STATEMENT OF COMMISSIONER J. THOMAS ROSCH ON
THE RELEASE OF THE 2010 HORIZONTAL MERGER GUIDELINES

Project No. P092900

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It would be wrong not to acknowledge that this project makes at least one monumental contribution to the guidance that the Agencies are providing to the business community, practitioners, and the courts. The 1992 Guidelines treated evidence of competitive effects as relevant to merger analysis. However, those Guidelines considered market structure and shares first and considered the competitive effects of a merger only after that. That created the misimpression that proof of market structure and shares are "gating items," without which competitive effects cannot be considered. These Guidelines properly consider competitive effects first, and market definition second, thereby making clear that while market definition is important to assessing competitive effects and that the market must be defined at some point in the process, ultimately merger analysis must rest on the competitive effects of a transaction. Additionally, these Guidelines make a substantial contribution by listing at the outset a variety of empirical evidence that may illuminate those competitive effects.

At the same time, it would be wrong not to acknowledge that these Guidelines are still flawed both as a description of how the staff (at the Commission at least) conducts ex ante merger review and what the Agencies should tell courts about merger analysis. Things have changed substantially since the 1992 Guidelines were issued twenty years ago. *First*, the Commission is increasingly challenging mergers in preliminary injunction and administrative (Part 3) proceedings. *See* Federal Trade Commission, The FTC in 2010, at 2 (Apr. 2010) (identifying merger enforcement rates); Federal Trade Commission & U.S. Department of Justice, Hart-Scott-Rodino Annual Report Fiscal Year 2008, at Appendix A (identifying the number of reported transactions and second requests issued). Thus, the staff's ex ante merger reviews are and must be tethered to the evidence that it plans to present and defend in those litigation proceedings. *Second*, economic theories embedded in the 1992 Guidelines emphasized price effects almost exclusively. Increasingly, the Agencies and courts have considered non-price effects, like effects on quality, variety, and innovation, to be no less important. *Third*, for a variety of reasons, many, if not most, courts have relied on empirical evidence instead of economic evidence, and have considered economic evidence as corroborative of that empirical evidence, if they have considered it at all. *See, e.g., FTC v. Staples, Inc*., 970 F. Supp. 1066 (D.D.C. 1997); *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26 (D.D.C. 2009). As previously discussed, that in turn has led the staff reviewing mergers ex ante to devote more attention to the empirical evidence that can be presented and defended at trial.

The process used in this project virtually ensured that the Merger Guidelines resulting from it would not fully reflect these substantial changes. I had hoped that this would be an instance in which the Commission would lead, not be led by, the staff. Lamentably, that did not happen.

More specifically, the perspectives of all stakeholders were not considered equally. First, of the six architects of the project, three were economists trained and steeped in price theory. To be sure, some of the Commission attorneys responsible for reviewing mergers ex ante and/or explaining to the Commission how they planned to present and defend their challenges in court or in Part 3 were consulted in connection with the project. But the three economists initiated and largely managed this project. Second, there was indeed a series of workshops held around the country, and a number of comments were submitted respecting these Guidelines. But the participants in the workshops were mostly members of the defense bar, academics, and other kindred souls, and the comments apparently given the most serious attention by the project's architects (and incorporated in these Guidelines) largely reflected those same perspectives. Third, long before these Guidelines were finalized, representations were made to the ABA Antitrust Section about the changes in the 1992 Guidelines that were likely to occur. Indeed at least one private meeting was held with the Section's leadership regarding their desire for changes in the April 2010 draft of the Guidelines.

This process inevitably led to overemphasis on economic formulae and models based on price theory. For example, Sections 4.1.1 and 4.1.2 retain the SSNIP test, an economic test which posits that a small but significant profitable price increase over "benchmark prices" may be used to define a relevant market's structure. Section 5.3 builds on the markets defined by the SSNIP test and provides what amount to "safe harbors" for mergers that result in certain levels of market concentration.

The architects of the project included colleagues who co-authored papers and articles proposing economic models relying largely on margins (prices minus incremental costs) to determine whether a merger was likely to result in coordinated or unilateral anticompetitive effects. As a result, many of the economic theories in the revised Guidelines are based wholly or partially on margins. For example, the April 20, 2010 draft of Section of 2.2.1 treated margins as a species of empirical evidence and asserted that "if a firm sets price well above marginal cost, that normally indicates either that the firm is coordinating with its rivals or that the firm believes its customers are not highly sensitive to price." The final version adds that in the absence of coordinated behavior, the presence of high margins is "not in itself of antitrust concern." But that should fool no one: that a sinister inference is intended to be drawn from this provision is unmistakable not only because the prior version omitted any benign explanation for high margins, but because the alternative—i.e., the existence of coordinated interaction—is unambiguously pernicious. To be sure, footnotes 3 and 6 acknowledge that "high margins are not in themselves of antitrust concern" and identify several benign factors explaining why margins may be high. However, the acknowledgement is contained only in footnotes, and the benign factors noted are nowhere mentioned in the text. If there were any doubt about the inferences to be drawn from high margins, those doubts are dispelled by Section 4.1.3, which opines that "[u]nless the firms are engaging in coordinated interaction . . ., high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price."

Section 4.1.3 goes on to discuss the role of margins in a critical loss analysis, saying that "[h]igher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test." Indeed, both Section 4.1.3, blessing for the first time the use of critical loss analysis in dealing with market definition, and Section 6.1, dealing with the likelihood of unilateral effects in differentiated product mergers, incorporate the concepts, if not the exact models, that two of the architects of the project have proposed in economic papers and articles in order to determine whether such effects were likely.

In contrast to heavy reliance on prices and margins (as described above, which are based in large measure on prices), the new Guidelines say comparatively little about non-price competitive effects, such as how a transaction affects quality, service, innovation, and product variety. To be sure, the Guidelines note in the introduction that "[e]nhanced market power can also be manifested in non-price terms and conditions" and contain a new section on innovation and product variety (Section 6.4). However, this same section asserts that "[m]any reductions in variety following a merger are not anticompetitive" and that "[m]ergers can lead to the efficient consolidation of products." (This observation, it should be emphasized, applies to factors other than reductions in variety. For example, economies of scale can be an efficiency in some contexts but a barrier to entry in others.) These additions are significant improvements over the 1992 Guidelines, but their comparative brevity (and their ambivalence respecting a merger's effect on variety) leaves the misimpression that non-price factors are far less significant than price factors to the Commission.

In addition, the Guidelines fail to offer a clear framework for analyzing non-price considerations. First, Section 4 mentions that non-price considerations can be incorporated into the SSNIP test but does not explain what a "small but significant" change in quality or service is. Second, the Guidelines do not offer any details as to how to evaluate a merger's effect on product quality or service, saying only that the agencies "employ an approach analogous to that used to evaluate price competition." (Section 1.) Third, the test for analyzing the loss of product variety raises more questions than answers. For example, how are the agencies to determine whether a reduction of variety is due to "a loss of competitive incentives attributable to the merger"? (Section 6.4.) Fourth, the Guidelines do not address some of the key issues involving innovation market analysis. For example, how should enforcers resolve cases when the predicted price effects of a merger suggest one enforcement outcome but the innovation effects suggest a different outcome? What role, if any, do entry and repositioning play in the analysis? How does one determine a diversion ratio for products that have not been invented? Are innovation concerns limited to unilateral effects, as suggested by the Guidelines, or can innovation concerns result from coordinated behavior? These deficiencies are illustrative and not exhaustive.

This process cannot be justified on the ground that the Guidelines are supposed to be transparent—i.e., to reflect the way that ex ante merger review is conducted. These Guidelines do not describe the way that the Bureau of Competition and enforcement staff at the Commission proceed today. They also do not reflect the way that the courts proceed. Time and again, appellate courts have rejected "high" prices as a basis for inferring market or monopoly power. *See, e.g.*, *Blue Cross & Blue Shield United v. Marshfield Clinic*, 65 F.3d 1406, 1411-12 (7th Cir. 1995) (Posner, J.); *United States v. Eastman Kodak Co.*, 63 F.3d 95, 107-09 (2d Cir. 1995); *Harrison Aire, Inc. v. Aerostar Int'l Inc.*, 423 F.3d 374, 381 (3d Cir. 2005). The district courts have likewise eschewed reliance on economic models based on margins for a variety of reasons, including their complexity (*see Staples*, 970 F. Supp. 1066; *CCC*, 605 F. Supp. 2d 26; *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004)), because margins are dependent on exogenous factors (*see Abbott Labs. v. Teva Pharms. USA, Inc.*, 432 F. Supp. 2d 408, 428 (D.

Del. 2006)), or because the use of such economic simulation models, in the absence of substantial, verified efficiencies, will almost always predict that a transaction will have price effects (*see CCC*, 605 F. Supp. at 68-72). To the contrary, economic theories based on prices and margins are considered to be just that—theories. Although they may be considered in order to corroborate the inferences drawn from the empirical evidence, they are not substitutes for that evidence.

The antitrust defense bar and its clients do not need safe harbors. That bar (including the many who are members of the Antitrust Section) are among the best and brightest lawyers in the world. What that bar and their clients deserve is what these Guidelines promise at the outset—namely, that they will be a complete and accurate description of what our enforcement staff considers in merger investigations and that they will be a helpful guide to courts. These Guidelines are neither. Notwithstanding these flaws, however, I concur with issuance of these Guidelines. The significant advancements described at the outset warrant and deserve the Commission's support.