other potential entrant except that its entry may be somewhat more likely than others because no sunk cost will be incurred and its entry is more apt to be timely.

The timely, likely and sufficient entry formulation, I think, is a robust one which does not require additional and confusing, perhaps contradictory distinctions.

The second point I'd like to address goes to the nature and extent of evidence which is required for merging parties to prevail on an assertion that entry will eliminate the anticompetitive effects of an acquisition.

In the first workshop last week, Rich Parker commented on how important it is that the guidelines be accessible and understandable to business persons and that they reflect the actual practice of the agencies.

The entry provisions of the guidelines fall short in an important way. Reading the current entry section, a business person at least, if not an antitrust lawyer, a business person would come away with the impression that analysis of the prospects for entry is a mechanical exercise.

First, entry alternatives are measured and weighed, what has to be done to enter. Then it is asked whether those alternatives could, hypothetically, be achieved in a timely, likely and sufficient way.

There is scant reference to the importance of actual experience, yet in practice it's the rare merger which the agencies or the states have permitted to proceed on the basis of entry without quite substantial, empirical evidence of a history of entry, vertical integration into the market, or at least credible expressions of intent to enter by particular identified firms.

In the guidelines, references to the role of this type of evidence are few. In Section 3.1 it is stated that recent examples of entry may provide a useful starting point for identifying the necessary actions, time requirements and characteristics of possible entry alternatives.

But that, that understates the role of entry experience and the existence of actual identifiable entrants likely to enter. It suggests, at least to the layperson, that an entry case based on economic analysis and hypothesized entry may succeed, even in the face of history and in the absence of credible and identifiable entrants.

Enforcers and experienced

antitrust counsel, though, know that an entry story almost never carries the day in the absence of such evidence.

Molly mentioned the two litigated cases. I didn't look at those, but I did go back and look to the cases that are described in the 2006 commentary.

In the commentary, in the entry analysis section, there are case examples, and by my count there are six examples of cases in which it was decided not to challenge the merger based on an entry analysis.

In five of those six cases, the summaries indicates that there was substantial evidence of entry history or intent as follows:

First, there was evidence of actual prior entry in three of the cases, Omnicare-NeighborCare, ADS-Hancor, and Wrigley-Kraft. There was evidence of prior entry based on outsourcing of the basic function at the issue in Playbill-Stagebill.

And there was evidence of the customer's stated intent and ability to sponsor entry and specifically identified entrants in the National Oilwell Varco transaction.

The sixth matter came close. It was the Cinram-Time Warner matter, which involved DVD/CD replication technology, and that technology was found to be readily available for license from patent pools.

In addition to the examples in the commentary, which I think illustrate the importance of concrete evidence of entry, the commentary text also does a better job than the guidelines, I think, of stating that entry experience is important to evaluating the entry starting.

And it does so effectively while emphasizing that past entry is by no means conclusive as to the likelihood of effective post-merger entry.

The point is not that there is anything economically or analytically wrong with the guidelines' approach. It's just that the guidelines fail to acknowledge that in most cases empirical evidence of entry history or intent will be necessary if there's any prospect of successfully defending an otherwise anti- competitive acquisition on entry grounds.

I would be remiss if I didn't note

that the NAAG 1992 Horizontal Merger Guidelines mirror the DOJ/FTC guide on the issue of entry with one exception.

The NAAG guidelines add at the end of the entry section references to evaluating empirical evidence and they emphasize the importance of historical entry.

That is an important and a valuable addition. I think it would be much better to integrate the references with the rest of the entry section rather than to simply append it to the end, as was done in the NAAG guidelines.

But it's a change that I think should be made to the federal guidelines and perhaps some fine-tuning of the NAAG guidelines as well.

That concludes my comments.

MS. BOAST: Bob, thank you for all the homework you did. That was incredibly illuminating just to hear the cases and commentary pulled together and analyzed that way.

And I think you put your finger on something that is, again, one of the challenges for the working group and all of us in this exercise, and that is how prescriptive do we make these guidelines.

I mean, you rightly point out what I see in the reported decisions that there's a kind of hierarchy of evidence that courts tend to rely on.

Entry is enough of a microcosm that we can see that pretty clearly; and by the same token, for the reasons Rob alluded to in his opening salvo, not so sure some of us are prepared to lay all that out in the guidelines. So more to come on that.

Last but not least, Dr. Carlton. Your turn.

MR. CARLTON: Thank you. It's a pleasure to be here to give my views on the merger guidelines.

My views on entry as well as other topics related to the merger guidelines are described more fully in the paper I submitted to the DOJ/FTC in their request for comments and also in a forthcoming interview that is going to be published by the ABA's Antitrust Magazine.

Let me here highlight my main recommendations on the entry section. And then I take no more than one minute for a few other comments on non-entry.

In general, the entry section, as other parts of the guidelines, I think are pretty good and they've served a very valuable purpose, though, of course, they, they could be improved somewhat.

My main recommendation on the entry section is to get rid of the distinction between committed and uncommitted entry.

Committed entry, a committed entrant incurs some cost to enter, while an uncommitted entrance does not. Almost all entry requires some sunk cost; so although this is a theoretical distinction that one can make, I've not seen it to be practically useful.

I've been in private practice as a consultant for Lexicon, worked on many mergers that have been taken before the division over the last twenty, thirty years; and I don't think I've ever had an occasion to use this distinction.

When I was the deputy at the

Department of Justice, I don't recall any cases before me that used this distinction. Maybe there are some, but I just don't think it's been practically useful.

That would be the main change in the entry section. I have three other comments, though, on entry that I'd make.

First, entry is not so easy -- based either on the theoretical literature, the recent theoretical literature in economics or empirical literature.

Let me talk about the theoretical literature for a moment. In the presence of sunk cost and uncertainty, Dixit and Pindyck show that entry may not provide the tight constraint on price that we think it would based on our very simple models of free entry and exit.

I've discussed this more thoroughly in a paper on entry barriers in the American Economic Review in 2004 and also in the recent ABA handbook that Dale Collins edited on antitrust.

I like the title of my AER article. It's something like Barriers to

Entry, Are They Barriers to Understanding. And I think they have been. And if you do use the word barriers to entry, I think you should be very careful what you mean.

So the theoretical literature has recently shown that this tight constraint that entry can provide may not be so tight.

What does the empirical literature show? Well, the empirical literature shows that entry often fails and that the type of firm that enters has an enormous effect on its success as well as its effect.

So for example, firms that are completely new to the industry grow much less rapidly after entry than firms that enter from related sectors.

So what's the implication of this first comment I'm making about entry? I think that if you're going to rely on entry providing a constraint to what might look otherwise as an anticompetitive merger, the agency should require evidence, strong evidence that entry could occur.

And one way to do that is to rely on a past history of successful entry. Second observation that follows is that both theory on sunk costs as well as the empirical literature will stress the importance of having a sponsored entrant.

If you have a few big buyers who either could vertically integrate themselves or collectively could sponsor a new entrant, that's something that matters a lot when there is sunk cost and can provide, and I think has provided in many instances, tight constraints on pricing.

My second comment on entry. To echo something Rob said, if an entry constraint exists post-merger to constrain prices, it likely exists pre-merger.

So what does that mean? That means the techniques you're using to analyze what's going on pre-merger should take count of that constraint.

As Rob said, if you did a merger simulation based on short-run elasticity in Bertrand competition, you probably are not reflecting that.

So what emerges from that? It means that the -- I won't say old style, but if

I was speaking to a new, young, industrial organization, academic, I would say old style.

MS. BOAST: Thanks a lot, Dennis,.

MR. CARLTON: The old style of price versus concentration is capturing exactly what you want, both pre-merger and post-merger, if you can do an empirical analysis that controls some of the econometric problems of endogeneity that we know exists.

Another way of saying this is reduced form analysis, which is a bit out of style amongst younger industrial organization economists, is precisely the right type of analysis for a merger case in comparison to the more detailed structural analysis.

And in fact, my experience has been both in the private sector and also when I was at Justice that the agencies, the FTC and DOJ, are cognizant of this point.

My third observation on entry, somebody beware of speculative theories that are related to entry.

What do I mean by speculative theories? There are two I'll mention in particular, theories that relate to something that I'll call innovation markets.

Those firms who in the future I can predict are going to be innovating in products that don't yet exist, okay, or theories relying on elimination of potential competitors.

Who are potential competitors? Competitors who would otherwise enter the industry. Both of those require the analysts to predict who are those new firms that are going to be coming into the future.

And I would be very cautious and underscore the difficulty of being able to predict those in reliable way and, therefore, be very skeptical of pursuing such theories.

All right. Let me just end by just listing, and I don't have time to go through, although the papers I mentioned do, some of my other comments in one minute.

In addition to my recommendation about getting rid of the committed versus uncommitted distinction, I would make the following general observations about the guidelines.

Keep market definition in the

guidelines. Although it's a crude concept, it provides a useful constraint, especially on what courts and what judges can do.

Second, don't make the guidelines a textbook of techniques to use. The analysis done by the agencies is much more sophisticated than what you would hypothesize based on the step-by- step approach in the guidelines and the reliance on market definition.

It's much more a competitive effects analysis, a much more integrated approach. I think that's fine. I think to deal with that in commentary is the right way. I don't think you should try and articulate that in the guidelines.

Third, I like HHI cut-offs. I like market share cut-offs even though I understand that they are crude. The reason I like them is they provide safe harbors, which I think is very desirable.

To the extent you do keep such cut-offs in the guidelines, it would be useful when you give numbers to say what basis you're using, empirical basis for some of the numbers.

My main comment, if I had to give

a fourth comment, I'd put a star on this one. The distinction between coordinated and unilateral behavior in the guidelines to me is not well-founded. They both rely on non-cooperative game theory, and I explain this in my paper. Unfortunately, I can't be at the session -- I know there's a specific session on that this afternoon.

But if I had to give one comment on the guidelines, it would be that one, that that needs improvement.

Two other comments. One, I'd alter the definition of geographic markets. The notion of drawing circles around locations rather than circles around buyers is confusing.

I understand theoretically how they can be integrated, but I think it leads to difficulties in particular agencies sometimes formulating market definition.

And my final comment has to do with efficiencies. I think the efficiency section should be tweaked a little bit in accordance with the recommendations of the Antitrust Modernization Commission in that you should give more attention to fixed-cost efficiencies, especially in industries that are dynamically changing. Because over the medium run a fixed cost is, in a sense, a variable cost. And you'd take a long enough view.

I'll stop there.

MS. BOAST: Thanks, Dennis. That was, again, very useful and we welcome the checklist. It sort of goes back to my opening comments about having now been more or less midway through the workshop process, I'm beginning to wonder how modest we can keep our goals in thinking about guideline provisions.

Does any of you want to comment on the specific points made here before we go into Q and A, which will probably elicit all of that comment anyway? Rob?

MR. GERTNER: I'd like to say one thing about Spencer's comments. I think the point he makes is an important one. I think it's actually broader.

I've been teaching strategy in the business school now for almost twenty years, so I've been thinking about competition issues from the business perspective a lot.

And you know, the antitrust

community tends to divide practices and implications into either kind of efficiency enhancing or anticompetitive.

And what's missing from all that is the search for and the attempt to maximize scarcity rents. And that's kind of what brands are about. In brands you are trying to create a scarce asset and try to extract as much profit as you can from that scarce asset that you're creating.

And that's an awful lot about what business is trying to do left and right. And I think, to a large extent, the way we think about antitrust, both economists and lawyers often kind of misses that. And I think that perspective is enormously useful.

It's probably even more useful in antitrust outside of merger analysis than it is in merger analysis, but I think it's really fundamental. I think that perspective should be added into the mix.

MS. BOAST: It reminds me of a program I spoke at several years ago when I worked at the FTC, and it was a pharmaceutical program where an investment banker stood up and talked about lifecycle management of the drug.

And I said, you know, what you call lifecycle management is what we call monopoly extension. So we do take it into account, from a different perspective.

MR. WEBER WALLER: I just had a brief comment on Dennis, particularly looking at the literature about entry and the type of entry being critical. I think that's obviously in the guidelines.

But I just want to emphasize something. It may well have been something you cited in the paper. I don't have it in front of me.

But there is a really interesting article in the Michigan Law Review by Avishalom Torr of the Haifa Law School Faculty, and it's both a combination of theoretical and empirical evidence, mostly from behavioral economics, which sort of bridges both sides of what you talked about.

It gets into the kinds of firms and the incentives as to why firms enter and why they often fail; and it makes the point, as you did, that oftentimes entry happens more often than we would think but by precisely the wrong firms for what we care about.

MS. BOAST: Which would also make it inherently ridiculously difficult to try to predict.

MR. LANGENFELD: Jim Langenfeld. Paul Denis is here, and he and I were fortunate enough to be on the revision process -- lucky enough to be involved with Bobby and John Peterman in the revision process back in 1992.

I certainly compliment you on the openness of this treaty. This looks like a star chamber since we did the revision; so this is a huge improvement, in my opinion.

But just focus specifically on entry. My recollection was the reason that committed and uncommitted, which seems to be a target of a lot of the commenters here, was put in the guidelines because there was a perception that any time -- well, partly was the economics literature at the time.

And the other part of it was there was a concern that the -- not necessarily the economic staff, but the legal staff, if they found any -- pretty much any, any barrier, any sunk cost associated with entry, they would pretty much say entry couldn't discipline anything.

This is before the more recent literature that Dennis points out. And there was a concern to try to get them to focus on the two separate issues.

And I agree with Rob that it's a bit of an artificial distinction to try to create market shares for an uncommitted entrant because they have very small entry costs.

But it does actually happen sometimes in my experience both at the FTC when I was there and new. If you have in very rare instances, for example, in gasoline and oil, pipeline and production mergers, the homogenous product is shipped around the country to a variety of different locations.

You're analyzing what's going to happen to a merger in a specific geographic reason. You can look at the net-backs, the profits you make from shipping oil from one place to another, it's not quite a national market, but almost, and you can actually identify when product will be profitable to ship from where it's currently going, say, in St. Louis, to Denver, if prices were to go up in Denver due to a result of a merger, hypothetically due to a merger.

You can then look at the pipeline capacity, and you can actually see what the most could be that could be shipped into that area in response to a merger.

So you could actually go through and do a market share analysis and see whether that would expand substantially or whether it would be a trivial, very trivial extension.

The concept of uncommitted entry, in my experience at least, never perhaps overstates the case because in some sense they're not shipping there but they could.

And I guess I'd want to find out from the panel in general whether it's true that Rob's experience -- and Dennis', I guess, that's true, that you never ran into a situation like that when doing a merger analysis. Or would you characterize that as something else other than uncommitted entry?

MS. BOAST: Let me supplement Jim's observation with another comment and then let those who wish to respond. And that is to echo a point that Bob Pratt made, and that is even taking the kind of analysis Mr. Langenfeld is suggesting, is it not adequately covered by other guidelines language.

MR. CARLTON: I would respond that when I was at the department, I actually asked if anyone had ever come across this; and I don't think the answer is never, as you point out. There may be cases where people have used it. My sense is it's rare.

But more importantly, to just reiterate what Molly said, I think that the distinction I found it, though I find many people find it confusing, and I think if you got rid of the distinction, the guidelines are sufficiently flexible that any competitive constraints that are on the price post-merger should properly and would properly be considered by, you know, either agency.

So I think the possibilities that you raised in your example would certainly be considered and as a constraint on price.

And that just goes, I think, more to the point that the analysis the agencies do is much more integrated than this kind of step by step. And the whole idea of are you a market participant or not a market participant, the only reason you need that in part is to figure out how do I calculate market share.

But then that raises the question, well, how do I calculate market shares? Is it based on sales, is it based on capacities if you're uncommitted entrant?

So then you're getting into fuzzy stuff, and we all know that market definition is very crude. So that's why you make this distinction so you can figure out how to calculate market shares.

You know, my sense is the agencies if they didn't have this distinction would understand the competitive constraints and take them into account.

They do things in a more sophisticated way than the guidelines. So that's why I don't disagree with what you're saying. As a theoretical matter, it could be a distinction and occasionally may come into play; but I think it could would be covered by the other language in the guidelines.

MR. GERTNER: I agree completely with Dennis, and I won't try to reiterate in my own words because I won't do it as well.

I think Dennis sort of pointed to it showing up maybe in the standard entry; but I think that in the example you gave, it seems hard to imagine that a careful competitive effects analysis wouldn't incorporate the exact issues that you were considering.

So I think, again, if you were constricted to just do kind of an HHI analysis, perhaps you'd run into problems. But if you actually try to think about how a price is determined in this market, both pre- and post-entry, I think that you know that the ability to people to reroute through their existing network would have to be a part of analysis of how prices and competition works.

MR. DENNIS: An observation here from a historical perspective. I think we had at the time we were drafting the guidelines our own little endogenated problems, and that related to presumptions and the role of presumptions.

If you look at it from today's

perspective where the structural presumption doesn't really matter that much anymore, certainly way less than '92, the debate over where you want to put uncommitted entrants seems a little bit silly, and the panel has sort of picked on that very effectively.

But if you roll the clock back and think about the importance of presumptions and the way the agencies used presumptions, the distinction actually meant a great deal more in practice and meant a great deal more in terms of shaping how the agencies thought about the problem.

And that's why I think the distinction made a much greater difference back then than it does today.

MS. BOAST: Another audience or comment question.

MR. MURPHY: There's a little bit of tension, it seems to me, to keep the presumption -- it falls on what you're saying. The presumption is based on share and then wanting to do kind of the right analysis from the point of view of competitive effects, which is what we ultimately want to do.

It seems to me that you -- why you say you want to keep them, that's precisely what makes this question of are they in or are they out kind of a discrete question as opposed to what it ought to be is they get incorporated to the extent they're important for competition.

So when you say I want to keep the presumptions based on HHI's and the like, I think there's a bit of tension between that and wanting to have a correct competitive effects analysis done.

I don't know quite how that's going to fit together very well. Often what I see is you want to do the market definition, as we always do in economics, well, what is the most illuminating from thinking about competition in the marketplace.

But that might not fit very well at all with, you know, the HHI-type guidelines that are in there. You might want to define a very narrow market or a very broad market realizing that it is what it is, either very narrow or very broad. And then I think you need to take that into account.

So I'm not quite sure how you can say let's keep the presumptions in there based on HHI and then at the same time allow to us deal with entry in this kind of fluid way of, well, we don't have to decide whether committed or uncommitted whether they go in the HHI's or not.

MR. CARLTON: Yeah, let me clarify. I didn't mean to suggest that I would keep necessarily the structural presumptions in which you, you know, block a merger if the HHI is high, or would always block it if it were high. I would say it kind of a little differently.

I like safe harbors. I would let a merger go through if, under reasonable market definitions, the HHI is real low.

That does not mean I would always attack a merger if the HHI as high. I think what an analysis of, say, price on HHI tells you if you could do such an analysis, if you have no effect it would tell you the market may well be broader than what you're defining it as.

And therefore, in those cases in which it's hard to define a market but a competitive effects analysis shows you don't see any effect, I would say that undercuts whatever market definition you're using -- the market definition is just a very crude way of trying to infer the forces of a constraint on price.

So you know, if you've got a narrow market and high HHI's and no effect on price, I would say you haven't defined the market right; and therefore, I would use the competitive effects analysis as a way to broaden the market definition.

I think the reason why I would not abandon market definition and just go to competitive effects is I think that gives too much discretion. I'm not so much worried about agencies.

But when you get into the courts, if you say to someone, you don't have to define a market. You know, just use the competitive effects analysis. And you know, whatever you think is reasonable, go ahead and do that.

That scares me. So I think market

definition, though it's very crude for a lot of the reasons you're suggesting, it is a useful constraint, especially in the courts. So that's why I wouldn't abandon it.

But I do think if there's a high HHI, I think that's what you mean by a structural presumption, you know, that's easily trumped by a competitive effects analysis.

MR. MURPHY: That's what I'm trying to say. I'm not trying to advocate for getting rid of market definition either, but I just think you have to realize that not all markets that are defined fit in the same box and can't always apply.

MR. CARLTON: I agree. If you had a high HHI and that was the structural presumption, you had no competitive effects, I think your conclusion shouldn't be it's a concentrated market, I'll sue. I think it should be, gee, maybe what I'm measuring as the HHI, which I think should give me an indication the price should go up is not the right thing to measure.

MS. BOAST: It's totally clear to me that committed versus uncommitted entry is the tail wagging the dog here. I think we ought to go back to entry, if we could, in a narrower sense, although this is useful.

I think if we have time at the end, I certainly see the connection; but there are some specific things that the working group wanted to try to get some focus on.

So let me trump the remaining comments and questions for the moment and return to some of the questions we've put together to try to bring a little bit of focus.

First question is we talk about entry in various manifestations in the guidelines. We've got expansion by incumbents. We have de novo entry. We have repositioning in different parts. We have it in who's in the market. We have it in unilateral effects analysis. And then we have the standalone, quote/unquote, entry section.

Should we be consolidating all of these entry considerations, where would we do that, and should the same standards, or time, likely and sufficiency of entry, apply in these various places in the guidelines where the entry currently exists.

I'll let anybody who wishes go first.

MR. WEBER WALLER: We've already pointed out in several instances why it's a bit of a seamless web. And the same issues keep coming up whether you call them market definition, competitive effects or specific entry.

I think the framework, and I think this is a point Bob Pratt made already, that the overall framework of timeliness, likelihood and sufficiency of entry is clear, realistic and useful. And I think it satisfies the overall goals of the guidelines.

Whether that should be the only place they appear sort of at the end after you've done market definition, competitive effects, I think the problem is it suggests the cookbook or the textbook that we all know the guidelines aren't.

I'm worried about something in the shadows of what Dennis is talking about, which is what happens when you get into courts. I think while all of us realize that this is just the beginning of the analysis that the parties and the agencies do, it's not clear to me courts actually do -- you know, there's not a lot of litigated merger cases obviously.

But it's not clear to me that they look at it the same way, and I think they tend to look at it as a cookbook. And there's certainly a couple cases where the agencies have lost where the court says market definition, you have to do market definition. And where the agencies have said we have or it's encompassed in our competitive effects, the court has said no, no, I need market definition because it says so.

And I would be concerned that the reverse. I understand that the agencies haven't lost cases where they've shown all the preceding steps and then had the parties rebut on the basis of entry. That doesn't happen very often and it won't no matter what you do.

But I'd be concerned about the court that looks at this as a cookbook. I think it's adequately -- I'll just state it this way. I think it's adequately handled in agency and party practice.

I'd be concerned that -- my main

concern is keeping entry as the separate section gives the court yet another opportunity to say agencies have to do A, B, C and D, and you didn't do D.

MS. BOAST: Let me see if I can push back a little, and just for purposes of this debate, if we just relied on timely and likely and sufficiency as the rubric for all forms of entry and we didn't specify anything further, how would we give guidance to courts or practitioners about the difference between an incumbent expansion, as one example, and de novo entry where intuitively one would think the standards, pick one, timeliness, might not be the same.

MR. GERTNER: I think the issue really goes to the point that I was trying to make earlier about integrating entry into thinking about the way in which competition works in the industry.

And because I think that you need to think about, what it is that's constraining firms in their pricing.

I think if there was something that was sort of holistic to describe all these different manifestations of entry, it would be to think about how do these non-pricing, expansion, entry, repositioning, activities of other firms, either incumbents or potential entrants, constrain pricing both pre- and post-merger.

In general, I like the words timely, likely and sufficient; and I think it would be near the bottom of my list of things to pick on, but since you bring it up.

One of the things I think about, I think about a firm, let's say it's a software firm, that could very well in its pricing decisions feel constrained by a potential entrant even though in order for somebody, any potential entrant out there to develop a competing product would take three years.

I'm sitting there as the incumbent firm and I may well price today in a way that would make that entry unattractive. All right.

In that way, you know, entry plays a really important role here; and thinking about it using especially sort of a two-year horizon on a timely, likely and sufficient really wouldn't be capturing everything that was relevant.

So in that hypothetical, entry plays a really important role even though maybe it wouldn't meet the standard, that particular entry wouldn't meet the timely, likely and sufficient standard.

That said, you know, you can't leave this all up in the air. You need some standards. You need some guidance. And I think those words are good words to have as a key element.

And I think if you incorporate this idea of thinking about the way in which entry and other manifestations like entry affect competition pre- and post-merger, I think those two things go a long way.

One final thing. There are all these elements, and people talk about to what extent is it a five-step process. All right.

The guidelines don't actually say you proceed in this order. They're just written that way. I think it's sort of become the practice and the way people think about it, especially with kind of burden shifting is also not in the guidelines.

I think it would be useful actually to move away from the perception of it as being kind of a sequential process as opposed to a more integrated process, however it's done, and actually be a little more explicit in saying that it's not first we decide what the short-run implications are and then we think about efficiencies and entry, but it's all part of a broader effects analysis and these are the elements.

MR. CARLTON: Yeah, would I agree with these comments that the focus is the competitive constraints on price both pre-merger and post-merger. And you know, attributing how much of a constraint each of a myriad of factors are can be difficult.

There's no question that each of these -- expansions by the incumbents, de novo entry, repositioning, all can be a constraint. To have to go down the list or in the guidelines and talk about each one separately strikes me as difficult and probably undesirable.

I think that you should simply say -- I agree with Rob, you should just say at the outset, and I think this does reflect agency practice, they look at all the competitive constraints on price when they're analyzing a merger.

Now, it is true that you can look in the data and sometimes do econometrically the exact hypothetical that sometimes the guidelines want, that if price goes up and there is an inability for existing firms to expand, does anyone come from outside the area, does a new firm come in. So you can actually see whether there's evidence on each one of these factors, and I think the agencies do that.

But I'm not sure I think it would be wise to sort of delineate a separate type of analysis for each one. I do think as you get more speculative as to what might occur, you could say the burden shifts because it becomes harder to prove that a new entrant would come in if a new entrant has never come in.

Now, let me just give a concrete example. I was involved in a case involving the toy industry. And if you can go around the country, there are certain parts of the country where if you look at the major toy sellers they're concentrated if you don't consider smaller toy stores, and there are other parts of the country where that's not true.

You now have a pretty good experiment. Are the prices in one place the same as the prices in another place? And if they are, then the constraint of having entry of small toy stores, which come in and out of existence pretty easily, you could say is likely to be constraining price.

So sometimes you can do these experiments quantitatively, econometrically; and it's exactly reflecting sort of the earlier comments that Rob and I made that the constraints pre-entry can tell you a lot about the constraints post-entry.

An integrated approach is clearly the right way to do it, and that's what I think the agencies do. But I don't necessarily think the guidelines have to be specific and delineate all the many techniques you could use.

MS. BOAST: Bob, do you want to comment on this? We've taken your useful point, and everybody is now free-riding on it. So I think we ought to give you some air time on this.

MR. PRATT: Right. Just to get back to your question, what guidance should we give to the courts on this, you know, on various types of entry.

Can we do it in a meaningful way, which doesn't somehow come back to undercut our own analysis or position in the court. And, you know I think that's, that's a tough question. I don't know what else to say.

I think there's some value, as Dennis points out. You know, the sponsored entry is often a more certain, more valuable type of entry, whereas in a de novo entrant often, you know, you got the wrong entrant of someone who fails.

Take the air transportation industry is replete with examples of failed entry. It's an attractive place to put capital for some people for some reason. But you know, it's a tough, it's a tough question. I suppose you could put something in the guidelines ranking various types of entry and providing some general comment as to why it should be valued more greatly than others. But that would be a difficult task.

MR. WEBER WALLER: Molly, if I may.

MS. BOAST: Sure.

MR. WEBER WALLER: Bob, the danger is the guidelines are -- you know, we have this lovely pamphlet, and the point is to have something that is pitched at a level of detail that is an accurate and sophisticated description of what the agencies do, but is reasonably understandable to the, high-end business community that has to live under them and can be applied and understood by counselors and courts, and other agencies can use it as well.

When you get into this kind of entry work under these circumstances, this kind of entry, you're describing the merger commentary, which is great, but it's a phone book.

MR. PRATT: Right. I don't disagree with at all.

MR. WEBER WALLER: I don't disagree with him there, you know. I agree with everything that everybody said. I'm just as torn as probably Molly and the other people who have to do this, is how do you encompass that in the kind of right pitch and level of detail in the guidelines.

I mean, I have lots of comments about why brand repositioning normally isn't going to happen, and therefore, isn't an effective alternative or form of entry. But I can't, frankly, think of how you work that into what should be in the guidelines rather than a more detailed analysis or commentary.

MS. BOAST: Let's turn to that for a moment because you said you wanted to get into it, and I'm happy to spend a couple minutes on it.

When you talk about brand repositioning, what I tend to think of is -- well, I guess maybe we ought to -- let me ask a different question.

Are there certain industries where your observation has more prominence, and if so, what are the characteristics of the industry?

MR. WEBER WALLER: It's more a matter

of language and vocabulary than industries. But the marketing literature that I've been reading in connection with this project tends to talk about product categories more than relevant markets than we do in antitrust; and in general, a lot of industries are characterized by kind of premium brands and value brands.

And so if you were to have a merger -- and by the way, it leads us back to market definition, we always seem to end up back there.

It just suggests that functional substitutability may not be really as important as scarcity and product differentiation if successful consumers view only certain things as reasonably effective substitutes even though in one case it's baking flour. You know, you can make cookies out of anything.

If the branding is successful, it's only the branded flour that consumers might view as interchangeable.

So if you had a merger that affected two of the only or the important premium brands, the question is, could manufacturers of value brands trade up.

The brand literature says that's virtually impossible because of the successful associations of quality and other things that the premium brands have been able to create. That's one example.

If you go the other way and you had a merger between two value brands, is there any reasonable likelihood that a premium brand would trade down? The answer is no, because the whole point was to create the scarcity and the rent or quasi-rent that Rob talked about.

They just wouldn't want to, and it would defeat the whole purpose of a successful branding campaign in the first point.

That's the kind of perspective I'm talking about. But again, I don't mean adding in literally in the text of a guideline.

MS. BOAST: Let me turn to another question, much smaller question. It sort of flows out of this distinction about what we say in the guidelines.

The guidelines, for all intents and purposes, I think, can be read to say that two years is the outside limit for entry analysis in whatever form you're looking at it, sometimes shorter.

And I guess my question is, is two years really too long to ask consumers to bear a transient effect; or looking at it from the other end of the telescope, is two years too short under certain conditions and certain industries?

Should we specify a time or should we just collapse this, as we've been talking all morning, into a discussion about constraints, prices and now how you assess the evidentiary value of the entry that's positive, whichever side?

MR. CARLTON: I have two responses.

MS. BOAST: Kevin has a response, too.

MR. CARLTON: One, should the overcharge last two years or less is sort of one way to phrase your question.

What's funny about phrasing the question that way, and this is a general problem with the guidelines, it's clear why they do it this way, is an economist doesn't just care about the price, he cares about the price times the quantity.

I mean, in a sense what you're trying to avoid here is dead weight loss caused by creation of market power. And we know that it's a triangle. It's a price element and it's a quality element.

So it's kind of funny, really for prosecutorial discretion, what the departments and the agencies should be looking at, it seems to me, is the dead weight loss you're imposing. Is that large or small.

And then presumably the reason why you allow any price increase to be imposed in the short run is because there's some off-setting benefit in the long run.

It's really a cost-benefit analysis. I don't think there's going to be a hard-and-fast rule two years is right or wrong.

But the second thing I want to comment on, the way you phrased the question makes it seem like two years is all that matters for entry. Paul and Jim made an allusion to the fact there was this -- that the guidelines were revised in '92 before.

And I was for a time a secret consultant to the Department of Justice, then revealed, but we didn't have open hearings. And I made many comments, and the only comment that I think is observable in the guidelines is on Page 28 based on paper that Rob and I wrote.

And it said, in a durable good industry, if you have entry after year two, and it's known, there can be enormous constraints on the price in years one and two. The guidelines explicitly recognize that. That simply underscores that it's the competitors' constraints that matter, period.

MS. BOAST: Bob?

MR. PRATT: I've got a short answer, and that is that, you know, these are guidelines. The two-year rule is useful because of its clarity. It sets forth an order of magnitude of duration that we're looking at, and it should be understood by everyone that there will be fluctuation in either direction. But it's important to have a guide, a benchmark.

MR. CARLTON: I agree with that.

MR. GERTNER: I agree with the bottom line, Bob's bottom line. But I almost think that -- I don't know, I went through the guidelines thinking would the guidelines be better and more accurate if every number was taken out. And I actually think the answer may well be yes.

I think the notion -- given the caveat that we've already talked about a number of times, so I won't repeat, I think some notion of timeliness is important.

Does adding the word, the number two years beyond the word timely actually reduce or increase confusion and quality of analysis? And I'm not so sure.

If two is interpreted to mean kind of sort of what we mean by timely is something around two years, then maybe that's about the level of precision we want.

But I think, you know, kind of throughout, I think the false precision -- I mean, Dennis said about HHI presumptions, you know, if we're going to keep them, we need an empirical basis for them.

Well, I think that means we don't have numerical presumptions anymore because I don't think anyone is going to find an empirical basis for those other than the practice, inferring what they are from the practice. Maybe you can identify them -- you can't identify them for what's going to be anticompetitive. Maybe you can identify what the agencies do.

MR. CARLTON: Safe harbors.

MR. GERTNER: Yeah, safe harbors are good -- I agree that we should have safe harbors. I don't agree that you could find what the threshold should be based upon anything other than what do the agencies do.

MR. CARLTON: You think you couldn't come up with an HHI safe harbor of a thousand and not worry for a first pass?

MR. GERTNER: If you're a UPP kind of guy, you'd get price increases at that level.

MR. CARLTON: I mean, I think the real question is given the type one and type two errors you make whenever you're making a decision, don't you want to give some guidelines to say, listen, if this is a small merger, you guys have tiny market shares. I'm not going to analyze it even though it may be a one-in-a-million chance.

MR. GERTNER: I actually agree that the best place for numbers are safe harbor presumptions with narrow market definition. I agree.

MS. BOAST: I must say that Rob's view is very much what we've heard from the staff as we've been meeting with them section by section to make sure that we don't trip up their work, of course, in this process.

And almost to a person the first thing they've said is get rid of the step-wise approach and all this structure because that's not what we do.

We go out and collect the facts and then we back into it because we think that's what the front office wants.

MR. WEBER WALLER: Very briefly on the timeliness, it says generally two years. In light of Bob's comments and in light of yours, Rob, can I conceive of a situation where entry farther out has some present or future effect? Sure, of course.

But I think the reality is it's a benchmark and it's a de facto presumption. And I think that's right. You know, the agencies sometimes struggle to predict competitive effects.

I think the burden should squarely

be on the parties. If they're really saying distant and unlikely entry somehow actually matters in this case, fine. If they've got the facts and it's quite concrete, then I'm confident the agencies will think about it under the current framework. So I kind of like that.

MS. BOAST: We've got about two-and-a-half minutes left. I'd like to have thirty seconds each on this question should there be a burden on the parties on entry, who should bear responsibility for the principal facts around entry. And then we'll just let each person give their number one item for merger change.

Anybody have a view on burden? Rob?

MR. GERTNER: Well, I think the questions are different. I think the guidelines work well without specifying burdens. I think that's probably the way it should be.

I think, again, that would raise it to the level of trying to tell courts what burdens should be; and I think that would, again, push it towards as if it's a litigation guide rather than what it's intended to be.

That said, I think on the question of who brings the facts, I think to some extent the entry facts and the entry -- the evidentiary process for trying to figure out these very difficult entry questions seem to me to be hard.

I think that the parties will have to bear the burden of providing the information because I think a lot of the standard types of documents and requests and things that agencies get easily might be more problematic with respect to entry issues.

MS. BOAST: Bob, do you have a view as an enforcer?

MR. PRATT: Yes, yes, the burden should be on the party. You know, that's not entirely joking. I do think they have the burden of bringing to our attention, at least, identifying the sources of entry.

And you know, of course we're not going to base our actions upon what information they provide; but you know, we'll certainly look into it. But I think the initial burden is on them to make an entry case.

MS. BOAST: Dennis?

MR. CARLTON: Well, I think figuring

out on whom to place the burden is a legal question that really has to do with type one and type two errors of the courts.

But putting that aside, from an economic point of view, I would say the burden shifts as the argument you're going to make departs further and further from general evidence in the economic literature.

And the way the burden should shift is that your empirical experience in the industry, to the extent that you're claiming it would be different than what a general literature is showing, becomes higher on you when you make that argument.

And just to clarify on these presumptions on HHI, I'm not big fan of these specific levels when you trigger things. So your suggestion of what the staff was saying about the levels, I think, is exactly right.

But that would not lead me to get rid of safe harbors as part of the definition. That would lead to -- I think to too much of an undisciplined approach.

MS. BOAST: Spencer, any views on burden? You don't have to chime in here if you don't want to.

MR. WEBER WALLER: Yeah, if entry remains something at the back end of the process, I think it should primarily be the party's burdens to the transactions for all the reasons I've said.

Be Careful-what-you-ask-for, if it becomes a more holistic analysis of competitive constraints pre- and post-merger, and more closely tied to market definition and competitive effects. Just be careful because if that happens, I think courts will likely make that more likely part of the government's burden.

MS. BOAST: That's why I'm asking the question.

Well, Dennis, you told us already what your number one change would be; and that is to loosen the artificial distinction between unilateral and coordinated effects analysis.

So I'm going to take your turn away and let the others go. If you could recommend one single change to us, what would it be, Rob?

MR. GERTNER: I hate to do this, but I

actually agree with Dennis, and so I'll make it very brief.

MR. CARLTON: Why do you hate to?

MR. GERTNER: I don't get to say something different. That's all. I like to agree with you, Dennis.

MS. BOAST: Bob, what about you?

MR. PRATT: Well, if I could change the question just a bit to say one thing that I think would be useful, and that is some reference in the guidelines to power buyers, what that means.

It's an issue that has come up in the courts over many decades. It goes back to the '60s and '70s, the concept of the importance of a power buyer. And I think in the Baker Hughes case it became even more pronounced.

So some discussion of what it means, what the agencies will view as a credible power buyer story, even if it's only sponsored entry by a power buyer. Even if you stop there and say, we'll take that into account, but beyond that, we're skeptical. But some treatment of the power buyer issue.

MS. BOAST: Spencer, what about you?

MR. WEBER WALLER: From my opening remarks, you might guess, it relates to market definition and the role of brands both in taking the existing test, such as SSNIP, more seriously in connection with branded consumer goods where sometimes it leads to more narrow markets than you might otherwise think is the case.

And in general, simply be more aware of the business approach to branding as to the market definitions it creates for analyzing these.

MS. BOAST: Thank you all for your thoughtfulness, your time, your contributions and putting up with the cold weather.

I've eaten a little bit into the break times, but we will reconvene at 10:45 so everybody can -- nobody needs to go outside I guess today. Thank you all.

(Applause.)

(Brief recess.)

PANEL 2: DIRECT EVIDENCE OF COMPETITIVE EFFECTS

MR. FEINSTEIN: We're slightly behind schedule. So why don't we get started.

For those of you who don't know me, I'm Rich Feinstein. I have the privilege of currently serving as the director of the Bureau of Competition at the FTC and the additional privilege of being part of the gang of six, along with Molly and four others, who have been tasked with managing this process of considering revisions to the Merger Guidelines.

It's a real pleasure to be here today and also to have the opportunity to moderate this very distinguished panel.

The format is going to be pretty similar to what we just went through. I've asked each of the panel members to have opening remarks of five to ten minutes, and I'm going to try to enforce that in terms of length.

After the opening presentations, we're going to talk about some questions. We'll welcome questions from the audience. I've also asked each of the speakers to offer some final thoughts in the last couple of minutes.

And, if they have thoughts that go beyond the specific topic of this panel, which is competitive effects, if they have larger suggestions for the guidelines process, I would also encourage them to feel free to offer those as well and we can perhaps do that at the end.

With respect to competitive effects, in some sense that's what the whole exercise of analyzing mergers is about is trying to make a well-informed prediction about likely competitive effects.

And one of the interesting corollaries of that is what do you do in instances where you have relatively direct evidence.

That may be easier to see with respect to consummated mergers, but there are certainly models or examples of direct evidence that have potential applicability of how you analyze prospective mergers.

And what this panel really is going to talk about or try to address is the different forms that evidence can take and what sort of significance it should be given and how, if at all, that should be incorporated into revised guidelines.

So let me introduce our four speakers, and I'll do it in the order in which they're going to be speaking, I think. That's my goal.

Our first speaker is Debbie Majoras, who is immediately to my left, and probably well known to everybody in the room. She was previously a very distinguished Chair of the Federal Trade Commission. Before that served as a Deputy Assistant Attorney General in the antitrust division and is currently a vice president and general counsel of Procter & Gamble.

I don't know whether she intends to address the imminent cancellation of As the World Turns that I read about yesterday, what the competitive effects of that might be, but I did think of you when I saw that in the paper.

MS. MAJORAS: That's our last soap opera.

MR. FEINSTEIN: Last soap opera. We're very pleased to have Debbie with us this morning.

Following Debbie will be Michael Whinston, who is the Robert E. and Emily H. King Professor of Business Institutions in the Department of Economics here at Northwestern and a very distinguish industrial organization economist.

After Michael, Monica Noether will be speaking. Monica is currently the executive vice president and chief operating officer of the Charles River Associates. She is also a very active consultant and testifying expert on a variety of matters, including, in particular, matters in the health care sector, where our paths have crossed from time to time over the years. We both served at one time as vice-chairs of the Antitrust Practice Group of the American Health Lawyers Association. And prior to going to CRA, Monica was also at the Federal Trade Commission back in the '90s. '80s and '90s?

MS. NOETHER: '80s actually.

MR. FEINSTEIN: Then our fourth speaker is Jim Langenfeld. Jim is a director at LECG, an adjunct professor at the Loyola University Law School here in Chicago, and has also spent ten years at the Federal Trade Commission, the last six of which he served as director for antitrust in the Bureau of Economics. And Jim also is a very experienced and thoughtful expert on these topics.

So with that, let me turn it over to Deb Majoras.

MS. MAJORAS: Well, thanks very much, Rich. It's good to be back. I was thinking that I'm not used to being outnumbered by economists anymore. I'm sort of outnumbered by MBA's these days, but good to be with all of you.

I doubt you could find any tool that the federal antitrust agencies used that's had a greater impact than the Horizontal Merger Guidelines.

If you look well beyond the two agencies, that methodology is used by private parties very extensively to determine whether to even pursue a merger in the first place.

Obviously it's used by courts in determining the validity of mergers and it's being used by jurisdictions outside the federal government here and, of course, around the world.

The one difficulty with guidelines I always found when I was at the agencies thinking about these things is that, they have to be stable enough for a period of time that they actually are helpful and useful in the transparency that they provide.

On the other hand, our discipline is not static. And we are constantly gaining experiences and learning new knowledge that we should be using in reviewing mergers.

So that's the trick in knowing when to make revisions. I do applaud the agencies' efforts to review the guidelines at this stage to see whether a revision seems to be a good idea, particularly given that it appears that the agencies are not contemplating, at least at this point, and I realize you're keeping an open mind, Rich, but don't appear to be contemplating a wholesale dumping of the framework that we have that we've all become pretty accustomed to and I think has worked pretty well.

That would potentially have a very tumultuous effect in the short term, particularly in a very, very difficult economy that's characterized by enough uncertainty right now, but obviously potentially also for the long term when you have a lot of constituents that rely on these. So it's something to think about.

I've been pleased to see that the commentary on the guidelines that the agencies issued in 2006 has been able to provide further guidance and transparency to all of the constituency; but I have no doubt that eventually the time would come to think about whether, okay, is it really time to revise these guidelines.

So we're here today to discuss on this panel the direct evidence of competitive effects, which has been described and I'm glad you all described it as evidence that is not based on inferences drawn from increases in market concentration.

So it seems like it's kind of the everything else outside of, outside of market concentration. And the reason I say I'm glad you defined it is because when I first saw the name of the panel and hadn't remembered how you had defined it when you put out the notices, I wasn't exactly sure what it was meant to cover.

And I'm not sure, to be honest with you going forward, whether we have the right label on all of that evidence. To call this all direct evidence seems to me to be perhaps a little bit broad and perhaps promises a little bit too much, but I'll get to that in a second.

The first thing I do want to say is there's been a lot of debate about how much weight to place on concentration inferences, including whether to eliminate them.

And there's no question that they're not a perfect indicator, and there's some question whether it's any indicator at all when we're talking about unilateral effects in differentiated products setting.

But I would say this. Without them, as imperfect as they may be, or some substitute or some set of safe harbors, the two most important merger review processes in the entire process chain would be rendered way too difficult and way too expensive.

And by that I'm talking about first the party's antitrust review that they do with their lawyers in-house and with outside counsel before deciding whether to even proceed with the merger.

That's a very important component of deciding whether to spend the time and money and the effort involved in a merger. And second, I'm talking about the agency's review within the first thirty days after the HSR filing is made. Most mergers live or die within those two time periods.

So whenever we're thinking about what kind of an analysis we do, we have to keep some of it simple enough that that can actually be done.

I think that, frankly, you can't perform a complete competitive effects analysis in thirty days. And given that most mergers pose no competitive issues, you've got to have efficiency in that thirty-day period.

That said, I do agree with what we said in the commentary, which is that the concentration levels are a starting point. Obviously the competitive effects analysis when you have a hypothesis that a merger may be a problem is the most important piece. And then what we're calling today direct evidence provides the basis for the closer scrutiny.

Now, the questions that were provided by the agencies for thinking about this evidence asks the question whether guidelines should discuss the types of evidence that are pertinent in a horizontal merger review and how they are used.

Now, a lot of people think it's a bad idea to put those in the guidelines. I actually think that putting some of that in the guidelines would be useful, or putting it in the guidelines appendix, for example, if it somehow makes the guidelines themselves a little bit too clunky.

Provided that, A, that guidance is broad enough and inclusive enough that it won't inhibit the introduction of new types of evidence, evidence not contemplated in the guidelines, but that is nonetheless probative because I don't think it's an unlimited set, but I think it could be beyond our imagination today.

B, that it's made clear that the guidance is not just providing a type of checklist. There's always that danger that people start looking at it as a checklist or start thinking that it's all equally probative, because I don't think that's the case.

And C, that it's also made clear that the agencies ultimately are going to look at the evidence as a whole in any given matter. So you might have some evidence of one type that's somewhat probative, evidence of another type that's more probative. You have to look at it as a whole piece.

The commentary stated that, quote, "The agencies assess the full range of qualitative and quantitative evidence obtained from merging parties, their competitors, their customers in a variety of sources."

And I might just build on this in the guidelines by discussing more specifically the types of evidence that the agencies look to as probative, perhaps some indication, based on experience of what might make it more or less probative without settling on, you know, this is the ultimate evidence or that's the ultimate evidence, because I do think that that would be a mistake. Again, making it clear this list is not intended to be exclusive.

I think this would be useful not only to parties contemplating a merger, and clearly it would be, but also to courts and other institutions that look to these guidelines for help.

That's not the primary purpose of the guidelines obviously, but it is a reality. There were many times during my travels when I was with the FTC or DOJ where after we were explaining the U.S. analytical framework to perhaps officials at a new agency or perhaps in a developing country someone would always ask, and usually it was the person who knew they were going to have to do the work on this at the end, would always ask the question, okay, okay, I see the analysis. How do you actually do it? How do you actually figure it out?

That's important, too. Again, if it's too clunky to put in the guidelines, I would think about an appendix. The question's been asked should it include examples, like the commentary does.

Perhaps not, given that the commentary is out there and that in itself could be updated. On the other hand, if you look at what the FTC on the consumer side does with its, for example, endorsement guidelines, where basically it sets out the guidelines and then has another document that sets out hypotheticals and examples from real experience. That might be, that might be a way to do it.

I'd like to talk a little bit about whether defining markets is necessary, but I think we'll probably talk about that in the Q and A. So I think I'll probably stop there, Rich, and let the others have their turn. Thank you.

MR. FEINSTEIN: Michael.

MR. WHINSTON: Thanks. It's a pleasure and an honor to be asked to participate in discussing the possible revision of the merger guidelines, an issue that I think is of great importance both for consumers and overall efficiency.

So in my opening remarks I want to comment on three topics. Two quite quickly, and then a third at a little more length.

The first point, I think, is the guidelines really should not be static. I think Debbie was just mentioning, and I would reiterate it, that the last significant revision was over twenty-five years ago.

And you know, I think a fundamental fact is in those twenty-five years knowledge in the field of industrial organization, in economics, knowledge in the area of horizontal mergers is one of the areas that's seen the most progress. So as such, I think the time is really right for an updating of the guidelines.

The second thing I wanted to comment on briefly is the issue of what are the aims of the guidelines. So I think if you're thinking about updating the guidelines, it's obviously worthwhile to think about what the purpose is.

You can think of a number of different purposes. One is they may provide an outline for internal use of the agencies themselves. Obviously then you want to describe the procedure that you're using.

Second thing is they're communicating to firms and the antitrust bar. And there, too, I think it suggests a very transparent approach so that firms aren't spending time investigating and thinking about mergers that ultimately aren't going to happen or aren't dismissing mergers that could happen and would be good.

The third issue which has come up, Debbie mentioned and it came up in the previous panel, is teaching and influencing the courts. So I think in that regard, if you're going to do that, it suggests the need to explain why the agencies believe certain kinds of evidence are useful or not useful.

And I think, you know, not -- I'm not a district court judge or an appellate court judge, but if I were, I probably wouldn't be looking at the economics literature, maybe not too much at law review articles explaining the economics literature, but I think there may be a real role for the agencies to be explaining, to have short documents that explain the procedures that they're using and when they think they're good and when they think they're not good.

Actually, until an hour ago, I personally did not know about the commentaries and I haven't even looked at them. But I think there's a real role for those kind of documents potentially.

And the final possibility is maybe they are relevant for bargaining position. Ultimately many problematic mergers are settled; and if you want to get to X, it's not clear necessarily that you should start at X.

That I think is perhaps a little more controversial. I think it is interesting to note that there's a big discrepancy right now between the current thresholds and current practices. And at least one argument for that might be this kind of bargaining element.

The third thing I want to talk about at greater length is the issue of market definition and concentration-based presumptions.

So I think when it comes to mergers that go to second requests, in some sense the agency seems to follow an open-ended and detailed inquiry that reflects really the very best methods currently available.

And while the guidelines don't

currently mention many of the methods that are used, they're twenty-five years old, and it's not surprising, they don't really seem to get in the way to too large a degree either.

To me I think the place where they do currently seem most out of sync in current learning is in their market definition and concentration-based procedures, which seem now in some sense mainly to be used as an initial screening device.

I completely agree with Debbie about the importance of having initial screening devices; and I think having some kind of device is critical. The question is what kind of device should it be.

Now, while intuitive, I think this market definition procedure and also the associated concentration thresholds are not based directly on any model, nor are they clearly linked to any empirical results of merger effects. Ultimately maybe they will be, but right now I don't think they are.

Moreover, the procedure currently has a somewhat odd and roundabout nature because if we have the information to answer the market definition question, we typically also have the information to just directly study the degree to which a merger would increase prices, at least in a unilateral effects sense.

So I think it would be nice to improve on this state of affairs. One interesting proposal for doing so, which is focused on differentiated product industry, appears in a recent paper by Joe Farrell and Carl Shapiro. And guess I'd like to say just a few things about it.

So the basic idea is fairly straightforward. A merger causes the newly merged firm intuitively to face a new cost of lowering its price, namely, the loss of profitable sales by the new and acquired division.

So if we measure the size of this effect, which equals the product of the diversion ratio and the division's price cost margin, we can then go compare it to some typical presumed level of merger- induced efficiency.

Maybe we say that 5 percent on

average. I'm not saying that's the right number, but whatever number you like. So if it's larger then in Farrell and Shapiro's terminology, there's upward pricing pressure caused by the merger. And then what they propose is using this as a screen to determine whether to investigate further.

Now, I think this is an attractive idea compared to current market definition procedure. It has the advantage that it's actually directly linked in a clear way to what we think is a key driver for merger-induced incentives for unilateral price increases.

In a sense, it's a poor man's merger simulation exercise; but for screening purposes, the poor man's approach is exactly what we want.

Now, it has some drawbacks. Given the time constraints, I guess I won't mention them now. It's not clear how often we're going to really know what price cost margins are or diversion ratios. It doesn't include other effects that, in a sense, the concentration thresholds could, such as typically a merger might encourage collusion, maybe it would encourage entry, maybe there would be capacity adjustments. And you know, their procedure is going to leave all of that out, just like merger simulation does.

So there are limitations, but I think it has the potential to be useful. That said, I'm a little surprised Joe and Carl stopped where they did.

In particular, they proposed this method for differentiated product industries, emphasizing their difference from homogeneous product industries where they seem to suggest that the concentration approach makes more sense.

But I think that in fact exactly the same kind of procedure could be used in homogeneous product industries where you think capacity is an important competitive asset.

So indeed the presence of upward pricing pressure in homogenous product industry can be judged directly from merging firms' margins. Unlike in differentiated product industries where you need to know diversion ratios, here you don't even need to know anything about demand.

Moreover, it's much more certain to translate into lower levels of consumer welfare than in a differentiated product industry.

So with this in mind, when I was thinking about it, I thought it was of some interest to see how this application of the upward pricing pressure approach would compare to existing concentration thresholds in homogenous good industries.

So for example, suppose we initially have an industry with equal-sized firms facing a constant elasticity of demand. The demand elasticity is 2, and presume this is for the overall demand in the market, and the presumed efficiency gain is 5 percent.

It turns out uniform pricing pressure would exist whenever the post-merger Herfindahl exceeded 1,052. With an efficiency gain of 10 percent, it would exist if the post-merger Herfindahl was above 2,222, which are numbers that are actually remarkably close to the current thresholds.

It turns out, however, that the

level of concentration at which uniform pricing pressure would be present depends greatly on the industry's demand elasticity.

So with a demand elasticity of 1.5, it would be present with possible efficiency gains of 5 percent and 10 percent, then it would be present if the HHI exceeded 769 with a 5 percent gain or 1,587 with a 10 percent gain.

On the other hand, if the demand elasticity were greater, then it wouldn't be present with a 5 percent efficiency gain until concentration was about 2,100, and with a 10 percent gain until it was 5,700.

So, I think one of the things this illustrates actually is in a pretty stark way some of the benefit of the pricing pressure approach relative to the current concentration ratios in that the pricing pressure makes the screen sensitive to an economic factor, namely the elasticity of demand, that has clear implications for pricing incentives, okay, while the concentration numbers don't have anything to do with that.

In that sense, I think it sort

of suggests that if there's a procedure like this that can readily be sensitive to include factors like that, it may be useful.

Now, that said, I think it's important before incorporating anything like this to get a good sense for how often it's going to be possible to use and, how it differs from the current screening procedures.

So to me, I think one thing the agencies should be doing is, both going forward and looking back, comparing methods like this and see what difference they would make and whether they seem to give good answers or not as screening devices. I'll stop there.

MR. FEINSTEIN: Thanks, Michael, very much.

As some of you may be aware, Monica was a testifying expert in one of the textbook examples of a merger where there was found to be or there were found to be direct effects, which I think to some degree drove the result; and that's, of course, the Evanston Hospital case.

I don't know if you're planning to talk about that specifically or not, Monica;

but in any event, certainly I think it's generally relevant to what we're talking about here today.

MS. NOETHER: And it's obviously helped me think a lot about the issues with respect to concentrated markets.

I want to start off by thanking the DOJ and FTC for inviting me to participate today. I'm honored to be able to take part in what I think is a very important session and very timely.

As Rich suggested, within the broad context of thinking about all sorts of nonstructural evidence, I'm going to focus primarily on evidence related to consummated mergers.

Obviously analyses of consummated mergers are a minority in the merger evaluations that take place, but I think they're still of interest both because there are situations where the agencies want to go back and look at a merger that has already happened and also because there may be some more general lessons that can be learned from a systematic analysis of consummated mergers.

So the question I think that comes up in this context is can a post-merger consummation investigation skip most of the structural analysis, and for that matter, most of the more qualitative evidence of competitive dynamics since there's evidence of actual conduct, particularly what's happened to prices following the completion of the merger.

I think all of us agree, and it's certainly been stated by various panelists, that market definition itself is really merely a tool that provides a context for analysis in competitive effects, either prospectively or retrospectively.

And certainly when you're talking about a differentiated product industry, precise market definition is always going to be arbitrary. It's really the closest substitution that's the relevant question.

But the question I think about skipping, most of the structural analysis in a consummated merger case is really the same question that you could apply to any kind of case where we have observations of actual behavior.

And the question is, is the use of anti-competitive market power the most probable explanation for the behavior of the market dynamics that we actually observe after this has happened.

And in most conduct cases, I think we end up actually doing the full analysis, which does involve at least some form of market definition, at least to establish the context in the which of the analysis is done.

I'd argue that even in the merger cases the same kind of logic holds, or at least, and here's sort of my fundamental theme, we need to check to make sure that the various pieces of the analysis all corroborate each other.

Is there a credible unilateral or coordinated effects story which comports with any observed price increases. And the question to ask in sort of checking on that corroboration -- and I'm going to, as Rich suggests, I focus on healthcare, and so I will use hospital mergers generally.

Whether you want to a draw an analysis to Evanston or not, I don't think is important to frame my comments on this.

So you know, the first question I look at is are the merging firms close substitutes for each others. Certainly hospitals are differentiated in various regards.

Did they offer the same range of services, are they geographically proximate, since you've got local markets generally. Did they have overlapping medical staffs.

Second, to what extent did the hospitals compete with each other prior to the merger. What evidence is there. What do their own marketing or planning documents say about each other versus other facilities.

Then focusing on their customers versus all the managed care organizations. Is there any evidence the managed care organizations played the hospitals off of each other.

And I would think certainly documents that one obtains in the normal course of business are probably generally going to be more credible than testimony at the time of trial, for example.

If you look at the MCOs network, can you see that one hospital was in some of the networks but not the other, suggesting that they were substitutes for each other.

Looking also at patients, the other customers in hospitals, what does patient flow data suggest about whether a significant number of patients chose between the merging facilities as opposed to other hospitals that service the areas. What do the patient survey say.

Third, to what extent did the other hospitals appear to compete with one or both of the facilities. Same types of evidence that you'd use to compare to try to determine whether the two hospitals in question were substitutes for each other.

And can MCOs live without both hospitals because there are other competitors that they can use to essentially build credible networks for patients.

Fourth, were the market dynamics changing, e.g., were there other hospitals that were repositioning by adding new services, building new ambulatory services, for example, or affiliating with new medical groups to bring patients to them.

And then finally we get to the econometric evidence of the direct effects, which I think has been sometimes suggested that's all we need to do; but I see that really as just one additional piece of the puzzle that needs to fit in with the others.

Essentially the econometric exercise is essentially finding a way to estimate what the but-for price would have been in the absence of the merger, and then comparing it to the prices that we actually observed after the merger occurred.

There are two approaches that are generally used. The so-called difference-in-difference approach, which is really looking at price changes. And in that situation, you need to find a control group that's identical in terms of all of the demand and cost pressures in every regard to the merging facilities, except that they didn't merge.

And to do the analysis, since you are focusing just on changes, essentially it's assuming that all of your control group facilities, as well as your merged facilities, were in complete equilibrium as sort of the base point from which you start the analysis.

And you know, for example, in the hospital context, contracts tend to go on for long periods of time. So to the extent that you've got hospitals at different points of their contractual cycle, the assumption that all are at the same point in equilibrium at the beginning may not always be valid.

The second approach is using multiple regression analysis -- controlling for all of the same relevant times, cost and demand features.

And I would argue again that in both of these methodologies, while theoretically they're certainly valid methodology, they're generally impossible to apply completely or sufficiently accurate, particularly in differentiated product industry.

You've got data limitations, measurement issues. Again, in the hospital context or health context, generally quality is a very important dimension of competition and just a dimension of differentiation, but very hard to measure in any kind of objective or qualitative way.

This kind of makes me think about the old saying that economists are the only ones that predict the past with about a 50 percentage accuracy.

But returning to the original question regarding the necessity of structural evidence, I just want to comment on one piece, and I know we'll talk about it more later.

There's a notion that one can back into market definition. In other words, if you observe prices went up, it must be the case that the merging firms constitute a market to themselves.

And that kind of logic, I think, again, is only appropriate if we're absolutely sure that we've ruled out all the alternative explanations of an observed price increase. And my comment would be that that's relatively impossible.

So again, just to sum up, I think you need to make sure that all of the different types of evidence, and it includes certainly the analysis of price, price changes that can be a piece of it, but you need to look at the other types of evidence to make sure that all the types of evidence are consistent with each other.

And if they're not, and in particular if you do observe price increases, but the other types of evidence suggest that the firms really weren't particularly close competitors, then you need to think about what the price changes are telling you and what it is that you're really measuring.

Is the price increase real or is it just a matter of timing. What's the appropriate baseline or benchmark? For example, are there quality issues that you haven't been able to take account of? Are there other data issues in the econometrics that you've done? Are all customers impacted? If they're not, is there a good explanation for why different competitors -- customers have been impacted in different ways? What's happened to output? That's an important question that certainly needs to be considered. If you see prices have gone up but output's gone up, too, what does that tell you. And just finally, are there alternative explanations?

And bringing it back to certainly the current question about should the guidelines be changed, if there's going to be a change that essentially suggests there should be more emphasis on direct effects, I think it would be important to stress that we need to consider the context of the evidence you're looking at, essentially look at all the pieces together.

MR. FEINSTEIN: Thank you, Monica, very much. Jim.

MR. LANGENFELD: Thank you, and once again, thank you and Molly for including me. I'm very honored to be part of the process and to get back on the horse.

After thinking about the Merger Guidelines for so long in the early '90s, now I get to think about changing them again a little bit and hopefully a little of what I think now might be of help, I hope.

The first thing I want to do, though, is be a little contrary and say I don't agree -- I'm going to focus on the topic at hand, which is the direct evidence of competitive effects.

I've submitted, as Dennis and Rob have, more general comments which are available. And I will have an article coming out in Global Competition Policy that summarizes some of my thoughts.

But to go specifically to this area, so I'm going to take a narrow focus. The first thing I'm going to do is I'm going to say that I don't think the panel is named correctly.

Now, I understand this is a definitional thing, but we need to think about what we're talking about here.

As Carl Shapiro has defined it, and Debbie mentioned this, that maybe it's a little too broad a topic in terms of classifying all these things as direct effects evidence.

Really, very little of what we're going to talk about today or what question two of the twenty questions that the agencies, I think, have very well crafted, question two talks about so-called direct effects evidence.

But the definition is, as Debbie

points out, anything other than structure. Well, that doesn't make any sense. Now, wait a minute.

What Monica is talking about here from a consummated merger is direct effects evidence. We had an action and you can hopefully, doing it the right way, as Monica has done, you get a result. That is direct evidence.

All the other things under this panel we're talking about are really indirect effects evidence. They just don't happen to be structural.

So I think we need to keep that in mind as we go through this, and I can focus on one of the specific types of evidence and maybe that will illustrate the point.

But I want to read, and before I talk about that a little bit, let's keep in mind also the agencies says their goal is, which is "to determine if updating the guidelines could more accurately and clearly describe current agency practice," all right, "and reflect and incorporate learning and experience gained since 1992."

Those are the goals. So I'm going

to look at question two in the context of those two. Seems the right thing to do.

Question two asks, "Should the guidelines be revised to address more fully how the agencies use evidence about likely competitive effects that is not based on inferences drawn from increases in market concentration?"

This is the language that I think would be more appropriate for the panel, you know, what else beyond concentration should we consider.

I think the answer to that is unequivocally a yes. The guidelines, even back in '92, we crossed this bridge. If you look at Sections 1.11 and 1.21, they talk about examples of evidence.

They talk about buyers having shifted or considered shifting. Now, we're not talking about a tool so much. But it also talks about whether sellers base business decisions on the prospect of buyer substitution in market definition, both geography and product, and the timing and cost of switching products.

So we're already past that. Now,

maybe more specific guidance is the type of tools and the questions that should be asked is a fair question. How general should they be, and Debbie mentioned that.

But I think that putting this type of so-called, this nonstructural evidence in the guidelines, and at least maybe at a general level, is really important.

So the answer to that, should they be in there, absolutely yes, for transparency purposes.

So let's look at the next question within question two. "If such revisions are undertaken, what types of such direct," once again, I wouldn't use the word direct, "evidence are pertinent? How should the following categories of evidence be used?"

Well, let's look at those categories that are listed. Those categories are natural experiments, evidence from consummated mergers, post-merger plans, a la Whole Foods, Kevin will know about this, benefits from parties from head- to-head rivalry, customer views, and the history of industry coordination.

While I'm sufficiently old to know that at least the last four of those, post-merger plans, benefits of head-to-head rivalry, customer views, and history of industry coordination, have been used since my first term as a staff person at the FTC, which goes back into the '80s.

So those are things that the agency have used, they continue to use, and perhaps they need some explanation. But they should be mentioned, in my opinion. These aren't new. So they sort of address the first part because this is what the agency has been doing for decades.

The new ones are what I would call natural experiments because that really has developed since 1992, and particularly with the Staples merger.

And evidence of a more sophisticated analysis of consummated mergers than we've had before, and Posner wrote about you should see what happens after a merger if it's not an HSR challenge.

But really, the type of work that Monica has been doing, and others, but that post-merger type of analysis has really become much more sophisticated, much more understandable, I believe.

So those are the two areas, and Monica has covered the second. So I'm going to talk about the first one, which is natural experiments.

And Mary Coleman, who's here, and and I have written the definitive paper on natural experiments, of course, that came in the issues of Competition Law and Economics.

You know, we thought a lot about this. We got comments. Our referee was Greg Werden, so you know, we got a few comments back. For those of you who know Greg, you can imagine. It still got in, so I feel pretty strong that we got this about as right as you can.

So controlled experiments are the first thing to keep in mind. Because if you know what a natural experiment is, let's figure out what an experiment is, right?

So let's look at the ones that really are the better ones, frankly, in a lot of ways, controlled experiments. Frequently used in scientific studies. What are they?

You create two groups that are really, really alike, all right. And you have one group that's going to be experimented on and one group that's not. And you subject one group to some exogenous experiment. You give them a pill that's supposed to make them feel better, and another one you give a placebo.

And then you compare the changes after they start taking the drug, let's say, and you see what the outcomes are. So you have sort of a benchmark. So what you're really doing is using a control group and an experimental group.

Now, sadly enough, in economics we really don't have the option, except sometimes with state laws, to really run these type of experiments. Things go on. The market goes on.

We can't say, okay, this group over here, you're only going to buy these products. And this group, you're going to buy other products. Which one of you are happier. We just don't have that, especially in a competition world.

So what we have defined as a natural experiment, and there is some disagreement about this because we were the first that really actually tried to define this, as far as Mary and I could tell, "A natural experiment compares the outcome associated with the firm or market of interest with those of other firms or markets that serve as a control group," that is to say unaffected by the behavior of interest. So you're trying to define something.

And the key, really, the first time in the merger context that this ever really took place was in the Staples case. And Malcolm Coate has -- we've talked about Malcolm. He's checked me. He thinks we're right on this. So if Malcolm believes it, there is some assurance we're correct on that.

But what really has happened is it wasn't a direct evidence because the merger hadn't taken place, but it was a natural experiment in the sense that there were different geographies.

There were a different number of office superstores that competed, one, two or three. And there was both econometric and documentary evidence, although the judge seemed to rely more on the documentary evidence, to say that if there were two, the prices were lower than if there was only one, and if there were three, the prices were lower than if there were only one or two.

And think about the challenges in market definition here. I mean, office superstores, you could buy pencils anywhere, right. But yet, this type of natural experiment, is what I would call it, actually won the day for the FTC in a litigated case.

So what's important to keep in mind in terms of writing something like natural experiments into the guidelines?

Well, the first thing, and these are sort of Daubert-type concerns, I mean, I teach as adjunct professor at a competing law school here, but really, the key thing is, in my senses, if we're going to do economic work, and the agencies are going to put forth something as a reliable piece of evidence, we should always think in terms of whether it's Daubert-proof or not.

So, first of all, does the

experiment fit the facts. In other words, how close are the facts to what you're trying to simulate, to the merger.

Do prices go up, for example, after a previous merger. And lastly, does the analysis employ sound economic methodologies. That is to say, are we really measuring outcomes effectively, prices, output or quantity, innovations? Are we measuring those accurately?

Are we controlling for other factors, such as what Monica has pointed out? Have we identified the most comparable groups for the experiment? And what are the results? Are they sound? Can we look at them if it's econometrically several different ways? Is it consistent with other market evidence?

Because I think all of these pieces that you could consider in terms of putting in and measuring nonstructural analyses all need to be checked against other types of real-world and other types of analyses.

I don't think you really want to put all of your eggs in a natural experiment, an econometric, a merger simulation study. I just don't think it's appropriate.

This is a real-world phenomenon. You should have evidence from more than one point of view. Thanks.

MR. FEINSTEIN: Thank you very much, Jim. What I want to do first is kind of follow up on something that was alluded to in several sets of remarks.

I'm happy to adopt nonstructural evidence as opposed to evidence of direct effects if that makes people happier.

MR. LANGENFELD: Makes me happier.

MS. MAJORAS: You're a good moderator keeping us happy.

MR. FEINSTEIN: I think it's a useful observation actually.

With that as background, as I think a couple of speakers noted, and as I suggested at the beginning, in some sense figuring out what the likely competitive effects are going to be with an unconsummated merger is the goal of this entire exercise.

Making a well-informed prediction that if you're in court is persuasive to a judge or if you're not in court it's persuasive to the enforcement agencies one way or the other.

And market definition is not the end. It's just one of the tools along the way. But for the lawyers in the room there are lots of cases, of course, that say you need to define a market and you need to assess the likely competitive effects in the context of that market.

And one of the ways traditionally that that's been done, of course, is based on structural evidence. So if we're going to leave the structural evidence off to one side, then the large question is what's the relationship between the use of what we'll call nonstructural evidence and market definition?

Is it still necessary to define the market from an economic perspective? Can you back into it in a way that's sufficient to meet one's burdens in court? Are there circumstances in which the existence of this sort of nonstructural or direct evidence makes it unnecessary to define a market at all?

I'd love to hear the views of any of the panelists who have views. Debbie, do you want to go first?

MS. MAJORAS: Sure. Well, as you know better, I can't speak for the economists, there's three sitting with me, but the way I've always looked at this is it seems to me from an economic standpoint that, yes, you would be able to dispense with defining markets the way we do because the way we define markets is a legal tool that we've come up with.

But having said that, we don't have a perfect economic system for reviewing mergers. We can't. We have to do it within the context and within the framework of a legal system and within the framework of a system that's fairly predictable.

You know, a lot of lawyers say, look, we understand the analysis, we understand the very close relationship between the evidence that you're using to define the market and the evidence you're using go to predict competitive effects, particularly in unilateral analysis with differentiated products, it's the same, and that's how people say you can back into it.

But what lawyers say again and again is that they're very concerned about taking away that discipline of starting with market definition. And there's also the reality that courts do expect to see it.

I guess what I would say is I think there is a disciplining effect. I think we can, we can pull apart a little bit, though.

First of all, at a minimum, I would say that even the guidelines or at some point, and we've tried to do this in decisions perhaps like Evanston and others, at a minimum, I think courts need to understand better how it is that there's this relationship between market definition and competitive effects so that when you define a market in a unilateral effects case, often you come up with this market definition that sounds very gerrymandered to people, it sounds really stupid, frankly, because it looks like it bears no relation to a market in the real world.

So that's a problem that the agencies have had, and I think that's a problem to be addressed. You could say, well, the underlying unilateral effects analysis is wrong, but I don't hear people necessarily saying that.

So if the analysis is right, you've got to get the way that it's described to courts and other constituents right because this is a legal exercise.

The second thing I would say is I think in a Federated case, the way the FTC said, look, we don't see a need to define a market, because even if we define it in X, Y, Z fashion, there's not going to be a problem.

I think that's actually an appropriate use, in other words, you know, when you are excluding the possibility of a problem.

I, by the way, was recused on that case, so I'm not tooting my own horn; but I actually think that much like you would in an analysis turn to entry and see that there's just absolutely no entry problems. So you can very quickly turn to that.

Finally, I think if people think -- and I've thought about this a bit, and I think if people think there are other situations where they want to push for not having to define a market, I'm not sure we're there yet.

And I think what I would rather see is some more discussion and work being done in this area because if we're going to that, if we go to that eventually, it would be very hard, back to the points I made before, which is that companies need to know how to evaluate these things, we need to know how to evaluate them within the first thirty days.

Where are the situations that we would think that a market doesn't need to be defined. Other than what I just said, I don't think we're there yet. So I'd be hesitant at this stage to take the discipline of market definition out.

MR. FEINSTEIN: Michael, do you want to go next?

MR. WHINSTON: Sure. So I think one thing that's worth just noting, I think saying that the concentration numbers are just structural and they're not including any nonstructural evidence or direct evidence, whatever you want to call it, is actually a little inaccurate because the market definition exercises is including information about demand substitution, for example. Right? And incentives for raising price. That's exactly how the question is structured. You know, would a hypothetical group of firms have incentive to raise prices of these products by 5 percent, whatever.

So to answer that question, you're using all of that information. The question is really how are you using it? In a sense, market definition and structure is some summary of that information. The question I think is whether it's the right summary.

Now, the issue, the separate issue is do we know for sure what the right summary is right now? Probably not. But I think we know some things.

And, I think this pricing pressure thing I was talking about is just a different way of using that same information.

I guess the other thing I would say is, I agree, getting from where we are to maybe where we're going to end up, first of all, we're not sure exactly where we're going to end up, but improving things in a way that -- I think the education point with the courts is actually an important one.

So you know, if you take it as given that the courts use market definition, they will always use market definition, that's never going to change, then what the agencies need to do maybe it's a little bit different than if you don't take that as given.

MR. FEINSTEIN: And I don't know that it's necessarily a given for all time; but as we sit here today, it seems to be an element as to which the government or the plaintiff has the burden of proof.

And I think this gets to another question, and I want to get back to hear from Monica and Jim as well on the question that's pending, because I think everybody agrees that these guidelines, certainly historically, they have influenced the courts, and I think it's likely to assume that they will continue to influence the courts.

And I think that makes it very important that they be written in terms that generalists judges can also comprehend. And that's one of our challenges, speaking for the two lawyers who are on the group, Molly and me.

But anyway, let's go back to Monica and then Jim on this question of the relationship between this kind of evidence and market definition.

MS. NOETHER: Again, I'll just maybe reiterate a couple of the points I made in my opening remarks that I think obviously market definition is something that provides the context for the rest of the analysis.

I agree with Mike, essentially it's an interactive process because you obviously need to look at the competitive dynamics, and in particular what do customers view as potentially good substitute products, to come up with an accurate or more reliable or useful market definition.

But it's really an exercise in and by itself, except that I think to bring up a point that was made in the first panel, which is that structural evidence can at least form a basis for some safe harbors, provided, again, that the exercise is done carefully.

And I guess I'll now take off on a point that Mike made in his remarks when he went through kind of the algebra of HHI's related to market elasticity and essentially we have a higher HHI threshold if the market elasticity is greater. All we're saying is that there are potentially more other substitutes.

Maybe you want to broaden your market definition. I guess what I'm saying it's a circular thing; but I do think, again, going back to my opening remarks, that it's often dangerous to think that you can just go straight to the competitive effects analysis without the context of market definition or back into market definition because you think you've done the competitive effects analysis.

Because I just don't think it provides enough sort of organizational structure around the analysis; and you can come up with some erroneous conclusions by essentially looking at evidence, for example, on what's happened to prices if you don't understand the market dynamics that are reflected by customer preferences essentially, which is what the market definition exercise is all about.

MR. LANGENFELD: Well, I agree that market definition and looking at shares can be helpful in the context of which Mike has pointed out. There is an analysis for doing market.

I think in terms of a consummated merger, if you have clear evidence that, controlling for other things, that prices went up as a result of the merger, I think that spending a lot of time on market definition is a waste of time.

I agree with Monica that at least talking about it a bit so people know what you're talking about is fine. But it's not critical or not as important, I would say.

When we're looking prospectively, and adopting my own term of all these being indirect market definition analyses that we're talking about here, nonstructural, I think you need to look at each of those to the extent that they're available.

You have data. You're not always going to have information available for a natural experiment. You're not -- sometimes you are. Sometimes you aren't -- to do it well.

Looking at what customers tell you, sometimes you'll get a clear picture. Sometimes it will be just blah. Or if it's a product that individual customers are buying, you know, downstream -- to food stores merging, for example, you're not going to be able to go out to the customers, unless you have a lot of survey data to find out what they're doing.

Market definition, I think, is an important element. It shouldn't be the critical element, and I know Paul Denis has some strong views which I tend to agree with on whether there should be presumptions built in to any of these things.

But I would look at market definition as being an important part along with the other types of analyses that we do and not to give it a trump card, but not to say it's irrelevant in most mergers.

MR. FEINSTEIN: Let me shift for a second to non-price effects. Jim, in your opening remarks I think you suggested that the only real direct evidence as opposed to the term nonstructural is evidence that tells you something directly about price effects, if I heard you correctly.

MR. LANGENFELD: That is correct.

MR. FEINSTEIN: As Michael pointed out, the whole hypothetical monopolist effect is focused on the likely ability to increase price.

The question I'd be very interested in hearing the group's views on is whether there is non-price-related evidence, direct or otherwise, but particularly direct, I guess, that really should be viewed as probative.

You know, for example, if there's evidence of reduced innovation or product or service degradation which doesn't necessarily translate directly into something that could be measured in terms of price, you know, should the guidelines address that type of direct or nonstructural evidence?

MS. NOETHER: I think absolutely if you can measure what's happened. I mean, I think we tend to gravitate towards prices because they're numbers and more easily measured and, therefore, one thinks one can analyze them better.

But if you can come up with measures, because of what's happened to quality or service or, you know, potentially innovation, that are concrete and not biased, and you can try to analyze that, then that's certainly appropriate. But I just think we're limited by the information that tends to be available.

MR. WHINSTON: I would echo that and say if we can do it, we should. Remember, we're trusting -- not in the case of consummated mergers, but in the case of predicting mergers that are not consummated -- we're trying to predict how those things are going to change.

So not only do you have the problems of measurement, and the evaluation of how they affect consumers, but you need to have some either natural experiment or model or something that allows you to predict what those changes will be.

You know, I think the reason we focused on predicting price is that we happened to have better models and be better at that, not because we think the other things are unimportant.

But you can imagine in an airline industry if you had some natural experiment of previous mergers and the merged firms had regularly cut back flight frequency, and you would want to include that in the effect on consumers, not just the effect of price.

MR. LANGENFELD: I'll be quick here. I mean, I agree with what's been said; but I think that -- and this is actually, once again, this is an amateur reading the law, right -- but I think that the law typically recognizes both price and output effects, at least in Section 2 type of cases and those type of things.

One of the things that Monica and I both worked on, I was hired by the Pennsylvania Insurance Department recently. We had not a natural experiment, but an actual experiment, direct effects evidence of what happened when there was entry and competition of certain part of Pennsylvania in healthcare.

Now, healthcare is really, really complicated, as Rich knows, and we -- actually, we worked on a healthcare matter together years ago.

But the one thing you can measure is to see whether output has gone up or down by the addition of one more competitors in the market.

There were some arguments about

that wouldn't take place, and I won't go into the details in this particular area. So one of the measures that we've looked at is to see whether there's evidence that output has gone up or down.

Because one argument was this firm came in and everyone was made worse off. Well, it was hard to get a good price, and you could look at some quality measures. But the one thing you could actually count would be whether in this case more people had health insurance or less.

So there actually are instances where you should not just look at these quality things, but I think you need to keep in mind that you can have these type of analyses where you look at output and that frequently will tell you what the net effect on welfare is.

MR. FEINSTEIN: Debbie?

MS. MAJORAS: I would say I think we've been a little bit, in the antitrust world, I think we've been a little bit schizophrenic about how we treat non-price effects.

I mean, I think -- there's a sense that they exist and we talk about them. And if you look the way some mergers have been decided over, say, the past eighteen months, certainly at the FTC, it's clear that at least some commissioners think that this is something that's very important. And yet, we're much more focused on price.

So I guess my point would be that guidelines are meant, I believe, to reflect actual practice. I'm sure that the 1992 guidelines, and those of you who were there could confirm this, also, it seemed, were intended to push the law a little bit forward as well, but mainly looking at what the actual practice is.

And if the agencies are looking at non-price effects, it would be very useful to know what the agencies were looking at and how.

And it's always been an interesting point to me. Because, as I say, I'll end where I started, I think it's a little bit schizophrenic.

MR. FEINSTEIN: I guess that what the agency should be looking and the how the agency should be looking at them for the non-price effect are two of the questions that these workshops are open to answering and to seek input on. That's not something that I think we would attempt to decide for ourselves.

MR. WHINSTON: Can I say just one other

thing?

MR. FEINSTEIN: Please.

MR. WHINSTON: I think coming back to something I said about how much our knowledge of mergers has changed in twenty years, I think it's worth remembering if we go another twenty years I'm quite sure, for example, non-price effects, we would be better at predicting them. I don't know how much better, but we will be better.

So I think it's important for the guidelines to be open, and other people have said this, to new methods and techniques that come in. In that regard, I've known about these commentaries now for an hour, but it seems to me that --

MR. FEINSTEIN: It's up to two hours now.

MR. WHINSTON: Sorry. You're right.

That a broad document, which is kind of almost more constitutional, here are the principles and general things we can look at that stays for quite a while, but with some related documents that are giving you more detail, more explanation for why you're doing what you're doing but that's revised much more frequently I think might be, you know, a useful approach.

MS. MAJORAS: Rich, if I could just go to your last point, which is you probably wouldn't just do it on your own but you want to know what people think about what you should do.

I think that's great government and I appreciate it. I was partially making the point that I think the agencies already do consider non-price effects, but we're not sure how that's being done.

So to the extent it is being done, just reflecting that alone would be, would be helpful.

MR. FEINSTEIN: We'll go a couple more minutes because we started a few minutes late, but I want to turn to give each of you a minute or so to offer any concluding remarks.

Somebody at the workshop in Washington last week said that the most important principle that we should be applying here is the Hippocratic oath. I would say we're mindful of that.

So I guess I would ask each of

you against that background, what would you change, if anything, and why?

If you had to, as Molly said, if you had to identify one thing, and it can be obviously on the narrow topic we've been discussing, or more broadly?

MS. NOETHER: I think, if anything, maybe make it clear that the analysis that is done by the agencies and that should be done by other folks who use the guidelines is really a holistic kind of analysis rather than a sequential series of narrowly defined steps.

There's a variety of different types of evidence that is and certainly should be considered. Depending on the case, different types of evidence are going to be more or less compelling, but essentially looking at all the pieces and making sure that at the end of the day you got a story that fits all the credible pieces of evidence in.

MR. FEINSTEIN: Ideally, yes, the pieces corroborate each other.

MS. NOETHER: Yes.

MS. MAJORAS: I'm going to do two and just do them fast.

MR. FEINSTEIN: That's fine. That's the former chairman's prerogative.

MS. MAJORAS: This one is not going to be original, but I'm going to add to the chorus. I would maintain some safe harbors or presumptions on structure, but I would revise the HHI's, if that's what you use, so that they actually reflect current practice.

People say that all the time. It's interesting when you counsel your client and you go through with them what the law is and then you tell them it says that but that's not really what they mean, that just undermines the whole thing for them.

And I actually do think it's important for your business clients to have respect for the process, which we try to give them. So I would do that.

The second thing I would do is I would make some changes if you keep sort of the dichotomy of coordinated effects, unilateral effects, and I know that Dennis Carlton would not, he would do that in a different way, but in any event, that discussion in unilateral effect particularly in differentiated products, I would fix that.

I think we've learned enough through experience now to understand where the problems are, not only in the guidelines, but in how the agencies have put on cases in unilateral effects where there's been some success but there's some some kind of confusion.

I would try to clear up that confusion, including what I said, making sure the relationship between market definition, provided you keep it, and I suspect you will, and how we think about unilateral effects. Link that together so it's more understandable.

MR. WHINSTON: I guess people say, say what you're going to say and then say it again. You know, I think there's lots of things that you could improve in the guidelines in terms of when we go to a full analysis describing what is done in a more accurate way, unilateral and coordinated effects being one example. That it isn't sequential, that it's integrated, that pieces have to add up, we're looking for consistency in what those things are saying.

But at some level I'm not sure if I look at the way things are being analyzed, I'm not sure that the guidelines are, as I said earlier, that constraining when things really get to a full analysis.

I look at what the expert reports are saying. I don't think they're hemmed in by some sense by the guidelines when it gets to that kind of stage.

So I think I would spend some time thinking about what these safe harbors are, whether they're the best safe harbors we can use in terms of the presumptions. That's where the market definition and the structural numbers really come in.

MR. FEINSTEIN: Jim?

MR. LANGENFELD: I guess -- well, I think that the way the twenty questions have been put is very good. I really do. And I think saying and keeping in mind when you're thinking about making any changes, A, is this really what the agencies do; and B, is this reflecting new things that we should do to improve.

If it's something that's been done

for decades, then it should be reflected in the guidelines somewhere, at least in general, I think, just for transparency purposes.

If it's something new, like natural experiments, more detailed analysis of consummated mergers, using a UPP test, any of those things, I think you need to think, okay, those are new things since '92.

We need to think about them carefully. Are they going to have legs. Are they going to be here in the future. You need to be careful about how you use those and put them in the right context.

So I think anything that you change, especially if it's something new, you need to think about it and be careful about sort of cementing it into the guidelines for the next ten or fifteen years. You really just need to be careful about that.

With that regard, I've also argued, my second point, and I wasn't chairman, that you should be revising, and I know you'll do this right after you finish the Horizontal Merger Guidelines, the non-horizontal merger guidelines because if you talk about agency practice, you know, the Horizontal Merger Guidelines are a lot closer to agency practice than the Vertical Merger Guidelines are. I think everyone knows them, to the extent you even know they exist.

Secondly, there's been a lot more analysis and thought about vertical issues since 1984, the last time the Vertical Merger Guidelines were revised.

I know with this you're going to sweep up in a few months and then we'll give you the next thing to do.

MR. FEINSTEIN: That's probably as good a place as any to stop. Please join me in thanking this panel for what I thought was a very lively conversation.

(Applause.)

(Lunch recess.)

PANEL 3: UNILATERAL EFFECTS

MS. BOAST: Welcome back to our afternoon workshop, and let me use this occasion to thank our hosts once again for offering us this space, but more particularly for feeding us so well. If it weren't so cold, I'd feel like I needed to go for a jog after that fabulous lunch.

The topic for this first panel this afternoon is the well-known unilateral effects. This is one of the areas where I think it's fair to say we know already and probably knew going into this exercise we were going to have to do some work.

So, the suggestion that you might see some changes in this part of the guidelines is probably not a surprise to anyone. That said, this is a complicated topic. There are lots of different ways in agency practice in which unilateral effects come into play.

There is a tremendous amount of writing and thinking that's gone on in the area; and as you've even heard throughout the discussion that we've had this morning, a large number of different views.

So over the course of the five workshops, this is one of the two or three topics that is receiving repeated multiple treatment because we really want to get as many viewpoints as we can and see where the consensus lies.

We are extremely privileged to have the panel that we do have today. Let me start with Kevin Murphy to my left. Kevin is the George Stigler Distinguished Professor of Economics at that other school, the University of Chicago School of Business, and also a principal with Rob Gertner in Chicago Partners.

Next to Kevin is Roxane Busey, a very long-time friend of mine, former head of the antitrust section of the ABA, and currently a partner at Baker & McKenzie here in Chicago.

Next to Roxane is Mary Coleman, who is now a senior vice president at Compass Lexecon, but served as a senior official in the Bureau of Economics at the FTC during the Whole Foods case, I believe.

MS. COLEMAN: No, no, before. I was on the other side of Whole Foods.

MS. BOAST: So I knew she had

something to do with Whole Foods. In any event, had real hands-on experience with some of the things we're going to be talking about.

And last but certainly not least, again, Paul Denis, a partner at Dechert in D.C. Paul was serving as counsel to Jim Rill during the 1992 guidelines revisions. So think of the position sort of as the functional equivalent as a law clerk to a judge. He's doing all the work, probably a lot of the thinking and giving all the credit to his seniors. But he was very deeply involved in it. In addition to working actively in his practice on these matters, he is able to speak to some of the history.

I think our order of play today is that we are starting with Mary Coleman.

MS. COLEMAN: Thank you, Molly. And thanks for the opportunity to participate on this panel and in this process.

For my discussion, I thought as a starting point it might be useful to discuss some of what we mean by unilateral effects.

I think a lot of times when people think about unilateral effects they think about differentiated products or consumer-type products that are sold at a single price and using Bertrand-type models to think those through. But there are many other types of models that are relevant to a unilateral effects discussion. There's really not a one-size-fits all approach. And particularly the information, analyses, and evidence that are most relevant can vary to some extent, depending on which model is appropriate in a particular case.

The guidelines, to some extent, already recognize this by the distinction between homogeneous and differentiated products. However, I think it might be useful to have some more clarification on these points in the guidelines.

The way I think about this is I characterize theories into three general buckets, although there are variations within each of those.

The first area in where you have a relatively homogeneous product and the key issue is how much output or capacity exists in the market, and that sort of determines where prices are in the market. For a merger then, the key question is whether the combined firm would have the incentive and ability to restrict output or capacity. And the general types of economic models that are generally most relevant here are dominant-firm-type models or potentially Cournot models, depending upon the structure of the market and how large the firm is and what the other competitors look like. The key types of issues that you tend to look at are, first of all, determining what the relevant market is is clearly important, what the demand elasticity is or the shares for the merged firm and how that changes with the merger. What does this reply response of others look like. What are their incentives to respond to a restriction and output, what are their abilities, and how does that change from the merger.

The second general bucket of theories are where you have differentiated products, but you essentially have one price to the purchasers of those products. It might vary geographically or the like, but within a particular channel or geography you have a single price. These would generally be consumer product-type mergers, could also be retail-type mergers. That would fall into this bucket. And generally the types of model that's considered here is a differentiated or Bertrand-type of model. How applicable it is to the particular case, of course, depends on the firms at issue. Retailers, that's probably a little more of a stretch to put it there just because you have multiple products being sold and priced in a fairly complicated way, and Bertrand may not pick up that well. But that's usually the nature of the models that we're looking at. Key issues, we are looking at here are what does consumer behavior look like, who are they considering as close substitutes for each other. If you have information, try and measure demand elasticities and cross-elasticities, and looking at potentially the diversions from that information between the products of the merging parties. One issue that can be important to consider, though, in those types of cases is whether or not the products of both companies are actually going to continue to exist after the merger.

In some cases, they'll actually be re-branding so that you really just go to the product of one of the companies. This is particularly the case in retailing mergers where it's not that frequent that the combined company actually keeps both names going forward but actually moves to one or the other. And that can change the competitive dynamic and how you look at the merger because even if pre-merger the two parties had a fair amount of diversion between them, if one of them is now gone, you have to think about, well, if prices go up, what's going to happen to customers who might have gone to the product that disappeared and now would they go somewhere else or would they stay with the merging party.

So it's not that the diversions don't have information, but it's sort of a somewhat different question. You're asking them when the two products continue to exist.

And the third area, and the one I think is not generally very well covered currently in the guidelines, is the case which is very common, however, in a lot of mergers where you have individualized customer-by-customer negotiations and some differentiated suppliers and where basically your -- the issue is what will be incentives or pricing in those individual customer negotiations post-merger.

The types of theories that fit generally best here are auction or bid models, although with a significant caveat that most of the time in the real world it's not really sort of auction setting that these models set up, but there's a lot of negotiation occurring between the customers and the suppliers that is different from what you'd see in the auction setting.

The key issue, as I note, is whether or not the combined firm will have the incentive to bid higher prices following the merger than they would to a significant number of customers.

There could be a couple reasons why this might occur. One, they're just with fewer bidders, the firms, all firms have the incentive to bid higher. There's some models that would suggest that would be the case. In other cases, it may be that you're taking away the next best option for a significant number of customers and the other options that are out there are substantially farther away.

So in the first case with the too

few bidders, the question would be, and the types of analyses you'd do, is does the number of bidders matter and do you have evidence to suggest that reducing the number of bidders by one will actually impact outcomes.

In the second case you want to look a lot at how close are the two merging parties as substitutes. How much do they compete against each other. What other options exist and customers could credibly turn to. Again, looking at what happened in the past, often you're looking at win/loss information or the like, is very important, but it's also important to take into context that the future will be somewhat different. Again the supply of the combined company is not likely to come out and be bidding two different options to customers. They may, but in many cases they'd probably come out with one bid. And the real question is whether the customer who may have seen the two companies, say, A and B, as their best alternatives could credibly bring in C and come to the same outcome as prior to the merger. So it's important to look at the ability of either customers to change their strategies and who they turn to as well as suppliers potentially to reposition and become a better alternative.

In general, I think that it would be useful for the guidelines to provide some more detail without getting too much detail so that they still are guidelines, on the type of theories that exist for unilateral effects as a starting point and then how you do the analysis depending on which theory makes the most sense.

MS. BOAST: Thank you, Mary. That was -- I'll call it an overview, although it was obviously more complete than that, but a really helpful way of thinking about the different kinds of cases we see and perhaps why there's confusion out there. But also why the guidelines don't currently come remotely close to adequately covering all those different buckets, as I think you put it.

I mean, your comment about the individual customer-by-customer negotiation group is quite potent with me because I think in the six or seven months since I've been at

DOJ, that's probably about at least 50 percent of the mergers we've looked at, if not more.

Let's move on this ladies-first afternoon to Roxane Busey next.

MS. BUSEY: Thank you, Molly, and thank you to both you and Rich for including me in this panel.

Obviously, I'm not going to be giving much of an economic perspective. I'm going to be focusing more on the legal aspects. And I thought for this just introductory part, I might give a little bit more of a background or framework for considering modifications to the guidelines.

As has been stated by others, the purpose of the guidelines, as stated in the guidelines, is to outline the present enforcement policy and to reduce uncertainty associated with enforcement of the antitrust laws in this area. They also serve a secondary purpose of advising the antitrust bar and their clients with respect to the risks associated with an antitrust analysis of a transaction.

But what I wanted to really emphasize was the importance of the guidelines in terms of the court. And I know this has been said before, but I'd like to say it a little differently.

Some courts do cite the merger guidelines in merger cases. Some don't. Some courts cite the merger guidelines in non-merger cases, and I think that's where in some way the greatest concern is. And I go even further, I'd say not only to do the courts in non-merger cases cite the merger guidelines, but the parties do and the economists do. My experience has been that they don't do it with the same rigor or analysis as they would do in a merger case. I think this is a problem; and I think the guidelines, as sort of a background comment, need to take this into account with respect to the drafting.

To the extent that there are topics, such as market definition or definition of monopoly power, or whatever, direct effects, if that's what we want to talk about. These are cropping up in other cases. And so for that reason as well as for what's going on in terms of merger analysis, I would encourage greater transparency and greater guidance.

A secondary comment that is related to that is what is the relationship between the guidelines and the commentary. Obviously there needs to be consistency between the two, but one thing I would point out is that these guidelines differ from other guidelines that are promulgated by the agencies. They don't include any hypotheticals. They include very few case cites. They have a very different style about them. That may be because they were one of the first guidelines. I don't know. But the point is that they're very different. I assume at this point no one wants to change that style dramatically.

On the other hand, instead of perhaps including hypotheticals, some reference to the commentary or the importance of the commentary one way or the other might be appropriate to consider in this revision.

The other thing that I wanted to mention that, again, comes from the point of view of a legal perspective, is the importance of these guidelines and the use of economic tools with respect to the challenges that are posed by the Daubert standard.

I think that this was made reference to by Jim in the prior panel. But here I think that there are some lessons to be learned in terms of the introduction of new theories. Whether they may be used by the agencies, that's properly appropriate, but they may or may not hold up in the court. And that should also be taken into account.

I think the guidelines are very clear in saying that they are not a litigation tool just as with respect to my first topic, clearly the courts are not bound by the guidelines. Nevertheless, I think it's important to keep in mind that the guidelines do play some role in litigation.

The other thing that I would say along those lines, and I think to some extent this may be done in the commentary, I'm not sure about this, but I think that the courts make errors in terms of understanding the guidelines or interpreting economic tools. I think the agencies are clear about this. They feel in some cases that they're not only just in terms of argument, but just in terms of the understanding of the courts.

I think that in terms of the commentary, some of the cases that are included are included because the agencies have seen the positive use of a particular analysis. And I believe some cases are excluded because there was some misunderstanding by the court or by the economist or by the lawyers with respect to the analysis. I would suggest that that might be an exercise that, again, doesn't have a lot to do with economic principles necessarily, but does have to do with the purpose and understanding of the guidelines in the context of litigation.

Another point that I would like to raise is what is the role of the guidelines with respect to the HHSR process. What role, if any, is there between the initial thirty-day review and the second request. At this point it's fairly clear, I think, that the guidelines have virtually no relationship to the process. There's no indication that if you're going to do further analysis or further analysis is required that it's required within that thirty-day period or that it's required as part of a second request.

I'm not necessarily suggesting that the guidelines be changed to accommodate that; but I am suggesting that, as a practical matter, lawyers tend to look to see, well, what can we do within the thirty-day period. How much time do we need to produce the documents or make the analysis, and that that should also be a factor that's taken into account.

I think the real question I was to answer is is there any need for amendment to the guidelines with respect to unilateral effects; and I think I'm going to say what a lot of people have already said, which is, yes, the HHIs are outdated, and if they continue to be used they need to be adjusted upwards.

Personally, I question the use of the presumptions. The guidelines are very clear in saying that they're not a litigation tool, and yet, they've used for many years the notion that if you satisfy a particular threshold, then there is a presumption -- I'm sorry, I guess it's the other way around. If you don't satisfy a particular threshold, then there is a presumption. I think the use of the term presumption is inappropriate and perhaps that should be viewed as a screen or a signal or a trigger that there should be further analysis required. I question the 35 percent rule. I think it's important to have a screen. I think we might want to reconsider whether that's the appropriate measure and the appropriate screen. To the extent that the agencies have had more experience and have relied on other econometric tools with respect to differentiated products, I think that they should be clearly stated, perhaps not in depth, but clearly stated. I also think the agencies have now had more experience with respect to, I guess, indirect evidence, to use Jim Langenfeld's term. And, to the extent that is the case, that should be noted.

Finally, with respect to consummated mergers, there's really no suggestion of whether the analysis would be any different. And I think it's clear that the analysis could very well be different because the evidence is there and, therefore, could be considered differently.

So with respect to all of my comments, I will stop. I have some other thoughts about the theories of unilateral effects and the use of bids. But for background purposes, I think I've covered what I'd like to say. Thank you.

MS. BOAST: Thank you, Roxane. That was helpful and a whirlwind tour of a lot of different points.

Your comment about the relationship between the guidelines and the HSR process itself was made in the workshops in Washington as well; and actually, in response to that one thing our task force is doing now is collecting our voluntary request letters that precede second requests and looking at those and second requests themselves to see whether it makes sense, not necessarily in this vehicle but we're certainly open to thinking about it, to articulate sort of what's the threshold body of information that we look at most closely in any transactional review. I think people tend to know that, but it's not really been published in a systematic form. So Kevin Murphy, please proceed.

MR. MURPHY: Thank you very much. And again, thanks for having me here today. I guess where I would start is, first of all, I would like to reiterate some of the things that were said this morning, which is kind of this distinction between sort of unilateral and coordinated effects is a little bit odd. Also the sort of distinction between structural analysis and analysis of direct effects, I think, again, is a little bit odd and not necessarily very helpful.

Finally, the one I would probably focus on the most is the interrelationship between what you might think of as market definition and a competitive effects analysis.

I think the best way to think about all these things is to go back and start with, well, what is a merger analysis about in the first place. Well, it's about how will competition in the marketplace change as a result of the merger. And to analyze that, you have to understand how competition takes place now and how the elements of that competition will be changed if and when the merger goes forward.

The evidence you can put forward on that could be based on a structural analysis or it could be based on an analysis of competitive effects or an estimate of competitive effects.

One of the things I like to think

of is that market definition plays an important role there, as does more direct evidence on competitive effects. And I think the important thing is that they not get in the way of each other. In principle they should be complements.

An example was sort of the Whole Foods analysis that I was involved in. In that case you had Whole Foods and Wild Oats who were the potential parties that were going to merge, and then you had a whole host of other supermarkets out there. When we started with market definition, and people kept saying, well, we've got to do market definition, that's the key here. And when you started with that analysis, you're left with two very unattractive market definitions.

One was all supermarkets lumped together, in which case this merger was a no-brainer. We should go home and forget about it. There's nothing there from a structural standpoint. And on the other side we were left with, well, you could define the market to be PNOS, in which case -- in most cases this was a merger to monopoly. Obviously neither one of those was a very good description of what that case was about.

The way I approached it is, I think, the way economists approached it generally, is, well, we should choose to define our aggregates -- I won't call them markets -- define our aggregates and firms in a way that's useful for letting insight into the case.

And the useful way to think about that case was that Whole Foods and Wild Oats and maybe a few other people who were distinct from a whole group of other participants in the market, traditional supermarkets.

Our whole question was would there be an anticompetitive effect here if there was a merger. That was the right lens to use for the analysis, and we shouldn't decide the case based on market definition. We should look at the competitive effect and then that will tell us at the end what was the right market definition. But the idea that we'd have a stage of market definition then and analyze the effects within the market was not very helpful in that case.

And I get back to Rob gave you an example earlier today of Thomson Reuters. It was the same issue. So the right lens for thinking about that was Bloomberg was different, Thomson and Reuters were more similar in what they did, and whether you called it a broad market that included all of them or a narrow market with repositioning or entry by Bloomberg really didn't matter. So you could do the analysis in either way.

Well, what's the burden in the current framework? Well, the problem is currently we have these sort of structural presumptions that are built into the guidelines which carry, like it or not, some weight to that second stage of the analysis.

You know, you're not free to say I'm going to choose the most effective lens for thinking about competition without getting some burden carried over from the presumption. So I think it's important that we try to reduce the presumptions, the structural presumptions in the guidelines.

If you think about it in terms of unilateral effects versus coordinated effects or structural versus direct effects -- if you think about those dichotomies, they're both useful frameworks, but you don't want them getting in the way of each other. You don't want them sort of interfering with doing the best analysis you can.

So one answer to that is, well, let's just jump in and do a competitive effects analysis right from the beginning. The problem with that is there's just way too many mergers to do a competitive effects analysis in every merger that comes over the transom. So what you need to do is you still need to have a stage one where we can screen things out and a stage two where we actually do a competitive effects analysis.

When it comes to stage two, I'm very much on board with what I think most people said this morning and from what I read people said at other workshops, this distinction that somehow we're going to parcel out entry and put it over here, and we're going to put efficiencies over here, and then we're going to do the analysis if none of those things existed and then we're going to bring those in later. I don't find that very helpful.

I think in many cases that I've

worked on, competitive effects, for example, and efficiencies are just intimately tied together. They're kind of part and parcel often in the same events. The same thing that generated efficiencies generates potential for competitive effects. I don't see any real reason to separate them out in a particular format.

As was said earlier today, same is true with entry. Entry is part of the market equilibrium that exists today. You think about direct evidence. Well, any direct evidence you put forward about pricing effects of market structure or pricing effects of market events. If entry is important, it's already influenced those numbers. You can't say entry's not part of my analysis. The data you have, you might wish you had data that didn't reflect the impact of potential entry, but the data you have does. You can't divorce it out of the data, so it has to be by definition part of your analysis.

So how do we do stage one, stage two? I think we should be able to do stage one and stage two where you have to decide which mergers are no problem and which mergers warrant further study.

It seems to me a structural market definition/Herfindahl approach isn't the only way to either push things forward or say we don't need any further analysis. So for example, if somebody comes in and says I have good evidence of direct effects or unilateral effects, that's probably enough to push this to stage two even if we can't jump through all the other hurdles.

Similarly, if somebody comes in and says, well, there's no overlap in what I sell and what he sells, so however you define the market, the diversion ratio is so low here, it's not going to cause a problem, that should get you through the review. If somebody says we have a well-defined marketplace and our shares are both small, then off to the side unless somebody came back and said either that market's wrong, or number two, I have evidence of direct effects, which, again, would presumably trump your market definition as being appropriate in that case.

So I guess the way I see it is the current guidelines are a little too focused on the structural side of things and the structural side of things sort of interferes with what I think is the most effective analysis of unilateral or direct effects.

I think both ought to play a role at both stages. I think getting rid of some of the structural presumptions would really help us do a better analysis, particularly at stage one and even at stage two because it would allow us to define the market not in terms of what fits a preordained set of guideline numbers, but what fits with the best analysis at stage two.

And this case came up earlier in today in Mike Whinston's discussion where he said, you know, what happens when you have a diversion ratio of a certain amount depends a lot on what the market elasticity is. What the elasticity was at stage one when you defined your market has to be carried forward to stage two. And the problem we have right now is that we have these presumptions that don't really allow sufficiently for that.

So I think getting rid of some of the presumptions on the HHI's would be a very good idea. At a minimum, they need to be adjusted to reflect current practice.

Finally, I think probably if they're going to be used at all, they should be used more in the safe harbor direction, although that safe harbor should be able to be defeated by evidence of direct or unilateral effects.

MS. BOAST: Kevin, if I heard you correctly, you said that the structural presumption could be used to -- if you had a well-defined market and low shares to make a decision that you didn't need to go to phase two.

I'm not sure I heard you say the other way around, and maybe you did by implication, that if you have a well-defined market and high market shares, you go to stage two?

MR. MURPHY: I think you probably would end up going to stage two unless someone could demonstrate the absence of effects in spite of those shares.

You're talking about a merger in Boston and I have market outcomes in forty other cities that have the market structure you're looking at and prices are no higher there than they are elsewhere, I think you're ready to go. You don't need to go to stage two. Maybe that is stage two.

MS. BOAST: I understand. I felt like you were using the screen one way, and I just wanted to raise the question about whether reducing reliance on the structural, quote, "presumptions," closed quote, meant -- and that would be a fair position to say you used the structural presumption to screen things out and otherwise you look at effects and start there.

I don't have a conceptual problem with that. I might have a practice problem with it. One comment, since I can't seem to resist commenting during the middle of these presentations, about structural presumptions in the guidelines.

The way I've always thought about it, and the way it certainly works in practice, is that I think of litigation as a burden-shifting exercise in the sense that burdens shift because courts want the burden on the party most in control of the relevant information at any given point in the process.

Internally, and I think Roxane is right, maybe the label is wrong. It's more a question of telling you that if this following set of conditions is satisfied, we will be operating from this premise. That's not to say that we're done and you do the rest of the work. But one of the internal discussions is, we periodically meet with staff to review the various matters. They'll say you've got X, Y and Z, bearing in mind they're mostly starting with what is a version of competitive effects analysis anyway. It's a way of guiding, you know, how far do we want to go and what is the next piece of evidence we should be looking at, and so sometimes setting priorities.

But it's also a way of saying you should know that as a general proposition when we reach this set of conditions, we will be thinking that there might be something to pursue further, which is essentially what you were saying.

Paul, please pick up with whatever you want to say.

MR. DENIS: Thank you, Molly, and thank

you, Rich, for the invitation to be here. It's a pleasure and honor to be part of this process.

My remarks are my own. They don't necessarily reflect my clients or my partners or my firm. But I would like to acknowledge I've been in a number of seminars on this past couple months on the guidelines revision process. Cornerstone had one, CRA had one, LECG just had one; and I've benefited a lot from being part of that. Most of all I'd be remiss if I didn't acknowledge how much I benefited from the transformative experience of working with Jim Rill, Bobby Willig, Donna Shore over at DOJ, Jim Langenfeld, John Peterman at the FTC and many others during the formation and drafting of the guidelines. It was really a unique professional experience, and one that I've gotten a great deal out of and definitely influences how I come out at this program today.

My own views on unilateral effects are driven by what I see is really a central tenet in guidelines drafting, and that's that the guidelines ought to be about asking the right questions.

That sounds a little bit trite to say in a setting like this. You can say, well, what are the right questions. Well, the right questions I think revolve around identifying the conditions that are necessary to establish that a merger is likely to have adverse competitive effects. They're categorizable under Section 7. That's what we ought to be focused on. Those are the right questions. And that necessarily implies a fairly high level of generality.

Roxane referred to this in her remarks, that merger guidelines are unlike some of the other federal enforcement guidelines, they don't go into a lot of examples, a lot of discussion of evidence. That was by design, and I think it actually was the right way to go. Because by sticking with the right questions approach and staying away from evidence, not entirely away from evidence, but largely we stayed away from evidence, created a document that had a great deal of credibility with people.

It's lasted far longer than any of us expected. No one would have predicted that the guidelines would have been around for seventeen years before encountering substantial revision. And I think it's because the guidelines achieved a level of credibility by focusing on the right questions, not getting into the nitty-gritty of the evidence.

The commentary is a far better document for that; and I certainly subscribe to the notion that we should have a regular updating of the commentary to go into more of those issues.

What's happened with the guidelines because of the approach they've taken, they've gotten widespread adoption. Not just by practitioners within the agencies and outside the agencies, but also by the courts and globally. I mean, it has become the template for merger analysis around the world, and it's because of the approach that we took. It had a fairly high level of generality and, therefore, was able to be applied in a wide variety of complex.

So we've got a durable document that I think has been largely successful. I certainly won't say it's perfect. As wedded as I am to what we did, I'd have to agree that it is time to change, and particularly in the area of unilateral effects that we're talking about here.

When we introduced the unilateral effects section to the guidelines in '92, it was definitely the single biggest innovation in the document. There had never been a unilateral effects section. There was a leading firm proviso in the '84 guidelines, but people really didn't talk about unilateral effects. So this was a big change at the time.

We're now all quite familiar with it; but when we rolled it out, it was pretty unfamiliar. It's turned out to be the most influential change, I think. If you look at government complaints, this is not a rigorous analysis. But having eyeballed a lot of them, they are largely dependent on the unilateral effects theories in this case. There are very few cases that are based entirely on coordinated effects theories, and I would suggest that the coordinated theory is usually subsidiary to the unilateral theory these days.

But ironically, despite being the most influence change, unilateral section is probably the least understood. And I think it's on just about everybody's short list of things that need to be revised.

So what went wrong? Where did we fall off the rails here and what can we learn from the history as we embark on a process of considering revisions to these guidelines?

At a high level, I see two things that went wrong. One, in some respects we adopted too high a level of generality. And in other respects, we got away from the central tenet of asking the right questions.

On the point of generality, we had a basic notion of unilateral effects that I think was well-articulated in the guidelines. By unilateral we meant, you know, without concurrence of rivals, without the need for coordination. It's a different mode of competitive analysis. I think it is different than coordinated, and Dennis Carlton and I have had this discussion a few times and I guess we'll have it again.

We stress in the guidelines that unilateral effects can arise in a number of different settings. We spent a fair amount of time on a couple of those settings in the document. We spent a lot of time on the setting in which firms are distinguished by differences among their products, and that's the bulk of the unilateral effects section. We spent less amount of time on the setting where firms are distinguished by their capacities. That's what most people call the homogenous products section of the guidelines. It's really not the homogenous product section. It's all about the source of distinction between the firms. And then we buried in the footnote this notion that firms might also be distinguished by their abilities to serve different customers or different groups of customers.

We threw in notions of auction markets and bidding markets. That's where we kind of fell off the rails, I think. There was not enough texture to those different settings and we didn't lay out the necessary conditions for establishing a problematic transaction in those settings. In part because I don't think the state of the economic learning was that good at the time, we weren't really in a position to do that with a lot of confidence. We didn't want to get ahead of the economics, and that's certainly something I would urge in this process, is we not get too far ahead of the economics.

We probably could have done a better job even with the state of economics at the time. So that's one source of our problem here. And we tried to put too much, I think, on the template of differentiated product site.

In terms of the right questions, we did fall off the rails on that one. We threw in a presumption in the middle of the unilateral effects section. The reason we did that was twofold. First, there were significant concerns about unilateral effects leading to a bunch of small effects cases, that resources would be wasted chasing small effects cases. So we started out by trying to put in a safe harbor to avoid that problem. We ended up with a presumption, sort of ended up with a camel, I think, because of the committee process.

Others were concerned the government would never be able to prove a unilateral effects case. I think, you know, we've seen the government can certainly prove a unilateral effects case. So the presumption that we ended up with practically defies application. The conditions that have to be met to apply it are so cumbersome as to be almost impossible in differentiated products.

So those two things, I think, have created a lot of confusion in unilateral; but they also point in the direction of things that can be done to fix the problem.

I think if the drafters can break out these different settings in more detail and set out the necessary conditions for establishing a problematic transaction, that will go a long way to solving the first problem. That's talking in more detail about auction markets, distinguishing between open and closed auctions, talking about the individualized negotiation setting, talking about locational- type spatial models that the government uses quite often.

If we can do that, I think people will understand the connection between what's in the guidelines now and the modes of analysis or the modes of competitive interaction that were not well treated there.

The other thing you have to do is go back to asking the right questions, and two corollaries to that. One is I would not put tools into the guidelines. I would not put in UPP or GUPP or GUPPI or any of these other tools. These are useful things to do. They inform us in certain settings about the right questions, but they're just tools. I would explore them in the commentary, but I wouldn't put them in the guidelines.

I would certainly drop the presumption that's in the unilateral effects section right now. In fact, I would drop all the presumptions. Others have made that point as well. When you think about Baker Hughes and presumptions, as Molly was getting into earlier, it's about burdens shifting in terms of coming forward with evidence.

Guidelines ought to be burden-neutral. They actually profess to be burden-neutral, but I think this is one area where they're not. The presumption has to go.

In its place the agencies are going to have to deal directly with the issue of substantiality. That's the elephant in the room, I think, and it's the hardest one to deal with. Nobody wants to say that we're willing to tolerate certain adverse effects that hurt certain people. But I think that is the thing that you're going to have to wrestle with the most.

I'm just about out of time here. I guess I will leave it at that. If the drafters can pull off that much, I think they may end up with a document that's going to outlive its predecessor.

MS. BOAST: Paul, do you mean substantiality throughout the entire merger analysis, or did you mean to be specifically referencing the concern that led to the safe harbor, and that is, you know, tiny effects cases?

MR. DENIS: I think it's a broader term than just the tiny, little unilateral effects cases. It was most pronounced there because we were making a change, but it comes up in other contexts as well.

If you have a statute that says there has to be a substantial lessening of competition, we never spent much time talking about the substantial part. We talked a lot about the lessening of competition part and how to make that operational. But we routinely duck the substantial one because that's a hard question.

MS. BOAST: Because I think it also says in a relevant market; and therefore, we spend all our time trying to figure that out before we figure out whether it's substantial.

MR. DENIS: Markets are one way of ensuring that we get substantiality. If you force yourself to define a market, you have a dimension over which to measure this effect. You're more likely to get something that's substantial as opposed to saying I can just identify this effect through whatever technique I happen to have because I've got very good economists.

MS. BOAST: Well, that was very helpful, the historical part of it. I'm dying to know, but save it for a private conversation, what the actual enforcement experience with unilateral effects theories was at the time these guidelines changes came into place in 1992.

First of all, do any of the panelists want to comment on anything you've heard thus far or expand upon it?

MR. MURPHY: I would just reiterate a little bit what you just said, which is if you go straight to the unilateral effects or direct effects kind of analysis, you always do have to circle back in some sense to market definition to get that substantiality component.

It's another place where market definition shows up in the guidelines, because we sort of say implicitly within a market if some people gain and some people lose, we look at the net and see who gains, but we don't do that across markets. And market definition, therefore, has yet another place that it shows up in the analysis. I think in some sense if you take a deemphasis on market definition, you then have to have a substitute way of talking about substantiality.

MR. DENIS: Molly, if I could, one other point. I think each of the panelists, I think it's fair to say each of the panelists all day have noted the interconnection between the various elements of the guidelines analysis. And Kevin really pushed on this in his remarks about how the various pieces keep feeding back into each other.

That's a really important observation, I think, in thinking about the drafting and this issue that's on the table about how did the pieces fit together and how should the guidelines be applied.

I'm a strong booster of keeping the framework and making people work through the framework in an orderly way. I mean, I agree that you can skip steps. Those of you, and this room is full of experienced practitioners, you can skip steps, right, because you're making assumptions about the steps you're skipping and you know what you're skipping. And you know how they fit together.

That is an important point I think people are forgetting. When they say I don't need this framework, they're ignoring how dependent they've become on the framework. They've completely internalized it. People have gotten very good at applying the framework. But I think to ensure that the next generation of practitioners will do as well, I think we need to keep the framework and keep the emphasis on the working through the framework in a fairly linear way.

MS. BOAST: Although we've heard a lot about making sure we recognize these are just tools, they're all leading to the same end, the process should be flexible, I think there's also a theme that some version of a framework is a helpful way of corroborating the results.

But this is one of the reasons that the very beginning, before we even began, opened our first panel, I said now that we're about halfway through the workshop process, I'm beginning to wonder whether our modest goals were too modest.

I think Steve Calkins has his hand up.

MR. CALKINS: All right, Kevin. I had careful notes during your remarks that you specifically were saying you ought to put a lot less weight on market definition. I've got you down as saying don't do market definition very much. Then in the comment just now you emphatically came out and said it's important to do market definition. And if you could reconcile those two, and indeed you might even reference back to your wonderful product example that you were discussing with Dennis Carlton and me during the break before, and think through exactly what would you do with market definition and how would you use it.

MR. MURPHY: I guess I would say the two shouldn't get in the way of each other, I guess is what my key emphasis was.

Ultimately we have to establish how things change and how competition is affected. And to do that, you can start with kind of a market definition because that kind of identifies the players and helps you understand how competition occurs today and then gives you a lens on how it's going to change when you introduce more people or reduce the number of competitors in that case.

The other is to start with competitive effects and say, look, if I can establish competitive effects, then I've learned a lot about how I should be defining the market and then come back to market definition later.

And either one can allow you to get to either stage one or stage two, but I don't see how you could jettison entirely the market definition problem for exactly where I ended up, which is you have to in the end establish some sort of substantiality because you can't have a situation where you're going to say some people are going to be hurt and I'm going to define them to be arbitrarily quoting market and, therefore, this merger shouldn't go through.

You have to have a way of saying this is at a level which this is an antitrust concern. This is something that has a competitive effect. For example, talk about repositioning. When somebody repositions, almost always somebody's going to be worse off. And it's not just an individual. Lots of individuals could be worse off. But you can't say, well, therefore I'm going to define a market of those people and, therefore, this merger shouldn't go through because that subset of people is worse off. That can't be the right way to go. We're never going to fully escape market definition, even though in many cases it doesn't help.

The final place I want to go, though, is to remember that you don't need to define every market definition at the same threshold. You can have a case where the best market definition is a narrow one and do a whole analysis realizing it's very narrow. In another case where it's very broad, and do the whole analysis realizing it's very broad. And those are fine. Do the market definition that suits the problem, that illustrates the issues and allows you to come to the right conclusion I think is the way I think about it. In the Whole Foods case, it seemed like the right way to do it was a narrow market, realize it was a narrow market, and go from there. That's what I would say.

MS. BOAST: Mary, Roxane, do you want to comment on this thread of the conversation?

MS. COLEMAN: One point I want to make as well on the market definition point is that a lot times, I think it was said earlier in the panel, that it's a disciplining process. A lot of times when you're doing a competitive effects analysis, you're really focused a lot on the competition between the merging parties.

And of course, doing it right, you should be looking at competition with all the other players as well. Market definition sort of forces that as well so that you're not only focused on that competition between the merging parties, but it forces you to be make sure you're looking at the other competitors as well. Kevin's point, making sure if there's a potential effect that it's either likely substantial or that you're actually measuring the right competitive effect, you haven't missed that, oh, no, there's actually a lot of other people out there through repositioning or whatever means might actually make it so there's no likelihood of competitive effects.

MS. BUSEY: I would only add, I would like to agree with Paul Denis. I hadn't really thought about this, but I think he's right that in the private practice we internalize a lot of the analysis. When we talk to a client, we're asking them about all the questions that the lawyers can ask. We don't just ask about who you compete with. We talk about possible entries and efficiencies, and it all kind of comes out. It's not in any particular order. So I guess I would say that.

The other thing that I would say is the question of market definition seems to be muddied a little bit by the HHIs and the presumption. I think if you just put that aside and talk about do you really need to know who competes in this market, can you approximate a market. That's informative. The market analysis, I think, is informative to some extent.

MR. MURPHY: I agree. I agree. You've got to understand the players and how competition occurs; but to think that that definition of a market, think of it in terms of the overall elasticity of demand for that market, you're going to have cases where that market is really, really broad and the elasticity of demand might be one and another case where it might be five. And you can't have a fixed set of presumptions to apply to both of those markets because those markets are incredibly difficult.

I don't care whether it's Bertrand competition or Cournot competition or anything else. Those markets are really different, and you can't have a fixed set of standards. You want to be able to choose the one that works the best for the case you have, and the presumptions stand in the way of that, the way I see it.

MS. BOAST: Jeff?

MR. GROSS: This last point that was made about confusing the market definition for purposes of the concentration analysis and market definition that you would handle unilateral effects, competitive effects, I think is an important one.

I think what happened is that historically we had the old structure performance paradigm of Philadelphia National Bank and Von's and some of those other cases; and I'd be interested, maybe in a private conversation, from Paul's reflection as to the extent that they were fearful of getting away from that old paradigm.

We sometimes let that in the HHI analysis overshadow what is going on in terms of competitive effects because you're really, if you're calculating the elasticities with what's going to happen in terms of market power as a result of a merger in the competitive effects, you are defining a market. You have to have that as a market.

But that's really a different, it's really a different approach and we need to push that structure paradigm, which is a nice way to start, particularly for safe harbors. You know, if you can get into the HHI and say, hey, we've got a safe harbor here, and we can move on. But once you get past that safe harbor, then I think you need to set that aside and start focusing on the competitive effects.

MS. BUSEY: I'd also like to state what I think is the obvious, which is no one pays any attention to the HHI's really.

MR. GROSS: Unless you're in a safe harbor.

MS. BUSEY: Well, yeah. Even then it's an embarrassment when you have to explain them.

MS. BOAST: Well, of course, the safe harbors from a strict enforcement point of view, a strict legal point of view, there is no safe harbor. So you could have a safe harbor for purposes of an HSR review; but if it turns out in a consummated transaction that there were competitive effects, there's no safe harbor, to make the point clear.

MS. BUSEY: To state it a different way, in the healthcare guidelines they don't have exactly safe harbors; but they state that certain things will not be challenged except in extraordinary circumstances. Which, you know, when I first read it, I thought, what is that. But you realize that that's the prosecutorial discretion, that there is a safe harbor of whatever percent. But it isn't for sure. It's just -- it is a guideline. That's really all that it is. And it wouldn't hold up in court, but neither would the healthcare guidelines.

So it seems to me there's some advantage to -- on the HHI, I just think that the decision has to be made whether to keep them at all. Personally I wouldn't do that. But if you're going to keep them, adjust them, or at least make the reference to say based on case experience thus far this is where the HHI's come out.

I mean, if you want to give some deference to them, that's fine. I think you should also take into account what EU's done. They've used HHI's, but they've got different numbers. Are their numbers better? I guess they're better. Are they good enough? I don't know. That's a whole separate issue.

MS. BOAST: Touching on the international issues is, unfortunately, truly a topic for another day.

It's one of the things Rich and I and the task force know we have to think about in undertaking this review is the legacy that we've left around the world with the '92 guidelines, and how many countries as they've tried to put guidelines in place or to undertake some kind of merger analysis have effectively started with the structural presumption in some kind of market share/concentration ratio/HHI.

MR. MURPHY: I would say just in reference to the last comment, Whole Foods was a good example where the structure just didn't really help. You were left with two structures, neither of which really directly addressed the concerns that were on the table. You know, a merger to monopoly or a merger of nobody's. And at that point you should say, well, that's just not a great framework for solving this problem. Let's go on and try to analyze the problem more effectively.

You know, that's what was in the way. In other places structure might be helpful, but in that one it wasn't.

MS. BOAST: I'm going to exercise the chair's prerogative and try to switch our topics because I want to be make sure we cover this in one of these workshops. And it strikes me that we have a couple of people with views on this, as that is the relationship in the guidelines in the economic literature and in the law between unilateral effects and coordinated effects.

The guidelines effectively treat these as two separate threads of analysis. Certainly that's the way they're understood. We've heard from Dennis this morning and Kevin alluded to it, that maybe this is not right. I'm interested in people's thoughts -- about whether there is a point of convergence or if it is indeed a complete overlap, how we ought to articulate that if we were to revise this part of the guidelines, particularly in light of the courts' continued -- less so now, but still continued -- reliance upon a coordinated effects framework.

Anybody can start.

MS. COLEMAN: I'll start, I guess. I

think in some cases there are significant differences between looking at a unilateral effects case and a coordinated effects case, depending upon the nature of what you're looking at and the types of models you're looking at.

So in, say, a more homogenous products type of industry or, actually, probably better to Paul's point, capacity-type industry, there may really be a question of a dominant-firm-type model where it really is a true unilateral effects type of analysis, where the merged firm will restrict output and how the other guys may react by expanding output, but they have limits on that. But I think that sort of fits better into that type of analysis.

When you're talking about a lot of the ways that people are pricing, say, differentiated products in a Bertrand-type setting, you can call that unilateral, but then you are really trying to take into account, at least to some extent, the reactions of others. Is that unilateral or coordinated? It's a little hard to tell.

I particularly always have

difficulty figuring out in the number of bidders models where when you reduce the number of bidders by one, you reduce the sum that were bidding and so everyone will raise their bids. Is that coordination or is that unilateral? It's kind of hard to pigeonhole that in one setting. It's sort of doing things in your own interest, so usually call it unilateral, not coordinated. But it's also clearly very much taking into account the reactions of others. While I think there's some reasons to think about the distinction of looking at whether the firm on their own, no matter how the other players react, would find something profitable. In some cases I think the distinctions aren't all that helpful.

MR. MURPHY: I guess I would come down in the same area. I think in many cases they're not very helpful because while you can come up with stories. For example, take the homogeneous products. You can say, well, I've got the dominant firm. Well, that's unilateral. Well, then you can just have some simple kind of coordination-type world. And suddenly that same market looks like a very coordinated effects world.

I've got Bertrand pricing for some

guys that take other prices given. Now, I've got two gas stations across the street from each other. I take into account the fact if I cut my price, he's going to cut his price in response.

Is that coordinated? Is that unilateral? I don't know. It's a bit of both. I guess I find most cases have evidence of both. And the models we put on may be unilateral models and coordinated effects models, but I don't think that's as good a description of reality as it is of the description of the models we throw at it.

MR. DENIS: Let me try to defend the distinction or draw it in a different way that maybe will make it more clear. I take the point that both Dennis and Kevin have made that all of what we're calling collateral and unilateral derives from noncooperative oligopoly theory. No dispute about that.

Where the difference lies is whether the reactions of rivals have any impact on the merged firm or not, whether they have to take that into account. Of course, everybody always thinks about what their rivals are doing. The distinction we tried to draw between coordinated and unilateral was whether the rivals' reactions mattered.

So if you want to take the case where firms are differentiated by their capacities. Essentially what the guidelines are saying is that there's a circumstance in which rival firms can't do anything about the merged firm's restriction of output. Why? Because they don't have the capacity to do it. That's the answer. That, we're saying, is unilateral because you can look at it as the rivals' reaction can't do anything or that the merged firm doesn't have to take it into account.

It gets a little squishy, I'll admit, on firms that are differentiated by their products when you take repositioning into account. We bifurcated repositioning away from sort of the initial inquiry. The initial inquiry is strictly unilateral. We're saying we're essentially assuming that the world's not changing. And we're saying if we assume the world's not changing, can you raise your price? All right.

So by defining away reactions, we've made it unilateral. That may seem like a bit of a trick. Maybe it is. But it was a way of simplifying the problem, and then focusing on repositioning as separate stuff.

If you look at coordinated, coordinated is all about mutual accommodation amongst the firms that are part of the market. And the notion of coordinated is this price elevation can't work without that mutual accommodation.

So I don't take it as a critique to say that all these things derive from non-cooperative oligopoly theory. They do. But they reflect very different modes of competitive interaction.

Firms are competing on output. Firms are competing on price. Firms may be competing on product positioning, and some have more product space. These are different modes of interaction. I think we need to look at them differently. And if the labeling of coordinated versus unilateral is bugging people, we can certainly change the label. But I think the idea that we have to keep in mind is not all markets work the same way.

MR. MURPHY: I guess I would say the last thing you said just sounded like whether they are strategic substitutes or strategic complements in some sense, is kind of what you were saying is which way people respond.

The other thing I would say on the repositioning point, is you say, okay, I'm going to do market definition without people repositioning. But ultimately market definition has to rely on data. And if the data was generated in a world where the potential to reposition was important, that's all part of what we're going to then use to define a market.

It's, like, I don't know how to pull that out of the data and then do the market definition analysis that wasn't there. Nor do I know why because I want to put it back in later anyway. I would just keep it in there and live with it.

MR. DENIS: If anybody could pull it out of the data, he could.

MS. BOAST: Actually, Paul's explanation is quite interesting to me because if you go back, even the drug wholesalers case where Judge Sporkin kind of got confused between coordination and the unilateral analysis in some points. The case law, the judge's early introduction to merger analysis was simple. If you take one rival in a defined market out, will it make it easier to collude. That's all they were really thinking about.

Now Paul is telling us we really never meant that -- not in those terms, in the coordinated effects discussion of the guidelines. So I feel like not only do we have a convergence issue in what that whole discussion was intended to do in the guidelines, but something not responsive to the case law because of the opportunity to collude piece.

MR. LANGENFELD: Actually, my recollection is consistent with yours, Molly. This is sort of an incipiency, arguably, type of statute. We want to prevent the facilitation of collusion; and even though the original Stigler models, your professor, chair, talked about it, I think it was based on, you know, a game theory, a Cournot-type model, but did talk about the facilitating conspiracy.

And that's certainly what the coordinated effects section looks at -- the likelihood of being able to reach an agreement, the aspects of whether you could punish someone if they deviate from the agreement. That's why you count the number of competitors. Right? So that's really where it's focused now, and that was my understanding back why it was in there.

But in the accommodation the way Paul puts it is at the center of that, too. And if you look right now at where a lot of the antitrust action is, it's suing every industry that you could possibly imagine for price fixing or customer allocation.

Look at the Europeans -- look here. That's where a lot of the non-merger action is right now. So think that there is a concern, a legitimate concern, about conspiracy or coordination that is not just unilateral.

I attended a session in part of the D.C. workshop in this, and Professor Marx, interesting name, had a very good insight that I thought that we had missed in '92.

MR. DENIS: We missed something?

MR. LANGENFELD: And that's the way the guidelines are currently written, it's a set of three negatives basically. You got to get over this hump, you got to get over this hump, you got to get over this hump. Well, if you're bringing a case based on coordinated effects and all you have to do is knock down one of those three humps, well, it gives the defensive side, that gives the merging parties a lot of ammunition. There's no positive there.

And Professor Marx made the point, which I think is very valid, that the guidelines need some balance here. She's done a bunch of analysis of coordinated effects and pricing, most of which I have seen. But her key point is, look, there should be something to weigh on the other side. In other words, shouldn't we have an element of the guidelines that says what is the gain to coordination?

And if the gain to coordination is really big, and she has some models to do this, I don't think you want to get that complicated, but if the gains of the coordination are very, very big, like, say, in an industry with low marginal costs, high priced fixed costs, then shouldn't that be a positive thing to show, to say, look, they've got all of this to gain and maybe they have these impediments to being able

to coordinate. But the gain is awfully big, so
we shouldn't be surprised that they are making
attempts, at least, at coordination. And that
pulling one major competitor out of the market
may increase that.

MS. BOAST: I want to just focus people
on -- first of all, let the panelists talk
since they're our guests, but try to focus on
how we think about fixing the guidelines to
make all of this clear, just to make sure we're
all still staying on the exercise of the today.
Paul.

MR. DENIS: Coordinated, the one thing
where we can fix the guidelines is to focus
more clearly on the question that Kevin put on
table right at the beginning of his remarks,
was how does the merger affect competition as
it exists today.

So the issue shouldn't be whether
there are great gains to coordination or
whether the market is conducive to
coordination. The question is, how is this
merger changing the gain. If we believe that
there's not coordination going on today, then we
must believe that the merger somehow is going to

enable coordination to flourish post-transaction. And what is it about taking out the acquired firm that does that. Or if we think that there was coordination pre-merger and we think that this is going to stabilize it in some way, improve it in some way, make it more perfect, what is it about this transaction that's doing that.

That's something that I don't think we were as clear on as we could have been in the guidelines, in part because I think people at the time were very concerned about Jim's sort of three negative points of saying, well, if you make it very clear that a merger has to change something, that we're going to be held to that standard in court.

I think the agencies are now held to that standard in courts, and maybe people won't be afraid to admit it.

MS. BOAST: Rob, if you have a thirty-second comment I'll allow that, and then I'd like to get one more question in.

MR. GERTNER: I'll try to do a thirty-second comment. I think one of the problems is that the way in which coordinated effects is handled is as if there's a sort of very specific set of models in mind.

And so the only way dynamics show up in the guidelines is really through some notion of punishment dynamics through punishments and cooperation.

But there's an enormous amount of dynamics out there in the world, things like investment and capacity, switching costs, you know, a whole variety of other things that create dynamic links, which in concentrated markets make things like accommodation matters, things like thinking about effects on competitors is essential to the way anyone would participate.

You don't need punishments; and there's sort of no natural place in the guidelines to think about the way in which the analysis of those kinds of mergers would occur.

They don't fit into the definition of unilateral effects. They don't fit the analysis as typically done in unilateral effects. But the coordinated effect language isn't what's going on in those markets necessarily either. And I think that really needs to be addressed.

MS. BOAST: This is obviously a topic where we could spend literally an entire workshop or more.

Let me ask one other question of the panelists, and we have only a couple of minutes left, so just some quick reactions.

One thing we hear routinely from the parties and quite frankly routinely from staff is these firms or these products, rather, are or are not the closest substitute.

I think Dr. Shapiro, were he here, would pound the table and say that's not really the test. I suspect every economist in this room would agree that while the closeness of substitution matters, that closest substitute or next best substitute isn't the proper test.

We are thinking about how we give guidance in this area without creating a standard in the world.

Any ideas?

MR. MURPHY: First of all, I will say that closest isn't the right test. That's the most obvious one. Whether you're the number one or number two depends on how close number one and number two are. But not only that, depends on how competition occurs in the marketplace. I think it's going to be difficult to have a firm discussion of that.

In a differentiated products world, you can be on the other side and still matter a lot. In a bidding auction market, maybe it doesn't matter that much where you are in terms of on the other side. It depends on where the fourth guy is because you're eliminating the third guy in line. Well, how close is the fourth guy to the second guy. So I don't think it's going to be easy to have a uniform standard there. I think it should be made clear that it's not always closest.

MS. BUSEY: I agree with that, although I wouldn't give up the closest. If you happen to have a closest that's merging, that's the problem. So I wouldn't abandon that altogether.

MS. BOAST: And that's helpful in explaining to clients especially.

MS. BUSEY: Helpful to explaining to clients, but seems to me it's also relevant.

MR. MURPHY: Showing you're not the closest isn't sufficient to say there's not a problem. I think that's really what we're trying to say here.

MR. DENIS: I think, Molly, if you adopt the approach that I was envisioning of breaking down your different modes of competitive interaction, laying them out in more detail in the competitive effects section, what you will find is that for some of them a standard is closest and for others it's not. And I think that would be informative to people. It's not uniformly the answer that you have to be closest. I agree with that.

But I can envision situations, Kevin alluded to bidding models, some bidding models where that is the test, and I would say you have to be the closest. Particularly if you go down the road of these kind of single customer product points.

MS. BOAST: Mary, do you want to comment at all?

MS. COLEMAN: What I would say, you know, that most economists would agree clarifying that issue would actually be very helpful because you see it a lot, they're not the closest substitutes that we're buying. And you try to explain to people why that's not necessarily the case, depending on the markets and everything. So having some clarification of that would be very helpful to giving guidance to practitioners, to business; and actually, you know, stepping back, we often talk about practitioners.

Giving guidance to staff is actually important. You get a lot of new staff in all the time, so actually having some guidance about what they should be looking for and not always be asking their colleagues, but having something they can look at to help them understand how they should be approaching cases is also really very important.

MS. BOAST: Well, we are officially out of time. It's been really my privilege to share this session with an incredibly illustrious panel, to whom I hope we will all give our thanks.

(Applause.)

MS. BOAST: We reconvene at 3:00 o'clock for efficiencies.

(Brief recess.)

PANEL 4: EFFICIENCIES

MR. FEINSTEIN: I guess I should disclose, actually, this is sort of an exquisite irony, on a panel that's supposed to address efficiencies, one of our panel members is trapped on an Amtrak train that is stuck somewhere between Detroit and Chicago. That's Dan Crane, who is a professor at the University of Michigan, so he will not be joining us. He's a victim of inefficiency.

MR. CALKINS: We're not even standing by to see if he walks in?

MR. FEINSTEIN: He sent me a note telling me ten minutes ago that he was still struck on the train. If he walks in, we'll be happy to see him, but I'm not counting on it.

So there will be four of us instead of five; and if nothing else, that may allow us some additional time for dialogue amongst the panelists and questions from the audience.

Let me introduce the panelists who are here. By the way, Dan Crane did submit, along with Joe Simon, some very thoughtful comments, and I think he will be submitting in writing some of what he was going to be presenting today, so they will still become part of the record.

Our first speaker today to my immediate left is Mike Baye, who is the Burt Elwert Professor of Business at the University, Kelley School of Business, and also served as the Director of the Bureau of Economics at the FTC during 2007 and 2008. He is a well-regarded expert on the issues that we'll be addressing today and a very thoughtful commentator.

After Mike, we will have John Treece, who is a very experienced trial lawyer at Sidley & Austin here in Chicago with a variety of experience on a lot of cutting-edge antitrust issues, both as a trial lawyer and also as a counselor.

Following John we'll hear from Professor Sam Thomson, who is currently at Penn State where he is the Arthur Weiss Distinguished Faculty Scholar and director of Penn State Center for the Study of Mergers and Acquisitions. He's also been a professor of law at UCLA, Director of UCLA Law Center for Study of Mergers and Acquisitions, and at one time was the head of the tax department at Schiff, Hardin & Waite here in Chicago in addition to a number of other positions. We're very pleased to have him with us.

And our final speaker is Stephen Calkins, who is currently the Associate Vice President for Academic Personnel and a professor of Law at Wayne State University. His teaching focuses extensively on antitrust and trade regulation. And Steve also served in the mid-'90s as the general counsel of the FTC during the time that Bob Pitofsky was the Chairman. He is a much sought-after speaker on antitrust issues of all stripes.

So with that, let's get started and I'll turn it over to Mike Baye.

MR. BAYE: Thank you, Rich. It's a real pleasure to be here, and I'm grateful to have an opportunity to help with your discussions. I agree with much of what was said this morning.

Certainly economics is a dynamic science. Things have changed since the guidelines and the revisions which dealt explicitly with efficiencies were put in place. I'm happy to contribute to that dialogue and wish you the best as you sort through the process of trying to deal with that.

Since this panel is on efficiencies and since I think I'm the sole economist on the panel, I thought it might be useful just to begin with just a discussion of what efficiencies are in the first place. I think we can all define things to mean whatever we want them to mean, but clearly there's a difference between the way economists view efficiencies and the way many attorneys, and, in fact, the law views efficiencies.

I think if you poll a hundred economists, a hundred an economists will say the appropriate measure of efficiencies would center on total welfare. When you look at the law, the law really deals with the issue of consumer welfare and the competitive effects on consumers.

I think it's useful just to kind of keep in mind what the economic arguments are for the total welfare standard as opposed to the computer welfare standard. This is not because I'm of the opinion that somehow in revising the guidelines that standard is going to be changed; but because I think it helps kind of cast a way for one to think about presumptions and burdens as one is thinking about some of the impacts of mergers that might not be counted formally in the courts as they're contemplating the impact of efficiencies on consumers, rather than the overall economy.

The reason economists favor total welfare over consumer welfare is that in the long run it's total welfare that's going to affect the health of the economy, total welfare being defined as the sum of consumer surplus and producer surplus. And, obviously, in the long run if the U.S. economy doesn't economize on the use of all resources, we're going to be producing goods and services at a cost that's more expensive relative to what we could be producing those goods and services for. I think that's especially important in an area where the buzzword certainly in business schools and around the globe is the term sustainability, okay.

So if you think of a merger, for example, a hypothetical merger that was going to save lots and lots of resources, say less money spent on electricity, for example. If those savings were in the form of fixed cost savings and, therefore, not passed on to consumers, should they count?

From an economist's viewpoint, to the extent they improve the overall efficiency of the allocation and resources, they might be relevant for considering to offset price increases. However, if you look at the law, maybe those efficiencies wouldn't be included. And indeed, a lot of the issues that we've dealt with earlier today and this morning really stem from issues that center around differences between total welfare and consumer welfare. For example, when Kevin Murphy talked about defining a market sufficiently small that some consumers are harmed from repositioning, that's because that just seems like a silly notion of welfare to focus on that one small group of consumers.

Lots of the issues that really center around the discussions for debate I would argue center around this dichotomy that we have between a focus on total welfare and consumer welfare.

Why might we care about total welfare over consumer welfare? Well, ultimately to the extent that one thinks that those savings on energy that accrued to a firm that contemplates a merger in this hypothetical that I proposed, if you imagine that those gains, those savings are going to accrue to shareholders, those shareholders are themselves ultimately consumers and one might argue should be counted in that.

But I'd make a broader point, to the extent that those savings accrue in the profits of firms, those profits are taxed at the corporate level and then again at the shareholder level so that well over half of those efficiency gains are going to be tax revenues to the federal government that could then use those revenues to redistribute incomes among disadvantaged parties.

I guess the big point I'd like to make is that total welfare is certainly an important issue to take into account as one is evaluating antitrust policy.

I'm no fool. I recognize the law focuses on a consumer welfare standard. But it's important to keep those things in mind as one is trying to calibrate the competitive effects of a merger. It's useful to keep in the back of your mind that there may be social benefits that are accruing to the economy as a whole that aren't being manifested or accounted for in the analysis of the merger.

That said, let's talk a little bit about the nature of efficiencies. If you take a close look at the guidelines, it's pretty clear that the nature of efficiencies that are contemplated in the guidelines are things like production costs, transportation costs and the like. The obvious question that arises then is whether one wants to make a distinction between efficiencies that save fixed costs versus efficiencies that save marginal costs.

The traditional story from an economic viewpoint is if you're focusing on total economic welfare, certainly reductions in fixed costs count. But if one is looking at a measure of consumer welfare, using traditional models, it's kind of hard to understand how reductions in fixed costs might ultimately impact consumer welfare.

If you look at the way the economy has evolved over the course of the past decade-and-a-half, there have been tremendous changes in the nature of the economy that blurs the impact of fixed costs and marginal costs on the overall efficiency of the market.

I would argue in addition to production costs and transportation costs, there are a number of synergies that might arise through merger that are quite difficult to quantify, but nonetheless, I would argue, should be counted as efficiencies in any event.

Just to give you a couple of examples, one can imagine a merger that might hike the informational advantages and the IT capabilities of firms in a manner that allows them to procure cheaper inputs. Whether or not those cheaper inputs, ultimately are passed on to consumers in terms of lower prices, they represent savings. The point is that many of the costs to achieve those savings might accrue through forms of various fixed costs. It's very difficult to associate those particular fixed costs and those synergies with the actual reductions that might occur in the procurement of input prices.

Another example would be in the area of coordination of R & D efforts. It might well be that a synergy that arises as a result of a merger might allow firms to more effectively engage in research and development. Again, that's not something that's going to be directly related to marginal costs. It might be related to fixed cost efforts of the firms and, therefore, difficult to actually account for in formal efficiencies analysis the way it's traditionally done.

Another example is in the online area, the impact of reputation and service quality, for example. One can imagine where one firm has a comparative advantage in production or distribution. Another firm has a comparative advantage in advertising or reputation. And it may well be the merger of those two firms creates value in the form of better information transmitted to consumers and ultimately better service quality. Again, those types of efficiencies are things that are not typically accounted for if you're using the standard fixed cost versus marginal cost analysis based on income statements, yet, these efficiencies stemming from those synergies can be very, very important.

I have a number of other examples that I'll talk about if we have time later; but the key point of all this that I'd like to make is that I think looking at the current state of the economy, it's very difficult for individuals to actually link underlying merger activity or the prospects of a merger, the impact of that on the ultimate synergies that will be realized from the merger. It's very difficult to quantify.

The typical story is that the parties have better information about the efficiencies that would stem from a merger than the government and, therefore, it makes sense to have the burden of demonstrating those efficiencies on the parties rather than the government. While I am somewhat sympathetic to the fact that firms often have better information than does the government about traditional types of efficiencies, like unit costs and production and so forth, I think in terms of the ability to actually quantify many of the synergies that arise through mergers, particularly in the new digital age, I think it's very difficult for firms to formally quantify the benefit of those synergies.

The big picture that I'd like to leave with you as you are contemplating revising the merger guidelines, I'd like to see a little bit more discussion about the nature of the efficiencies, recognizing that efficiencies don't only manifest themselves in shifting production from a high-cost firm to a low-cost firm, but can also manifest themselves in various synergies really on the demand side that improve the quality of the product that consumers receive, as well as the nature of services that they receive. Those things are incredibly hard to quantify; and it would be very useful, I believe, for the guidelines to provide some guidance about how parties might realistically attempt to make those efficiency gains cognizable.

MR. FEINSTEIN: Thank you, Mike. I should mention before John begins, there's a handout so people have the ability to take a look while John is offering his remarks.

MR. TREECE: Thanks, Rich. Yeah, I think you'll find it helpful. It's very, very, very simple, but I'm going to be referring to them.

I want to start by thanking the Department of Justice and FTC, specifically Molly Boast and Rich Feinstein for arranging this workshop and inviting me to participate. It's an honor. I also want to thank Henry Butler of the Searle Center for hosting. This is the second conference in as many months I've attended here recently. I received an excellent research paper from the Center on Consumer Litigation. And Henry's done a terrific job in a very short period of time to establish the Center as a place where important work is done well, and all of us Chicagoans look forward to seeing the Center assume an ever-important role in our community.

Efficiencies and mergers analysis. Well, some of my defense bar colleagues might say the empirical evidence would suggest that if we're talking about the role of efficiencies, this must be the last panel of the day. So here we are.

I think I have a very common perspective on the overall enterprise. I agree that it is time to revise the guidelines; but like many people, I think it should be done with a relatively light touch.

The guidelines have served us well by providing broad principles that have permitted our understandings evolve, to the point, in fact, where it's now appropriate to capture the evolution in a revised set. But I also believe that the revision process should be limited and have very well-defined objectives.

The most important objective in my view, is to reflect the reality of how the Agencies do their work. That is important not only because the guidelines should provide the bar and their clients with an ability to predict the government's treatment of the transactions, but also because they are relied upon by the courts to identify the right questions they should be trying to answer.

In that respect, I'd echo what Paul Denis said, the point is the guidelines should highlight the questions, not the answers. That means the guidelines should not be so detailed as to lay down prescriptive rules that try to answer all possible questions in all possible factual circumstances.

Although a couple of the comments that I've read seem to rehash significant arguments that perhaps have been lost at the agency level, I think there's relatively widespread agreement that the guidelines should not be too detailed.

But the other side of the no-prescriptive-rules coin is that the guidelines should not, without very good reason, foreclose or appear to foreclose particular types of analyses that in a way could hinder further evolution of our thinking. Just as the agencies should not insert new rules into the guidelines that are overly prescriptive, they should also consider deleting overly descriptive language that's currently in the guidelines.

If we look at the efficiency section, let's begin by acknowledging, I think it's fair to say, that the general perception among defense lawyers is that the agencies are too skeptical, perhaps too dismissive of efficiency claims. I think that perception is probably overblown. After all, I assume that the agency attorneys and staff ask themselves the same initial question that we ask our clients, why do you want this deal. The answer almost always evokes a host of consumer benefits. I agree with Roxane Busey that we ask our clients a whole set, a panoply of questions, but almost always we start with that. Certainly, efficiencies asserted with the transaction are acknowledged in consideration of the competitive effects. The two concepts are completely intertwined.

But there's nonetheless a view that the agencies are too slow to acknowledge the efficiencies that are usually the very core reasons for the deal. That reluctance has been reflected in the existing guidelines.

On the one hand, for the existing guidelines there seems to be an almost universal agreement that the core notion of cognizable efficiencies asks exactly the right questions. Are the asserted efficiencies merger-specific? Are they verifiable? And by the way, that does not say quantifiable, but verifiable. And do they arise from anticompetitive output restrictions?

But then the existing guidelines seem to me to proceed to undercut that simplicity by suggesting that efficiencies, and I'll quote here, "relating to research development, procurement, management, or capital costs are less likely to be verifiable, merger-specific or substantial, or may not be cognizable for other," and I will point out, "completely unexplained reasons." This passage in the guidelines, in my view, is more fiat than logic and should be deleted. In any specific case, obviously one must determine whether R & D, procurement, management and capital cost efficiencies are cognizable. But there's no reason to pre-judge that issue.

Footnote 36 of the guidelines, in my view, suffers the same problem. It seems to cabin the consideration of certain cognizable efficiencies without adequate reason. Footnote 36, which is on page 1 of the handout, describes when efficiencies created by a merger in one market might be considered to justify it, despite some anticompetitive effects in another market. I'll just read part of it. "The agency normally assesses competition in each relevant market affected by the merger independently and normally will challenge the market if it is likely to have anticompetitive effects in any relevant market. In some cases, however, the Agency, in its prosecutorial discretion, will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect," et cetera.

Now, I want to discuss Footnote 36 for three reasons. First, if one purpose of revising the guidelines is to clarify them, the question of cross-market efficiencies deserves some attention because it's not immediately obvious what it means. For one market to be inextricably linked with another, to me the term has a mysteriously talismanic ring to it, which suggests that the exercise of prosecutorial discretion may prove to be more arbitrary and less transparent than we would like.

Second, the inextricably linked language seems to establish a threshold question designed principally to foreclose consideration of legitimate efficiencies. That is, the footnote acknowledges that a merger may create substantial and legitimate efficiencies in markets other than the market under consideration, but nonetheless suggests that for largely unexplained reasons they won't be seriously considered.

Third, my experience is that when antitrust rules don't accurately reflect how businesses actually strategize about their competitive responses, and more often than not we need to rethink our rules and our language rather than condemn the strategy. In this regard, I think antitrust lawyers and economists sometimes tend to think narrowly in terms of relevant markets, I think that was Kevin's point, but businesses certainly don't. When they formulate competitive responses, they look at all the tools they have, including their entire arsenal of products, business methods, distribution channels and R & D.

The footnote fails to acknowledge this reality by continuing to limit the consideration of efficiencies within single relevant markets that more often than not because of the unilateral effects analysis have been narrowly defined by the agencies.

An easy example, of course, is the economies of scope that often create cross-market efficiencies. The joint production of multiple products, the manufacture of distinct products in a single facility can reduce the cost of producing products other than the product that is in the relevant market under scrutiny. In fact, depending on the relative size of the markets or sales volumes of the products, it may be the case that most of the efficiencies accrue to products that fall outside the market that's under consideration. Furthermore, there are efficiencies which seem in many cases to satisfy easily the guidelines test for cognizable efficiencies.

A second example is research in basic science or common research and development that may support multiple products, product lines that are properly deemed to be in separate markets. Spreading the fixed cost of that research across multiple products, some of which are acquired in the merger, may not only lower the cost for all products, it may very well incentivize R & D investment that might not otherwise occur. So while there may be a debate about how to allocate those savings across the product lines, they don't seem to inherently fail the cognizable efficiency test.

Finally, joint sales and promotions, of course, of multiple products have the same effect. Significant savings are realized when a sales force is able to present multiple products as they knock on doors. And the same comment about cognizable efficiencies applies there well. These are all legitimate and potentially significant efficiencies, but it's very hard to see why they should not be routinely recognized in merger analysis.

Now, in addition to cross-market efficiencies associated with economies of scope, I would argue that recent scholarship has suggested another form of efficiency that we had seen in conglomerate merger analysis and back in some of the doctrines about retrenchment and that concept. These are pricing efficiencies, including the effects of bundled product competition. I think it's fair to say that we've thought a lot more about bundled competition than we did even a few years ago. One of the benefits of the bad decision in LePage's has been a proliferation of scholarship on the issue. And I don't see any reason why some of that learning can't be applied in a merger context.

Now, as a disclaimer, I'm not an economist, or frankly, a mergers maven; but I draw some experience from a case we tried a couple of summers ago in which the evidence provided some useful examples. The core fact in the case, illustrated on Page 4 of the handout, was a significant procompetitive price effect of competition between symmetrical bundles.

Very briefly Johnson & Johnson and its rival, U.S. Surgical, together sold more than 90 percent of sutures and/or 90 percent of medical devices called endo-mechanical products or endos. Beginning in the 1990's, both companies marketed their sutures and endos to hospitals through group purchasing organizations in bundles. In J & J's case, the hospital got the lowest price if it purchased both 90 percent of its sutures and 80 percent of its endos from J & J. Our expert, who was Kevin, showed that as a result of this bundled competition, prices for sutures remained flat for eight years, and this is shown on the page of the handout, and prices of endos declined about 20 percent.

So for fun I've illustrated on the next three pages one way, and there are several, one way in which we explained to the jury why bundle-to-bundle competition is so powerful.

If you look at page 5, we first ask, well, who's going to win a suture contract in a single-product line competition. And the answer is that while you can't confidently predict a winner, J & J certainly seems to have the edge. The next page we ask, okay, who's going to win the endo contract in a single-product line competition for endos. U.S. Surgical has the edge. Finally, we asked the jury who's going to win the combined suture/endo contract. Well, in addition to increasing the financial risk of losing the entire contract, by creating the bundle, the advantages that one company has over the other are diminished.

The companys' product offerings become more homogeneous, uncertainty increases, bidding becomes more competitive, and prices decline.

My point is that the price-lowering effects of this bundle-to-bundle competition were all totally predictable. Even commentators like Barry Nalebuff, who tend to find bundling anticompetitive, are extremely clear that the procompetitive effects of bundle-to-bundle competition are obvious. Professor Hovenkamp is commenting that bundle pricing, even by a monopolist, should be, per se, legal if any firm in the industry could offer a competing bundle of the same or nearly the same products, even if none are currently doing so.

In our case we had testimony on how customers reacted when U.S. surgical had expanded its sutures business through an acquisition that laid the groundwork for this bundle-to-bundle transaction. That transaction can be roughly characterized in the next two pages. The next page shows the pre-merger shares, and you'll see U.S. Surgical starts out with 10 and it has an acquisition of another suture company, and of course, the next page shows post-merger structure. One of our witnesses had worked in the purchasing department at a hospital buying group. He testified that when they heard that U.S. Surgical had bought another suture company, they flooded out of their offices and they danced in the halls. Not because U.S. Surgical's expanded business would constrain J & J's suture prices, but instead because the hospitals could continue to buy U.S. Surgical's endos to satisfy its doctors demands, and yet constrain its endo price increases by threatening not to buy U.S. Surgical's sutures, a business that it had just invested in heavily.

So in short what the agencies might see as a suspect 3-to-2 merger of the sutures market clearly empowered the hospitals to pit two more relatively symmetrical bundles against each other, countering each company's strength.

Now, I submit that if a hospital purchasing department knows enough to dance in the halls to celebrate this glorious development, the agency should be keen on noting the effects of this merger, the suture merger to the endo market, even when the suture market might be asserted to the be the relevant market for the analysis.

I tell this story not to suggest that any revised guidelines should frame rules about how to consider price lowering effects in one market that are occasioned by a merging in the second. I think that would be a serious mistake. Rather, the story illustrates the fact that our thinking about markets evolve, and here, our thinking about how bundling works and continues to involve.

Any revised merger guidelines should not foreclose, or even appear to foreclose, consideration of all effects of a transaction.

I would suggest deleting the last paragraphs of the efficiency section of the guidelines and in Footnote 36 before the mention of the inextricably linked markets.

I'd like to make one final comment, this about process. I would encourage that the agencies make any draft of revised guidelines available for public comment, which I understand was not the process that was followed in the '92 or '97 revisions. This request actually came to me from a client, and I thought about it and agreed with it.

I think, first, the draft would naturally elicit more focused comments. And second, I am concerned that antitrust practice is increasingly seen as an inside-the-Beltway practice; and for that reason, I certainly appreciate the agencies holding this workshop here in the Midwest. I think exposing a draft revision to public comment would help ameliorate that perception.

MR. FEINSTEIN: Thank you, John.

MR. Thomson: Rich, I want to thank you for inviting me to participate today. This is a particularly enjoyable time for me to be here because I started my academic career here at Northwestern Law School back in January of 1973. So it's great to return to this great law school.

What I'm going to do I have seven slides that I want to go through. Let me simply outline for you first the position I'm going to be taking here. In a 1968 article that many of you are familiar with in the American Economic Review, Professor Williamson, who won the Nobel prize in economics this year, and who is now at Cal-Berkeley, provided a theoretical justification for the efficiencies defense.

As we know, the DOJ/FTC merger guidelines and court cases take a cautious approach in dealing with efficiencies. Former FTC Chairman Muris and others have argued that efficiencies should in many cases trump the anticompetitive effect. That is, with significant efficiencies, the authorities should be less concerned about the anticompetitive effect.

Now, on the basis of the analysis in my paper entitled "A Critique of Williamson's Case for an Efficiencies Defense The Rectangles Are Rarely Larger than the Triangles." I argue for a continuation of the cautious approach that is currently in the regulations. Now, I do not address other objections to an efficiency defense, such as Posner's view that all the costs are not reflected in Williamson's approach. So I'm focusing simply on the theoretical justification.

Let's start with the traditional presentation of the Williamson justification. This is a graph based on his 1968 article in the American Economic Review, his 1997 article in the Penn Law Review, and the presentation of this issue in the ABA's third edition of its antitrust book, the 6th chapter dealing with efficiencies.

So this graph, which started in '68, has life today as reflected in this ABA treatise, which was written a year or so ago.

Now, let's make sure everybody understands this graph. I'm sure many of you are completely familiar with it; but there may be someone uninitiated in the audience, and let me just take a minute and tell you what the graph is telling us.

This graph is showing a market that moves from a competitive market to an anticompetitive market -- not completely to a monopoly market, but to a market that is not competitive.

The initial price for the product in this, in this marketplace before the merger takes place is at P1, which is AC1, average cost 1, which is a surrogate for marginal cost. And we see that quantity is Q1, so that the quantity under competition is Q1, the price under competition is P1, and then the firms merge. And as a result of the merger, price goes up to P2 and quantity goes down to Q2.

Now, however, something else happens as a result of the merger. There is an efficiency and a reduction in cost. So cost drops from AC1 to AC2.

And Williamson's insight is that if the cost savings here, which are reflected by A2 and A1, are greater than the dead-weight loss to consumers, which is reflected in B1, then this merger increases total welfare and arguably should be permitted even though there's a huge wealth transfer from consumers to producers, and the wealth transfer is in B2.

So that's his insight. His insight is that A2 plus A1 exceeds B1 so that in many cases the efficiencies resulting from a merger will overcome or swamp the dead weight loss.

All economists agree that B1 is a detriment to society. But if there's an A2 and an A1 and an efficiency associated with the merger and that efficiency overpowers the dead-weight loss, then under a total welfare approach, which is what Mike just talked about, arguably this merger would be permissible, even though consumers are harmed because consumer welfare is reduced by B2.

Now, notice a couple things about this graph. One, it has a concave demand curve. Not a linear demand curve, but a concave demand curve.

Now what I have done here is taken this basic Williamson graph, and made the demand curve linear. And I asked the question what happens to the triangle and what happens to the rectangle.

I also assume that as a result of the merger there is monopoly pricing, so I draw a marginal revenue curve. And the marginal revenue curve is the second slanted curve. It's the red curve in the middle. It's a marginal revenue curve.

I made the demand curve in the Williamson analysis linear, and I've added a marginal revenue curve. I needed a marginal revenue curve in order to determine the actual monopoly quantity and monopoly price.

Okay. Now, how do I determine a monopoly quantity and monopoly price? I determine it by the intersection of the marginal revenue curve and the average cost curve. So we see then that initially as a result of the merger when we move from competition to monopoly, the price jumps from P1 not to P2, but to Pm. So it jumps quite high. Huge, a huge jump.

But we also have efficiencies, the same efficiencies we had in the first graph. The efficiencies here are represented by the yellow rectangle.

The efficiencies cause the quantity to go up from Qm to Qme, that is quantity with monopoly but efficiencies, and the price to drop from Pm to Pme, that is price under monopoly with efficiencies.

So some you might say that some of the benefit of the efficiencies is being passed on to consumers in the form of a lower price, a price that is lower than the monopoly price would be if there were no efficiencies.

Then I asked the question, well, what happens to the triangle, the dead-weight loss. That's the red area in this graph. And how does it compare to the efficiencies gains, the yellow area. And in this case the triangle exceeds the rectangle. Even though in this particular situation, even though in the Williamson presentation of the efficiency gains, the efficiencies are about 18 to 19 percent of costs. So there are cost savings of about 18 or to

19 cost savings. But even with 18 to 19 percent cost savings, the rectangle is not larger than the triangle.

So this causes me to say, hey, Williamson's got it wrong, when he says it is evident that relatively modest cost reductions are usually sufficient to offset relatively large price increases.

This graph leads me to believe that that statement is not accurate in many cases, which leads me to believe that, apart from any other reason for being against an efficiency defense, there may not be a solid justification for an efficiencies defense.

And that leads me to my policy descriptions. In any merger giving rise to a significant increase in market power, the size of the efficiency rectangle is not likely to be substantially larger than the consumer and (producer welfare triangles) and in many cases may be smaller.

Now, notice I have "and producer welfare triangles" in parens. Why do I have that? Because the Williamson analysis uses a flat marginal cost curve.

In most industries the marginal cost curve is upward sloping. If you have an upward sloping marginal cost curve, in addition to having a welfare loss from consumers or associated with consumers, you will also have a welfare loss associated with producer surplus.

So there's another element of potential loss in welfare not reflected in the Williamson analysis. Thus, I say that the U.S. antitrust authorities should not consider liberalizing the approaches to efficiencies taken in the guidelines. The guidelines have an implicit requirement that the efficiencies must overpower the anticompetitive effect and keep the post-merger price from rising. The EU guidelines even provide that in certain cases the parties will have to establish that the efficiencies will be passed on to consumers.

At a minimum, I believe the efficiencies should have to keep the post-merger price from increasing; and if there's any doubt that the guidelines adopt this standard, the doubt should be eliminated by clarifying the amendments.

This standard is most likely to be

satisfied when anticompetitive effects of a merger are small and efficiencies are substantial.

Now, as a way of conserving resources for both agency officials and parties, I suggest that the guidelines be amended to provide that the antitrust officials will consider efficiencies only in those cases where on the basis of factors other than efficiencies, the officials determine that a decision to oppose the transaction or require a divestiture or a remedy is a close one. In other words, if on the basis of looking at market concentration and other factors the issue is a close one, you know, we may be prohibiting a merger that's not anticompetitive, then consider efficiencies.

But if it's not close on the basis of those other factors, I think the agencies should not consider efficiencies. If the decision is not close, the officials would not consider efficiencies and the parties would not have to go through the expense of preparing white papers supporting efficiency claims.

Only if officials decided that the

decision was otherwise close would the parties be permitted to submit arguments regarding the efficiencies to be realized in the transaction; and in such cases, in evaluating the overall transaction, the officials would take into account any efficiency claims that satisfied the merger-specific verification, cognizable and sufficiency requirements of the current guidelines.

Thus, the submission of efficiency analyses would be permitted when the officials decided on the basis of an analysis of other factors that there was a significant concern that a challenge to the transaction or a requirement to divest may lead to type one error, that is, a finding that the merger is anticompetitive when it is not.

Finally, given the findings with regard to the possibility that even a significant marginal cost efficiency may not swamp the welfare triangle, it would be appropriate for officials to consider only variable costs savings.

Now, in this connection, a 2009 FTC study of efficiencies found that both the

Bureau of Competition and the Bureau of Economics are as likely to accept fixed cost savings as variable cost savings at about the same rate. Variable cost savings impact price, but fixed cost savings generally do not, at lease in the short run. Unless the parties can establish that fixed cost savings will be reflected in price in the reasonable future, they should be rejected.

Thank you very much.

MR. FEINSTEIN: Thank you, Sam. I'm sure we'll have a lively discussion about what we just heard, and that will probably begin with what we're about to hear from Steve Calkins.

MR. CALKINS: Thank you. A pleasure to be here. All the same thanks as everybody else. Henry Butler throws a great party and a lovely event, and so we appreciate that. Hopefully we'll get invited back regularly.

It has been a privilege to be here listening to so many really distinguished people, people who have played important roles in leading cases, and especially the people who played leading roles in the writing of the big guideline revisions. I want to make very clear that I had no role in that process. I had a role only in that I was the general counsel of the FTC back when the efficiencies section was revised. So I did live through that.

I want to assure you that it would have been bad public policy to share all of those drafts with the public for many reasons. We can go into that later.

I emerged from that process with mixed feelings about the efficiency section as revised. It's not elegant and you can take potshots at it. Indeed, I for a long time reveled in taking pot-shots at it. For instance, I have an antitrust case book out there, but at the time I did not and I was using somebody else's case book. And they reprinted the guidelines, including the efficiencies section, without the footnotes. And of course, it's in the footnotes that you get a little bit of the tension with what's in the text. You can see that the Federal Trade Commission is made up of lawyers and economists. Sometimes they get more their way in the text, sometimes more in the footnotes. And if you read the efficiencies section without the footnotes, you're really missing much of what's going on.

So I made fun of the editor of that case book and gave my students the real efficiencies language and went through, and there's some tensions here and I've made fun of them in my classrooms many times.

I now had to think about these in connection with this presentation. And I went back and I looked at them; and I have come to the conclusion that the efficiencies section of the guidelines is, I think it is fair to say, a work of pure genius. It really strikes precisely the right note. It gets it about as perfectly as can be done. My advice to be to leave it entirely alone; do not touch a single word.

Efficiencies is a subject about which there's some ambiguity, there's some tension, there's some uncertainties. You want to proceed a little differently in this case than you might in that case, and you can do all of that with the words as written. So I urge you to leave them alone.

Now, you think I'm making fun of this, but I'm not. For instance, there have been learned people, the Antiturst Modernization Commission Report being the most prominently known. We heard it in previous sessions today who said, by God, the guidelines are terrible because they say look at marginal cost, do not look at total cost.

But of course, they don't say that. What do they say? If you happen to have copies of them, you could pull them out. They never say look only at marginal cost, ignore fixed cost. We were too clever for that. What do they say? They say, "The Agency will not challenge of merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market." Is not likely to be anticompetitive. That's the test. Not anticompetitive.

Does that say you have to look only at price effects and you ignore quality? No. It says not likely to be anticompetitive. Does it say you have to look only at marginal cost and not total cost? No. It says not likely to be anticompetitive.

But then you say, keep reading, so I do. "...the agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market."

And I would like to remind the lawyers and inform the economists that there's a difference between i.e. and e.g. I.e., had we used i.e., it would have meant reverse the merger's potential to harm consumers, in orders, by preventing price increases. But we didn't say i.e.; we said e.g. And e.g. means for instance. So one way you can show that efficiencies should prevail is by saying that they prevent price increases. But that's only one way.

Nothing in here requires someone to come along and look only at marginal cost or look only at price increases. This is an invitation to be thoughtful.

And in case there's any question about that, you then go down to the footnotes. And in the footnotes, Footnote 37, a beautiful footnote, talks specifically about how, yes, "the result of this analysis over the short term will determine the Agency's enforcement decision in most cases," but, "the Agency also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market."

What could be more clear? Sometimes the agencies will look at effects, not only prices. Delayed benefits from efficiencies will be given less weight, and they probably should be. In short, the efficiency section gets the tension and the balance precisely right and ought to be left alone.

People talk about pass-on and, when that can be shown, that is a virtue if you're a defense lawyer. But it's not absolutely necessary under the guidelines as written.

Some people have complained that, and indeed our missing colleague in his written remarks did complain that the guidelines are tougher on efficiencies than on competitive effects, if you will.

And I frankly don't go as far as Sam Thomson does; but in general, I think that it makes sense to have a little bit more skepticism about efficiencies than about competitive effects.

Bob Pitofsky wrote an article shortly before I went to the FTC in which he came out squarely in favor of having a broader efficiencies defense while at the same time having a much more aggressive approach in terms of competitive effects. I'm simplifying this, but basically he said, you know, be worried about more mergers but then look seriously at efficiencies. And of course, it's all a tradeoff.

If you're going to look at mergers to monopoly, then there ought to be pretty darn huge efficiencies that are going to overcome that, indeed, that level of nervousness was sufficiently great that there's that sentence stuck in the middle of the guidelines saying that efficiencies almost never justify a merger to monopoly or near monopoly because of nervousness about that. So if that's the kind of mergers you're challenging, well, then you ought to be pretty skeptical about efficiencies.

On the other hand, if we get back in the world of challenging mergers going from seven to six, or six to five, or something like that, well, then it's more important to let more mergers off the hook, if you will, because of efficiencies. There's a tradeoff.

But in the world in which we are living today with the kind of standards that are actually applied by the agencies, efficiencies aren't going to make a difference except in mergers that raise all sorts of questions that you ought to be thinking about. And I think that it is appropriate then to proceed with a certain level the skepticism.

Anybody who has practiced law or worked with business persons has run across the phenomenon of business leaders deciding to make a transaction for reasons having nothing to do with efficiencies and everything to do with something else. You can list your different things they might have something to do with. They hire a consulting firm and suggest to the consulting firm that it would be good for the consulting firm to come up with a thick, glossy document that shows this is a very pro-efficiency, wonderful merger. And consulting firms are masters at coming up with those sorts of studies.

In that kind of world, when we know that business leaders are not always motivated by reasons of efficiency, if we're looking at mergers from 3 to 2, and 2 to 1, and such, I think that it's appropriate to proceed cautiously when it comes to efficiencies. But that's all these say, is just be a little bit cautious.

So where are we? That's sort of my bottom line. Why then is there all of this concern? Why all the upset?

I had a conversation with a leading economist in the last week who said, by God, the problem is not the guidelines, the problem is with how they are being enforced. Why, I went in to Carl Shapiro just very recently and I said look at all these cost savings; and Carl said to me, are they marginal cost or are they fixed cost. And I said, Carl, give me a break.

There are two possible take-aways from that. One is that the people who are upset about the efficiency guidelines are driven by individual experiences. We all take the two experiences we've had and generalize. The other possibility is that, in fact, there are times when the agencies mindlessly say I'm going to totally ignore fixed costs no matter what.

I don't think the latter is true. As was just referenced earlier, I think Sam did, there was an article that came out of the FTC the only this year that showed that fixed costs are given serious considerations.

We know that fixed costs played a part at least in the published comments about a number of mergers, Jensen, XM Sirius, a number of others; so it appears to me that the agencies take fixed costs into account, and so I don't think there's the problem that some people think out there.

If you really insist on doing something to this part of the guidelines, even though it is about the most perfect part of the guidelines, you could, without doing harm, trying to be practical in my advice, do a little search for the word marginal. And you could simply delete the word marginal without actually causing great harm. So that you can see that there's an example in a coordinated interaction context, marginal cost reductions made coordination less likely or effective. You could probably delete the word marginal and not cause a lot of time. And if you were to remove one or two or three of the word marginals, you probably wouldn't really change much of anything. I mean, it really is true that, you know, marginal or fixed depends on the time horizon that we're talking about. So I think you could, if you had to do something, you could remove a marginal or two and not do any great harm.

If you insisted on doing more serious surgery, you could delete some of the last paragraph without causing a lot of harm. When that was written, there was no commentary.

That sort of stuff is now in the commentary, and so you can say we don't need that kind of practical example kind of thing because it's in the commentary.

If you have to do something, those are the two things to do; but I really don't think that you need to do something because I don't think that the criticisms are well- founded in how the guidelines are written and how they at least ought to be applied.

MR. FEINSTEIN: Thank you.

What I'd like to do first before I

pose any questions is give each of the panelists an opportunity to react to what they've heard from any of the other panelists. And why don't we do it in the order in which they spoke, so we'll start with Mike.

MR. BAYE: Thanks. There's a lot to, a lot to respond to, I guess.

Let me just first say that I agree with some of what I heard. In particular, John mentioned that there's an important difference between verifiable versus quantifiable.

I guess part of my concern stems from the fact that in many merger analyses, we're actually able to do a fairly good job of quantifying price effects. Increasingly over the past decade-and-a-half we've had econometric tools and the data and so forth to do so. Staples/Office Depot is always kind of held up as a poster child. But those types of analyses are readily available now and guide analysis.

My concern is that within an agency, one might expect the same level of rigor when it comes to evaluating efficiency claims.

I guess the point I would like to emphasize is that efficiency claims are extremely difficult to quantify. If the government had the burden to prove that there were not efficiencies, there's no data to prove that. Okay. And conversely. So the burden matters there a lot. I can see that oftentimes parties are in a better position to muster the argument, and I think it's incentive-compatible for parties to have to do that.

So I think in that sense we're agreeable. I think where there's some disagreement is between the asymmetry with which economists view efficiencies and the way attorneys typically have your efficiencies. I think attorneys generically think of efficiencies in terms of things like reductions in marginal costs, reductions in fixed costs, economy of scope, economy of scale. In my experience, oftentimes when economists are talking about efficiencies, they're talking about things other than the traditional cost-based efficiencies. Things that improve product quality or network effects and things like that, which are equally hard to quantify if you're imagining what a merger might look like.

And I think there is some

evidence. Two of my colleagues mentioned this study by Malcolm Coate and by Andrew Heimert, both in the Federal Trade Commission. Malcolm is an economist. He's in the Bureau of Economics. Andrew is an attorney in BC. So I think it's an interesting study. They looked at memos that were written by the Bureau of Economics and the Bureau of Competition in the recent past. And it is true that -- I think this is very, very important. I think the agency does a very good job of evaluating efficiencies claims. The memos clearly demonstrate that both economists and attorneys are giving serious considerations to efficiency claims.

One thing that strikes me as interesting from that study is it turns out, and there are many ways you can slice this, but it turns out that BC memos, Bureau of Competition memos, generally accept efficiency claims about 8 percent of the time, whereas the economics memos accept efficiency claims about 27 percent of the time.

There's a huge asymmetry between the way economists interpret the term what is a "cognizable" efficiency. Should we just let parties blow smoke and say efficiency, and therefore, get mergers approved; but I think even within agencies, it's very helpful to have a better understanding of what does it mean for something to be verifiable. How strong does that evidence have to be.

The commentary has some nice examples. One of the best examples I've seen in a number of years is in the commentary regarding the eBay/PayPal merger where the DOJ ultimately concluded, I believe, that the price effects were very fairly small in the overlapping payment systems because, of course, there's Visa and MasterCard and other constraints that might limit the ability to raise prices. But they also recognized that there were potential efficiencies as a result of the PayPal/eBay merger. Efficiencies in terms of convenience of transactions on the part of consumers and reductions in fraud, which are presumably valuable to consumers.

My point is, what would have happened in that merger had it not been demonstrable that there was something to limit the price increases, that there wasn't Visa and

Master Card lurking in the background. My guess is that the benefits, the reductions in fraud and the increased convenience on consumers would not have been quantifiable and, therefore, interpreted by some not to be verifiable. And therefore, the merger might have been blocked.

I'm not making any statement on whether the Justice Department made the right or wrong decision, but somehow one has to be able to balance off those potential benefits of cost.

MR. FEINSTEIN: Just before we get to the others, Steve, when you were using the example of merger to monopoly, or a three to two on the one hand versus a seven to six, or a six-to-five on the other hand, it seems to me just sort of intuitively that one of the reasons that the agencies may traditionally be more comfortable relying on the efficiency arguments in the less concentrated markets, I'll say, is because I think it's easier to assume that because of the competition that will remain, the benefits of those efficiencies will likely be passed through to consumers. Is that a fair statement?

In other words, if in the six to five

situation, wouldn't the merged party that is capturing some efficiencies have a greater need to make sure that its prices reflect the benefits of those efficiencies?

MR. CALKINS: I think it really depends. You could be in a situation where the price isn't really controlled by those folks. For example, it's a pricing situation that is controlled by other people in the industry, and so it's not really going to be passed on.

MR. FEINSTEIN: But wouldn't you expect if there are five or six remaining competitors that you're more likely to have a competitive price at the end of the day.

MR. CALKINS: I guess in general I am sympathetic to the idea that if we really are saving a lot of money, that ought to count for something.

And so in that sense, I'm with Mike in saying that if I really am believing that we're having substantial savings, that's a good thing. And my guess is that it's going to end up, to some extent, being passed on.

It's not going to be a usual situation where no cost savings would be passed on at all. That would be an unusual kind of market. And so to that extent, I don't personally think that one has to think only about passing on savings in terms of money to consumers.

It's a little bit more that my guess is that in the six to five there's a sort of unstated, unfashionable sort of deep-seated belief that rivalry is a good thing, it matters, and that the spur to competition from having a couple of people out there is a good thing and that bad things may well happen if you simply get too concentrated.

I mean, I'm from Detroit. And I've said this before, but it really is true. When there was a Big Three and that's all there was as a practical matter and they were bargaining with the same union and facing the same kind of costs and not feeling serious, vigorous pressure and rivalry the way that, say, the firms in Japan were feeling in competing with each other, you had the classic kind of, you know, quality slipped and costs went up and contracts were entered into that just made no sense in the long run, and feather bedding went in, and poor management went in. And having three firms was not enough of a spur to competition. And you know, it was only once that model was broken that the whole thing blew up; but frankly the city of Detroit and the state of Michigan have been paying a long, long, steep price for having gone through a period of very relaxed competition.

So I'm guessing the six to five is less about the precise assurance that this will be passed on right away and more about saying that, gosh, if we're saving some resources and we still got five firms left, we don't have to worry so much.

MR. FEINSTEIN: That may well be correct, and I guess the other way of thinking about it is even if it isn't obviously passed on, there's less concern about a price effect in a six to five market because of the remaining competition.

MR. CALKINS: Well, the price effect or quality effect.

MR. FEINSTEIN: John, do you have anything you want to say?

MR. TREECE: First of all, Steve, I

suggested we circulate a draft, not all your drafts, back and forth. That was my suggestion, and I stand by it because I do think if we had a draft for public comment we'd get a little more focused responses, and I think would be helpful.

Really, based on what you said. I don't think you and I are terribly far apart because I just meant to be fairly complimentary on the guidelines efficiencies.

I was really focusing on those few instances, being the last paragraph of 36, and my view that that deviated from the general tenor of the drafting of that section. Generally it was open-ended and said, yes, we're not saying it should be only variable costs, we're not making this prescriptive rules. But I did think that in the last paragraph, and again, as I've said in my remarks, Footnote 36 crossed the line.

Now, having said we don't disagree very much, let me disagree. My clients aren't the scoundrels that you make them out to be. You know, my experience, at least recently, has been when people come in with a merger, often the justification is some kind of technology synergy, that they're looking for some type of intellectual property, but not in the sense I want this patent, but rather, an expertise. This gets to what Mike said. The problem is it's not quantifiable, and I acknowledge that the long run for business people is not the long run for economists.

What they're doing is they're betting their business, their careers, or whatever, and hoping that in the next five to seven years, if I go through with this merger I'm going to pick up some technology, some know-how, some expertise, and I don't really know that it's going to work out. I'm hoping it works out. I'm making a bet. You can't quantify it, but certainly it's real and it drives the transaction.

And the problem is that it is speculative, so does that mean we ignore it? I don't think so because you are at the same time rebutting a speculative anticompetitive effect oftentimes.

In that respect, I mean, Sam, I acknowledge your graph, but it assumes that the conclusion of the merger is a pure monopoly. A lot of times we don't know what the anticompetitive effect is of the merger. We're speculating, often I'm just speculating that no one else is going to change, that we're facing a static market. And yet, we've had lots of discussion today about repositioning and other competitive responses to that merger. So nothing is going to stay the same. And you are speculating about the anti-competitive effect.

There's a real tension, I think, among practitioners, or sense among the defense bar that, wait a second, your anticompetitive effect that you're speculating about is being honored while my pro-competitive justification or efficiency, which we admit has some speculation to it, is not being honored.

I will say also that -- I do a lot work in pharmaceuticals, and that's an area where I'm a little mystified with what the agencies do. At one time I thought where they were heading was that if a product was in a phase three clinical trials, okay, that's not speculative, we'll consider that and look at the effects of the merger. Now you look at the cases and they reach back farther and farther into the pipeline. I also do some patent litigation, I have some pharmaceutical patent litigations, I have spoken to people who do medical development; and you know, there's one kind of research and development where, say, with certain types of software, you know here's what I have, I want to get here. There's some uncertainty, but by and large, you may get there. When you're talking about developing a drug, there is no way to balance the concept that the possibility that, okay, if I eliminate or I merge two research efforts, do I reduce a chance of discovery. Or alternatively, am I putting minds together that in fact increase the chance of innovation. The fact is we don't know, and nobody knows.

So I am a little mystified sometimes by the willingness to reach back into the pipeline to find a need to divest certain research development efforts. And I think it's entirely speculative and, really, not with justification. I'll stop.

MR. FEINSTEIN: Sam?

MR. Thomson: I just have three points to make. Steve mentioned that -- by the way, I would associate myself with Steve's comments. Maybe there's one thing that he said that I disagree with, and that is searching for the word marginal and deleting it, I would keep marginal in there.

MR. CALKINS: That was only if they insist on making a change. I recommend no change as my opening position.

MR. Thomson: Efficiencies were one of the factors that the DOJ considered in the XM Sirius deal. I was listening to one of the business shows about three weeks ago. And the Chairman of Sirius was on talking about their very good third-quarter report. And he said, well, you know, one of the things is, if somebody wants to be in satellite radio, they can only deal with us. What he was saying is that we have pricing power. You know, I think it was a huge mistake for the DOJ to have credited those efficiencies in that particular transaction.

Also, as I point out that in the Williamson analysis, it is only a small price increase that would be swamped by efficiencies in general. We're talking about predictions about what's going to happen on the price side. If the merger goes through, the parties have every incentive if they got any market power to raise the price as high as possible. So we may be predicting a low price effect when in fact there is a high price effect, which, again, makes me skeptical of accepting an efficiencies defense.

Finally, one of the things I've sort of taken a look at is bank mergers. I noticed in bank mergers, every one that I've looked at, the DOJ and the Federal Reserve Board, the Federal Reserve Board has an antitrust screen for bank mergers, mergers involved with bank holding companies. Every one of those uses a concentration standard for determining whether there's going to be an approval. It's an HHI with a post-merger HHI of 2,000 with a delta of 200. If any of those banking markets have a higher post-merger HHI than 2,000 or a higher delta than 200, there's an automatic divestiture in those markets. So it's a pure Philadelphia National Bank approach in the bank area. There's no discussion of efficiencies; and indeed, in the commentary, the DOJ and the FTC commentary, you go through, there's a beautiful discussion of the efficiencies and the various cases in which efficiencies they've been applied.

There's no discussion of applying

efficiencies in bank merger cases. So bank mergers, to my knowledge, are an illustration of where the authorities are taking a Philadelphia National Bank basic concentration analysis; and it seems to me that that is appropriate in other markets as well.

That is, forget about efficiencies, except in those rare cases where the agencies themselves are afraid that they may be making a mistake and prohibiting a merger that's not likely to be anticompetitive.

MR. FEINSTEIN: Steve, did you want to --

MR. CALKINS: I've jumped in. We've only got ten minutes. I'll let you move on.

MR. FEINSTEIN: This isn't so much a guidelines question, but it sort of illustrates a practical challenge that I think the agencies face on a fairly regular basis with respect to efficiencies. So maybe it implicates the guidelines.

In the interest of full disclosure, this actually wasn't on the list of questions that I circulated to you guys. But I think it's a fair question anyway. One of the things we've been talking about is what's quantifiable; what's verifiable and what's speculative; and what's credible at the end of the day because ultimately we're trying to make as well-informed a prediction as we can.

Steve, you alluded to the situation where parties come in with studies at varying points in the process, and sometimes there are studies that can demonstrate -- and sometimes there are contemporaneous documents that can demonstrate -- that efficiencies really were driving the deal from the very beginning, or one of the things that was driving the deal.

Sometimes that happens later in the process and it can be characterized as sort of a little bit of a post hoc effort. Doesn't mean it may not be correct, but it's also not uncommon for there to be situations where you have a respectable efficiencies presentation, and you also have business documents from senior people in these companies which express a different view.

They're not saying there are no efficiencies. They're saying this is going to help us because we're taking out a competitor, or words to that effect.

MR. THOMSON: Whole Foods.

MR. FEINSTEIN: Well, for example. I'd be interested in hearing your thoughts about that: that could be viewed as uninformed, it could be viewed as speculative, it could be viewed as something that isn't necessarily credible. But it sort of gets right to the ultimate trade-off where there's some risk of reduced competition. But there are also some potential for efficiency gains.

I mean, does it make a difference if we have that situation where, in fact, there is some unvarnished intent evidence in terms of how the agency should view efficiency claims?

What do you think?

MR. CALKINS: The intent evidence tells you that the people whose words you're reading, to the extent you're interpreting them correctly, believe that the merger will result in less vigorous competition, higher prices or less direct rivalry from this firm, or something whereby they're viewing it as their lives will be better because this important competitor is gone.

In general, business people know a great deal about their business. They're not always right; but you know, that's pretty good evidence of what's going to happen. It's not proof, but it's pretty good evidence.

So it tells you, it gets you along the road of saying there may be a serious competitive problem here. On the other hand, it's possible as a matter of theory that a merger that is motivated by take out this important competitor might also be one that is going to yield some very, very substantial efficiencies and cost savings.

So at least in theory, even if you prove the lessening of competition on the one hand, that doesn't mean that there cannot be a very great savings in terms of efficiency.

The fact that they're going the route that they're going for reasons that are anticompetitive makes one less likely to believe the efficiency story; but you still have to take a look at it. And even though that may not have been how they stumbled across the idea, it might still be correct. You still have to take a serious look at it, I think.

MR. FEINSTEIN: Others reactions?

MR. TREECE: I agree with Steve that intent evidence isn't really about intent, it's about an understanding of how the market works.

But I think that in the example you gave, the question is how, how does competition actually work. In the example I gave of my bundling case, obviously we had a plaintiff. The plaintiff was a small company that made one of type of endo-mechanical product. This was a defense that we did not have the guts to raise in front of the jury; behind the scenes we called it the roadkill defense. And that is that all economists said, yeah, the pro-competitive benefits of the bundle-to-bundle competition the between U.S. Surgical and J & J were enormous. Was there some foreclosure of a small competitor? Of course. Was that small competitor so fringe that the pro-competitive benefits of allowing to say, well, you can't bundle because we want the small guy to be able to thrive? Every economist who looked at this issue said, no, obviously the pro-competitive benefits of the bundle-to-bundle competition outweighed the anticompetitive effects of whatever the foreclosure effect was.

That goes to the question which I think Paul mentioned earlier, and that's substantiality. You have to measure substantiality within some market.

But there is a tradeoff, and I would not be surprised at all to see the case that you've described where, you know, the merger has both components.

In addition to substantiality, I think you have the difficult question, well, what happens, going back to my theme about cross-markets, what happens when you have an anticompetitive effect in one market and pro-competitive effect in the other.

The example I gave from this case was easy in the sense that you have the same consumer. That's not always the case, of course; and I think it's a very uncomfortable position for the agencies to think about favoring one group of consumers over another in the context of a merger.

I don't have an answer, but I certainly recognize the problem.

MR. FEINSTEIN: Sam?

MR. Thomson: I don't have anything else.

MR. FEINSTEIN: Mike?

MR. BAYE: I would agree. I think documents are useful pieces of information; but as far as intent, I mean, if you look at the academic literature on the value of mergers, for example, McKenzie's study suggests that over half of mergers lose value for the acquiring firm's shareholders. Okay.

The finance literature, there's a recent paper in the Journal of Financial Studies which shows that in fact about 58 percent of mergers are overvalued, and of those 58 percent that are overvalued, shareholders lose about 14 percent of the value of their company.

You ask yourself, well, what is this? These are people, you know, excited about the prospects of either foreclosing a competitor or the synergies that are going to arise in the market. People get that wrong. So I think it's useful. It can point you to a direction whether or not this is right. But certainly -- and even in a case like Whole Foods, the documents alone may point you in a direction.

But without additional evidence, I think that the documents are not particularly --

MR. Thomson: Can I ask Mike a question on a point you just made?

MR. BAYE: Sure.

MR. Thomson: You indicated that this study showed that, and I assume that you were talking about the acquiring company's shareholders lose in 58 percent of the transactions. But the target company shareholders win virtually in all.

MR. BAYE: Well, that's because -- again, the reason is because people are paying more than something's worth for the assets.

MR. Thomson: They're paying more than the trading value of the stock. But there still could be -- even though the acquiring company shareholder's lose, there could still be significant efficiencies in that merger. It's just that the acquiring company has, in essence, paid the cost of those efficiencies to the target company's shareholders.

MR. BAYE: Exactly. There may be well be efficiencies to the merger; but I guess the point I'm really trying to make is if you see the document that says we think we're going to be able to raise price 20 percent post-merger, maybe 5 percent.

We're going to save a gazillion dollars in cost as a result of a merger. Ah, maybe a half a gazillion.

I'm just pointing out that you have to be cautious when you look at documents. I think especially when you look at the type of strategy, the type of MBA's that I teach, they're good salesmen.

MR. FEINSTEIN: We have a question. Go ahead, Jim.

MR. LANGENFELD: Just two quick comments. One, in terms of how you weight this stuff, a lot of times I've found that it's been particularly useful to see if the company has a track record in acquisitions, because that gives you, and perhaps it's not a natural experiment to see what type of credibility whatever they're doing now.

Secondly, just a comment from one of John's points. A lot of times when you see a merger, you're going to take the narrow approach, just look at whether the efficiencies are specific to a merger, especially if the market is narrowly defined. You can push off a lot of those efficiencies.

I think one useful question is to think, okay, if may affect several markets, as John has pointed out. Even if you're going to use are-the-customers-disadvantaged test, a lot of times you'll find that not all, but virtually all the customers that are buying product A may also be buying product B, too. Maybe 90 percent of them.

So that even though it may be separate antitrust market, we're still going to do the markets, right. Those same customers may not on net benefit because of a price increase of something else they're buying.

So I think that it's legitimate if you're going to keep the consumer test to ask, -- and you're going to keep it specific to a set of customers, you need to look at all the stuff that those customers are going to be buying from the merged firm and balance that out to whatever the best you can.

MR. Thomson: Can I ask you a question,

Rich?

MR. FEINSTEIN: Sure.

MR. Thomson: Am I correct that in bank mergers the DOJ does not generally, or it maybe never takes into account efficiency?

MR. FEINSTEIN: Well, I wish you had asked that question while Molly was here.

MR. CALKINS: The FTC doesn't do bank mergers.

MR. FEINSTEIN: We don't do banks. I think it would be ill-advised for me to answer that question definitively because I can't really answer it.

MR. Thomson: Does anyone in the audience know the answer to that question?

(No response.)

MR. FEINSTEIN: But it's a good question.

MR. Thomson: Maybe I'll send her a note and ask her.

MR. FEINSTEIN: By the way, if you could, if you have a hard copy of your handout if you could send it to me, just e-mail me, and we can make sure it gets into the record along with the transcript.

Any final thoughts in thirty seconds or so from anybody on the panel?

MR. CALKINS: I would just observe that I do think that it would be better if we developed a little better shared understanding of what counts as an efficiency.

MR. FEINSTEIN: Yeah.

MR. CALKINS: I remember -- and here I may disagree with one of my colleagues here, but I remember reading the reported opinion in the Heinz baby food where apparently there was a massive amount of litigation over whether or not access to the better recipes of one major baby food company by another baby food company was a social benefit efficiency that ought to justify a merger that was otherwise anticompetitive. And I guess I just thought, my God, if we can't expect baby food companies to make a decent product without having an anticompetitive merger, you know, we really ought to send everybody back to business school to try again. I thought that wouldn't count.

I have seen debates about whether it is a pro-competitive efficiency to let one firm buy another firm in order to use tax breaks. And I would have thought that depleting the Federal Treasury of revenue would never count as a virtue that would save what would otherwise be an anticompetitive merger. But I've seen a discussion of that.

Someday soon I'm sure that somebody will say a merger should be justified because it will let us become too big to fail and then our cost of credit will be less because there will be the implied protection of the federal government. And I hope that's rejected out of hand and as not the kind of thing that counts.

But I don't want to suggest, by saying I think the guidelines as written are perfect, I don't mean to suggest this area is perfect; and obviously, there's enough disagreement about it that it could use some more work.

MR. FEINSTEIN: Any other closing comments?

MR. CALKINS: If we're actually done, can I throw in one last caution.

MR. FEINSTEIN: Of course. Well, fine

then we're not done, but go ahead.

MR. CALKINS: I want to flat-out point out one very wrong comment made earlier today by the very distinguished Professor Gertner when he said that it's very important in writing these guidelines to remember that they are not a litigation guide.

I would just like to point out to you that any word that you issue, whether in a draft or in a final document, will be used against you with a vengeance in a courtroom. I don't care how many disclaimers you put on here about this is just to guide our internal deliberations.

You know, you are a government agency and the Department of Justice is part of the government; and if you issue guidelines, those will be used against you.

So that if, for instance, you just amend the HHI thresholds by doubling them, those will be used against you. And so you have to think about how to proceed.

If you want to get people away from the numbers, maybe go for a safe harbor thing and say, you know, the presumption against it will start here and beyond that we'll look at a bunch of factors, including where you are or something.

But if you just go forth and inflate the numbers to try to comport with reality, that's a fine thing to do in terms of guidance; but immediately that will become the minimum threshold for any case you want to bring.

So yes, one of the problems of the guidelines is they're addressing all these different audiences: government officials and business persons and academics and people around the world and judges.

But as a government officials, you can't afford to write a document that's going to prevent you from winning an important case in that last arena.

MR. FEINSTEIN: I don't disagree with any of that.

MR. TREECE: As a litigator, let me respond briefly, I agree entirely. If you think of the guidelines as jury instructions, my gosh, the incentives for the person with the burden of proof to give expansive sway to his burden and to crimp the affirmative defenses are enormous.

I think that's part of the reason the defense bar is skeptical of the treatment of efficiencies. There seems to be a reluctance to acknowledge the efficiencies in the guidelines for exactly the purpose that Steve has suggested. When you go the to court, they don't want to see that.

MR. FEINSTEIN: Well, I guess the last thing I would offer to say as evidence that mergers don't always work out quite the way people expect them to, as I was riding in here this morning I heard on the news that today is the day that AOL was moving forward on a stand-alone basis. And I suspected that the shareholders of AOL and Time Warner probably don't look back fondly on the last ten years.

Let me, let me do two things. First of all, I want to thank Henry Butler and his crew here at Northwestern for being wonderful hosts. This has really been terrific. We appreciate it.

MR. BUTLER: My pleasure.

MR. FEINSTEIN: And then secondly, I think this has been a really lively, informative way to end the day, and I want to salute the panel. So thank you very much.

(Applause.)

(Whereupon, at 4:37 p.m., the
hearing was adjourned.)

STATE OF ILLINOIS)
) SS:
COUNTY OF COOK)

JANICE M. KOCEK, being first duly sworn, on oath, says that she is a court reporter doing business in the City of Chicago; and that she reported in shorthand the proceedings of said hearing, and that the foregoing is a true and correct transcript of her shorthand notes so taken as aforesaid, and contains the proceedings given at said hearing.

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Janice M. Kocek, CSR, CLR