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UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Joseph J. Simons, Chairman**
Noah Joshua Phillips
Rohit Chopra
Rebecca Kelly Slaughter
Christine S. Wilson

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation.**	**Docket No. 9378**

RESPONDENT'S APPEAL BRIEF

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TABLE OF ABBREVIATIONS

The following abbreviations and citation forms are used in this Appeal Brief:

CCPF	CC's Proposed Findings of Fact
CCBR	CC's Post-Trial Brief
CCRBR	CC's Post-Trial Reply Brief
ID	Initial Decision
IDFOF	Findings of Fact in Initial Decision
PX	CC's Exhibit
RPF	Respondent's Proposed Findings of Fact
RBR	Respondent's Post-Trial Brief
RRBR	Respondent's Post-Trial Reply Brief
RCCPF	Respondent's Replies to CC's Proposed Findings of Fact
RX	Respondent's Exhibit

CONCISE STATEMENT OF THE CASE

I. INTRODUCTION

The Commission should set aside the ID of the Administrative Law Judge ("ALJ"). Respondent Ottobock HealthCare North America, Inc.'s ("Ottobock") acquisition of FIH Group Holdings, LLC ("Freedom") ("Acquisition") has not, and will not, harm competition in any relevant antitrust market. In ruling that Ottobock failed to rebut Complaint Counsel's ("CC") *prima facie* case, the ALJ compartmentalized and ignored substantial evidence, disregarded applicable law, and grounded his determinations primarily on the unreliable and discredited testimony of a few customers.

Uncontroverted evidence established there are no significant barriers to expansion by three major, non-merging competitors—Össur hf. ("Össur"), Chas. A Blatchford & Sons Ltd., d/b/a/ Endolite ("Endolite"), Proteor, Inc., d/b/a/ Nabtesco & Proteor USA ("Proteor")—which have the ability to fill any very small void left by Freedom. Freedom sold only about [redacted] MPKs in 2017 out of an alleged market consisting of annual sales typically exceeding [redacted] units. Pre-Acquisition, the market had rejected Freedom, it was failing, and in far worse condition than its competitors. The only knee Freedom markets as a microprocessor-controlled knee ("MPK"), Plié, was at the end of its life cycle and substantially behind competitor MPKs in quality and functionality. The notion that it was just Freedom, and its [redacted] Plies, that made the U.S. MPK market competitive and kept Ottobock, already with [redacted]-plus MPK market share, from raising prices makes no economic sense.

With the agreed-upon divestiture of the entire Freedom MPK business, there is no increase in Ottobock's market share in the MPK market or a basis for a presumption of harm. The ALJ summarily dismissed the MPK divestiture in contravention of substantial authority—including an opinion issued by this Commission earlier in this case—that courts must consider a merger together with any proposed partial divestiture in analyzing the merger's competitive effects.

II. STATEMENT OF FACTS

A. Acquisition.

Ottobock acquired Freedom on September 22, 2017 for [redacted] RPF 17. Pre-Acquisition, Ottobock and Freedom separately manufactured various lower-limb prosthetic components, including feet, ankles and knees, for sale to prosthetic clinics and distributors. RPF 1-6. Freedom primarily sells foot products, which is Ottobock's weakest product line. RPF 943-947. Ottobock's primary strategic rationale for the Acquisition was to [redacted]. RPF 941.

Ottobock has a history of success in prosthetic knees. Ottobock introduced the first "swing-and-stance" MPK, the C-Leg, to the United States in 1999. RPF 1099. Since introduction, Ottobock's C-Leg has been considered the "gold standard" MPK.[1] RPF 607, 610-611. Ottobock has continued to innovate MPKs by offering customers new versions and various tiers of MPKs including, through partnership with DOD and VA, the waterproof X3 for U.S. military personnel. RPF 181-188, 218-219, 505-507.

Ottobock also sells hydraulic and pneumatic swing-and-stance mechanical knees for high-activity patients, such as the 3R80 and 3R60. The swing-and-stance control is done manually, not with a microprocessor, yet these knees offer certain advantages over MPKs (*e.g.*, waterproofness, enhanced flexion, and lighter weight). RPF 143-148.

[1] The ID correctly found that for many years Ottobock had between 80-98% share of the MPK market; however, there is no record evidence or allegation that during these years Ottobock was able exert market power, able to raise prices, slow innovation, or thwart new entry and expansion. IDFOF 489. The same would hold true post-Acquisition.

Conversely, Freedom sells mostly feet and ankles—*not* knees. RPF 6, 945-946. For the first five years of Freedom's existence, it sold exclusively carbon fiber foot products. RPF 7. Since 2007, Freedom has only manufactured one knee, the Plié. RPF 7. Unlike all other competitive swing-and-stance MPKs available in the US, the Plié's microprocessor cannot vary the resistance throughout the gait cycle. IDFOF 264-266. Unlike all of its MPK rivals, Plié's resistance levels are pre-set by a prosthetist using a wrench and a pump. IDFOF 264-266. As a result, if an amputee using a Plié wanted to run instead of walk, she would need to take the wrench and pump to a prosthetist to change the settings, unlike all other competitive MPKs that modify resistance automatically with a microprocessor. RPF 7.

The FTC began investigating the Acquisition within a week of its closing, after receiving a complaint from Hanger, Inc. ("Hanger"). RPF 992; RCCPF 115. Hanger is a public company with more than $1 billion in annual revenue, the largest clinic organization in the United States with approximately 800 clinics, and the largest prosthetic customer for all of the major MPK suppliers, including Ottobock, [redacted] Freedom, and [redacted] RPF 50-51, 971-975.

Under common ownership, Freedom operated separately from and continued to vigorously compete against Ottobock under a dual-brand strategy consistent with the differences between Freedom's and Ottobock's products. Nonetheless, Ottobock proposed, executed, and has complied with a Hold Separate and Asset Maintenance Agreement dated December 19, 2017 ("HSA"). RPF 1111-1115. On December 20, 2017, the FTC filed its Complaint. RCCPF 176.

B. <u>MPK Divestiture</u>

[redacted]

[redacted]

[redacted]

[redacted]

C. Freedom's Failing Status

Immediately pre-Acquisition, Freedom was on the verge of liquidation. Freedom projected [redacted]

[redacted]

[redacted]

[redacted] For approximately 18 months, Freedom and its investment bank, Moelis, exhausted good faith efforts to find both potential investors and potential acquirers. RPF 1450-1451. [redacted] Freedom's pending debt payment made time of the essence. RPF 1313. Ottobock was the only serious potential buyer that was prepared to close an acquisition in time to pay Freedom's debt. RPF 1506.

III. SUMMARY OF THE ARGUMENT

The U.S. MPK market is incredibly competitive and dynamic. It is characterized by numerous viable, innovative, well-established prosthetics suppliers aggressively and continuously competing against one another for each and every clinic customer. This dynamic was as true pre-Acquisition as it is today and will be in the future. The ALJ did not consider these market dynamics. Rather, he focused myopically on a few speculative soundbites from a handful of customers regarding their opinions of several years-old products, most of which are no longer even on the market.

The ALJ's Section 7 and unilateral effects analyses are flagrant misapplications of *United States v. Baker Hughes*, 908 F.2d 981, 984 (D.C. Cir. 1990), its progeny, and the Horizontal Merger Guidelines ("Guidelines"). The ID should be overturned because:

1. Respondent rebutted CC's *prima facie* case of harm to competition by producing evidence of: (i) likely expansion by viable MPK competitors; (ii) market dynamics that foster MPK competition; (iii) bargaining power of clinics; (iv) the lack of close substitution between C-Leg and Plié; (v) the potential for procompetitive efficiencies; (vi) Freedom's imminent market exit pre-Acquisition; and (vii) the elimination of any purported harm by the MPK Divestiture.

2. The ALJ's finding of a strong presumption of anticompetitive effects in the face of a clean-sweep divestiture was plain error. There is no increase in Ottobock's share of any MPK market and no basis for any structural presumption.

3. The ALJ erred in accepting CC's alleged MPK-only relevant market in the first place. The ALJ relied on faulty economics—the Lerner Condition—and a faulty variable—diversion—that not only fail to define a clear relevant market here, but that have properly been criticized and rejected as a basis on which to draw conclusions on market definition.

4. Freedom faced immediate bankruptcy on the eve of the Acquisition. Freedom's financial problems were so serious in 2017 that its auditors explicitly raised "substantial doubt" about Freedom's ability to continue as a going concern in Freedom's 2016 audited financial statements. Nevertheless, the ALJ concluded that the failing firm defense did not apply because the auditors issued a "clean" 2016 opinion, relying on a highly discredited e-mail that was directly contradicted by sworn audited financial statements. The Acquisition saved Freedom from inevitable collapse.

5. The ALJ's proposed remedy of effectively a complete divestiture is overbroad. To the extent the Commission finds the Acquisition otherwise illegal, the remedy should be limited to the MPK Divestiture, [redacted]

6. This Part 3 proceeding is unconstitutional.

The Commission should dismiss the Complaint or order that Ottobock proceed with the MPK Divestiture to allow the transaction to benefit competition.

<u>SPECIFICATION OF THE QUESTIONS INTENDED TO BE URGED</u>

1. Did the ALJ correctly apply the *Baker Hughes* burden-shifting framework where the ALJ did not review and accept rebuttal evidence produced by Respondent that, in its totality,

demonstrated the market concentration statistics did not accurately reflect the potential competitive effect of the Acquisition, including: (a) evidence of potential expansion by Össur, Endolite, and Proteor in the U.S. MPK market; (b) evidence that the reimbursement system facilitates interbrand switching; (c) evidence of buying power of customers that fosters competition; and (d) evidence that unilateral harm is unlikely because Ottobock and Freedom's MPKs are not close substitutes.

2. Did the ALJ err by failing to consider the Acquisition together with the MPK Divestiture in determining whether there was a presumption of economic harm?

4. Did the ALJ err by adopting a definition of the product market that is internally inconsistent, insufficiently specific, and based on flawed economics?

6. Did the ALJ err in rejecting Respondent's failing firm defense?

7. Did the ALJ err by imposing an overbroad, punitive remedy where any potential anticompetitive harm would be eliminated by divestiture of only the MPK assets?

8. Did this Part 3 proceeding violate the United States Constitution's Appointments Clause and guarantees of due process and equal protection?

COMMISSION STANDARD OF REVIEW

"[T]he Commission reviews the ALJ's findings of fact and conclusions of law *de novo*, considering 'such parts of the record as are cited or as may be necessary to resolve the issues presented.' The Commission may 'exercise all powers which it could have exercised if it had made the initial decision.'" *In re ProMedica Health System, Inc.*, No. 9346, 2012 WL 1155392 (F.T.C. March 28, 2012) (quoting 16 C.F.R. § 3.54). Factual findings must be supported by a "preponderance of the evidence." *In re Chicago Bridge & Iron Co.*, No. 9300, 138 F.T.C. 1024, 1027 n.4 (F.T.C. Dec. 22, 2004) (quoting *Carter Prods., Inc. v. FTC*, 268 F.2d 461, 487 (9th Cir. 1959)).

ARGUMENT

I. THE ID FUNDAMENTALLY MISAPPLIED WELL-ESTABLISHED SECTION 7 LAW.

The ALJ essentially acknowledged that Respondent produced rebuttal evidence as required under the *Baker Hughes* burden-shifting framework, but then erroneously analyzed that evidence on a piecemeal basis, under a heightened standard and dismissed it as unpersuasive. The Supreme Court, however, demands a "totality of the circumstances" approach to Section 7, requiring the factfinder to weigh all factors together, rather than independently, to determine the likely effects of a particular transaction on competition. *Baker Hughes*, 908 F.2d at 984.

"Given the stakes, FTC's burden is not insubstantial." *FTC v. Arch Coal, Inc*., 329 F. Supp. 2d 109, 116 (D.D.C. 2004). CC has the "burden on every element of their Section 7 challenge, and a failure of proof in any respect will mean the transaction should not be enjoined." *Id.* "That the government can establish a prima facie case through evidence on only one factor, market concentration, does not negate the breadth of this analysis." *Baker Hughes*, 908 F.2d at 984.

In this case, the purpose of the 13-week trial was to allow Respondent to rebut HHI numbers, which, by themselves, cannot guarantee victory. *Id.* at 992. As then-Circuit Judge Thomas stated in *Baker Hughes*, where the government makes a strong *prima facie* showing simply by presenting market concentration statistics, "to allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under Section 7." *Id.*

The ALJ's approach to Respondent's rebuttal evidence demonstrates a fundamental misunderstanding of how rebuttal evidence must be analyzed under the second step of the *Baker Hughes* framework. The ALJ ignored or rejected substantial, credible evidence produced by

Ottobock and instead relied on extremely unreliable, outdated, discredited and speculative testimony from a few customers called by CC. This infected the entire ID.

A. <u>There Are No Barriers To Expansion.</u>

It is well-settled that likely expansion by existing competitors can counteract anticompetitive effects that would otherwise be expected. *See United States v. H&R Block*, 833 F. Supp. 2d 36, 73 (D.D.C. 2011); *Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."). To rebut the purported *prima facie* case here, Respondent carries the burden of producing evidence that ease of expansion is sufficient "to fill the competitive void that will result" if the transaction is not unwound. *H&R Block, Inc.*, 833 F. Supp. 2d at 73.

The ALJ ignored substantial evidence produced by Respondent that demonstrated that Össur, Endolite, and Proteor are collectively poised to expand in a way that is "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract" any potential anticompetitive effects resulting from the transaction. *Id.* at 74 (quoting Guidelines § 9). As explained by Respondent's expert economist, Dr. David Argue, at trial, "if Ottobock were to try and raise prices above competitive levels, it would lose enough sales to competing manufacturers that the price increase would be unprofitable. Therefore, Ottobock would never do it in the first place." Argue, Tr. 6149. The ALJ remarked that CC's questions about post-Acquisition price increases were "ridiculous" because they ignored "the possibility that there are four or five other MPKs that a clinic could buy if the Plié 3's price is increased." Argue, Tr. 6355-6357.

Respondent's evidence regarding potential future expansion by existing competitors was uncontroverted. In addition to their current sales, within one year, Össur could supply [redacted] MPKs, (DeRoy, Tr. 3692) Endolite could supply [redacted] MPKs, (RCCPF 1530) and Proteor could sell [redacted] Nabtesco Allux MPKs in the U.S. market. RCCPF 1583. That is [redacted] available

MPKs in the U.S. market that, on a timely basis, are likely to be deployed and sufficient to counteract any impact from an acquisition of a company that has never sold that many MPKs in a year and has an aging, declining product.

In analyzing the probabilities of expansion in the future, "it is critical to maintain a dynamic view of the relevant market." *FTC v. Cardinal Health*, 12 F. Supp. 2d 34, 58 (D.D.C. 1998). As Dr. Argue testified at trial, from an economic standpoint, "you need to be focusing on what's coming in the future and what potential Endolite and Nabestco have as competitors in the event of some future action occurring and that future action being an attempted price increase by Ottobock." Argue, Tr. at 6213-6214.

The ALJ's conclusions regarding the competitive significance of potential expansion missed this crucial point. Instead of looking forward, the ALJ looked backward to the state of the market several years ago when different products were being sold. His conclusions are unreliable and cannot withstand the overwhelming evidence of industry acceptance of Össur, Endolite and Proteor products, [redacted], and the likely and timely expansion in the market by Össur, Endolite, and Proteor that would be sufficient to offset any post-merger pricing or output conduct that could result from the Acquisition, with or without the MPK Divestiture.

1. **Össur**.

Össur is the clear number two prosthetics company in the world and in the United States. RCCPF 993. Össur's direct sales force, which consists of 50 sales representatives and clinical specialists, dwarfs Freedom's team of 14. DeRoy, Tr. 3568; Testerman, Tr. 1077-1078. The evidence at trial established that Ottobock's closest substitute in the MPK market is Össur. RPF 646-660. An Ottobock executive with first-hand knowledge of MPK market dynamics warned

Ottobock's sales team: "Plié is NOT the competition. Rheo Is. Plié is a fly and Rheo is a vulture." RCCPF 1494.

Össur has well-developed and well-resourced MPK innovation plans and is well-positioned to totally thwart any unilateral harm. [redacted] RCCPF 1492, 1519.

DeRoy testified that [redacted]

Certified prosthetists with first-hand knowledge of MPKs testified uniformly that improvements in the Rheo in 2014, 2016, and 2017 have established the Rheo has having a *better reputation* than the Plié 3.

- Michael Oros: The quality of Össur's Rheo MPK has improved over time, making it a closer rival to the C-Leg 4. RPF 650.
- Scott Sabolich: Rheo is the closest substitute to the Ottobock C-Leg 4, followed by Orion 3, then Plié fourth. RPF 659.
- Rob Yates: Rheo, C-Leg 4, Orion, and Plié are in the "same class" of knee; Rheo is "absolutely" a "good product"; and there have been recent improvements to the Rheo. RCCPF 1514.
- Keith Watson: He presents "all microprocessor knee solutions" to his patients, including the Rheo. RCCPF 1508.

This testimony is confirmed by other clinic employees, including Government witnesses Asar, Brandt, and Endrikat, discussed *infra*.

The ALJ inexplicably ignores all this evidence and instead finds that any expansion by Össur would not fill a competitive void because "clinicians view the Rheo 3 as functionally different from C-Leg 4 and Plié 3." ID 51. The ID inaccurately relies on the testimony of three customers for this point. Two of those witnesses (Senn and Ford) lack first-hand knowledge of the functionality, features, and benefits of MPKs. They are not prosthetists and do not fit MPKs. Senn's testimony is contradicted by his company's own records showing [redacted][3] POA only purchases 7-10 MPKs per year, and it did not purchase a Plié, Rheo, or Orion between March 2015 and the Acquisition. IDFOF 545-546. Ford testified that POA can credibly threaten to switch to other MPKs thereby constraining Ottobock's prices, even without buying other MPKs. IDFOF 545-548.

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[3] The ALJ repeatedly cites to Senn of COPC in his ID, including for facts on the functionality of prosthetic knees, and the benefits of MPKs over non-MPKs. During the hearing, the ALJ recognized that as a person who is not a prosthetist, has no medical training, and who does not interact with patients as part of his role, Senn lacks the foundation to reliably testify regarding the benefits of microprocessor knees and functionality of prosthetic components. Senn, Tr. 163. In fact, the ALJ specifically constrained the scope of his testimony to be only probative of his *observations* about prosthetic knees—not about the knees themselves. Senn, Tr. 174. Senn testified that his office is not in a clinical location, and he does not see patients on a daily basis—even in passing. He testified instead that he sees patients "monthly" but not in a clinical setting. Indeed, Senn testified on direct that he had *never observed* a person wearing an MPK go up hills or stairs. Senn, Tr. 173.

On cross, Senn admitted that he lacked knowledge regarding mechanical knees appropriate for K3 patients. When asked to compare different knees appropriate for K-3 and K-4 patients as listed on the product selection guide for his company, Senn stated that he was not as familiar with the non-MPKs. Senn, Tr. 241. Further, when pressed on the functionality of particular MPKs, Senn testified that he was "not qualified" to answer such questions. Senn, Tr. 255.

Despite this admitted lack of knowledge, the ALJ cites Senn's testimony for propositions such as:

- For a K-3 or K-4 patient, the "MPK is the best available knee that's available to those patients, so we want to provide . . . what those patients deserve and what works best." ID 20; IDFOF 368.

- It would be a disservice to the patients and poor patient care to threaten to shift to mechanical knees because MPKs are "a much better knee" and if a patient is eligible for one, that is the knee that they would prefer and deserve." ID 22; IDFOF 449.

These factual findings by the ALJ are not supported by reliable evidence and do not meet the required standard under Rule 3.51. They should not be adopted by the Commission.

The third witness cited in the ID is Tracy Ell, owner of Mid-Missouri O&P who admitted that he does not have first-hand knowledge choosing MPKs. Ell, Tr. 1777. There is no evidence in the record that Mid-Missouri clinicians would not switch to Rheo in response to a post-Acquisition price increase. In fact, Ell testified that the C-Leg, Rheo, Plié, and Orion are all in the same "class" of MPK: PX05129 (Ell, Dep. 108).

2. **Endolite.**

Endolite's U.S. headquarters is in Miamisburg, Ohio. RCCPF 911. Endolite employs 900 people worldwide, including 80 in the United States. RCCPF 913. Endolite's U.S. sales force is larger than Freedom's and consists of two regional sales managers, fifteen sales representatives and five clinical support specialists. RCCPF 913. [redacted]

In 2017 Endolite began pricing Orion 3 more aggressively to clinics in the United States. RPF 831. After a meeting with [redacted] RPF 852-853. Based on these improvements, Endolite's MPK sales have [redacted] RPF 854-856. Freedom's sales team noted that Orion 3 was "costing us business" in various clinics, including Human Technologies where Endolite was selling Orion 3 for $11,000. RPF 832. Mark Ford (POA) testified that competition from Endolite has led to innovative improvements with MPKs. RPF 833. As a result of these efforts, Endolite's MPK sales skyrocketed to [redacted] in 2017, and Endolite was on pace [redacted] at the time of trial. RCCPF 920. In 2018, Endolite was selling [redacted] MPKs per month and had idle capacity for an additional [redacted] MPKs per month. RCCPF 1530. That's sales of [redacted] MPK unit sales with idle capacity of [redacted] MPKs immediately available. RCCPF 1530.

At trial, Endolite's President, Stephen Blatchford, testified that it [redacted] RCCPF 921-922. [redacted] *Id.* [redacted] *Id.* [redacted] *Id.* Endolite's MPK growth plans are possible due to a capital infusion by investor CPBE Capital in November 2018. RCCPF1529.

All but one Ottobock MPK market competitive analysis cited by the ALJ between 2015 and 2018 includes Endolite. IDFOF 411-421. Every Freedom competitive analysis regarding the MPK market between 2015 and 2018 includes Endolite. IDFOF 422-426. Össur's competitive assessments of the MPK market also always include Endolite. IDFOF 427-428.

Nonetheless, the ALJ concluded that Endolite cannot expand in a way that is "timely, likely, and sufficient" due to historically smaller market share and reputational barriers. ID 51-53. This conclusion is unsupported by the record.

First, the ALJ ignored the evidence of Endolite's post-2016 growth, *supra*. Second, the record is undisputed that Endolite has rehabilitated its MPK reputation. The out-of-context testimony cited in the ID for this point referenced predecessor MPKs launched several years ***before*** the Orion 3. RCCPF 1536. Blatchford testified that Orion 3 has allowed Endolite to overcome its reputational barriers and that the new Orion 3 is now C-Leg 4's primary substitute. RCCPF 1536.

Competitors and customers with first-hand knowledge of MPKs confirmed that Endolite does not *currently* face significant reputational barriers to expansion. The most important customer in the MPK market, Hanger, [redacted] according to its CEO. Asar, Tr. 1448. This fact—from the CEO of the company that buys almost [redacted] of Freedom's MPKs—is dispositive of the lack of barriers to expansion. Reams of evidence confirm this point.

- DeRoy (Össur) testified that the Orion 3 has made inroads in the MPK market increasing Endolite's market share. DeRoy, Tr. 3668-3669.
- Ottobock's head of U.S. MPK marketing testified that Endolite has significantly improved Orion, and increased trials of Orion 3 have allowed Endolite to steal MPK share. RCCPF 916.
- Freedom's VP of Key Accounts testified that, starting in 2016, Endolite was pricing the Orion 3 very aggressively. RCFOF 917.
- Freedom was concerned that Endolite had started [redacted] RCCPF 917.
- Ottobock competitive assessments noted that Endolite is "[q]uietly building a following through positive experience with performance, customers are commenting on improved functionality with [Orion 3]" RCCPF 1531.
- Ottobock's competitive assessment in 2017 indicated that Orion 3's substantial growth was eroding C-Leg 4's share. RCCPF 1531
- James Patton, III (certified, practicing prosthetist, Prosthetic Solutions) testified that Endolite's sales representatives had started offering aggressive price discounts against other MPKs, and that his clinic favors the Orion 3 and C-Leg 4 because they are easier to fit on patients than Plié 3 and better for new amputees. PX05151 (Patton Dep. 38-39, 111-113, 136).
- Anthony Filippis (certified prosthetist, Wright & Filippis) testified that the Orion 3 is equivalent to C-Leg 4 and Plié 3. PX05167 (Filippis Dep. 115).
- Jeff Sprinkle (certified, practicing prosthetist, Sprinkle Prosthetics, LLC) testified that, despite prior reliability problems, if Ottobock raised the price of the C-Leg, he would switch patients to Endolite's Orion 3 or Össur's Rheo. RCCPF 1544.

- [redacted]

Indeed, despite crediting Brandt's testimony regarding MPKs generally, the ALJ did not even acknowledge that Brandt, CC's witness, testified that, if faced with a price increase on C-Leg (its most frequently purchased knee), Brandt would switch one-third of those C-Leg patients to other knees, including Orion 3. RCCPF 1507; Brandt, Tr. 3808. The ALJ also erroneously cited to the CFO of COPC and CEO of POA to support his conclusion that Endolite's MPKs face significant reputational barriers. These witnesses do not support this conclusion:

- [redacted] Senn testified that "Orion I think is becoming more interchangeable [with mainstream MPKs] as they improve that product." RCCPF 1533. At trial, Senn testified:

  > [redacted]

- Ford (POA) also has no first-hand knowledge or foundation to testify about the differences between MPKs; POA did not purchase any MPKs from Freedom, Össur, or Endolite between 2015 and the Acquisition. RCCPF 1540. Ford's speculation that Endolite has a smaller sales force and fewer clinicians than Freedom is demonstrably wrong. RCCPF 913.

3. **Proteor.**

Pre-Acquisition, Proteor was one of four distributors selling a beta version of the Nabtesco Allux, and it had only two salespeople. RCCPF 931. Proteor was considered a "fringe" player in the MPK market at that time. That positioning materially changed in 2017 and 2018.

In June 2017, Proteor launched the full-release version of the Nabtesco Allux which had previously only been available in beta. RPF 209-214. In June 2018, Proteor acquired Ability Dynamics, its highly successful RUSH Foot product line, and a team of former-Freedom salespeople that have extensive experience selling MPKs (one of whom is Freedom's former National Sales Director). Proteor's clinical director is also a former Freedom employee who was "critical" to the development of Freedom's MPKs. RCCPF 1559.

In September 2018, as the trial was underway, [redacted] RCCPF 1562. In the roughly two weeks between execution of the distribution agreement and the date Brad Mattear of Proteor testified at trial, Proteor sold [redacted] Allux MPKs (a pace of over [redacted] Allux MPK sales per year). Proteor has current capacity to sell [redacted] Alluxes a year. RCCPF 1583.

Proteor's current market significance is reflected in the fact that Hanger invited it to present the Nabtesco Allux at the Hanger Education Fair in 2018. RCCPF 1591. This is one of the preeminent industry conferences for the MPK market. RBR 74. Craig Armstrong, a certified prosthetist and above-the-knee amputee presented the Allux to the several prosthetists in the audience. RCCPF 1591.

Market participants with first-hand knowledge of MPKs confirm that Proteor's Nabtesco Allux has become a "mainstream" MPK:

- Freedom's VP of National and Key Accounts attributed the recent decline in Plié 3 sales to the "introduction of the Allux by Nabtesco," and admitted that the Allux was giving Freedom's MPK sales team "heartbreak." RCCPF 1585. He testified that Freedom had created sales strategies targeting the Allux. RCCPF 1590.

- Freedom's former CEO worried that the Allux is a "very low cost, very good [microprocessor] knee." PX05122, Smith, Dep. 31.

- Freedom's head of R&D testified that [redacted]

- Freedom's head of marketing testified at trial that "Allux was continuing to make noise in the market," that Freedom was "actively monitoring" the Allux, and that Freedom was concerned about the Allux's "functionality" and "price point." RCCPF 1585, 1590.

- Endolite's President concluded that the Allux is "quite a nice functioning knee" and is a direct competitor of the Orion 3, C-Leg 4, Rheo, and Plié 3. RCCPF 1571.
- Össur's Executive VP of R&D testified that the Allux had become a "mainstream" MPK along with the C-Leg, Rheo, Orion, and Plié. PX05124 (DeRoy, Dep. 71).
- An Ottobock executive testified that "we're getting reports back from customers that are using [Allux]" and characterized its growth as follows:

> Q. Has Nabtesco's Allux been able to make inroads in the United States market within the last year?
>
> Schneider: It has. The Allux product is very intriguing. They had used a distributor in the United States that was pretty small, but dedicated, and they have recently purchased the company Ability, which has a prosthetic foot which is called the RUSH, that has done a tremendous job marketing and has taken a lot of -- earned a lot of sales of their foot product. And now they have -- the Allux product will have a truly dedicated sales staff and aggressive marketing staff and many more feet on the street and people in the United States that will be marketing and selling the Allux product.
>
> Q. How is Ottobock addressing Proteor Nabtesco's recent acquisition of Ability Dynamics?
>
> Schneider: We're monitoring it. RCCPF 1572.

- Oros (certified, practicing prosthetist, Scheck & Siress) testified at his deposition that Allux is a "very, very interesting knee" that his clinic is "absolutely" open to trying. PX05134 (Oros, Dep. 134). At trial, Oros testified that those trials resulted in his clinic fitting patients with Allux as often as it fits the Plié and Orion 3 in 2018. RCCPF 1580.
- Sabolich (certified, practicing prosthetist, SSPR) testified that Allux's exposure has increased in 2018. RCCPF 1593.

Once again, the ALJ improperly took a backward-looking view of the competitive significance of the Nabtesco Allux, contrary to the Supreme Court's instruction in *Cardinal Health* to focus on market dynamics in the future. ID 54. The ID exaggerates unreliable, limited evidence to reach the conclusion that "many" customers have not heard of Nabtesco and that "many" would not fit a Nabtesco Allux. ID 54. The ALJ relied on isolated depositions of five clinic employees who were deposed months before Nabtesco began to trial the Allux and raise its brand awareness.

RCCPF 1559. Not surprisingly, the only trial testimony came from Senn (COPC) and Ford (POA), who have no first-hand knowledge related to the benefits and features of different MPKs. *See* page 16, *supra*.

B. <u>The Reimbursement System Facilitates Interbrand Substitution.</u>

The ALJ failed to accept rebuttal evidence produced by Respondent that demonstrated that the reimbursement system for MPKs constrains the ability of Ottobock to raise prices above competitive levels. Manufacturers of prosthetic components typically sell products to prosthetic clinics, which then fit those products on amputee patients. Patients do not purchase prosthetic devices directly from manufacturers. Prosthetic clinics employ certified prosthetists to make and fit prostheses and manage comprehensive patient care of amputees. RPF 114.

There are several different factors that affect what type and brand of prosthetic knee an amputee receives from a prosthetic clinic. IDFOF 134. Surgeons rarely include the specific brand of prosthetic knee in prescriptions for prosthetic knees, meaning, clinics are free to switch between MPKs for patients that clinically require an MPK—brand does not matter. IDFOF 141. Prosthetists are the individuals that choose the specific type and then the brand of the knee. IDFOF 143. The prosthetist is the "subject-matter expert in terms of the specific componentry" who is "driving that conversation." IDFOF 143.[4]

Insurance providers determine a patient's eligibility for an MPK, not the brand of MPK. IDFOF 151-161, 169-186. Once the provider authorizes eligibility, the prosthetist can select any brand of MPK. IDFOF 151-161, 187-211. Only active patients, meaning K-3 or K-4 amputees,

[4] ALJ found that "[t]he patient has significant input into which knee they get"; however, CC did not depose or call an MPK user to testify at trial, and successfully moved to preclude the only MPK-user Respondent planned to call. Order Granting Motion to Exclude Witness (June 27, 2018).

are eligible to receive an MPK in the United States, and witnesses with first-hand knowledge do not expect that to change for at least five to ten years. IDFOF 162-168.

Clinics are reimbursed for prosthetic devices based on "L-Codes" developed by CMS. IDFOF 115. Reimbursement rates are set by combining L-Codes based on product functionality. IDFOF 117. The L-Code definitions are not manufacturer-specific. IDFOF 120. Clinics receive the same reimbursement amount, as established for each L-Code, regardless of the manufacturer of the device provided to the patient. IDFOF 120, 320-321. The net result is that clinic customers are reimbursed virtually the same amount regardless of which mainstream MPK they pick. IDFOF 320-21. All of the mainstream MPKs recommend that their knees be reimbursed under L-Code 5856. IDFOF 442-443.

Private insurers reimburse [redacted] less than Medicare. RPF 287-289. [redacted]

Dr. Argue testified that the reimbursement system "puts a ceiling on what the manufacturers can realistically charge the clinics for the purchase of the knee." Argue, Tr. 6229. "They've said, when we are building a knee, that reimbursement is part of the strategy of how much they can put into that knee and how much they're going to be able to charge for that knee, because they have to leave enough margin for the clinics to cover their other costs, so it very much puts a restraint on the manufacturers." Argue, Tr. 6229. Clinic representatives also confirmed that the industry's third-party-payer system constrains price-raising ability—reimbursement is such a factor that clinics believe there is no risk of manufacturers raising prices. RPF 318, 964 (prosthetist and clinic owner testified that because Medicare "sets the price," that makes him "want to sort of stand up and scream 'why are we all here.'").

C. All Clinic Customers Have Demonstrated Buying Power That Fosters Expansion And Can Prevent Unilateral Harm.

"A clinic has greater bargaining leverage in negotiations with an MPK supplier if it can credibly threaten some portion of its purchases to another MPK." IDFOF 495. "During price negotiations with any MPK supplier, clinic customers will use a competitor's MPK prices to negotiate for lower prices." IDFOF 496. The evidence is undisputed that ***all*** clinic customers receive discounts from MPK suppliers based on the overall volume of MPKs they buy. IDFOF 318. This fact has a two-pronged effect. First, it incentivizes customers to use as few different MPK brands as possible to earn the biggest discount with that supplier. IDFOF 318. Second, it allows a customer to earn bigger and bigger discounts as it shifts volume to a particular MPK. IDFOF 318.

The ID recognized Hanger's buying power. ID 55. Hanger's post-acquisition plans show [redacted] RPF 991-1003. Other clinics have similar buying power via their ability to switch MPK brands easily. IDFOF 525, 531. For example, at COPC, "where 'two knees are essentially clinically the same, [and] are good for a patient and one is substantially cheaper than the other one,' it is beneficial for the clinic's business to take the cost savings." ID 43. According to Jonathan Endrikat at Empire Medical, he uses "ballpark" pricing to play the microprocessor knee manufactures off of each other during price negotiations and uses only MPK competitor pricing to negotiate extra discounts for MPKs. IDFOF 410.

D. Unilateral Harm Is Unlikely.

A merger is unlikely to have unilateral harm if the acquiring firm lacks the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms. *See H&R Block*, 833 F. Supp. 2d at 81 (D.D.C. 2011).[5] The question is not whether the merging firms are simply "direct" competitors. The central question is "[t]he extent of direct competition between the products sold by the merging parties." Guidelines § 6.1. Courts evaluate the "extent of direct competition" under the following conditions:

> (1) the products must be differentiated; (2) the products controlled by the *merging* firms must be close substitutes, *i.e.*, "a substantial number of customers of one firm would turn to the other in response to a price increase; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning must be unlikely.

FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 68 (D.D.C. 2009). If the ALJ had properly considered these conditions, he would have concluded that no unilateral harm is likely post-Acquisition.

At trial, CC attempted to prove that Ottobock and Freedom competed vigorously "head-to-head" for MPK sales. However, there is scant record of such competition in the record. ID 40-49. The ALJ did not find that Ottobock and Freedom were closest competitors and appeared to concede that they were not. ID at 43 ("it is not necessary for the merging products to be each other's closest competitor"). Instead, the ALJ found that "[t]he evidence demonstrates that,

[5] There should be no rebuttable presumption of anticompetitive effects based on market concentration in this differentiated products unilateral effects case. *See, e.g.*, *United States v. Oracle*, 331 F. Supp. 2d 1098, 1122 (N.D. Cal. 2004); *see also* Remarks of Joshua Wright, available at https://www.ftc.gov/sites/default/files/documents/public_statements/ftc%E2%80%99s-role-shaping-antitrust-doctrine-recent-successes-and-future-targets/130924globalantitrustsymposium.pdf (while "the presumption is a convenient litigation tool," it is not "supported by sound economics in unilateral effects cases").

regardless of the asserted differences between the C-Leg 4 and the Plié 3, from the perspective and experience of a significant fraction of clinic customers, both knees are *acceptable*, C-Legs and Pliés are their *top two choices*, and Freedom's presence as a competitor has enabled clinics to increase their bargaining leverage and negotiate lower prices..” ID 48-49 (emphasis added).

This is a misapplication of well-settled unilateral effects analysis. *See, e.g.*, *CCC Holdings*, 605 F. Supp. 2d at 68. The question is not whether Ottobock and Freedom competed directly or whether a supposed "significant fraction of customers" consider the C-Leg 4 and Plié 3 to be "acceptable." ID 43. The analysis required under the Guidelines and well-established legal precedent demands **much** more.

To create a likelihood of unilateral harm, Ottobock and Freedom must be close substitutes, not simply "direct" competitors or the "top two choices." Ottobock, Freedom, Össur, Endolite, and Proteor are all direct competitors and are all considered "mainstream" or "base class" MPKs. IDFOF 428; RBR 68-70. That some subset of clinics may *currently* consider C-Leg and Plié "top two choices" says nothing of their substitutability for one another in response to a *future* price increase. RPF 577-616; Argue, Tr. 6150 (concluding that "Plié 3 is probably one of the most distant MPK competitors to C-Leg 4"). Moreover, the ALJ's analysis totally ignores whether Ottobock's and Freedom's MPKs are "sufficiently different" from rival MPKs and whether repositioning by those competitors would be unlikely.

For the few clinics that sell mostly C-Legs and Pliés, there is no evidence that these customers would consider Ottobock and Freedom to be first and second choice *and* sufficiently different from Rheo, Orion, and Allux, in response to a price increase. For example, Hanger's CEO testified that it could [redacted] (Asar, Tr. 1448), and

[redacted] RPF 674, 766; RCCPF 1150.

Average prices for rival mainstream MPKs further show that the C-Leg 4 and Plié 3 are not close substitutes. Average pricing for mainstream MPKs are as follows: C-Leg [redacted], Rheo [redacted] Plié [redacted] Orion [redacted] and Allux [redacted]. IDFOF 203, 241, 270, 291. According to Professor Scott-Morton, the value that the MPK is delivering to the market is reflected by its price. IDFOF 475. Plié 3 pricing tends to be lower than higher-quality manufacturers for this reason. IDFOF. 492-493. Moreover, the ID did not identify a single, specific instance of head-to-head price competition between C-Leg 4 and Plié 3. IDFOF 487-638.

Össur, Endolite, and Proteor supply higher quality, better functioning MPKs than Freedom, and these rivals have all released new MPKs since Plié 3 debuted in 2014: Rheo (2017), Orion 3 (2016), and Allux (2017). RCCPF 926. Unlike Freedom, there are established clinical benefits of using Össur's and Endolite's MPKs for K-3 and K-4 patients. RCCPF 508, 671-673; RPF 359-360.

The ID's unilateral effects "analysis" totally ignores mountains of evidence showing that all mainstream MPKs are close enough competitors to prevent unilateral harm. For example, all mainstream MPK suppliers track each other's market positioning. IDFOF 405-410. Freedom's Plié 3 launch materials from 2014 investigated the mainstream MPKs at that time: C-Leg 3, Rheo 2, and Orion 2. IDFOF 550-571. Ottobock's launch materials for the C-Leg 4 examined the same. IDFOF 580-591.

Freedom witnesses with first-hand MPK market knowledge testified that it will lower the price of the Plié 3 to compete with any MPK supplier. "Freedom frequently provides lower prices to customers in response to competition from other microprocessor knee manufacturers." IDFOF 496. Freedom's chairman "acknowledged that when a competing MPK manufacturer offers Freedom customers a lower price, customers often seek to renegotiate their contracts with Freedom. Freedom has lowered the price of its MPK during these negotiations due to competitive pressures from other MPK manufacturers." IDFOF 498. The evidence does not support the conclusion that these materials targeted C-Leg, specifically. IDFOF 550-591.[6] For example, [redacted] RPF 803-804. [redacted] RPF 805. Ford (POA) testified:

> Q. Now, while POA clinics fit almost exclusively C-Legs, you acknowledge that your prosthetists view the Össur Rheo to be in the same category as the C-Leg, correct?
>
> Ford. As a microprocessor knee, yes. RCCPF 1510.

Not a single clinic customer considers rival MPKs "sufficiently different" from Plié and C-Leg, let alone a significant number of customers, or customers as a whole. CC's own hand-picked witnesses do not consider rival MPKs "sufficiently different" under a proper unilateral effects analysis.

- Hanger sells MPKs from Ottobock, Össur, Freedom, Endolite, and Nabtesco. IDFOF 499-501.
    - Freedom's former CEO testified that "Hanger's ability to switch to another MPK manufacturer gives Hanger bargaining leverage against Freedom to obtain lower prices." IDFOF 496.

[6] CC attempted desperately to establish that Ottobock added IP-67 water-resistance rating to the C-Leg 4 in response to the Plié 3 as the only real example of innovation competition between the merging firms. But Ottobock finalized the requirement for IP-67 rating of the C-Leg 4 in April 2013, over a year before Plié 3 launched. IDFOF 580; RCCPF 1011.

- Hanger's CEO, Vinit Asar, testified that [redacted]
- Asar testified that [redacted] Asar, Tr. 1448.
- Asar testified that [redacted]
- Asar testified that [redacted]
- Hanger invited Proteor to present the Nabtesco Allux at the Hanger Education Fair in 2018 as part of an effort to raise the profile of all U.S. MPK suppliers. RCCPF 1591.

- COPC has negotiated MPK prices with Ottobock, Össur, Freedom, Endolite, and Nabteso. RCCPF 597-598, 1533.
  - COPC's CFO, Keith Senn, testified that COPC [redacted] Senn, Tr. 236-247.
  - Senn also testified that Orion is close in "capability" to the C-Leg and Plié and that its become "interchangeable" with the C-Leg and Plié, specifically testifying:

    Q. Now, in order to maximize the profits of your clinic, if the Plié stopped being available or increased in price, you'd have to consider buying more Orions, wouldn't you?

    Senn. It's definitely a possibility. Yes. Senn, Tr. 254-256.
  - Senn testified that [redacted]

- Jeff Brandt (CEO, Ability): Rheo is a "preferred MPK option with respect to quality, durability, service, and performance." RCCPF 1507. He continued:

  [redacted]

  [redacted]

  [redacted]

  [redacted]

[redacted]

- Endrikat (Empire): Empire purchases MPKs from Ottobock, Freedom, Endolite, and Össur. PX05001 (Endrikat IH 19-20).
    - Endrikat considers Rheo just "slightly" different than the C-Leg, but is actually "more nimble and agile" than the C-Leg 4. RCCPF 1483.
    - Regarding comparisons between Orion and C-Leg, Endrikat testified: " I do know with their recent update on the 3.0 that the software configuration is similar to the Ottobock knee, and also their safety profile is similar." PX05001 (Endrikat IH 23-24)..
- Jonesboro P&O considers the Freedom Plié, Ottobock C-Leg, Endolite Orion, and Össur Rheo to be the "base class" of MPKs. RCCPF 1514.
- Ell testified that the C-Leg, Rheo, Plié, and Orion are all in the same "class" of MPK as follows: PX05129 (Ell Dep. 108). Ell testified that his clinic does not ***currently*** purchase the Nabtesco Allux but that he would if he were approached by Proteor and learned about the product. *Id.* at 77.

CC's evidence is particularly unimpressive considering that there are approximately 3,400 prosthetic clinics and 6,500 certified prosthetists in the United States, RPF 113; IDFOF 78, and CC interviewed over 400 individuals at over 160 clinics as part of its investigation. *See* CC Initial Disclosures, Appx. A. The twelve clinic customers selected by CC to testify provided no evidence that rival MPKs are "sufficiently different" from C-Leg and Plié for these clinics, let alone the other thousands of clinics that were unrepresented in this case, and there is no support in the law to extrapolate from the mild preferences of a few customers to customers generally or to even a significant fraction of customers. *See United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1167 (N.D. Cal. 2004) ("Drawing generalized conclusions about an extremely heterogeneous customer market based upon testimony from a small sample is not only unreliable, it is nearly impossible.")

Because the evidence shows that Össur, Endolite, and Proteor are capable competitors for the fraction of customers that use primarily C-Leg and Plié, [redacted]

[redacted] any postulated or presumed unilateral harm from the transaction is rebutted. Without a reason to believe Össur, Endolite, and Proteor are currently "sufficiently different" competitors and that they will remain "sufficiently different" competitors in the future, basic economics indicate that the Acquisition will have no effect.

E. <u>The Acquisition Will Provide Procompetitive Efficiencies.</u>

Under common ownership, Ottobock realized that low substitution between Ottobock's and Freedom's products supported a dual-brand strategy. RBR 78-81. This strategy, when applied to Freedom's entire portfolio of products, identified Acquisition-specific efficiencies of at least [redacted] RRBR 94-95.

II. THE TRANSACTION INCLUDING THE MPK DIVESTITURE WILL NOT INCREASE OTTOBOCK SHARE IN ANY MPK MARKET AND THERE IS NO BASIS FOR ANY PRESUMPTION OF ANTICOMPETITIVE EFFECTS.

Ottobock's proposed divestiture of the MPK business must be included in any structural analysis. There is no basis for a presumption of anticompetitive effects where the acquirer has agreed to divest the acquisition target's entire business in the alleged relevant product market. The ALJ focused on the MPK Divestiture's appropriateness as a remedy, but ignored its impact on CC's *prima facie* case. The Acquisition with the MPK Divestiture results in [redacted] and CC failed to establish a *prima facie* case.

A. <u>Divestiture of the Target's Entire Business in the Alleged Market Cannot Be Ignored.</u>

Statistical evidence is insufficient to establish anticompetitive effects where the evidence does not account for the future impact of a divestiture. In *United States v. General Dynamics*

Corp., 415 U.S. 486 (1974), the Supreme Court held that an acquisition would result in no substantial lessening of competition—despite the government's undisputed showing of undue concentration based upon market share statistics at the time of the merger. Although market share statistics are "the primary index of market power," "the probable anticompetitive effect of [a] merger" can only be judged by considering a market's "structure, history *and probable future*." *Id.* at 498 (emphasis added). Thus, post-acquisition evidence is admissible to evaluate the future competitive effects of an acquisition. *Id.* at 504 (citing *FTC v. Consol. Foods Corp.*, 380 U.S. 592, 598 (1965); *United States v. E.I. DuPont de Nemours & Co.*, 353 U.S. 586, 597 (1957)).

A court must consider post-acquisition evidence of a planned divestiture as part of the reviewed transaction itself, not just as a potential remedy. In *FTC v. Arch Coal, Inc.*, No. 1:04-cv-00534, ECF No. 67 at 7 (D.D.C. July 7, 2004), the FTC argued that a divestiture was an issue related to "remedy" not to the likelihood of success on the merits in the Section 13(b) injunction action. *See id.* at 2-3. The court disagreed, holding that it was required "to review the *entire* transaction in question." *Id.* at 7. The court was "unwilling simply to ignore the fact of the divestiture." *Id*. Although the court ultimately found that the FTC made out a *prima facie* case, that case was weak because the FTC was required to rely on HHI calculations that accounted for the divestiture. *See Arch Coal, Inc.*, 329 F. Supp. 2d at 124-25; *FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 46 (D.D.C. 2002).

The court likewise rejected the government's position that a post-merger divestiture should be ignored in assessing anticompetitive effects in *United States v. Atlantic Richfield Co.*, 297 F. Supp. 1061 (S.D.N.Y. 1969). The court rejected DOJ's argument that there should be a presumption of anticompetitive effects based on the merger, ignoring the divestiture. *Id*. at 1067-69. It found that "[f]or the arrangement *viewed as a whole* indicates that, instead of competition being eliminated, a new vigorous and viable competitive force will be substituted for the present competitor." *Id.* at 1069 (emphasis added).

Courts have thus consistently recognized that a post-merger partial divestiture must be considered together with the challenged merger in assessing whether the government has established its *prima facie* case. *See, e.g.*, *United States v. Aetna*, 240 F. Supp 3d. 1, 60 (D.D.C. 2017) (stating that "a defendant may introduce evidence that a proposed divestiture would 'restore the competition' lost by the merger counteracting the anticompetitive effects of the merger.") (quoting *FTC v. Sysco*, 113 F. Supp. 3d 1, 72 (D.D.C. 2015)); *White Consol. Indus., Inc. v. Whirlpool Corp.*, 781 F.2d 1224, 1227-28 (6th Cir. 1986) (affirming order vacating injunctive relief after curative divestiture occurred).

B. <u>The MPK Divestiture Is Sufficiently Certain to Require Consideration.</u>

A proposed divestiture should be considered so long as it is "sufficiently non-speculative." *Aetna*, 240 F. Supp. 3d at 60. However, "the divestiture need not be iron clad for a court to consider it." *Id.* at 60, 63-64 (rejecting argument that merger was too uncertain to be considered); *see also* *Atlantic Richfield*, 297 F. Supp. at 1068. The ALJ erred by imposing a standard that would effectively require that any partial divestiture to be completed *before* the termination of litigation over the challenged transaction.

Here, the MPK Divestiture is sufficiently non-speculative to be considered. The ALJ noted that "there are conditions precedent to closing the [redacted] which affect the likelihood of the divestiture[,]" including that [redacted]

ID 80-81. But no potential divestiture partner would close a transaction without government approval while the seller of the assets is actively engaged in litigation with the FTC over the future of those very same assets. The Commission should reject the impossible and legally erroneous standard articulated by the ALJ.

C. The Commission Has Already Acknowledged that the MPK Divestiture Could Rebut Likely Anticompetitive Effects.

The Commission's April 18, 2018 opinion and order denying CC's Motion to Strike Respondent's Seventh Affirmative Defense (the "April 18, 2018 Order") confirms that the competitive effect of the Acquisition, subject to the MPK Divestiture, must be considered as part of the competitive effects analysis, not only as part of any remedy analysis. The Commission held that the divestiture:

> could potentially be relevant to rebut a showing of likely anticompetitive effects [redacted] and Respondent remains entitled to develop and present relevant evidence regarding [redacted]

April 18, 2018 Order at 6.

The evidence at the hearing demonstrated that Ottobock entered the HSA as of December 19, 2017, that the parties have faithfully abided by their respective obligations under the HSA, and that Freedom has continued to operate independently. RPF 1042-1044, 1084, 1111-1115, 1156-1160, 1686; RCCPF 145-175, 1477. CC failed to introduce evidence of actual anticompetitive effects from the Acquisition either before or after the effective date of the HSA. Regardless whether the MPK Divestiture is a complete defense to CC's claims, it defeats CC's attempt to suggest a structural presumption of anticompetitive effects in the face of a clean-sweep divestiture.

D. The MPK Divestiture Effectively Preserves Competition in the Alleged MPK-only Relevant Market.

1. [redacted]

With the MPK Divestiture, Ottobock will not increase market share in MPKs. [redacted] (unlike, for instance, *Arch Coal*, in which there would have been a significant increase in concentration even after the divestiture). [redacted] As in *Arch Coal*, CC cannot establish a *prima facie* case by ignoring the divestiture.[7]

2. [redacted]

The only evidence of likely sales of MPKs by [redacted] RPF 1206-1238. There is no valid basis in the evidence to conclude that [redacted]

a. [redacted]

The ALJ narrowly focused on [redacted]

[7] [redacted]

[redacted]

[redacted]

[redacted]

b. [redacted]

[redacted]

[redacted]

c. [redacted]

The ALJ ignored significant evidence in finding that [redacted]

d. [redacted]

The ALJ also ignored significant evidence in finding that [redacted]

[redacted]

e. [redacted]

The ALJ noted that a [redacted]

III. THE "MPK ONLY" PRODUCT MARKET ENDORSED BY THE ALJ IS LEGALLY INSUFFICIENT AND IS BASED ON FAULTY ECONOMICS.

The product market adopted by the ALJ is not supported by reliable evidence and should not be adopted by the Commission. *First*, the product market adopted by the ALJ is internally inconsistent and not sufficiently specific to satisfy the requirement under the antitrust laws to define a relevant product market. *Second*, the ALJ's product market rubber-stamped unreliable expert testimony that relied on the flawed Lerner Condition and unverified cherry-picked figures as a substitute for economic analysis. The Commission cannot allow that precedent, which would effectively outlaw all mergers.

A. The MPK-Only Market as Adopted and Described by the ALJ is Impermissibly Vague.

The ALJ erroneously adopted a market consisting of all MPKs, and no other prosthetic knees. The evidence established that prosthetic knees are highly differentiated, have a variety of different features and functions and range in sophistication, and there is significant technology overlap between knees that contain microprocessors, and those that do not. RCCPF 617. The ALJ does not address sophisticated prosthetic knees that do not contain microprocessors, but function more like many knees that do. ID 17-35.

Neither the evidence nor the ALJ's analysis could support rejecting sophisticated non-MPKs for K-3 and K-4 amputees, but including a wide variety of MPK's that are differentiated. The ALJ failed to address the significant variation among prosthetic knees—and within his vague term "MPKs." Within knees that contain microprocessors, there are wide ranges of price points, features, and microprocessor control. RPF 164-239. Some microprocessors control only the swing phase of the knee, some only the stance phase of the knee, some only the switch between the two, and some control all three. RPF 164-190. There are some knees that contain microprocessors with a sales price of $12,000 and some that cost in excess of $32,000. RPF 232, 643, 671. Some knees with microprocessors are reimbursed by mainstream insurance, and some are not. RPF 228, 254-258. Some knees with microprocessors are created for K-2 patients; others for K-3 or K-4 patients. RPF 182, 214. There is no recognition of this range in functionality, price, insurance coverage, and target patient group in the ID. Treating all knees that contain microprocessors as a monolithic group is contradicted by all of the evidence. RPF 164-239. When the range of features and functions of prosthetic knees are accounted for, the application of *Brown Shoe* cannot lead to the conclusion that knees containing microprocessors are a relevant product market. RPF 164-239.

As a result, there is no clear break in the chain of substitutes within prosthetic knees for K-3 or K-4 patients. *See Oracle*, 331 F. Supp. 2d at 1120. The ALJ's failure to address this fundamental aspect of the prosthetic knee market renders the product market unusable.

B. The ALJ Relied on Faulty Economic Analysis In Accepting an MPK-Only Relevant Market.

CC's economist's opinion is so unreliable and flawed that it should be disregarded entirely by the Commission. Professor Scott Morton used an overreaching and unreliable critical loss analysis to reach her core conclusions regarding the relevant product market. She used unreliable methods and an unsupported and speculative estimate of so-called "diversion" in a draft document.

1. Professor Scott Morton's Lerner Condition Produces Flawed Results in Merger Cases That Would Face Preclusion in Federal Courts.

Although not mentioned in the ID, CC's economist's opinion relies on deeply flawed methodology known as the Lerner Condition that has received significant and fundamental criticism in economic literature. *See, e.g.*, Joseph Simons, *The Potential Impact of New Economic Tests in Merger Analysis: A New Direction*, ABA Antitrust Section Spring Meetings (March 5, 2010); Malcolm B. Coate & Joseph J. Simons, *Critical Loss v. Diversion Analysis, Clearing up the Confusion, Competition Policy International* (Dec. 2009), at p. 5.

The Lerner Condition results "in extremely narrow markets" consisting of "only the two merging firms." RPF 541. Indeed, "virtually all unilateral effects models utilizing the Lerner Condition produce price increases for any horizontal merger." *Id*. Because every merger is predicted to raise prices under this analysis, the method that Scott Morton has used "has no empirical support and would face serious *Daubert* issues if used in court." *Id.* (emphasis added).

2. Professor Scott Morton Made No Effort to Verify Her Diversion Rate.

Professor Scott Morton used just one piece of one draft document (PX01003) to arrive at a diversion rate that she unquestioningly plugged into her critical loss analysis. RCCPF 783. The most current version of PX01003 is in draft form, and is not sufficiently reliable to form the basis of the key portion of Scott Morton's analysis. *Id.* Scott Morton applied no "economic rigor" or independent analysis to the numbers that she hand-picked from one piece of a draft document. She simply accepted it at face value, and assumed it described what she needed it to describe.

Indeed, Dr. Scott Morton did not use her training or qualifications in economics to conduct any independent analysis that would assist in validating this number. She did not conduct any of the tests or analyses that are typical in determining diversion rates—such as analyzing bid data or win-loss rates. In his recent AT&T-Time Warner decision, Judge Leon took issue with an analogous reliance solely on the merging parties' documents without applying economic analysis to verify the validity or accuracy of the figure. *United States v. AT&T Inc.*, 310 F. Supp. 3d 161, 205 (D.D.C. 2018).

Compounding the issue here is that both the ALJ and Scott Morton chose to ignore the testimony of the *creator of the document* relied upon, who characterizes the document as a "draft" and "preliminary." RCCPF 783. While she ignored the author's testimony, Scott Morton chose instead to "verify" the contents of the document through the testimony of a disgruntled former executive who was not involved with the drafting of the document, and admitted at trial that there was nothing "scientific" about the estimates contained in the document. RCCPF 722, 783.

Given the fundamental flaws in the central piece of Scott Morton's analysis, the Commission should disregard her opinion as it relates to relevant product market.

IV. THE FAILING FIRM DEFENSE IS A COMPLETE DEFENSE TO CC'S CASE.

The ALJ erred in rejecting Respondent's "failing firm" defense. The defense has been recognized by numerous courts and in Section 11 of the Guidelines. *See, e.g.*, *International Shoe Co. v. FTC*, 280 U.S. 291, 299-303 (1930).

A. <u>Freedom Was Unable to Meet Its Financial Obligations in the Near Future.</u>

Undisputed evidence established that Freedom was unable to pay its insurmountable debt absent the Acquisition, and otherwise would have been liquidated. RPF 1369, 1412-1413, 1519. During the years before the Acquisition, Freedom was failing in all financial respects. RPF 1291-1358. Indicators including revenue and gross margin were dramatically declining, and Freedom's EBITDA, operating income, and gross profit percentage fell every year from 2012 to 2016. RPF 1294-1296, 1300, 1362, 1519.

The ID relies heavily on Squire's 2016 audited financial statements of Freedom but incorrectly states that Squire issued a clean audit opinion. ID 64-65. The audited financial statement actually provides, "**The uncertainties related to successfully refinancing the debt or obtaining additional funding <u>creates substantial doubt about the Company's ability to continue as a going concern within one year of issuance of these financial statements</u>.**" RPF 1444 (emphasis added). The ID bolsters the "legitimacy" of the Kim Memo (ID 64-65) with findings that are demonstrably false and/or misleading. *See, e.g.*, RPF 1417-1448; RCCPF 1850.

Freedom's default and negotiations with its Lenders, its overall and drastic financial failure, and the substantial doubt contained within Freedom's 2016 audited financial statements are detailed in Respondent's Post-Trial Briefing. *See* RBR 93-112; RPF 1291-1424, 1444, 1517-1519, 1527, RRBR 100-114; RCCPF 1816-1945, 2012, 2030, 2039-2046.

B. <u>Freedom Would Not Have Been Able to Reorganize Successfully Under Chapter 11 of the Bankruptcy Act.</u>

Contrary to the Merger Guidelines, a number of courts have held that "dim prospects for bankruptcy reorganization are not essential to successful assertion of the failing company defense." *See California v. Sutter Health Sys*., 130 F. Supp. 2d 1109, 1135 (N.D. Cal. 2001) (quotation omitted). The ALJ did not address potential reorganization. ID 68. Regardless whether required, Freedom specifically considered Chapter 11 reorganization as an alternative to acquisition or liquidation, but determined it lacked the ability to successfully emerge from that process. RPF 1521-1528.

C. Freedom Exhausted Good Faith Efforts to Obtain Reasonable Alternatives to the Acquisition.

The defense only requires good-faith efforts to obtain ***reasonable alternative*** offers, not that every possible financing partner or strategic alternative be contacted. *See* IV Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 954d (4th ed. 2016); RPF 1487.

The evidence contradicts the ID's conclusion that Freedom did not seriously pursue refinancing. *See* RBR 115-122; RRBR 120-122; RPF 1453-1469; RCCPF 2048-2060, 2100-2218. Freedom preferred refinancing to an acquisition. RPF 1453.

Because Freedom could not obtain refinancing, a sale to a strategic acquirer was Freedom's only viable option to avoid liquidation. RPF 1470-1472. The ID's finding that "Freedom's sales process focused on Ottobock" disregards significant evidence. ID 70; RCCPF 2075-2099. Because the quickly approaching Term Loan Maturity Date and time pressure from the Lenders, speed and certainty to close the transaction were more important than price in selecting the buyer. RPF 1473-1475. Respondent introduced substantial evidence of good-faith efforts to find reasonable alternative offers, which necessarily did not include contacting every conceivable company in the prosthetics industry that might have made an offer because doing so would have delayed the process and ultimately been fruitless. RBR 117-118, RRBR 120-129, RPF 1470-1505; RCCPF 2119-2163.

Össur's non-binding indication of interest in Freedom was not a "reasonable alternative offer." Össur never made a *bona fide* offer to purchase Freedom. RPF 1490-1498, RCCPF 2164-2169. Össur's proposed purchase price of [redacted] was too unreasonably low to qualify as a "reasonable alternative offer." *See* U.S. Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies* at 30-31 (June 2011). Moreover, an Össur acquisition at any price would not have posed a less severe danger to competition, if any, than the Acquisition by Ottobock. Areeda & Hovenkamp ¶ 954c2-c3. Not only would an Össur acquisition of Freedom have been "presumed to be likely to enhance market power" under the Guidelines in an MPK market, but an Össur acquisition would have also led to a presumption of harm in a market for K-3 and K-4 prosthetic feet. RPF 1500-1505; RBR 122-123.

V. THE ALJ'S PROPOSED REMEDY IS PUNITIVE AND INAPPROPRIATE.

Any remedy should be limited to divestiture of the assets in the alleged MPK-only relevant market. An effectively full divestiture of Freedom's business is an inappropriate remedy. "The key to the whole question of an antitrust remedy is of course the discovery of measures effective to restore competition. Courts are not authorized in civil proceedings to punish antitrust violators, and relief must not be punitive." *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 326 (1961); *see also Gilbertville Trucking Co. v. United States*, 371 U.S. 115, 129-30 (1962); *United States v. Reed Roller Bit Co.*, 274 F. Supp. 573, 589-90 (W.D. Okla. 1967) ("[S]ince this is a situation where divestiture of part of the assets is at least as effective as a divestiture of all of the assets it is appropriate to take into consideration at least to some degree the hardship imposed on the defendants.").

"[I]nclusion of assets used to produce items not included in the" relevant market "would not aid in restoring competition in that line of commerce. In fact, ordering such divestiture could be construed as a punishment, and civil proceedings to punish antitrust violators are not authorized. The relief must not be punitive." *In re Jim Walter Corp.*, 90 F.T.C. 671, 1977 FTC LEXIS 10, at *117-18 (F.T.C. 1974) (Initial Decision), *vacated on other grounds,* 625 F.2d 676 (5th Cir. 1980). Thus, "total divestiture is not an automatic remedy which must be applied in all cases." *Id.* (quoting

In re Union Carbide Corp., 59 F.T.C. 614, 659 (F.T.C. 1961)); *see also Berkey Photo, Inc. v. Eastman Kodak Co.*, 457 F. Supp. 404, 428-29 (S.D.N.Y. 1978) (holding divestiture not appropriate), *rev'd in part on other grounds*, 603 F.2d 263 (2d Cir. 1979).

Over [redacted] of Freedom's business relates to prosthetic feet. RFP 1104. CC has neither alleged nor proven adverse effects on competition in any market that includes prosthetic feet. Thus, any adverse effects on competition alleged in the Complaint would be completely restored by an MPK Divestiture remedy.

The FTC and courts frequently approve settlements that involve partial divestitures. *See, e.g., United States v. US Airways Grp.*, 38 F. Supp. 3d 69 (D.D.C. 2014); *United States v. SBC Communications, Inc.*, 489 F. Supp. 2d 1, 7 (D.D.C. 2007); *United States v. Abitibi-Consolidated, Inc.*, 584 F. Supp. 2d 162, 164 (D.D.C. 2008); *United States v. Newpage Holdings, Inc.,* 2015 U.S. Dist. LEXIS 175650, at *7 (D.D.C. Dec. 11, 2015); *United States v. Sinclair Broadcast Grp., Inc.*, 74 F. Supp. 3d 468, 473-74 (D.D.C. 2014). Partial divestitures have also been held appropriate in litigated matters. *See, e.g., Reed Roller Bit Co.*, 274 F. Supp. 573, 586; FTC v. PepsiCo, Inc., 477 F.2d 24, 28-29 (2d Cir. 1973); *In re Warner-Lambert Co.*, 88 F.T.C. 503, 1976 FTC LEXIS 122, at *2-6 (F.T.C. 1976); *United States v. Waste Management, Inc.*, 588 F. Supp. 498, 514 (S.D.N.Y. 1983), *rev'd on other grounds,* 743 F.2d 976 (2d Cir. 1984).

Because the MPK Divestiture would cure any harm claimed by CC, any broader remedy would be punitive and wholly unnecessary to achieve CC's only legitimate objective of restoring competition. Thus, the Commission's remedy, if any, should be limited to an MPK Divestiture to [redacted]

VI. FTC PART 3 PROCEEDINGS ARE UNCONSTITUTIONAL.

The ALJ's hiring violates the Appointments Clause, and the post-hoc ratification effectuated by the Commission is insufficient to cure the constitutional defect. Because ALJ

Chappell was not originally appointed via the Appointments Clause, but was only ratified by the Commission on September 11, 2015, and because ALJ Chappell has powers similar to those of SEC ALJs, ALJ Chappell is an unconstitutionally appointed "Officer[] of the United States." *See Lucia v. S.E.C.,* 138 S.Ct. 2044, 2053 (2018); *In the Matter of LabMD, Inc*., Docket No. 9357 (Sept. 14, 2015 Order); 16 C.F.R. § 3.42(c)(1)-(6), (8). The Commission's subsequent ratification did not and does not cure ALJ Chappell's unconstitutionality and, therefore, the hearing before ALJ Chappell, his rulings, and his Initial Decision should be void as unconstitutional. Additionally, ALJ Chappell's two-level protection from removal by the President is unconstitutional. The Administrative Procedure Act allows ALJ Chappell, to be removed only "for good cause" found by the Merit Systems Protection Board ("MSPB"). 5 U.S.C. § 7521. The President may remove members of the MSPB only for "inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202. Accordingly, this "multilevel protection from removal" is unconstitutional. *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd*., 561 U.S. 477, 484 (2010).

Part 3 procedures provide unequal treatment to respondents and CC, respectively. Examples of unequal treatment include one-sided evidentiary rules that relax the admissibility and authentication rules as they relate to CC, and that defer to the preferences of CC. *See, e.g.*, §3.43(d)(3) (obviating need for CC to authenticate documents produced by Respondent); §3.43(e) (allowing CC to use as evidence anything obtained during its investigation but not affording same permission to Respondent); Commission Order, July 9, 2018 (denying application for removal to settlement process because CC disagreed); Commission Order, May 23, 2019 (declining to provide enough time for Respondent to file briefs of sufficient detail to present its case). Part 3 litigation fails to afford respondents with procedural due process, particularly in light of the punitive remedies sought by CC in these case.

The 2002 FTC and DOJ Clearance Agreement, and any similar subsequent implicit or explicit agreement, is an arbitrary and capricious division of antitrust enforcement that relies on factors which Congress has not intended it to consider. *See* 5 U.S.C. § 706(2)(A). Congress created the FTC to prevent persons or corporations from using unfair methods of competition and to investigate violations of antitrust statutes. 15 U.S.C. §§ 45, 46. Congress did not intend the DOJ and FTC to arbitrarily and capriciously divide and unequally apply antitrust enforcement by industry, a division that causes similarly situated groups to be subject to different procedures, and levels of due process leading to different substantive outcomes in violation of the Equal Protection Clause. There is no rational basis justifying this disparate treatment.

CONCLUSION

For the foregoing reasons, Commission should vacate the ID and enter an order in the form attached dismissing the Complaint with prejudice. In the alternative, to the extent the Commission determines Respondent is liable under the Complaint, the Commission should vacate the ID and enter an order in the alternative form attached, providing for the divestiture of the MPK assets.

Respectfully submitted,

Date: June 5, 2019

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Counsel for Respondent Otto Bock HealthCare North America, Inc.

PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS:	**Joseph J. Simons, Chairman** **Noah Joshua Phillips** **Rohit Chopra** **Rebecca Kelly Slaughter** **Christine S. Wilson**

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation.**	**Docket No. 9378**

[Proposed] ORDER

Upon consideration of the briefs submitted by Respondent and Complaint Counsel, the argument of counsel before this Commission, and the record in this matter, it is hereby ORDERED that:

1. Count I of the Complaint is DISMISSED WITH PREJUDICE;

2. Count II of the Complaint is DISMISSED WITH PREJUDICE; and

3. The Commission finds that the Acquisition of FIH Group Holdings, LLC by Ottobock HealthCare North America, Inc. does not substantially lessen competition or tend to create a monopoly in any line of commerce or in any activity affecting commerce in any section of the country.

By the Commission.

April J. Tabor
Acting Secretary

ISSUED: _________, 2019

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS:	**Joseph J. Simons, Chairman**
	Noah Joshua Phillips
	Rohit Chopra
	Rebecca Kelly Slaughter
	Christine S. Wilson

In the Matter of

OTTO BOCK HEALTHCARE NORTH AMERICA, INC.,
a corporation.

Docket No. 9378

[Alternative Proposed] DECISION AND ORDER

Upon consideration of the briefs submitted by Respondent and Complaint Counsel, the arguments of counsel for the parties before this Commission, and the record in this matter:

ORDER

I.

IT IS ORDERED that, as used in the Order, the following definitions shall apply:

A. "Acquisition" means Respondent's acquisition of Freedom pursuant to an agreement and plan of merger dated as of September 22, 2017.

B. "Business" means the development, evaluation, manufacturing, commercialization, distribution, marketing and sale of a Product.

C. [redacted]

D. "Categorized Assets" means the following assets and rights of Freedom, as such assets and rights are in existence as of the Closing Date:

1. all Product Intellectual Property to the extent primarily used in or arising out of the

Divestiture Product Business that is not Product Licensed Intellectual Property;

2. all Product Scientific and Regulatory Materials;
3. all Product Technology;
4. all Inventory that is not already sold to a Third Party as of the Closing Date;
5. all Component Parts;
6. all Manufacturing Materials;
7. all Marketing Materials;
8. all Training Materials;
9. all Product Contracts set forth in the Remedial Agreements;
10. all Permits set forth in the Remedial Agreements;
11. all Customer Lists; and
12. all of Freedom's books, records, and files related to the foregoing;

provided, however, that "Categorized Assets" shall not include: (i) documents relating to Respondent's general business strategies or practices relating to the conduct of its business outside of the Divestiture Products, where such documents do not discuss with particularity the Divestiture Products; (ii) information that is exclusively related to the Retained Products; (iii) all Product Licensed Intellectual Property; and (iv) certain other assets set forth in the Remedial Agreements;

provided further, *however*, that in cases in which documents or other materials included in the assets to be divested contain information: (i) that relates both to the Divestiture Products and to Retained Products or businesses of Respondent and cannot be segregated in a manner that preserves the usefulness of the information as it relates to the Divestiture Products; or (ii) for which Respondent has a legal obligation to retain the original copies, that Respondent shall be required to provide only copies or relevant excerpts of the documents and materials containing this information. In instances where such copies are provided to Purchaser, Respondent shall provide that Purchaser access to original documents under circumstances where copies of documents are insufficient for evidentiary or regulatory purposes. The purpose of this provision is to ensure that Respondent provides Purchaser with the above-described information without requiring Respondent completely to divest itself of information that, in content, also relates to Retained Product(s);

provided further, that, with the agreement of Purchaser, Respondent may retain co-ownership of an undivided interest in the following (but only to the extent it is not exclusively related to the Divestiture Products being acquired by Purchaser): (i) Product Scientific and Regulatory Materials; (ii) Product Technology; (iii) Marketing Materials; (iv) Training Materials; and (v) books, records and files related to the foregoing.

E. "Closing Date" means, as to the Divestiture Products, the date on which Respondent (or a Divestiture Trustee) consummates a transaction to assign, grant, license, divest, transfer, deliver, or otherwise convey the Divestiture Product Assets to Purchaser and grant the Divestiture Product License pursuant to this Order.

F. "Commission" means the Federal Trade Commission.

G. "Complaint" means the administrative complaint issued by the Federal Trade Commission challenging the acquisition of Freedom by Respondent.

H. "Component Parts" means all component parts and other raw materials owned by and in the possession of Freedom, to the extent used in or intended for use in the manufacture of the Divestiture Products.

I. "Confidential Business Information" means all information owned by, or in the possession or control of, Respondent that is not in the public domain and to the extent that it is directly related to the conduct of the Divestiture Product Business. The term "Confidential Business Information" *excludes* the following and Respondent is not required to submit this information to Purchaser:

1. information relating to Respondent's general business strategies or practices that does not discuss with particularity the Divestiture Products;
2. information specifically excluded from the Divestiture Product Assets;
3. information that is contained in documents, records, or books of Respondent that is provided to Purchaser by Respondent that is unrelated to the Divestiture Products or that is exclusively related to Retained Product(s);
4. information that is protected by the attorney work product, attorney-client, joint defense, or other privilege prepared in connection with the Acquisition, administrative litigation related to the Complaint, and MPK Product Divestiture Agreements and relating to any United States, state, or foreign antitrust or competition Laws;
5. information that subsequently falls within the public domain through no violation of this Order or breach of confidentiality and non-disclosure agreement with respect to such information by Respondent;
6. information related to the Divestiture Products that Respondent can demonstrate it obtained without the assistance of Freedom prior to the Acquisition; and
7. information that is required by Law to be disclosed.

J. "Customer Lists" means all lists of customers that have purchased the Divestiture Products directly from Freedom or any of its affiliates.

K. "Direct Cost" means a cost not to exceed the cost of labor, material, travel, and other expenditures to the extent the costs are directly incurred to provide the relevant assistance or service. "Direct Cost" to Purchaser for its use of any of Respondent's employees' labor shall not exceed the average hourly wage rate for such employee;

provided, however, in each instance where: (i) an agreement to divest relevant assets is specifically referenced and attached to this Order, and (ii) such agreement becomes a Remedial Agreement for a Divestiture Product, "Direct Cost" means such cost as is provided in such Remedial Agreement for that Divestiture Product.

L. "Divestiture Products" means the microprocessor prosthetic knee products developed, under development, manufactured, marketed, commercialized, distributed, and sold by Freedom, including:

1. Plié 3; and
2. Developmental project code-named "Quattro".

M. "Divestiture Product Assets" means all rights, title and interest in, to and under all of the assets of Freedom used in or arising out of the Divestiture Product Business, to the extent legally transferable, including the Categorized Assets.

N. "Divestiture Product Business" means the Business of the Divestiture Products to the extent that such Business is owned, controlled, or managed by Freedom and the assets related to such Business to the extent such assets are owned by, controlled by, managed by, or licensed to, Freedom.

O. "Divestiture Product License" means a perpetual, non-exclusive, and royalty-free license under the Remedial Agreements (with rights to grant sublicenses) to all Product Licensed Intellectual Property owned, licensed, held, or controlled by Freedom to use the Product Licensed Intellectual Property as it exists as of the Closing Date, solely in the conduct of the Divestiture Product Business;

provided, however, that for any Product Licensed Intellectual Property that is the subject of a license from a Third Party entered into by Freedom prior to the Acquisition, the scope of the rights granted hereunder shall only be required to be equal to the scope of the rights granted by the Third Party to Freedom.

P. "Divestiture Trustee" means the trustee appointed by the Commission pursuant to Paragraph IV of this Order.

Q. "Freedom" means FIH Group Holdings, LLC; its directors, officers, employees, agents, representatives, successors, and assigns; and its joint ventures, subsidiaries, divisions, groups, and affiliates, in each case controlled by FIH Group Holdings, LLC, and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

R. [redacted]

S. "Government Entity" means any Federal, state, local, or non-U.S. government; any court, legislature, government agency, or government commission; or any judicial or regulatory authority of any government.

T. "Hold Separate and Asset Maintenance Agreement" means the Letter Agreement and Hold Separate and Asset Maintenance Agreement between the Bureau of Competition and Respondent dated December 20, 2017.

U. "Intellectual Property" means all worldwide intellectual property rights, including patents, patent applications, trademarks and service marks, trademark and service mark applications, trade names, logos, copyrights, works of authorship, software, proprietary know-how and trade secrets, methods and processes.

V. "Inventory" means Freedom's finished product inventory of the Divestiture Products and any work-in-progress inventory of Divestiture Products.

W. "Law" means all laws, statutes, rules, regulations, ordinances, and other pronouncements by any Government Entity having the effect of law.

X. "Manufacturing Designee" means any Person other than Respondent that has been designated by Purchaser to manufacture a Divestiture Product for Purchaser.

Y. "Manufacturing Materials" means all specialized manufacturing and servicing materials (including equipment, tooling and software) owned by and in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business.

Z. "Manufacturing Technology" means all specialized manufacturing and servicing materials (including equipment, tooling and software) owned by and the in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business.

AA. "Marketing Materials" means all advertising, marketing and promotional materials owned by and in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business.

BB. "Monitor" means any monitor appointed pursuant to Paragraph III of this Order.

CC. "MPK Product Divestiture Agreement(s)" means the following:

1. [redacted]

2. [redacted]

3. [redacted]

The MPK Product Divestiture Agreements are contained in Non-Public Appendix II.A. The MPK Product Divestiture Agreements that have been approved by the Commission to accomplish the requirements of this Order in connection with the Commission's determination to make this Order final and effective are Remedial Agreements.

DD. "Order" means this Decision and Order.

EE. "Order Date" means the date on which the final Decision and Order in this matter is issued by the Commission.

FF. "Otto Bock" means Otto Bock Healthcare North America, Inc.; its directors, officers, employees, agents, representatives, successors, and assigns; and its joint ventures, subsidiaries, divisions, groups, and affiliates, in each case controlled by Otto Bock Healthcare North America, Inc., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

GG. "Patent(s)" means United States and foreign patents and utility models and applications therefor and all reissues, divisions, reexaminations, renewals, extensions, provisionals, continuations, and continuations-in-part thereof, in each case filed, or in existence, on or before the Closing Date.

HH. "Permits" means all consents, registrations, waivers, certificates, filings, franchises, licenses, notices, and permits necessary to conduct the Divestiture Product Business.

II. "Person" means any individual, firm, corporation, partnership, limited liability company, trust, joint venture, Governmental Entity, or other entity.

JJ. "Product(s)" means any "medical device" as defined by the FDA pursuant to Section 201(h) of the United States Federal Food, Drug, and Cosmetic Act.

KK. "Product Contracts" means all written contracts, leases, subleases, licenses, indentures, agreements, commitments, and other legally binding instruments to the extent related to the Divestiture Products;

provided, however, that in no event shall any purchase order for the sale or purchase by Freedom of any goods or inventory constitute a Product Contract.

LL. [redacted]

MM. "Product Intellectual Property" means all Patents, Trademarks, copyrights, trade secrets, and other Intellectual Property, in each case owned by and in the possession of Freedom as of the Closing Date, to the extent used in or arising out of the Divestiture Product Business and as specified in the Remedial Agreements.

NN. "Product Licensed Intellectual Property" means all Product Intellectual Property that is not primarily used in or arising out of the Divestiture Product Business and as specified in the Remedial Agreements.

OO. "Product Scientific and Regulatory Material" means all technological, scientific, and regulatory material and clinical performance reports owned by or in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business.

PP. "Product Technology" means all design history files, technical files, drawings, product specifications, quality control standards, regulatory records, other confidential or proprietary information, know-how, customer sales databases, market research reports and other marketing materials, other related proprietary rights, and all goodwill connected with the use of the foregoing, in each case owned by and in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business.

QQ. "Proposed Purchaser" means a Person proposed by Respondent (or a Divestiture Trustee) to the Commission and submitted for the approval of the Commission as the acquirer for particular assets or rights required to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed pursuant to this Order.

RR. "Purchaser" means the following:

1. [redacted]; or
2. An entity that receives the prior approval of the Commission to acquire the Divestiture Product Assets and rights that Respondent is required to assign, grant, license, divest, transfer, deliver, or otherwise convey pursuant to this Order.

SS. "Remedial Agreement(s)" means the following:

1. any agreement between Respondent and Purchaser that is specifically referenced and attached to this Order, and including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets or rights to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed, including, without limitation, any agreement to supply specified Divestiture Products or components thereof, and that has been approved by the Commission to accomplish the requirements of the Order in connection with the Commission's determination to make this Order final and effective;
2. any agreement between Respondent and a Third Party to effect the assignment of assets or rights of Respondent related to a Divestiture Product to the benefit of Purchaser that is specifically referenced and attached to this Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, that has been approved by the Commission to accomplish the requirements of the Order in connection with the Commission's determination to make this Order final and effective;
3. any agreement between Respondent and Purchaser (or between a Divestiture Trustee and Purchaser) that has been approved by the Commission to accomplish the requirements of this Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets or rights to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed, including, without limitation, any agreement by Respondent to supply specified Products or components thereof, and that has been approved by the Commission to accomplish the requirements of this Order; and/or
4. any agreement between Respondent and a Third Party to effect the assignment of assets or rights of that Respondent related to a Divestiture Product to the benefit of Purchaser that has been approved by the Commission to accomplish the requirements of this Order, including all amendments, exhibits, attachments, agreements, and schedules thereto.

TT. "Respondent" means Otto Bock Healthcare North America, Inc.

UU. "Retained Product(s)" means any Product(s) of Respondent other than a Divestiture Product.

VV. "Third Party(ies)" means any non-governmental Person other than the following: Respondent; Freedom; or Purchaser of particular assets or rights pursuant to this Order.

WW. "Trademark(s)" means rights in trade names, logos, service names, brand names, common law trademarks and service marks, design rights, corporate names, trade dress rights, and other source or business identifiers, related rights of privacy and publicity, together with all registrations, applications for registration, renewals, and extensions thereof and the goodwill associated therewith.

XX. "Training Materials" means all demonstration models, prototypes, samples, instruments, and related supporting equipment that are owned by and in the possession of Freedom, to the extent used in or arising out of the Divestiture Product Business, and copies of all training materials owned by and in the possession of Freedom, to the extent used for training in the proper use of the Divestiture Products.

YY. "United States of America" means the United States of America, and its territories, districts, commonwealths and possessions.

II.

IT IS FURTHER ORDERED that:

A. Not later than forty-five (45) days after the Order Date, Respondent shall divest the Divestiture Product Assets and grant the Divestiture Product License, absolutely and in good faith, to Purchaser pursuant to, and in accordance with, the MPK Product Divestiture Agreements (which agreements shall not limit or contradict, or be construed to limit or contradict, the terms of this Order, it being understood that this Order shall not be construed to reduce any rights or benefits of Purchaser or to reduce any obligations of Respondent under such agreements), and each such agreement is incorporated by reference into this Order and made a part hereof.

B. Respondent shall:

1. Prior to the Closing Date, shall not rescind the Hold Separate and Asset Maintenance Agreement;
2. submit to Purchaser, at Respondent's expense, all Confidential Business Information related to the Divestiture Product Assets;
3. deliver or provide direct electronic access that is fully accessible by Purchaser to all Confidential Business Information related to the Divestiture Product Assets to Purchaser:
    a. in good faith;
    b. in a timely manner, *i.e.*, as soon as practicable, avoiding any delays in transmission of the respective information; and
    c. in a manner that ensures its completeness and accuracy and that fully preserves its usefulness;
4. pending complete delivery of all such Confidential Business Information to Purchaser, provide Purchaser and the Monitor with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files directly related to the Divestiture Product Assets that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order;
5. not use, directly or indirectly, any such Confidential Business Information related to the Divestiture Product Business other than as necessary to comply with the following:
    a. the requirements of this Order;
    b. Respondent's obligations to Purchaser under the terms of any Remedial Agreement; or
    c. applicable Law;

6. not disclose or convey any Confidential Business Information, directly or indirectly, to any Person except (i) Purchaser, (ii) other Persons specifically authorized by Purchaser to receive such information, (iii) the Commission, or (iv) the Monitor and *except* to the extent necessary to comply with applicable Law;

7. ensure that Confidential Business Information related exclusively to the Divestiture Product Assets is not disseminated among the employees of Respondent; and

8. after the delivery of the Confidential Business Information to Purchaser and upon request of Purchaser, destroy any copies of Confidential Business Information exclusively related to the Divestiture Product Assets (other than electric copies of Confidential Business Information created as a result of automatic back-up procedures) within thirty (30) days of such request except as otherwise agreed to between Respondent and Purchaser or to the extent necessary to comply with applicable Law.

C. Respondent shall:

1. [redacted]

2. [redacted]

3. [redacted]

4. [redacted]

   a. [redacted]

   b. [redacted]

[redacted]

[redacted]

D. Respondent shall include in the MPK Product Divestiture Agreement [redacted], subject to the approval of the Commission.

E. The purpose of the divestiture of the Divestiture Product Assets and the related obligations imposed on Respondent by this Order is:

1. to ensure the continued use of such assets for the purposes of the Divestiture Product Business within the United States of America;

2. to create a viable and effective competitor that is independent of Respondent in the Divestiture Product Business within the United States of America; and

3. to remedy any lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint in a timely and sufficient manner.

III.

IT IS FURTHER ORDERED that:

A. At any time after the Order Date, the Commission may appoint a monitor ("Monitor") to assure that Respondent expeditiously comply with all of its obligations and perform all of its responsibilities as required by this Order, the Hold Separate and Asset Maintenance Agreement, and the Remedial Agreements.

B. The Commission shall select the Monitor subject to the consent of Respondent, which consent shall not be unreasonably withheld. If Respondent has not opposed, in writing, including the reasons for opposing, the selection of a proposed Monitor within ten (10) days after notice by the staff of the Commission to Respondent of the identity of any proposed Monitor, Respondent shall be deemed to have consented to the selection of the proposed Monitor.

C. Not later than ten (10) days after the appointment of the Monitor, Respondent shall execute an agreement that, subject to the prior approval of the Commission, confers on the Monitor all the rights and powers necessary to permit the Monitor to monitor Respondent's compliance with the relevant requirements of the Order in a manner consistent with the purposes of the Order.

D. If a Monitor is appointed, Respondent shall consent to the following terms and conditions regarding the powers, duties, authorities, and responsibilities of the Monitor:

1. The Monitor shall have the power and authority to monitor Respondent's compliance with the divestiture and asset maintenance obligations and related requirements of the Order, and shall exercise such power and authority and carry out the duties and responsibilities of the Monitor in a manner consistent with the purposes of the Order and in consultation with the Commission.

2. The Monitor shall act in a fiduciary capacity for the benefit of the Commission.

3. The Monitor shall serve until the later of:

a. the date Respondent completes: (i) the transfer of all Divestiture Product Assets, and (ii) the grant of the Divestiture Product License;

b. the date on which the [redacted] terminates; and

c. the date of written notification from Commission staff that the Monitor, in consultation with Commission staff, has determined that Purchaser has abandoned its efforts to manufacture a Divestiture Product that is being monitored by the Monitor;

provided, however, that the Monitor's service shall not extend more than four (4) years after the Order Date *unless* the Commission decides to extend or modify this period as may be necessary or appropriate to accomplish the purposes of the Order.

E. Subject to any demonstrated legally recognized privilege, the Monitor shall have full and complete access to Respondent's personnel, books, documents, records kept in the ordinary course of business, facilities, and technical information, and such other relevant information as the Monitor may reasonably request, related to Respondent's compliance with its obligations under the Order, including, but not limited to, its obligations related to the relevant assets. Respondent shall cooperate with any reasonable request of the Monitor and shall take no action to interfere with or impede the Monitor's ability to monitor Respondent's compliance with the Order.

F. The Monitor shall serve, without bond or other security, at the expense of Respondent, on such reasonable and customary terms and conditions as the Commission may set. The Monitor shall have authority to employ, at the expense of Respondent, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Monitor's duties and responsibilities.

G. Respondent shall indemnify the Monitor and hold the Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Monitor's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from gross negligence, willful or wanton acts, or bad faith by the Monitor.

H. Respondent shall report to the Monitor in accordance with the requirements of this Order and as otherwise provided in any agreement approved by the Commission. The Monitor shall evaluate the reports submitted to the Monitor by Respondent, and any reports submitted by Purchaser with respect to the performance of Respondent's obligations under the Order or the Remedial Agreement(s). Within thirty (30) days after the date the Monitor receives these reports, the Monitor shall report in writing to the Commission concerning performance by Respondent of its obligations under the Order.

I. Respondent may require the Monitor and each of the Monitor's consultants, accountants, attorneys, and other representatives and assistants to sign a customary confidentiality agreement; *provided, however,* that such agreement shall not restrict the Monitor from providing any information to the Commission.

J. The Commission may, among other things, require the Monitor and each of the Monitor's consultants, accountants, attorneys, and other representatives and assistants to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the Monitor's duties.

K. If the Commission determines that the Monitor has ceased to act or failed to act diligently, the Commission may appoint a substitute Monitor in the same manner as provided in this Paragraph.

L. The Commission may on its own initiative, or at the request of the Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of the Order.

M. The Monitor appointed pursuant to this Order may be the same Person appointed as a Divestiture Trustee pursuant to the relevant provisions of this Order.

IV.

IT IS FURTHER ORDERED that:

A. If Respondent has not fully complied with the obligations to assign, grant, license, divest, transfer, deliver, or otherwise convey the Divestiture Product Assets as required by this Order, the Commission may appoint a trustee ("Divestiture Trustee") to assign, grant, license, divest, transfer, deliver, or otherwise convey these assets in a manner that satisfies the requirements of this Order. In the event that the Commission or the Attorney General brings an action pursuant to § 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondent shall consent to the appointment of a Divestiture Trustee in such action to assign, grant, license, divest, transfer, deliver, or otherwise convey these assets. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(*l*) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondent to comply with this Order.

B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondent, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a Person with experience and expertise in acquisitions and divestitures of Product businesses. If Respondent has not opposed, in writing, including the reasons for opposing, the selection of any proposed Divestiture Trustee within ten (10) days after notice by the staff of the Commission to Respondent of the identity of any proposed Divestiture Trustee, Respondent shall be deemed to have consented to the selection of the proposed Divestiture Trustee.

C. Not later than ten (10) days after the appointment of a Divestiture Trustee, Respondent shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture required by this Order.

D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph, Respondent shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:

1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to assign, grant, license, divest, transfer, deliver, or otherwise convey the assets that are required by this Order to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed.

2. The Divestiture Trustee shall have one (1) year after the date the Commission approves the trust agreement described herein to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the one (1) year period, the Divestiture Trustee has submitted a plan of divestiture or the Commission believes that the divestiture(s) can be achieved within a reasonable time, the divestiture period may be extended by the Commission; *provided, however*, the Commission may extend the divestiture period only two (2) times.

3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records, and facilities related to the relevant assets that are required to be assigned, granted, licensed, divested, delivered, or otherwise conveyed by this Order and to any other relevant information as the Divestiture Trustee may request. Respondent shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondent shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture(s). Any delays in divestiture caused by Respondent shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.

4. The Divestiture Trustee shall use commercially reasonable efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondent's absolute and unconditional obligation to divest expeditiously and at no minimum price. The divestiture(s) shall be made in the manner and to Purchaser as required by this Order; *provided, however*, if the Divestiture Trustee receives bona fide offers from more than one acquiring Person, and if the Commission determines to approve more than one such acquiring Person, the Divestiture Trustee shall divest to the acquiring Person selected by Respondent from among those approved by the Commission; *provided further, however*, that Respondent shall select such Person within five (5) days after receiving notification of the Commission's approval.

5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondent, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the

authority to employ, at the cost and expense of Respondent, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of Respondent, and the Divestiture Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of all of the relevant assets that are required to be divested by this Order.

6. Respondent shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.

7. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be divested by this Order; *provided, however,* that the Divestiture Trustee appointed pursuant to this Paragraph may be the same Person appointed as Monitor pursuant to the relevant provisions of this Order.

8. The Divestiture Trustee shall report in writing to Respondent and to the Commission every thirty (30) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.

9. Respondent may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys, and other representatives and assistants to sign a customary confidentiality agreement; *provided, however,* that such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.

E. The Commission may, among other things, require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys, and other representatives and assistants to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the Divestiture Trustee's duties.

F. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph.

G. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture(s) required by this Order.

V.

IT IS FURTHER ORDERED that, in addition to any other requirements and prohibitions relating to Confidential Business Information in this Order, Respondent shall assure that its own counsel (including its own in-house counsel under appropriate confidentiality arrangements) shall not retain unredacted copies of documents or other materials provided to Purchaser or access original documents provided to Purchaser, except under circumstances where copies of documents are insufficient or otherwise unavailable, and for the following purposes:

A. to assure Respondent's compliance with any Remedial Agreement, this Order, any Law (including, without limitation, any requirement to obtain regulatory licenses or approvals, and rules promulgated by the Commission), any data retention requirement of any applicable Government Entity, or any taxation requirements; or

B. to defend against, respond to, or otherwise participate in any litigation, investigation, audit, process, subpoena, or other proceeding relating to the divestiture or any other aspect of the Divestiture Products or the assets and Divestiture Product Business;

provided, *however*, that Respondent may disclose such information as necessary for the purposes set forth in this Paragraph pursuant to an appropriate confidentiality order, agreement, or arrangement;

provided further, *however,* that pursuant to this Paragraph, Respondent needing such access to original documents shall: (i) require those who view such unredacted documents or other materials to enter into confidentiality agreements with Purchaser (but shall not be deemed to have violated this requirement if Purchaser withholds such agreement unreasonably); and (ii) use best efforts to obtain a protective order to protect the confidentiality of such information during any adjudication.

VI.

IT IS FURTHER ORDERED that:

A. Any Remedial Agreement shall be deemed incorporated into this Order.

B. Any failure by Respondent to comply with any term of such Remedial Agreement shall constitute a failure to comply with this Order.

C. Respondent shall not seek, directly or indirectly, pursuant to any dispute resolution mechanism incorporated in any Remedial Agreement, or in any agreement related to any of the Divestiture Products, a decision the result of which would be inconsistent with the terms of this Order or the remedial purposes thereof.

D. Respondent shall not modify or amend any of the terms of any Remedial Agreement without the prior approval of the Commission, except as otherwise provided in Rule 2.41(f)(5) of the Commission's Rules of Practice and Procedure, 16 C.F.R. § 2.41(f)(5).

Notwithstanding any term of the Remedial Agreement(s), any modification or amendment of any Remedial Agreement made without the prior approval of the Commission, or as otherwise provided in Rule 2.41(f)(5), shall constitute a failure to comply with this Order.

VII.

IT IS FURTHER ORDERED that:

A. Within five (5) days of the Closing Date, Respondent shall submit to the Commission a letter certifying the date on which the divestiture occurred.

B. Within thirty (30) days after the Order Date, and every ninety (90) days thereafter until Respondent has (i) transferred all of the Divestiture Assets to Purchaser; (ii) fully provided the Divestiture Product Assets and granted the Divestiture Technology License to Purchaser, and (iii) completed all transitional services as provided for in transitional services agreement between Purchaser and Respondent, Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying, and has complied with these requirements of the Order. Respondent shall submit at the same time a copy of its report concerning compliance with this Order to the Monitor, if any Monitor has been appointed. Respondent shall include in their reports, among other things that are required from time to time, a full description of the efforts being made to comply with the relevant paragraphs of the Order, including:

1. a detailed description of all substantive contacts, negotiations, or recommendations related to (i) the divestiture and transfer of all relevant assets and rights, and (ii) any transitional services being provided by Respondent to Purchaser; and
2. a detailed description of the timing for the completion of such obligations.

C. One (1) year after the Order Date, annually for the next four (4) years on the anniversary of the Order Date, and at other times as the Commission may require, Respondent shall file a verified written report with the Commission setting forth in detail the manner and form in which it has complied and is complying with the Order.

VIII.

IT IS FURTHER ORDERED that Respondent shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of Respondent; (2) acquisition, merger, or consolidation of Respondent; or (3) other change in Respondent that may affect compliance obligations arising out of this Order, including, but not limited to, assignment, the creation or dissolution of subsidiaries, or any other change in Respondent.

IX.

IT IS FURTHER ORDERED that, for purposes of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request and with reasonable notice to Respondent made to its principal United States offices, registered office of its United States subsidiary, or its headquarters address, that Respondent shall permit any duly authorized representative of the Commission:

A. Access, during office hours of Respondent and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondent related to compliance with this Order; and

B. Upon five (5) days' notice to Respondent and without restraint or interference from Respondent, to interview officers, directors, or employees of Respondent, who may have counsel present, regarding such matters.

X.

IT IS FURTHER ORDERED that this Order shall terminate on the date ten (10) years after the Order Date.

By the Commission.

April J. Tabor
Acting Secretary

SEAL

ISSUED:

NON-PUBLIC APPENDIX I
ACQUISITION AGREEMENTS
[Cover Page]

NON-PUBLIC APPENDIX II.A
AGREEMENTS RELATED TO DIVESTITURE OF THE DIVESTITURE PRODUCTS
[Cover Page]

REDACTED IN ENTIRETY

NON-PUBLIC APPENDIX III
MONITOR AGREEMENT

[Cover Page]

PUBLIC APPENDIX IV
MONITOR AGREEMENT

[Cover Page]

NON-PUBLIC APPENDIX V

[redacted]

[Cover Page]

PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Joseph J. Simons, Chairman**
Noah Joshua Phillips
Rohit Chopra
Rebecca Kelly Slaughter
Christine S. Wilson

In the Matter of

Otto Bock HealthCare North America, Inc.,
a corporation.

Docket No. 9378

INDEX OF ATTACHMENTS
TO RESPONDENT'S APPEAL BRIEF

Attachment	Description
A	ALJ Order on Respondent's *In Camera* Documents (Oct. 10, 2018)
B	Complaint Counsel's Initial Disclosures, Appx. A (Jan. 18, 2018)
C	*FTC v. Arch Coal, Inc.*, No. 1:04-cv-00534, ECF No. 67 (D.D.C. July 7, 2004)
D	Joseph J. Simons, *The Potential Impact of New Economic Tests in Merger Analysis: A New Direction*, ABA Antitrust Section Spring Meetings (March 5, 2010)
E	Malcolm B. Coate & Joseph J. Simons, *Critical Loss v. Diversion Analysis, Clearing up the Confusion, Competition Policy International* (Dec. 2009)

ATTACHMENT A

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of Otto Bock HealthCare North America, Inc., a corporation, Respondent.	Docket No. 9378

ORDER ON RESPONDENT'S *IN CAMERA* DOCUMENTS

Pursuant to Rule 3.45(b) of the Commission's Rules of Practice and the Scheduling Order entered in this matter, Respondent Otto Bock HealthCare North America, Inc. ("OttoBock") and Freedom Innovations ("Freedom") filed motions for *in camera* treatment for certain materials that the parties listed on their exhibit lists. Those motions were resolved by the Orders issued July 27, 2018, August 8, 2018, and September 17, 2018. Attachment A of this Order lists the Ottobock and Freedom documents for which *in camera* treatment has been granted by those Orders, the corresponding PX or RX numbers, and each document's *in camera* treatment expiration date.

ORDERED:

DM Chappell
D. Michael Chappell
Chief Administrative Law Judge

Date: October 10, 2018

Attachment A

The following documents shall be accorded *in camera* treatment for a period of three years, to expire on July 1, 2021:

Exhibit Numbers
PX00758 (p. 2), PX00795, PX01236, PX01281, PX01924, PX01981, PX03170, RX-0467, RX-0485, RX-0911, RX-0912, RX-0913, RX-0914, RX-0916, RX-0917

The following documents shall be accorded *in camera* treatment for a period of five years, to expire on July 1, 2023:

Exhibit Numbers
PX00753, PX00754, PX00755, PX00757, PX00760, PX00761, PX00762 (pp. 2-11), PX00763, PX00772, PX00774, PX00775, PX00776, PX00780 (p. 2), PX00781, PX00782, PX00785, PX00786, PX00789, PX00791, PX00796, PX00798, PX00799, PX00800, PX00801, PX00802, PX00804, PX00808, PX00809, PX00818, PX00821, PX00822, PX00825, PX00826, PX00828, PX00829, PX00830, PX00831, PX00832, PX00833, PX00834, PX00838, PX00839, PX00840, PX00842, PX00843, PX00860, PX00862, PX00863, PX00867, PX00869, PX00870, PX00871, PX00886, PX00887, PX00888, PX00889, PX00890, PX01001, PX01009, PX01010, PX01011, PX01012, PX01017 (p. 2), PX01029 (pp. 2-3), PX01050, PX01051, PX01053, PX01054 (pp. 1-13), PX01055, PX01056, PX01058, PX01061, PX01062 (pp. 4-6), PX01065, PX01066, PX01068 (pp. 24-41), PX01069 (p. 2), PX01075, PX01077, PX01079, PX01080, PX01083, PX01084, PX01085 (pp. 4, 6), PX01087, PX01088, PX01089, PX01091, PX01097, PX01098, PX01099, PX01102, PX01103, PX01104, PX01105, PX01106, PX01107, PX01108, PX01109, PX01115, PX01154, PX01156, PX01157, PX01160, PX01162, PX01163, PX01173, PX01184, PX01187, PX01189, PX01192, PX01197, PX01199, PX01205, PX01211, PX01217, PX01220, PX01224, PX01231, PX01232, PX01233, PX01234, PX01237, PX01238, PX01239 (p. 2), PX01241, PX01244, PX01245, PX01249, PX01255, PX01256, PX01257, PX01259, PX01260, PX01261, PX01262, PX01263, PX01264, PX01265 (pp. 1-2), PX01277, PX01278, PX01279, PX01282, PX01285, PX01292, PX01293, PX01294, PX01295, PX01297 (pp. 24-25, 59-61), PX01299, PX01300, PX01302, PX01303, PX01304, PX01306, PX01307, PX01310, PX01311, PX01312, PX01313, PX01314, PX01315, PX01321 (p. 1), PX01323, PX01324, PX01330 (pp. 6-8), PX01333, PX01334, PX01336, PX01339 (pp. 2-4), PX01347, PX01350, PX01351, PX01352, PX01360, PX01362, PX01363 (p. 1), PX01364, PX01365 (p. 4), PX01366, PX01374, PX01378, PX01379, PX01384, PX01389, PX01390, PX01394, PX01396, PX01397, PX01399, PX01401, PX01403, PX01409, PX01411, PX01413, PX01418, PX01420, PX01423, PX01426, PX01427, PX01428, PX01429, PX01431, PX01432, PX01434, PX01437, PX01438, PX01439, PX01441, PX01443, PX01444, PX01448, PX01455 (p. 2), PX01456, PX01457, PX01458, PX01460, PX01462, PX01463, PX01467 (p. 2), PX01469, PX01470, PX01472, PX01474, PX01477, PX01478, PX01479, PX01496, PX01500, PX01501, PX01502, PX01504, PX01507, PX01510, PX01512, PX01514, PX01518 (pp. 10, 15, 17), PX01520, PX01521, PX01522, PX01524 (pp. 6-9), PX01533, PX01534, PX01538, PX01539, PX01540, PX01541, PX01544, PX01545, PX01546,

PX01547, PX01551, PX01552, PX01553, PX01554, PX01556, PX01560, PX01561, PX01562, PX01572, PX01573, PX01575, PX01576, PX01577, PX01578, PX01584, PX01590, PX01592, PX01595, PX01596, PX01597, PX01598, PX01600, PX01603, PX01609, PX01619, PX01621, PX01622, PX01623, PX01624, PX01626, PX01627, PX01628, PX01629, PX01630, PX01631, PX01632, PX01634, PX01635, PX01636, PX01637, PX01638, PX01639, PX01640, PX01641, PX01642, PX01643, PX01644, PX01645, PX01646, PX01647, PX01648, PX01649, PX01650, PX01651, PX01652, PX01656, PX01657, PX01658, PX01659, PX01660, PX01661, PX01662, PX01663, PX01664, PX01667, PX01670, PX01671, PX01672, PX01673, PX01674, PX01676, PX01677, PX01678, PX01680, PX01685, PX01687, PX01695, PX01697, PX01698, PX01701, PX01703 (pp. 9-10, 44-46), PX01704, PX01709, PX01710, PX01718, PX01720, PX01730, PX01751, PX01755, PX01756, PX01760, PX01761, PX01837, PX01844, PX01845, PX01850, PX01854, PX01857, PX01858, PX01859, PX01860, PX01862, PX01879, PX01885, PX01890, PX01891, PX01896, PX01897, PX01900, PX01902, PX01903, PX01904, PX01910, PX01914, PX01916, PX01917, PX01919, PX01922, PX01923, PX01926, PX01927, PX01928, PX01929, PX01930, PX01932, PX01933, PX01944, PX01959, PX01961, PX01965, PX01966, PX01967, PX01968, PX01977, PX01978, PX01979, PX01980, PX01983, PX01989, PX01991, PX02003, PX02004, PX02008, PX02014, PX02023 & PX02023R, PX02024 (pp. 5, 6), PX02026, PX02027, PX02028, PX02029, PX02030, PX02033, PX02034 & PX02034R, PX02036, PX02037, PX02047, PX02048, PX02052, PX02053 (pp. 2, 3), PX02054 (p. 3), PX02056, PX02057, PX02058, PX02066, PX02068, PX02069, PX02075, PX02077, PX02079, PX02080, PX02081, PX02087 (p. 1), PX02090, PX02093, PX02102, PX02103, PX02104, PX02109 & PX02109R, PX02111, PX02112, PX02113, PX02115, PX02119, PX02120, PX02122, PX02124, PX02125, PX03002, PX03016, PX03041, PX03044, PX03045, PX03049, PX03055, PX03056, PX03059, PX03060, PX03111, PX03113, PX03114, PX03115, PX03116, PX03118, PX03185, PX03215, PX03215, PX03216, PX03275, PX03279, PX03280, RX-0006, RX-0007, RX-0013, RX-0017, RX-0040, RX-0041, RX-0042, RX-0056, RX-0070, RX-0073, RX-0079, RX-0110, RX-0111, RX-0113, RX-0120, RX-0121, RX-0126,RX-0128, RX-0147, RX-0148, RX-0159, RX-0169, RX-0170, RX-0172, RX-0173, RX-0176, RX-0177, RX-0179, RX-0182, RX-0183, RX-0190, RX-0195, RX-0201, RX-0204, RX-0210, RX-0217, RX-0221, RX-0230, RX-0239, RX-0240, RX-0243, RX-0244, RX-0246, RX-0249, RX-0252, RX-0253, RX-0257, RX-0262, RX-0263, RX-0270, RX-0272, RX-0274, RX-0275, RX-0276, RX-0279, RX-0282, RX-0284, RX-0289, RX-0293, RX-0294, RX-0295, RX-0296, RX-0299, RX-0300, RX-0304 (pp. 1-4), RX-0308, RX-0309, RX-0315, RX-0318, RX-0324, RX-0327, RX-0328, RX-0333, RX-0335, RX-0338, RX-0339, RX-0349, RX-0354, RX-0360, RX-0363, RX-0364, RX-0366, RX-0368, RX-0370, RX-0374, RX-0377 (p. 2), RX-0379, RX-0384 (p. 1), RX-0389, RX-0391, RX-0393, RX-0409, RX-0420, RX-0421, RX-0423, RX-0424, RX-0425 (pp. 6-10), RX-0426, RX-0430, RX-0432, RX-0456, RX-0468, RX-0469, RX-0488, RX-0501, RX-0511, RX-0514, RX-0519, RX-0520, RX-0524, RX-0529, RX-0537, RX-0538, RX-0539, RX-0543, RX-0548, RX-0561, RX-0562, RX-0573, RX-0577, RX-0582, RX-0584, RX-0585, RX-0587, RX-0588, RX-0589, RX-0591, RX-0596, RX-0604, RX-0611, RX-0614, RX-0616, RX-0618, RX-0625, RX-0630, RX-0632, RX-0634, RX-0635, RX-0655, RX-0658, RX-0668, RX-0669, RX-0677, RX-0682, RX-0683, RX-0684, RX-0685, RX-0687, RX-0688, RX-0691, RX-0692, RX-0693, RX-0695, RX-0696, RX-0698, RX-0700, RX-0710, RX-0720, RX-0724, RX-0732, RX-0741, RX-0746, RX-0747, RX-0748, RX-0756, RX-0757, RX-0764, RX-0765, RX-0772, RX-0774, RX-0777, RX-0792, RX-0796, RX-0797 (pp. 8, 10, 12), RX-0817, RX-0818, RX-0819, RX-0820, RX-0821, RX-0823, RX-0827, RX-0828, RX-0830, RX-0833, RX-0884, RX-0885, RX-0891, RX-0892, RX-0893, RX-0902,

RX-0915, RX-0972, RX-0973, RX-0975

The following documents shall be accorded *in camera* treatment for a period of ten years, to expire on July 1, 2028:

Exhibit Numbers
PX01605, PX01606, PX03186, PX03189, RX-1044, RX-1098, RX-1099, RX-1100

The following documents shall be accorded indefinite *in camera* treatment:

Exhibit Numbers
PX00764, PX00765, PX00767, PX00790, PX00794, PX00817, PX00819, PX00827, PX00841, PX00844, PX00856, PX00872, PX00884, PX00885, PX01003, PX01004, PX01013, PX01014, PX01015, PX01019, PX01020, PX01021, PX01023, PX01024, PX01025, PX01026, PX01027, PX01032, PX01032, PX01033, PX01034, PX01035, PX01037, PX01039, PX01040, PX01041, PX01042, PX01043, PX01044, PX01045, PX01046, PX01047, PX01048, PX01049, PX01052, PX01057, PX01059, PX01060, PX01070, PX01072, PX01073, PX01086, PX01114, PX01116, PX01117, PX01118, PX01120, PX01122, PX01124, PX01125, PX01126, PX01127, PX01128, PX01129, PX01130, PX01132, PX01133, PX01136, PX01137, PX01138, PX01139, PX01140, PX01142, PX01143, PX01144, PX01146, PX01147, PX01148, PX01149, PX01155, PX01159, PX01164, PX01171, PX01174, PX01175, PX01185, PX01188, PX01193, PX01194, PX01195, PX01196, PX01198, PX01202, PX01203, PX01208, PX01218, PX01221, PX01222, PX01223, PX01227, PX01228, PX01243, PX01284, PX01286 (pp. 1-2), PX01289, PX01290, PX01296, PX01301, PX01305, PX01308, PX01318, PX01353, PX01354, PX01355, PX01358, PX01370, PX01371, PX01372, PX01373, PX01376, PX01387, PX01388, PX01392, PX01393, PX01405, PX01406, PX01407, PX01408, PX01410, PX01419, PX01422, PX01435, PX01464, PX01465, PX01473, PX01484, PX01498, PX01503, PX01505, PX01511, PX01515, PX01531, PX01532, PX01542, PX01543, PX01555, PX01559, PX01563, PX01564, PX01565, PX01585, PX01602, PX01607, PX01608, PX01611, PX01614, PX01615, PX01616, PX01617, PX01618, PX01633, PX01665, PX01681, PX01682, PX01735, PX01743, PX01752, PX01754, PX01762, PX01763, PX01842, PX01843, PX01847, PX01849, PX01853, PX01871, PX01878, PX01887, PX01892, PX01920, PX01925, PX01931, PX01962, PX01964, PX01975, PX01988, PX01996, PX02001, PX02003, PX02005, PX02031, PX02032, PX02035, PX02041, PX02089, PX03236, PX03237, RX-0015, RX-0030, RX-0067, RX-0069, RX-0097, RX-0112, RX-0117, RX-0122, RX-0156, RX-0163, RX-0166, RX-0186, RX-0196, RX-0198, RX-0205, RX-0207, RX-0214, RX-0232, RX-0236, RX-0248, RX-0255, RX-0256, RX-0259, RX-0260 (p. 2), RX-0261, RX-0265, RX-0269, RX-0280, RX-0283, RX-0303, RX-0305, RX-0306, RX-0317, RX-0321, RX-0322, RX-0323, RX-0325, RX-0330, RX-0331, RX-0380, RX-0381, RX-0388, RX-0403, RX-0431, RX-0434, RX-0443, RX-0499, RX-0516, RX-0521, RX-0553, RX-0569, RX-0575, RX-0578, RX-0603, RX-0642, RX-0686, RX-0718, RX-0719, RX-0788, RX-0789, RX-0971

The following deposition transcript excerpts shall be accorded *in camera* treatment for a period of five years, to expire on July 1, 2023:

Exhibit Numbers	***In Camera* Designations for Deposition Transcripts**
PX05005 Investigational Hearing Transcript of David Smith (HEP)	9:18 – 10:1, 13:8 –14:22, 27:19 –29:4, 29:11□30:7, 31:24□33:7, 35:14□24, 37:3 – 6, 45:4□12, 45:22□60:4, 67:16 – 68:19, 71:8–5, 96:17 –98:1, 106:25 –107:10, 110:13 –121:25, 123:7□130:3, 131:16 – 25, 133:11 – 136:14, 142:6 – 12, 144:14 – 153:2, 154:16–156:14, 158:10 – 159:2, 164:6 – 168:1, 168:20□174:8, 179:20□183:5, 184:7□ 186:2, 188:22-190:2, 191:12-192:5, 197:1-199:2, 201:1-203:9, 207:9-209:7, 213:1-214:18, 221:1-16, 234:10-237:12
PX05006 Investigational Hearing Transcript of John Robertson (Freedom Innovations)	12:7 □ 16:6, 17: 17 □ 19:20, 20:4 □ 21:2, 22:15 □ 23:2, 24:1 □ 12, 25:24 □ 27:16, 29:2 □ 32:12, 33:7 □ 36:21, 38:14 □ 43: 3, 43: 23 □ 47: 11, 48:3 □ 63:1, 64:12 □ 84:10, 85:8 □ 87:7, 87:22 □ 88:22, 90:1 □ 93:5, 93:19 □ 96:20, 97:6 □ 99:21, 100:4 □ 1017, 102:17□105: 8, 105:18□ 110:5, 112:1 □ 113:7, 115:10 □ 120:6
PX05007 Investigational Hearing Transcript of Maynard Carkhuff (Freedom Innovations)	24: 7 □26: 17, 63:24 □ 64: 15, 79: 15 □80: 2, 90: 13 □ 91:8, 101:14 □ 106:14, 109:1□ 111:23, 112:12 □113:11, 115:23 □122:2, 137: 4 □ 138:24, 149:10 □ 150:5, 154:16□155: 1,156: 15 □ 157:2, 163:23□ 164:15,166:20 □ 168:4, 169:10 □ 171:1,172:22□ 173:4, 177:25□ 178:12, 216:14□219:18, 222:25□224:12, 226:7□227: 22, 229:8 □ 233:19, 235:18□237: 2, 239:18-240:4, 243:9-270:23, 273:18-279:2, 287:6-296:8, 300:11-303:11, 304:24-311:4
PX05010 Investigational Hearing Transcript of Scott Schneider (Otto Bock)	15:6□16: 21, 21:7□23, 28:23□29:3, 37:2-4, 37:17□20, 41:15□42: 1, 42:20□43: 13, 43:15□25, 44: 19 □22, 56:17□58:9, 61:9 □63:9, 78:12□24, 79:23□80:6, 80:25□82:20, 82:25□83:16, 94:17□95:8, 95:20□22, 96:24□97: 2, 97: 24 □ 98: 6, 99:7 □ 11, 101: 3 □ 103: 6, 103:18□106:21, 114:13□115:13, 118:10□25, 119: 4 □11, 121:4□ 122:19, 125:9-131 :7, 131:12-134:16, 135:1-4, 135:11-24, 139: 5-141: 4, 141:7-146:23, 147:4-148:2, 149:24-150:11, 151 :19-152:6, 153:6-155 14, 156:2-161:16, 161:21-165 :7, 165:14-167:24, 168:12-169:25, 171:23-181:23, 182:12-187:1, 187:5-10, 187:20-23, 188: 4-191:18, 192:12-199:21, 201:1 -225:6, 227:25-228 :2, 229 :2-241:2, 241:14-247:20

PX05101 Deposition Transcript of Scott Schneider (Otto Bock)	22: 21 □ 22, 23: 7 □ 16, 26: 17 □ 27: 21, 28: 9 □ 19, 33: 5 □ 34: 3, 35: 18 □ 22, 38: 11 □ 20, 40: 23 □ 41: 18, 43: 24 □ 44: 23, 46: 10 □ 47: 12, 47: 21 □ 48: 20, 49: 4 □ 50: 25, 59: 11 □ 21, 60: 15 □ 61: 5, 71: 17 □ 72: 4, 72: 22 □ 76: 10, 78: 7 □ 79: 3, 81: 1 □ 9, 95: 15 □ 97: 11, 99: 2 □ 100: 19, 101: 11 □ 19, 105: 2 □ 106: 1, 106:14 □107:22, 112:21□ 113:9, 124:12 □126:23, 129:9 □ 130:8, 130:24□132:15, 133:25-135:2, 135:21-137:5, 138:15-140:11, 141:7-142:1, 142:5-143:7, 145:9-153:5, 154:7-159:11, 161:21-163:14, 165:6-170:3, 170:19-171:2, 171:17-172:12, 173:16-174:7
PX05103 Deposition Transcript of Lee Kim (Freedom Innovations)	17:19 □ 19:10, 33:13 – 18, 35:15– 20, 36:16 □ 37:6, 43:18 □ 45:14, 45:22 □ 48:22, 60:21 □64:18, 68:2– 21, 71:2□74:1, 83:2 □ 84:19, 106:22□108:10, 108:16□110:2, 110:3 – 20, 113:3– 8, 113:9□117:25, 120:6□121:5, 126:2 – 15, 136:15 –22, 140:18□141:22, 143:24□ 145:11, 145:22-147:25, 152:3□153:15, 154:23-161:9, 162:10-166:5, 171:24-172:15, 175:4-12, 175:13-176:10, 181:2-19, 185:21-187:20
PX05104 Deposition Transcript of Soenke Roessing (Otto Bock)	23: 20 - 24: 16, 24:17 - 27:2, 27: 3 - 8, 28: 17 - 29: 2, 29: 24 - 30: 13, 30:14 - 32:4, 33: 8 - 37: 10, 39: 10 - 43:23, 46: 4 - 50: 23, 51: 6 - 53:17, 54: 6 - 55:11, 56: 1 -20, 57: 2 - 11, 57: 19 - 61: 12, 61: 13 - 19, 63: 3 - 67: 20, 69: 6 - 71: 18, 79: 22 - 81:17, 82: 24 - 86: 19, 90:1 - 92:14, 93:13 - 94: 6, 96: 4 - 10, 105:1-109:20, 111:24-112:17, 116:4-121:19, 128:18-131:23, 133:9-134:20, 140:21-144:16, 146:1-147:4, 148:6 -150:19, 154:16-167:23, 173:16-183:3
PX05109 Deposition Transcript of Maynard Carkhuff (Freedom Innovations)	30:11□31:4, 34:7□35:24, 35:25□38:9, 42:6□44:25, 45:1□5, 46:11□ 48:23, 48:24□55:25, 56:4□59:23, 60:2□61:9, 61:15□64:1, 64:12□ 68:5, 69:24-72:23, 74:5□11, 83:11□84:11, 116:12□119:1, 122:16□ 127:22, 132:14□136:9, 138:19□142:23, 146:15□153:14, 154:18-157:25, 159:5-160:15, 162:9-11, 162:22-163:11, 163:17-167:18, 168:3-169:5, 169:9-183:17, 184:1-186:15, 186:22-190:4, 190:10-192:16, 192:25-193:16, 194:19-220:4, 220:7-230:13, 230:19-242:22, 248:12-249:3, 249:7-250:4
PX05110 Deposition Transcript of Jon Hammack (Moelis & Company)	87:23 □ 88:8, 88:9 □90:9, 115:6□119:8, 126:24 □127:11, 127:12 □ 130:5, 184:19 □188:3

PX05111 Deposition Transcript of Stephen Prince (Freedom Innovations)	11: 14 □ 21, 11: 25 □ 12: 11, 12: 25 □ 13: 15, 14: 13 □ 22, 15: 24 □ 16: 2, 16: 12 □ 18, 17: 16 □ 21, 18: 9 □ 18, 19:17□20, 20:1□8, 20: 20 □ 25, 21: 19 □22: 22, 23: 18 □ 24: 17, 25:1□9, 25: 15 □26:2, 26:9□18, 27:12□21, 28:12□15, 28:24□29:14, 31:12□19, 32:10□17, 34:9□17, 35:17□37:18, 37:22□41:19, 43:6-16, 45:1-11, 45:15-46:4, 46:16-49:1, 49:5-52:4, 53:5-21, 55:6-14, 57:19-24, 60:11-61:7, 61:14-62:13, 63:19-76:4, 76:11-77:9, 77:12-88:20, 89:2-10, 89:15-92:18, 93:7-94:9, 94:25-95:6, 96:9-16, 96:24-97:4, 97:9-98:8, 98:21-103:21, 104:7-25, 105:5-8, 105:13-108:19, 108:23-112:2, 112:14-115:11, 116:5-120:6, 120:14-129:1, 129:6-135:22, 136:6-146:9, 147:19-148:4, 148:24-150:19, 151:2-152:7, 152:17-153:5, 153:18-162:21, 162:25-165:6
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<u>Notice of Electronic Service</u>

I hereby certify that on October 10, 2018, I filed an electronic copy of the foregoing Order Closing Hearing Record, Order Granting Joint Motion to Request a Correction of the Official Transcript, Order Memorializing Bench Ruling, Order on Post-Trial Briefs, Order on Respondents In Camera Documents, with:

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I hereby certify that on October 10, 2018, I served via E-Service an electronic copy of the foregoing Order Closing Hearing Record, Order Granting Joint Motion to Request a Correction of the Official Transcript, Order Memorializing Bench Ruling, Order on Post-Trial Briefs, Order on Respondents In Camera Documents, upon:

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, **Plaintiff,** **v.** **ARCH COAL, INC., et al.,** **Defendants.**	**Civil Action No. 04-0534 (JDB)**
STATE OF MISSOURI, et al., **Plaintiffs,** **v.** **ARCH COAL, INC., et al.,** **Defendants.**	**Civil Action No. 04-0535 (JDB)** **(Consolidated Cases)**

MEMORANDUM OPINION

On May 29, 2003, defendant Arch Coal, Inc. ("Arch") entered a Merger and Purchase Agreement to acquire defendant Triton Coal Co. ("Triton") -- including two mines, the Buckskin mine and the North Rochelle mine -- from Triton's parent, defendant New Vulcan Coal Holdings, LLC ("Vulcan"). Arch and Triton filed pre-merger notification forms on July 11, 2003, with the Department of Justice and the Federal Trade Commission ("FTC" or "Commission") under the Hart Scott Rodino ("HSR") Act, 15 U.S.C. § 18a. In August 2003, the FTC sent Arch and Triton Requests for Additional Information ("Second Requests") to aid in its investigation of the proposed acquisition. Arch informed the FTC in early December 2003 that it was contemplating the sale of the Buckskin mine to Peter Kiewit Sons, Inc. ("Kiewit"). Arch notified the FTC in late January 2004 that an agreement to sell Buckskin to Kiewit had been signed ("Kiewit transaction"). The FTC considered the Arch-Triton merger in light of the additional information concerning the proposed Kiewit transaction, but nevertheless issued an administrative complaint challenging the merger.

On April 8, 2004, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), the FTC filed a motion for preliminary injunction to enjoin Arch from acquiring, directly or indirectly, any stock, assets, or other interests in Triton. That same day, plaintiffs States of Arkansas, Illinois, Iowa, Kansas, Missouri, and Texas ("States") filed a similar motion for a preliminary injunction pursuant to Section 16 of the Clayton Act, 15 U.S.C. § 26.[1] Presently before the Court is the motion in limine filed by the FTC to exclude, for the purposes of the preliminary injunction proceeding, all evidence and argument on the issue of Arch's proposed sale of the Buckskin mine to Kiewit. In effect, the FTC asks this Court to assess the proposed merger as if Arch would retain both the North Rochelle and Buckskin mines.

DISCUSSION

The FTC characterizes the proposed post-merger divestiture of Buckskin to Kiewit as a "self-help permanent remedy" that is not properly before this Court. FTC Mot. at 3. The FTC argues that the Court should exclude consideration of the Kiewit transaction because, as a question of "remedy," it cannot be considered by this Court in a Section 13(b) action for

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[1] By minute entry order issued on April 21, 2004, this Court consolidated the FTC and States cases for purposes of the preliminary injunction hearing and all discovery and pre-hearing proceedings related thereto.

preliminary relief, and because the proposed Kiewit transaction is not a sufficiently binding commitment in any event. In their responses to plaintiffs' complaints and requests for a preliminary injunction, defendants have explained that the proposed acquisition challenged by the FTC is properly seen as a set of two transactions involving, first, the acquisition of Triton's North Rochelle and Buckskin mines by Arch, and then the "concurrent divestiture" of the Buckskin mine to Kiewit. Arch Answer at 1. Defendants argue that ignoring the second transaction would be tantamount to the Court assessing "a purely hypothetical transaction of the Commission's making -- that none of the parties are proposing." Defs.Opp. at 2.

The Court's analysis centers initially on the task of defining the transaction that is being challenged by the FTC. The FTC argues that the Kiewit transaction is merely a proposed remedy to the Arch-Triton merger, while defendants argue that it is a central component of what they are proposing to do and hence what the FTC is challenging. The case most directly on point is Federal Trade Comm'n v. Libbey, 211 F.Supp.2d 34 (D.D.C. 2002). In Libbey, the FTC brought a Section 13(b) preliminary injunction proceeding to enjoin the acquisition of one glassware manufacturer by another. About a month after the FTC had voted to seek a preliminary injunction, and a week after the FTC had filed its complaint in district court, the parties to the merger amended their agreement to allow one party to acquire only a part of the other's manufacturing plants and glassware business, while the rest of the assets would be transferred to another entity. Id. at 38. The court in Libbey, noting that the parties had made a good-faith effort to address the FTC's concerns regarding the original merger agreement in amending that agreement, concluded that

> . . . parties to a merger agreement that is being challenged by the government can abandon that agreement and propose a new one in

> an effort to address the government's concerns. And when they do so under circumstances as occurred in this case, it becomes the new agreement that the Court must evaluate in deciding whether an injunction should be issued.

Id. at 46.

The FTC makes much of the fact that here defendants Arch and Triton, unlike the defendants in Libbey, have not amended their merger agreement to include the sale of Buckskin to Kiewit. The Commission notes that the Kiewit transaction is separate and distinct from the Arch-Triton merger agreement, that the Arch-Kiewit contract is contingent upon the successful acquisition of Triton by Arch and contains provisions that allow one or both parties to walk away from the deal, and that the deal might be renegotiated. The Commission therefore argues that the only transaction squarely in issue before this Court is the Arch-Triton merger.

While it cannot be denied that Arch, Triton, and Kiewit have chosen to structure the proposal as two separate transactions rather than one three-way agreement, the Court does not find this structural choice to be dispositive on the issue whether the Kiewit transaction should be considered in the preliminary injunction proceeding. In Libbey, the court noted that even after the parties had amended their merger agreement, the FTC remained capable of vetting the amended agreement and had in fact voted to enjoin the amended merger agreement. The court therefore concluded that it was the amended merger agreement that the FTC was challenging and that was properly before the court for review on the FTC's motion for preliminary injunction. Libbey, 211 F.Supp.2d at 46. Here as well, Arch informed the Commission in late January 2004 that it had signed an agreement with Kiewit and the FTC then issued its administrative complaint challenging the merger after "determin[ing] that the competitive concerns posed by Arch's acquisition of Triton were not remedied by Arch's offer to sell the Buckskin mine to Kiewit."

FTC Mot. at 4. Thus, the FTC has assessed and is in reality challenging the merger agreement imcluding the Buckskin divestiture.

The fact that the Kiewit transaction is contingent on the successful acquisition of Triton by Arch is not only a logical matter of course, but also reinforces, rather than casts doubt on, the representation the parties have made that the sale of the Buckskin mine will in fact take place after the Arch-Triton merger. The uncontroverted facts, as presented to the Court by both parties, reveal that the Kiewit transaction was proposed as a good faith response to the Commission's investigation and concerns regarding the competitive effects of the Arch-Triton merger. Arch and Kiewit, through senior officers, have testified unequivocally that each is fully committed to the transaction if the Arch-Triton merger is allowed, and that the Buckskin sale will definitely occur. The contract termination provisions referenced by the FTC do state that either Arch or Kiewit may terminate the agreement after a certain set "expiration date," if the closing on the Kiewit transaction, as determined by the closing of the Arch-Triton transaction, has not occurred by that date. But that is little more than a restatement of the obvious fact that the Arch-Kiewit contract is contingent upon the successful acquisition of Triton by Arch. Although theoretically the parties could renegotiate the Kiewit deal, senior officers have affirmed their intent to consummate all aspects of the transaction if not enjoined by this Court. The Court therefore concludes that the transaction that is the subject of the FTC's challenge is properly viewed as the set of two transactions involving the acquisition of Triton by Arch and the immediate divestiture of the Buckskin mine to Kiewit.

The FTC also argues that consideration of the Kiewit transaction is beyond the purview of this Court in a Section 13(b) preliminary injunction hearing and would impinge on the authority of the FTC . The FTC contends that, absent a preliminary injunction from this Court, if Arch were permitted to acquire Triton and then sell Buckskin to Kiewit, the Commission would be unable to order Triton's current operations to be reconstituted in the hands of a new competitor if the Commission were to permanently enjoin the challenged transactions.[2] Therefore, the argument goes, the Commission would be irreparably prejudiced in its ability to fashion a complete and effective permanent remedy at the end of the administrative proceedings. The Court notes again, however, that the FTC, in bringing its administrative complaint against defendants in this Court, first determined that the Kiewit transaction did not resolve its concerns about the transaction. Consistent with the review structure created by Section 13(b), the burden is on the FTC to convince this Court that its judgment is correct that the Arch-Triton merger including the Kiewit transaction raises questions so serious, substantial, difficult and doubtful as to make the challenged transactions fair ground for permanent injunction proceedings before the Commission.

The role of the district court, according to the FTC, is not to sit as the ultimate fact-finder. See Federal Trade Comm'n v. Food Town Stores, Inc., 539 F.2d 1339, 1342 (4th Cir. 1976) ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in FTC in the first instance. The only purpose of a proceeding under § 13 is to preserve the status quo until FTC can perform its function."). Rather, this Court's role is simply to determine whether the FTC has established a likelihood of success on the merits of its case by "raising questions going to the merits so serious, substantial, difficult and

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[2] This argument is not much different from the competing problems presented in considering whether to allow any merger. If not enjoined preliminarily but later found to violate the law, can pre-merger competition really be recreated; and if enjoined preliminarily, would the merger be abandoned and thus no longer possible even if ultimately found lawful? See Federal Trade Comm'n v. Heinz, 246 F.3d 708, 726 (D.C. Cir. 2000).

doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." Federal Trade Comm'n v. Heinz, 246 F.3d 708, 714-15 (D.C. Cir. 2000) (citations omitted). The FTC therefore argues that the DOJ antitrust cases cited by defendants are not applicable because in those cases the district court does sit as the finder of fact. This distinction, however, does not affect the applicability of the observation in United States v. Franklin Electric Co., Civ. A. No. 00-c-0334-c (W.D.Wisc. July 19, 2000) (order denying plaintiff's motion in limine), that a proposed transaction to resolve government antitrust concerns regarding a proposed merger or acquisition should be considered by the district court as "relevant to the determination whether, considered as a whole, defendants' transaction will lessen future competition substantially." Even under Section 13(b), this Court's task in determining the likelihood of the FTC's success in showing that the challenged transaction may substantially lessen competition in violation of Section 7 of the Clayton Act requires the Court to review the entire transaction in question. Given this Court's conclusion, based on all circumstances including the evidence presented at the preliminary injunction hearing, that the Arch-Kiewit transaction will in fact occur as agreed if the Arch-Triton merger goes forward, the Court is unwilling simply to ignore the fact of the divestiture of Buckskin to Kiewit.

CONCLUSION

Because this Court regards the challenged transaction as consisting of both the acquisition of Triton by Arch and the divestiture of the Buckskin mine to Kiewit, and because its role under Section 13(b) requires it to give the challenged transaction a thorough, good-faith review, the Court concludes that excluding evidence and argument regarding the Kiewit transaction would be tantamount to turning a blind eye to the elephant in the room. The FTC's motion in limine will therefore be denied. A separate order accompanies this memorandum opinion.

/s/ John D. Bates
JOHN D. BATES
United States District Judge

Dated: July 7, 2004

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ATTACHMENT D

THE POTENTIAL IMPACT OF NEW ECONOMIC TESTS IN MERGER ANALYSIS: A NEW DIRECTION?

By

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I. INTRODUCTION

For two decades, the fundamental approach to merger analysis contained in the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines ("Merger Guidelines" or "Guidelines") has enjoyed strong bipartisan consensus. Data released by the Federal Trade Commission shows that the core of merger enforcement over this period has involved challenges to mergers that involve four or fewer firms in the relevant market premerger.[1] New approaches to merger analysis have been proposed, which although innovative and elegant, would threaten the existing bipartisan consensus if adopted.

Over the last few years, various economists have proposed using "revealed preference" analysis for market definition[2] and greatly expanding the use of the economic models underlying the Guidelines unilateral effects. The Lerner Condition sits at the heart of both approaches. It is used to derive demand elasticities for market definition and plays an important role in certain unilateral effects models, including Upward Pricing Pressure ("UPP") models.[3] Given the Lerner Condition, proponents develop relatively

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1 Fed. Trade Comm'n, *Horizontal Merger Investigation Data, Fiscal Years 1996-2007*, Table 3.1, Dec. 1, 2008, *available at* http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf.; U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Challenges Data, Fiscal Years 1999-2003, Table 1, December 18, 2003, available at http://www.usdoj.gov/atr/public/201898.pdf.

2 E.g. Michael Katz & Carl Shapiro, *Critical Loss: Let's Tell the Whole Story*, 17 ANTITRUST L.J. 49 (2003), Daniel O'Brien & Abraham Wickelgren, *A Critical Analysis of Critical Loss Analysis*, 71 ANTITRUST L.J. 161 (2003), Joseph Farrell & Carl Shapiro, *Improving Critical Loss*, ANTITRUST SOURCE (Feb. 2008), available at http://www.abanet.org/antitrust/at-source/08/02/Feb08-Farrell-Shapiro.pdf.

3 Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, Feb. 15, 2010. Available at SSRN: http://ssrn.com/abstract=1313782; Daniel

simple formulas using margins and diversion ratios to define markets and to create presumptions and/or screens for unilateral effects. Implementing these approaches could have dramatic consequences, however, substantially increasing the universe of mergers challenged (or subject to challenge) to levels not seen for over 30 years.[4]

We have known for many years that the overwhelming majority of economic models of unilateral effects produce price increases for any merger among competitors no matter how fragmented the market. The Lerner Condition underlies all of these models and is critical to their results. As long as the Lerner Condition applies, virtually every horizontal merger is predicted to increase prices, absent offsetting efficiencies. Because there is no price increase tolerance under Section 7 of the Clayton Act, application of the Lerner Condition becomes a very serious issue if we really believe the results it produces. Thus, the use of price/cost margins to estimate demand via the Lerner Condition in market definition or to drive unilateral effects analysis would dramatically change the character of merger enforcement.

Before adopting approaches that would transform merger enforcement to such an extent and threaten bipartisan consensus, we should have some significant degree of

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O'Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559 (2000); Serge Moresi, *Cournot Competition and The UPP Test*, Merger Guidelines Review Project Public Comment, Nov. 9, 2009, available at http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00036.pdf; Steven C. Salop & Serge Moresi, *Updating the Merger Guidelines: Comments*, Merger Guidelines Review Project Public Comment, Feb. 9, 2009, available at http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00032.pdf.

4 To the extent these approaches are being proposed as screening tools for enforcement authorities in suggesting which mergers to investigated more fully rather than a means to predict price effects of mergers, they fail in that function because very few mergers would be screened out absent unrealistically high efficiencies assumptions or price increase tolerances.

confidence in the validity of the results produced by these new approaches. There is currently, however, no empirical evidence that these approaches can as a general matter reliably predict price effects from mergers . If the Lerner Condition applies generally, merger enforcement has been far too lenient for over 20 years. In that case, one might expect to see evidence of anticompetitive price effects from a very large number of consummated mergers.[5] Indeed, one could view the last 20 years as a natural experiment on the general applicability of the Lerner Condition to merger analysis.

The remainder of this paper is organized as follows. Section II describes the impact of using the unilateral effects approaches that rely on the Lerner Condition through simulations of the UPP model. These simulations show that even with the assumption of very large efficiencies, the model produces anticompetitive price effects for 10 to 9 mergers involving firms with margins of 50% or greater, and for 6-5 mergers with relatively low margins of 30%. Clearly, enforcement at such a level would be a big departure from current practice.

Section III describes how use of the Lerner Condition would impact market definition. The primary impact would be through the use of the Lerner Condition to derive market demand elasticity from marginal cost data as opposed to estimating an elasticity from demand related data. The various versions of this approach that have been proposed produce very narrow markets even for industries with low margins.

Section IV provides concluding remarks.

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5 Pointing to a few mergers here or there that went unchallenged but produced price effects would not be

II. UPP AND ITS IMPLICATIONS[6]

UPP analysis focuses on the pressures for unilateral price effects while avoiding both the need for market definition and the much greater data requirements of traditional merger simulations. If the merging firms are symmetric (i.e. they are sufficiently similar for relevant purposes), UPP analysis can be undertaken with just evidence on diversion ratios, price-cost margins and an assumption on efficiencies. Assuming symmetric firms and assuming only one of the merger partners realizes efficiencies (i.e. ignoring efficiencies realized by the other merger partner), a merger is predicted to increase price if the %UPP is positive such that:

1) $\%UPP = D * M - E_1 * (1-M)$

where D equals the diversion ratio between the merging firms (i.e. the percentage of lost volume retained by one merger partner when the other raises price), M equals the margin (i.e. price minus marginal cost all divided by price), and E equals the efficiency measured as the percentage reduction in marginal cost.[7] Crediting efficiencies to both merging parties produces the following slightly more complex equation:

2) $\%UPP^* = D * M - E * (1-M) * (1-D)$

The UPP technique predicts that every horizontal merger in a differentiated product market exerts some upward pressure on price because each merged firm is able to recover the margin on sales gained by the other merged entity when that entity raises

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nearly sufficient given the extent of the price effects predicted by these new approaches.

6 This discussion relies primarily on Simons & Coate, *Upward Pressure on Price Analysis: Issues and Implications*, March 1, 2010. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1558547#.

7 Farrell & Shapiro (2010), *supra* note 3 at 10.

price. These results can easily be confirmed by observing what happens to Equation 1 when efficiencies (E) are set to zero. Since the margin (M) is a positive number less than 1, the UPP percentage will be positive as long as the diversion (D) is positive.

Farrell and Shapiro propose an example setting a "standard efficiencies deduction" of 10 percent for marginal cost savings achieved by the merged firm. Whatever upward pressure that exists will be offset to some degree by any marginal cost reductions in the relevant market under investigation. The assumption of efficiencies avoids the result that every horizontal merger raises price. Marginal cost savings of 10% in the relevant market, however, would represent a level rarely if ever accepted by the agencies in practice. Even assuming such large efficiencies, the approach continues to predict price effects in a very large universe of mergers.

Tables 1-a and 1-b evaluate the UPP model defined by equation 2[8] for given values of the margin and diversion parameters, first when the efficiency index is set to 0 and then when it is set to 10 percent. Table 1-a shows all mergers in differentiated products result in a positive UPP, placing upward pressure on price. This confirms that the approach always predicts the merger will lead to higher prices in the absence of efficiencies. Given the symmetry assumption, the merger would generate the same upward price pressure for both merger partners.

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8 Using equation 1 would not produce significantly different results. See Simons & Coate, *supra* note 6.

Table 1-a – UPP Model by Margin and Diversion, No Efficiencies

	Diversion						
Margin	0.10	0.15	0.20	0.25	0.30	0.35	0.40
0.90	0.0900	0.1350	0.1800	0.2250	0.2700	0.3150	0.3600
0.80	0.0800	0.1200	0.1600	0.2000	0.2400	0.2800	0.3200
0.70	0.0700	0.1050	0.1400	0.1750	0.2100	0.2450	0.2800
0.60	0.0600	0.0900	0.1200	0.1500	0.1800	0.2100	0.2400
0.50	0.0500	0.0750	0.1000	0.1250	0.1500	0.1750	0.2000
0.40	0.0400	0.0600	0.0800	0.1000	0.1200	0.1400	0.1600
0.30	0.0300	0.0450	0.0600	0.0750	0.0900	0.1050	0.1200
0.20	0.0200	0.0300	0.0400	0.0500	0.0600	0.0700	0.0800
0.10	0.0100	0.0150	0.0200	0.0250	0.0300	0.0350	0.0400

Table 1-b – UPP Model by Margin and Diversion, Ten Percent Efficiencies

	Diversion						
Margin	0.10	0.15	0.20	0.25	0.30	0.35	0.40
0.90	0.0810	0.1265	0.1720	0.2175	0.2630	0.3085	0.3540
0.80	0.0620	0.1030	0.1440	0.1850	0.2260	0.2670	0.3080
0.70	0.0430	0.0795	0.1160	0.1525	0.1890	0.2255	0.2620
0.60	0.0240	0.0560	0.0880	0.1200	0.1520	0.1840	0.2160
0.50	0.0050	0.0325	0.0600	0.0875	0.1150	0.1425	0.1700
0.40	-0.0140	0.0090	0.0320	0.0550	0.0780	0.1010	0.1240
0.30	-0.0330	-0.0145	0.0040	0.0225	0.0410	0.0595	0.0780
0.20	-0.0520	-0.0380	-0.0240	-0.0100	0.0040	0.0180	0.0320
0.10	-0.0710	-0.0615	-0.0520	-0.0425	-0.0330	-0.0235	-0.0140

Table 1-b adds a 10% standard deduction for efficiencies to the simulation. A quick review of the table shows that enforcers could be much more active than would be consistent with current agency practice. UPP would be positive for all mergers involving firms with 50% margins or higher and for substantial numbers of mergers with margins in the 20% - 30% range as well.

Table 2 links the UPP results to market structure, again relying on equation 2. The analyses take the assumed diversion ratios and translates them into the number of competitors that would result assuming each competitor is equally situated (i.e., volume diverts equally to each other competitor assuming a price increase by one of the firms). For example, a 20% diversion ratio implies that there would be six equally situated premerger competitors (five firms receiving 20% of the diversion each for a total of 100%, plus the firm raising price). A merger would reduce the number of competitors to five. Table 2-a illustrates that (without efficiencies) all horizontal mergers are predicted to raise price under this approach. For example, there would be a positive UPP of 1.1 percent for situations involving a merger from ten to nine firms when the firms have margins of only 10%.[9]

[9] Although it is conceivable that not all equally situated competitors would be included in a market technically defined under the Merger Guidelines, we are aware of no instances where this has occurred in practice. Accordingly, we believe the simulations in Table 2 provide valuable insight and allow for good comparisons with historic levels of enforcement.

Table 2-a - UPP Model by Margins and Rivals, No Efficiencies

	Rivals								
Margin	2	3	4	5	6	7	8	9	10
0.900	0.900	0.450	0.300	0.225	0.180	0.150	0.128	0.113	0.100
0.800	0.800	0.400	0.267	0.200	0.160	0.133	0.114	0.100	0.089
0.700	0.700	0.350	0.233	0.175	0.140	0.117	0.099	0.088	0.078
0.600	0.600	0.300	0.200	0.150	0.120	0.100	0.085	0.075	0.067
0.500	0.500	0.250	0.167	0.125	0.100	0.083	0.071	0.063	0.056
0.400	0.400	0.200	0.133	0.100	0.080	0.067	0.057	0.050	0.044
0.300	0.300	0.150	0.100	0.075	0.060	0.050	0.043	0.038	0.033
0.200	0.200	0.100	0.067	0.050	0.040	0.033	0.028	0.025	0.022
0.100	0.100	0.050	0.033	0.025	0.020	0.017	0.014	0.013	0.011

Table 2-b - UPP Model by Margins and Rivals, Ten Percent Efficiencies

	Rivals								
Margin	2	3	4	5	6	7	8	9	10
0.900	0.900	0.445	0.293	0.218	0.172	0.142	0.119	0.104	0.091
0.800	0.800	0.390	0.253	0.185	0.144	0.117	0.096	0.083	0.071
0.700	0.700	0.335	0.213	0.153	0.116	0.092	0.074	0.061	0.051
0.600	0.600	0.280	0.173	0.120	0.088	0.067	0.051	0.040	0.031
0.500	0.500	0.225	0.133	0.088	0.060	0.042	0.028	0.019	0.011
0.400	0.400	0.170	0.093	0.055	0.032	0.017	0.005	-0.003	-0.009
0.300	0.300	0.115	0.053	0.023	0.004	-0.008	-0.017	-0.024	-0.029
0.200	0.200	0.060	0.013	-0.010	-0.024	-0.033	-0.040	-0.045	-0.049
0.100	0.100	0.005	-0.027	-0.043	-0.052	-0.058	-0.063	-0.066	-0.069

Table 2-b shows the results assuming the 10% standard deduction for efficiencies, which constitutes a level that is rarely seen in practice. Even with this deduction, however, enforcers could still be extremely active. For example, a merger that results in ten equally situated firms pre-merger (i.e., a ten-to-nine merger) produces a positive UPP as long as the margins are 50% or higher. UPP would also be positive for instances involving six equally situated firms pre-merger with margins as low as 30%. This approach would essentially condemn six-to-five mergers where margins would be considered low to moderate at best. For higher margins, (those usually applicable in differentiated products markets) the approach would be much more aggressive, condemning any merger where there are ten or fewer equally situated competitors. Table 2 thus makes clear that the UPP approach even with the 10% standard efficiencies deduction would mark a substantial break with recent historical enforcement patterns.

III. THE LERNER CONDITION, REVEALED PREFERENCE AND MARKET DEFINITION

Some economists have argued that the market definition exercise should use what they refer to as revealed preference. The intuition is to use firm behavior premerger to predict post merger behavior. Specifically, they suggest using the premerger Lerner Index to derive the demand elasticity facing an individual firm.[10] If the Lerner Condition applies, then the demand elasticity is given by the Lerner Index. It provides that the demand elasiticity facing the firm should equal the inverse of the firm's marginal cost. Mathematically, $\epsilon = 1/m$ where ϵ equals the elasticity facing the firm and m equals the

[10] E.g. Katz & Shapiro, *supra* note 2, O'Brien & Wickelgren, *supra* note 2.

firm's marginal cost.[11] Thus, assuming the Lerner Condition applies, one can estimate the expected loss in sales to an individual firm by multiplying the estimated demand elasticity by the SSNIP. For example, if the margin is 50%, the projected demand elasticity will be 2 (1/.5) and multiplying by the SSNIP (say 5%) results in an estimated 10% loss in volume caused by the SSNIP.

Superficially, it would appear that this approach can easily be combined with Critical Loss Analysis (CLA) to complete the hypothetical monopolist test of the Guidelines. CLA provides a means to determine the loss in volume necessary to make the hypothetical SSNIP unprofitable (i.e. the Critical Loss). Then the Lerner Index can be used to determine whether the projected loss in volume from the SSNIP (i.e., the Actual Loss) will exceed the Critical Loss.[12] The use of the Lerner Index can also be used with diversion ratios in a similar way, which has been proposed by several economists.[13]

There are, however, several significant problems with this approach. First, contrary to what some economists have claimed, demand elasticity estimates derived from the Lerner equation do not constitute empiric evidence and should not considered the gold standard of evidence. The Lerner equation presents a theoretic relationship between margins and elasticity given certain assumptions including that demand and supply curves are differentiable. Empiric evidence involves observations that support the

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11 E.g. Farrell & Shapiro, *supra* note 2.

12 Id.

13 See references cited *supra* note 2.

theoretic predictions. There are no observations or studies showing that the Lerner Index's theoretical predictions of the relationship between margins and demand have general applicability to the real world.

Second, application of the Lerner Index results in the definition of extremely narrow markets. Table 3 provides an illustration with a single firm SSNIP as suggested by several economists.[14] It assumes 10 equally situated firms such that 11.1 % of volume will divert to the other nine firms when any one of them raises price. The first column lists the range of margins from 10% through 90%. The second column displays the Critical Diversion Ratio for a 5% SSNIP.[15] The third column displays the number of firms in the market, which is calculated as the firm hypothesized to raise price plus the number of other firms necessary to achieve the critical amount of diversion listed in column 2. Thus, where one of the ten firms raises price 5% and margins are 10%, three other firms are necessary to attract at least 33.3% of the volume diverted from the first firm in order for the price increase to be profitable. (Recall each firm only attracts 11.1 % of the diversion.).

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[14] Katz & Shapiro, *supra* note 2, O'Brien & Wickelgren, *supra* note 2.

[15] The critical diversion ratios are taken from Table 1 of O'Brien & Wickelgren, *supra* note 2.

Table 3

Margin	Critical Diversion Ratio for 5% SSNIP	Implied # of Firms in Market
90%	5.3%	2
80%	5.9%	2
70%	6.7%	2
60%	7.7%	2
50%	9.1%	2
40%	11.1%	2
30%	14.3%	3
20%	20.0%	3
10%	33.3%	4

As Table 3 shows, the single firm SSNIP produces very narrow markets. With a 10% margin, the market will be defined to include 4 firms. But once the margin hits 20-30%, the number of firms in the market drops to 3 so that a merger with those margins will be viewed as reducing the number of competitors from three to two. Once the margin gets to 40% and above, only the merging firms are included in the market. These results are quite dramatic in a situation where there are 10 equally situated firms. A key point to notice here is that even margins of 10-30% produce very narrow markets.

The intuition for this result is similar to that of UPP. If the Lerner Condition applies, then every horizontal merger raises price absent offsetting efficiencies. If markets were defined as any set of firms the merger of which will increase price, then every merger would result in defining a market of only the two merging firms absent offsetting efficiencies. However, because market definition is done assuming a hypothetical price increase of usually 5% or more, the results are not quite that severe.

Although the Lerner Condition results in every horizontal merger producing a price increase, the predicted price increase may be less than 5%.[16]

Economists have also modeled a series of sequential price increases in order to approximate an across the board SSNIP. Given certain assumptions, this approach produces the same results as the single firm SSNIP. That is, it produces exactly the same set of very narrow markets.

Third, the extreme results produced by the Lerner Condition (either in market definition or UPP analysis) should make us skeptical of its validity. If the Lerner Condition is applicable generally, then merger enforcement has been extremely lax for well over 20 years and we should expect to see widespread evidence of anticompetitive price increases from the large universe of mergers that went unchallenged by enforcement authorities. Perhaps that evidence will be developed, but it does not exist currently.

Finally, there is substantial theoretic and empirical evidence to suggest affirmatively that the conditions necessary for the applicability of the Lerner Index are generally not present.[17]

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[16] There are also very serious theoretical problems with using single firm SSNIPs for market definition unrelated to the Lerner Condition. These include the fact that this approach results in defining markets for which we know ahead of time that coordinated or unilateral effects are very unlikely. Malcolm B. Coate & Joseph J. Simons, *Critical Loss vs. Diversion Analysis: Clearing up the Confusion*, CPI ANTITRUST CHRONICLE (December 2009) at 13-15. The approach also dramatically limits the universe of relevant firms for repositioning analysis, and it bears no relationship to analysis of coordinated interaction. *Id.*

III. CONCLUSION

Antitrust enforcement has enjoyed a strong bipartisan consensus for many years. New approaches have been proposed, however, that would dramatically expand merger enforcement to levels not seen for 30 years and thus, threaten the existing consensus. These proposals should not be adopted lightly. If these proposals are valid, then antitrust enforcement has been grossly lenient for over two decades and one might expect to see significant evidence of large numbers of mergers producing anticompetitive price effects over that period. Perhaps further investigation would be appropriate before such a radical change in course is undertaken.

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[17] David Scheffman & Joseph J. Simons, *Deconstructing the Analysis of Unilateral Effects for Differentiated Products: Theory, Assumptions and Relevant Research*, forthcoming in ANTITRUST SOURCE.

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ATTACHMENT E

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Critical Loss vs. Diversion Analysis: Clearing up the Confusion

Malcolm B. Coate & Joseph J. Simons

Federal Trade Commission & Paul,Weiss

Critical Loss vs. Diversion Analysis: Clearing up the Confusion

Malcolm B. Coate & Joseph J. Simons[1]

I. INTRODUCTION

Critical Loss Analysis has been a standard method of implementation for the market definition algorithm of the Department of Justice ("DOJ") and Federal Trade Commission ("FTC") Horizontal Merger Guidelines ("Guidelines").[2] A few years ago, it was recognized as one of the major developments of the modern Merger Guidelines era.[3] At the same time, however, there has been a lively debate about the pros and cons of the standard Critical Loss Analysis ("CLA") methodology. An alternative methodology has been proposed by the current chief economists at both the FTC and the DOJ.[4] With the recent announcement by the agencies of their intent to amend the Guidelines, this debate takes on some urgency.

A few years after the issuance of the 1982 Merger Guidelines, CLA was introduced as an empirical structure to define relevant markets, as well as a method to aid in the full competitive effects analysis.[5] Recently, however, various commentators have suggested problems with CLA ranging from fairly minor issues[6] to claims that the approach is not consistent with basic economic theory.[7] Not surprisingly, there is considerable confusion in the antitrust community regarding the appropriate use of CLA and its potential alternatives. This article attempts to bring some clarity to this situation.

There are multiple sources for this confusion. We identify four. Once these sources of confusion are understood, the only real area of disagreement relates how to measure the

[1] Malcolm B. Coate is an economist at the Federal Trade Commission and Joseph J. Simons is a Partner in Paul, Weiss, Rifkind, Wharton & Garrison LLP and Director of the Bureau of Competition at the Federal Trade Commission from June 2001 to August 2003. The authors would like to thank Jeffrey Fischer, Mark Williams, Aidan Synnott, Jonathan Lave, Barry Harris, David Scheffman, Dennis Carlton, and an anonymous referee for helpful comments. The analyses and conclusions set forth in this paper are those of the authors and do not necessarily represent the views of the Federal Trade Commission, any individual Commissioner, or any Commission Bureau.

[2] Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (Issued April 1992/Revised April 1997) at § 1. For an overview on the Guidelines market definition test, *see* Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 ANTITRUST L. J. 253 (2003).

[3] David Scheffman, Malcolm Coate, & Louis Silvia, *Twenty Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective*, 71 ANTITRUST L. J. 277, 285 (2003).

[4] Joseph Farrell & Carl Shapiro, *Improving Critical Loss*, ANTITRUST SOURCE, Feb. 2008, http://www.abanet.org/antitrust/at-source/08/02/Feb08-Farrell-Shapiro.pdf.

[5] Barry C. Harris & Joseph J. Simons, *Focusing Market Definition: How Much Substitution is Enough*, 12 RES. L. & ECON. 207 (1989). This model has been generalized for increasing marginal cost conditions in Malcolm B. Coate & Mark Williams, *Generalized Critical Loss for Market Definition*, 22 RES. L. & ECON. 41 (2007). Moreover, background on the critical loss debate can be found in Malcolm B. Coate & Mark Williams, *A Critical Commentary on the Critical Comments on Critical Loss*, 53 ANTITRUST BULL. 987 (2008). This paper builds on the Harris and Simons' observation that a general critical loss methodology can also be used for the overall competitive effects analysis.

[6] Michael G. Baumann & Paul E Godek, *Reconciling the Opposing Views of Critical Elasticity*, GCP MAGAZINE September 2009 (2) for the basic presentation and Michael G. Baumann & Paul E Godek, *Could and Would Understood: Critical Elasticities and the Merger Guidelines*, 40 ANTITRUST BULL. 885 (1995) for details on the elasticities.

[7] Daniel O'Brien & Abraham Wickelgren, *A Critical Analysis of Critical Loss Analysis*, 71 ANTITRUST L. J. 161 (2003).

demand responses to a Guidelines' hypothetical price increase when defining relevant markets. CLA, applied properly, turns out not to be the issue.

The first source of confusion involves some ambiguity over what the Critical Loss is and the appropriate way to do a Critical Loss Analysis. Critical Loss is merely an estimate of the amount of sales volume a hypothetical monopolist must lose to make a hypothetical small but significant and non-transitory price increase ("SSNIP") unprofitable. It is the first step in Critical Loss Analysis and is based on margin data and nothing else. It does not assume any type of demand curve or economic model. Other than the fact that it involves an estimation of the margin, it is pure arithmetic—algebra to be precise.[8] Critical Loss Analysis includes a further step, which is to estimate whether the predicted actual loss in volume from the hypothetical price increase (the Actual Loss) will exceed the Critical Loss and thus require expansion of the candidate market under the Merger Guidelines test. This further step does, of course, involve some serious economic analysis, and turns out to be the source of the real conflict. While economists can advance other methodologies, Critical Loss Analysis is a simple break-even concept used to define relevant markets.[9]

Second, the scope of the SSNIP is another source of confusion. The common application of the Merger Guidelines test for market definition hypothesizes an across-the-board SSNIP for all products in the candidate market. Various proposals have been made to use: (1) a price increase on only one of the products in the market (single-firm SSNIP) or (2) different price increases for different products in the market, which we term a variable SSNIP.[10] Obviously, calculating Critical Loss for different price increases would require different formulas, and this could easily generate different market definitions. It is important to make sure that the SSNIPs being compared are of the same type when trying to compare the results of two Critical Loss Analyses. And given the very serious disagreement over the appropriateness of using any type of single-firm or variable SSNIP in market definition, their widespread use is problematic. We discuss problems with the use of single-firm and variable SSNIP concepts in market definition in the Appendix.

Third, there is confusion over the role of Critical Loss when diversion ratios are introduced into the analysis. In effect, calculating a critical diversion ratio, as Farrell and Shapiro propose,[11] is merely a variant of calculating a Critical Loss. Rather than ask how much volume the hypothetical monopolist must lose to make the price increase unprofitable, the critical diversion approach asks how much volume must be kept by the firms in the market to make the price increase profitable. This is effectively identical to estimating Actual Loss under the Farrell & Shapiro structure.[12] Whether looked at from the point of view of loss or diversion,

[8] Adriaan Ten Kate & Gunnar Niels, *The Concept of Critical Loss for a Group of Differentiated Products*, J. COMPETITION L. & ECON. (2009) at 4, available: doi:10.1093/joclec/nhp015. This is not to say that determining the margin is a trivial exercise.

[9] We will leave it to others to discuss what the Guidelines meant by the term "likely would impose" in relationship to a SSNIP. Our position is clear: For roughly 20 years, merger analysts have applied the standard CLA to define markets with a break-even analysis.

[10] Oystein Daljord, Lars Sorgard, & Oyvind Thomasseen, *The SSNIP Test and Market Definition with the Aggregate Diversion Ratio: A Reply to Katz and Shapiro*, 4 J. COMPETITION L. & ECON. 263 (2008) and Janusz Ordover & Robert D. Willig, *Economics and the 1992 Merger Guidelines: A Brief Survey*, 8 REV. INDUS. ORG 139 (1993).

[11] Farrell & Shapiro, *supra* note 4 at 5.

[12] Breakeven diversion defines the percentage of the sales lost by incumbent firms in response to a SSNIP that must be recovered by (diverted to) incumbent firms such that the SSNIP will breakeven with respect to profits earned

the question is essentially the same. In the literature, the diversion analysis may look different, because it is frequently discussed with assumptions regarding demand estimates baked into the calculation. We see no reason to explore this issue in greater depth.

Fourth, and most importantly, the disagreement is very real and highly significant with respect to how to compute the likely demand response to the SSNIP (the Actual Loss). Katz and Shapiro and, more recently, Farrell and Shapiro, propose an approach (the "FKS approach") based on the general applicability of: (1) the Lerner Condition, and (2) a specific method for aggregating the results from the firm level to the market level.[13] Given these two assumptions, they advocate a theoretic approach that emphasizes "premerger margins" to derive (rather than measure directly through empirical analysis) the predicted demand response to a price increase by a hypothetical monopolist under the Merger Guidelines test for market definition. Farrell and Shapiro suggest that empirical analysis of demand could rebut this theoretic "evidence," but one is left with the impression that they would impose a high burden of proof in this regard such that the theoretic evidence would almost always prevail.

As we explain below, the FKS approach has serious drawbacks, and this is the focus of our paper.[14] First, the methodology is designed to almost guarantee narrow markets, even in low-to-moderate margin industries. Courts are unlikely to get comfortable with this result, because it appears to shift the burden of proof on market definition away from the plaintiff.[15] Second, the FKS approach models firm level outcomes, while market definition under the Merger Guidelines and Critical Loss methodology focuses on market level outcomes. Thus, the FKS approach must aggregate firm effects together to obtain a market effect, but it does so through the use of restrictive assumptions that may lack empirical basis.[16] Without these

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by the incumbent firms. Mathematically, (1-D) S/M = S/(S+M) where, D is the break-even diversion, S/M is the elasticity of demand defined as the ratio of the SSNIP (S) to the Margin (M) via the Lerner index and S/(S+M) is the critical loss for a linear demand curve. Re-arranging terms shows (1-D) = M/(M+S) and then D = S/(M+S), so in percentage terms, the break-even diversion equals the breakeven critical loss for a linear demand curve.

[13] Michael Katz & Carl Shapiro, *Critical Loss Let's Tell the Whole Story*, 17 ANTITRUST L.J. 49 (2003) and Farrell & Shapiro, *supra* note 4. For a round of response-rejoinder, *see* David T. Scheffman & Joseph J. Simons, *The State of Critical Loss Analysis: Let's Make Sure We Understand the Whole Story*, ANTITRUST SOURCE, Nov. 2003, http://www.abanet.org/antitrust/at-source/03/11/scheffman.pdf , Michael L. Katz & Carl Shapiro, *Further Thoughts on Critical Loss Analysis*, ANTITRUST SOURCE, Mar. 2004, http://www.abanet.org/antitrust/at-source/04/03/katzshapiro.pdf ; and Daniel P. O'Brien & Abraham L. Wickelgren, *The State of Critical Loss Analysis: Reply*, ANTITRUST SOURCE. Mar. 2004, http://www.abanet.org/antitrust/at-source/04/03/obrienwickel.pdf.

[14] In a companion paper, Coate and Simons discuss a number of situations in which the price-based model of product differentiation is not applicable. In effect, the conclusions of the two papers are the same; the theorists' approach to Critical Loss Analysis represents a special case generalization of the standard technique. *See* Malcolm B. Coate & Joseph J. Simons, *Critical Loss: Modeling and Application Issues*. (2009). Available at http://ssrn.com/abstract=1520069 .

[15] In Swedish Match, the FKS approach was rejected by the court, but the views of the competitors and distributors, along with the internal documents, were considered sufficient to support a narrow market of loose-leaf smokeless tobacco. Here, the court felt the loose-leaf business would not lose more than the critical level of sales in response to an across the boards SSNIP. *See*, FTC v. Swedish Match 131 F. Supp 2d 151 (D.D.C. 2000). Broader markets were sustained in the face of close head-to-head competition from the merger partner in Gillette and Russell Stover. *See*, U. S. v. Gillette 828 F. Supp. 78 (D.D.C. 1993) and Pennsylvania v. Russell Stover Candies, 1993-1 Trade Cas. 70,224 (E.D. Pa. 1993).

[16] Although almost standard procedure for game theoretic economists, this type of analysis substitutes deductive logic for empirical evidence. Under the Daubert standard, experts are limited to fact-based analysis. *See*, Malcolm B. Coate & Jeffrey H. Fischer, *Daubert, Science and Modern Game Theory: Implications for Merger Analysis*, 2009, forthcoming in SUP. CT. ECON. REV. Draft available at http://ssrn.com/abstract=1268386.

restrictive assumptions, almost any result can obtain, depending on the facts.[17] Third, use of the Lerner Condition to measure elasticities depends critically on the accurate measurement of marginal cost. This may prove impossible, thus precluding the FKS approach. Even if a point estimate of marginal cost is available, it would be a mistake to conclude that marginal cost equals the estimate of incremental cost needed for a Critical Loss Analysis. We conclude that any form of Critical Loss Analysis requires factual evidence.

II. THE LERNER INDEX, AND DIVERSIONS, VIRTUALLY GUARANTEE NARROW MARKETS

The Lerner Index exploits the basics of profit maximization to link the firm's own elasticity of demand with the relevant marginal cost condition facing the firm at the optimal level of output. Assuming applicability of the Lerner Index, the economic theorists recognize that if you know marginal cost, you know the own elasticity, and visa-versa. This proposition (coupled with the concept of diversion) underpins the theorists' criticism of the standard application of CLA.

It is well known in economics, however, that virtually all unilateral effects models utilizing the Lerner Condition produce price increases for any horizontal merger. That is, every horizontal merger is predicted to raise price, which of course has no empirical support and would face serious Daubert issues if used in court.[18] Because the FKS approach uses the same underlying assumption (i.e. the Lerner Condition), it produces narrow markets even for low-margin industries. Thus, even though there are serious issues with the use of the Lerner Condition, we continue our discussion assuming its validity.

To understand the basic impact of the Farrell-Katz-Shapiro analysis, it is helpful to reconstruct the basic math to see how the methodology exploits the optimization relationship that underlies the standard Lerner Index to highlight how even small amounts of diversion to products within the purported market are sufficient to turn broader markets into narrow ones. Table 1 presents the aggregate Critical Loss calculations associated with evaluating the profitability of a standard SSNIP in a differentiated product market.

The first column lists the margin, which is allowed to range from a high of ninety percent (.90) to a low of ten percent (.10). Column 2 is the linear demand, break-even Critical Loss for a 5 percent SSNIP corresponding to the margins in Column 1.[19] The next column simply converts Critical Loss into Critical Elasticity by dividing the Critical Loss by the five percent SSNIP.

Assuming the Lerner Condition applies, Column 4 computes the demand elasticity for the hypothetical monopolist (i.e. the candidate market demand elasticity) as the inverse of the margin. Although this demand elasticity estimate based on the Lerner Condition is technically defined for an individual firm, it can also be used as the maximum demand elasticity facing a

[17] The Lerner analysis, coupled with the firm-level diversions implicit in the aggregate diversion analysis, implies every horizontal merger generates price increases, and absent special circumstances or offsetting reductions in marginal cost, could be prima facie illegal. There is simply no empirical support for this modeling structure, and its predictions must be considered unconfirmed.

[18] Coate & Fischer, *supra* note 16.

[19] For the calculation with differentiated products, *see*, Ten Kate & Niels, *supra* note 8 at equation 3.

larger group of firms (i.e. the maximum market demand elasticity).[20] This maximum market demand elasticity is then used to estimate the predicted maximum Actual Loss associated with an across-the-board five percent price increase assuming a linear demand curve, which appears in column 5.

The sixth column presents the ratio of the Critical Loss to predicted Actual Loss. This fraction defines the percentage of the hypothetical monopolist's predicted Actual Loss that must be lost to products outside the candidate market (i.e., not diverted among products within the candidate market) for the relevant SSNIP to be break-even. For example, if the margin is 60 percent, the hypothetical monopolist must lose more than 92.31 percent of its foregone sales to entities outside the proposed market for the narrow market to be rejected.[21]

Table 1 – Critical Loss vs. Predicted Actual Loss (for a five percent SSNIP)

Margin	Critical Loss (%)	Implicit elasticity	Est. Elasticity	Predicted Loss (%)	Critical/Predicted
0.9000	5.2632	1.0526	1.1111	5.5556	.9474
0.8000	5.8824	1.1765	1.2500	6.2500	.9412
0.7000	6.6667	1.3333	1.4286	7.1429	.9333
0.6000	7.6923	1.5385	1.6667	8.3333	.9231
0.5000	9.0909	1.8182	2.0000	10.0000	.9091
0.4000	11.1111	2.2222	2.5000	12.5000	.8889
0.3000	14.2857	2.8571	3.3333	16.6667	.8572
0.2000	20.0000	4.0000	5.0000	25.0000	.8000
0.1000	33.3333	6.6667	10.0000	50.0000	.6667

Farrell and Shapiro parameterize the sales diverted to other firms in the proposed market by the Aggregate Diversion Ratio, which they denote as "A." The sixth column in Table 1 is equal to 1-A. Whether expressed as A or 1-A, the basic point Farrell and Shapiro try to make is that when margins are moderate to high, only a very small share of the lost sales must

[20] The market elasticity must equal or exceed (be less elastic than) the firm-level elasticity, because a firm's departing customers may switch to other products in the market, while industry customers searching for alternative products must switch to suppliers outside the market. Obviously, the concept also requires the analyst to be able to define a composite good to aggregate the differentiated products together.

[21] This calculation matches the results in O'Brien & Wickelgren's Table 1 for a five percent SSNIP (the 7.69 percent recovery by firms within the market is the same as a 92.31 percent loss to firms outside the market, O'Brien & Wickelgren, *supra* note 7, at 174). Because the Lerner index assumes profit maximization, the predicted Loss from a pure Lerner Index model must be more than the Critical Loss.

be diverted to other firms in (or a very large share of the lost sales must diverted to other firms outside) the candidate to confirm (reject) a candidate market.

Farrell and Shapiro summarize their result as follows:

> **Proposition 1**: If each firm owns a single product and prices to maximize its profits and if demand is linear in price for small price changes starting from the premerger price, then a symmetric group of products forms a market under break-even analysis if:
>
> $A \geq S/(M+S)$ (where S is the SSNIP and M the margin.)[22]

According to Farrell and Shapiro, Proposition 1 means that the standard Merger Guidelines implementation of the SSNIP will generally lead to narrow markets for high-margin industries. Essentially, the diversion must be larger than the Critical Loss, which ranges from 5 percent to 33 percent (for margins ranging from 10 to 90 percent) for a 5 percent SSNIP.[23] Looking at these diversion numbers (5-33 percent), one might think superficially that they are very low thresholds that would generally result in narrow markets even in low-margin industries.

This proposition, however, only results in narrow markets if there will be sufficient diversion in the face of an across-the-board price increase by ***all of the firms in the market***. But why would customers divert volume among firms that are raising prices jointly, as opposed to diverting volume to firms that are not raising price? For example, if Mercedes, BMW, and Audi all raise prices simultaneously by the same amount, why would we expect any Mercedes customers to switch to BMW or Audi? We think that generally the Mercedes customers would not but, at a minimum, it is an empirical issue. If the answer is that we do not expect such switching, then the Farrell & Shapiro approach (with a linear demand curve) would result in expanding the candidate market for across the board SSNIPs because A would be very close to zero and thus, will be less than $S/(M+S)$ in their Proposition 1. This result is the opposite of the one they seek to draw.

III. AGGREGATION NEEDS TO BE MODELED

The theorists attempt to deal with this problem using the following structure. Rather than start with an across the board SSNIP, they hypothesize a series of sequential price increases for the firms in the market. That is, they impose, firm by firm, the single-firm price increase, compute the firm-specific diversions, and then aggregate.[24] Following Farrell & Shapiro's example, let BMW raise its price by the SSNIP, while the other prices remained constant; then let Mercedes raise its price rise by the SSNIP, but let BMW's price remain at the higher level, while the prices of the other rivals remain fixed. The process repeats itself for Audi, as it sees the prices of all its competitors at the high level, and imposes its own SSNIP. As each price increases, some output would divert around, moving first to competitors with lower

[22] Farrell & Shapiro, *supra* note 4 at 5. Technically, the break-even concept of the hypothetical monopolist means the firms in the market simply impose the SSNIP even if a lower price increase would be more profitable.

[23] Replace the linear with a "constant elasticity" demand curve, and the critical diversion falls to a range from .3 to 10.5 percent. O'Brien & Wickelgren, *supra* note 7, at 175.

[24] In the Katz & Shapiro paper (*supra* note 13, at 54), a sequential aggregation scheme is suggested, but the reader is cautioned, at footnote 31, that aggregation could cause the "aggregate diversion ratio" facing one firm to fall when the prices of the other firms in the market are increased. We are aware of no attempt to parameterize this effect.

prices and then possibly back to the original firm now selling at the high price or possibly out of the market entirely as the customers are unable to find any supplier in the candidate market holding the competitive price.

Using the linear demand structure, however, Farrell and Shapiro find that the diversion to other firms in the market caused by a single firm raising price is the same as when all firms in the market raise price at the same time. Thus, given their construct, Farrell and Shapiro predict the substantial diversion among firms in a market will not be lost to entities outside the market when all of those firms impose an across the board SSNIP. What Farrell and Shapiro appear to assume is that the product differentiation in the market leads to a relatively inelastic demand for the specific products in the hypothetical market, such that consumers are willing to pay the higher prices to retain access to the unique characteristics of the in-market products. When just one firm raises price, customers divert to close rivals, but when the across-the-boards SSNIP is imposed, customers remain with an in-market supplier. Obviously, this could happen, but it is an empirical question.

We suggest that this modeling structure often obscures the reality faced by customers in responding to a series of price increases (or the analogous simultaneous market-wide SSNIP). Firm level Diversion, A, is estimated based on the assumption that only the price of the firm's own product changes.[25] All other prices remain the same. However, in the sequential analysis discussed above, all prices eventually change. For example, take the situation faced by the customers of BMW that choose to divert to Mercedes and Audi to obtain a substitute product at a lower relative price. At the end of the sequential analysis, these customers find all the prices are higher. In effect, they have three choices: return to their original supplier; remain with their alternative supplier; or leave the narrow market. Farrell and Shapiro exclude this last alternative by their choice of mathematical structure. Customers are simply denied the option of switching to Japanese luxury cars when the prices of all German luxury cars increase together. This limitation may have significant effects.[26]

To account for all three potential customer responses, we suggest that an Aggregate Retention Rate (R) is needed to define the percentage of the sales "initially" diverted from each firm to its rivals within the market in response to a single-firm SSNIP that is retained by firms within the market when all the rivals raise price by the SSNIP. The modeling assumptions imposed by Farrell and Shapiro are equivalent to setting $R = 1$ and thus all sales initially lost to an in-market competitor by any entity in response to the first stage SSNIP analysis end up as retained by the firms within the proposed market. An alternative structure would set $R = 0$ and assume that the marginal customers would switch to out-of-market suppliers when all the firms in the market raise price by the SSNIP.

[25] Farrell and Shapiro report "that A is calculated on the assumption that the price of one product changes and the other prices do not." Farrell & Shapiro, *supra* note 4 at 6.

[26] While Farrell and Shapiro explicitly assume linearity to obtain their result, all they really need is a first-order Taylor's series expansion for the relevant demand system. Exclude the higher-order derivatives and their result obtains. However, real world systems of demand equations can not always be accurately linearized and, thus, empirical evidence suggesting substantial switching in a high margin market is easy to reconcile with optimization models of economics. All that is needed is a set of second (and higher order) derivative effects to "offset" part (or even all) of the first order Farrell & Shapiro diversion result. In effect, the "diverted" customer, seeing the prices for all differentiated products rise by a SSNIP, may find some alternative outside the market.

More complicated modeling structures could impose any value on R between 0 and 1, but the fact remains that the modeling structure would assume the value of the key parameter.[27] Theoretical Lerner Index analysis, parameterized with market data for linear equations, cannot conclusively define the predicted Actual Loss, because the value of the Retention Rate parameter is an empirical question. Natural experiments could generate an implicit estimate of the retention parameter by combining Lerner analysis with a direct measure of the predicted Actual Loss for the proposed market to back out the Retention Rate. However, the predicted Actual Loss is sufficient to complete the Critical Loss arithmetic; thus making the estimation of the more complex modeling structure redundant.

IV. AN EXAMPLE OF DIVERSION ANALYSIS WITH A RETENTION PARAMETER

We use a simple example to illustrate the market-narrowing potential of the FKS approach. Assume that there are nine equally-sized firms each selling a separate differentiated product, along with one composite actor representing the other alternatives, such that volume diverts equally among them (eight firms and outside choice) for any firm-specific unilateral price increase. Each firm takes one-ninth (11.1 percent) of the volume lost by the firm raising price by the five percent SSNIP.[28]

To demonstrate the impact of the differences among the market definition concepts, we first model the analysis with a very low margin of 10 percent and assume that half of the sales diverted to competitors return to the firm raising price if the rival that obtained diverted sales also raises price, and that the other half are diverted to firms outside the proposed market (*i.e.*, the Retention Rate is 50 percent).

Going back to Table 1 momentarily, recall that it shows the Critical Loss for a ten percent margin is 33 percent. Thus, if the modeling exercise shows an actual loss above 33 percent, the collection of firms does not comprise a relevant market. Likewise, Table 1 estimates the Actual Loss under the Lerner Index model as 50 percent. Under the Farrell & Shapiro analysis, this implies (as per Proposition 1) that a narrow market survives if 33 percent (or more) of this 50 percent loss in sales is diverted to firms within the market boundaries. Our more complex analysis requires a more detailed review of these "diverted sales" to be sure that they are retained by a firm within the market in response to the market-wide SSNIP. Overall, we show that market definition turns on the interaction of the Diversion Ratio and the Retention Rate.

Table 2 illustrates these calculations. The first column shows the number of firms in the candidate market. The second column computes the Aggregate Diversion Ratio to other firms inside the candidate market, and the assumed Retention Rate is provided in the third column.

[27] The concept of a retention rate could be illustrated for a class of relatively homogeneous goods. First select M firms producing homogeneous goods for inclusion in a hypothetical market and N firms producing the same good for exclusion. When a single-firm SSNIP is imposed, some of the customers of the affected firm switch to the M-1 firms within the market and others to the N firms outside the market. For a market-wide SSNIP, virtually all customers of the M firms will switch to the N firms outside the market. Thus, while a firm-specific aggregate diversion index can be calculated, the Retention Rate is almost 0, leading to the conclusion little market-wide diversion will occur. If all M+N firms are included in the market, the firm-level diversion rate will be large. The Retention Rate will probably be substantial, because all the M+N firms are now in the market. Still, some of the diverted sales will leave the market in response to an across the boards SSNIP. The exact level of retention depends on the overall elasticity of demand and the firm-level diversion.

[28] The composite entity is referred to as a firm for brevity of explanation. In effect, "firms not in the market" can be read as "firms not in the market and the composite entity for outside alternatives."

The fourth column provides the volume lost directly to firms outside the candidate market, which is the estimated Actual Loss (50 percent) multiplied by the share lost to firms NOT in the candidate market (*i.e.*, not diverted to firms in the proposed market). For a two firm candidate market, the direct loss multiplies the number of firms outside the market (eight) by the 11.1 percent lost to each firm and then by the overall sales loss (50 percent) to get .4445.

In addition, because firms 1 and 2 will both raise prices in the standard SSNIP, we need to calculate what we term as the indirect loss as well. Recall that we suggest that when firm 2 also raises price, the market will lose some of the sales retained after firm 1's price increase. We assume a Retention Rate of 50 percent so that the firms in the candidate market will be able to keep one-half of what was initially diverted to firm 2 when firm 2 follows firm 1 and raises price. Thus, for the two firm candidate market, we multiply the number of other firms inside the candidate market (*i.e.*, 1) by the 11.1 percent, then by the output lost (50 percent) and finally by the Retention Rate of 50 percent to compute .0278. The sixth column shows Total Loss, which simply sums the two Loss columns and defines the predicted Actual Loss.

Table 2 – Market Definition for Standard SSNIP with Diversion and Retention

Number of Firms	Diversion Ratio	Retention Rate	Direct Loss Outside	Indirect Loss	Total Loss
2	.1111	.5	.4445	.0278	.4723
3	**.2222**	**.5**	**.3889**	**.0556**	**.4445**
4	.3333	.5	.3333	.0833	.4166
5	.4444	.5	.2778	.1111	.3889
6	.5556	.5	.2222	.1389	.3611
7	.6667	.5	.1667	.1667	.3333
8	.7778	.5	.1111	.1944	.3055

CLA simply compares the level of Critical Loss (33.3 percent from Table 1 for a margin of .1) with the predicted Actual Loss. For the Farrell & Shapiro analysis, we read the resulting Actual Loss off the direct loss outside column (because Farrell and Shapiro implicitly set the Retention Ratio to 1) and find the market will include four rivals.

When accounting for the Retention Rate (.5 in this example), the final column (total loss) is controlling. Thus, if two firms raise price by the SSNIP, these entities will each lose 47.23 percent of their sales to entities outside the proposed market, a loss well above the Critical Loss and thus this market definition fails. The market is expanded by adding rivals until seven firms are in the market, since this seven-firm market just passes the Critical Loss test when the Retention Rate is considered. Thus, the market definition under the Farrell & Shapiro approach is almost half the size of a market defined with a 50 percent retention ratio (4 firms vs. 7 firms).

It is possible to undertake the same analysis for a range of values for the margin and Retention Rate. As shown in Table 3, decreases in the retention from 100 percent (the standard FSK assumption) to 10 percent (only 10 percent of the lost sales are diverted to rivals within the market remain with firms within the market in response to an across the boards SSNIP) broaden out the market towards the homogeneous goods baseline of 9 firms.[29] Likewise, lowering the margin from .9 to .1 also broadens out the market. While using the high margin of .9 generally suggests that markets must be narrow (2 or 3 firms), 6 firms will remain in the market if the retention parameter is set a 10 percent.

Table 3 – Number of Firms in Market by Retention Rates (for a five percent SSNIP)

Margin	Retention set to 100 percent	Retention set to 50 percent	Retention set to 25 percent	Retention set to 10 percent
0.9000	2 firms	2 firms	3 firms	6 firms
0.8000	2 firms	3 firms	4 firms	7 firms
0.7000	2 firms	3 firms	4 firms	7 firms
0.6000	2 firms	3 firms	4 firms	8 firms
0.5000	2 firms	3 firms	5 firms	9+ firms
0.4000	2 firms	3 firms	5 firms	9+ firms
0.3000	3 firms	4 firms	7 firms	9+ firms
0.2000	3 firms	5 firms	9 firms	9+ firms
0.1000	4 firms	7 firms	9+ firms	9+ firms

Two points emerge from Table 3. First, the use of the FKS approach (retention rate of 100 percent) generates narrow markets (with between 2 and 4 rivals) for all possible values of the margin (as defined in column 2). Thus, instead of just narrowing the market definition for high margin markets, the FKS approach narrows markets for all values of the margin parameter. Second, generalizing the FKS approach for the Retention Rate shows that anything can happen. Markets may remain broad for low margins and low Retention Rates or narrow dramatically for large margins and high Retention Rates (closer to the FKS assumption). Market definition must be considered an empirical question. Theory may raise interesting questions

[29] For very low values of the margin and retention parameter, the level of actual diversion to rivals within the market is too small to overcome the difference between the Critical Loss and the Lerner estimate of Actual Loss (both given in Table 1) for any market structure. In this case, the dynamics of competition implicit in this particular simulation model preclude the definition of any narrow market and more than 9 rivals (9+ firms) must compete in the market. It is important to remember that our model is designed only to illustrate the need to consider the effect of an across-the-boards SSNIP when undertaking merger analysis and not focus on the simulation result that seems to show differentiated products may result in broader markets than homogeneous goods.

and suggest needed lines of analysis (*i.e.*, is the product differentiated material?), but the Actual Loss from a SSNIP remains an empirical question.

V. MARGINAL COST AND DIVERSION ANALYSIS

The measure of the marginal cost that defines the Lerner index represents a final and often ignored problem with the entire FKS methodology.[30] In a theoretical analysis, the relevant marginal cost is the economic cost to produce the very last unit of output. In contrast, the appropriate cost under the standard CLA is the incremental cost associated with output lost to a SSNIP, an output that could vary from a few percent to 20 percent or more of the premerger output. As a result, there is no reason to assume that the average incremental cost will be the same—or even close—to the theoretical marginal cost. Thus, the determination of the elasticity of demand from an estimate of the incremental margin may easily generate a misleading result. Unless the analyst can measure the marginal cost at the market equilibrium, the elasticity of demand cannot be accurately estimated even assuming the applicability of the Lerner Condition. And even when the theoretical marginal cost can be measured, the Critical Loss analysis will need both the theoretical and incremental marginal cost variables to complete the analysis.

Thus, a more complete Critical Loss analysis would combine the adjustment for the Retention Rate (detailed in Table 3) with two estimates of the margin (a margin driven by the generally higher value of the theoretical marginal cost needed for the Lerner calculation and a margin defined by the generally lower incremental cost associated with the output lost to the SSNIP needed for the Critical Loss calculation). Use of a low margin in the Lerner analysis generates an initial estimate of a relatively large Actual Loss (from Table 1, a 20 percent margin leads to a predicted loss of 25 percent), but the diversion/retention analysis may reduce the Actual Loss substantially. This adjusted loss is the estimate of the predicted Actual Loss that is then compared to the breakeven Critical Loss benchmark computed using the higher margin (and tabulated in the second column in Table 1). Empirically, no strong conclusions can be drawn, because the differences in the two margin estimates, the diversion rate and the retention variable all interact in the revised Critical Loss Analysis calculation. Once the market conditions associated with the Critical Loss Analysis are fully considered, it is clear that market definition must remain an empirical process.

V. CONCLUSION

Other than a call for more careful analysis, it is hard to take much away from the Farrell, Katz, and Shapiro critique. They argue that their diversion parameter A is controlling, while never really explaining the strength of their results (virtually all markets are narrow) or the special case nature of their mathematical modeling. Moreover, their entire methodology collapses if the analyst is unable to estimate the theoretical marginal cost. Once more general demand structures are considered, it becomes clear that anything can happen. Thus, in differentiated

[30] Bauman & Godek, *supra* note 6 at 3. Their analysis is comparable to Coate & Williams (*supra* note 5) but focuses on profit maximizing price increases, instead of break-even price increases.

goods markets, critical loss remains an empirical issue and empirical evidence on actual loss is required to apply a critical loss test. Theory cannot trump fact.

VI. APPENDIX —THE VARIABLE SSNIP TEST AND CRITICAL LOSS

The 1992 Merger Guidelines introduced a variable SSNIP structure for market definition in which the hypothetical monopolist was required to: (1) raise the price of a product (product line) offered by one of the merged firms by the SSNIP, and (2) ensure that this price increase, when coupled with optimal price increases for the other products in the proposed market, was more profitable than smaller potential price increases. Ordover & Willig explained how the variable SSNIP enables the definition of a relevant market when various groups of products are relatively close competitors.[31]

In the Ordover & Willig example, a frozen string bean monopolist is unable to raise price by five percent without losing too many sales to frozen carrots.[32] The frozen bean/carrot monopolist still cannot raise price by five percent without losing too many sales to frozen spinach. The analysis could continue and chain together all frozen vegetables. In effect, the standard SSNIP analysis could create a huge market and totally miss the potential for market power in market niches like string beans and carrots. The bean/carrot monopolist could behave in a less-than-competitive manner by charging the full five percent SSNIP for beans and a smaller price premium for carrots. This price increase might be profitable and thus the standard SSNIP methodology needs to be tweaked to define a relevant market in which to study this special case situation.[33] The variable SSNIP methodology provides the required algorithm.[34]

Starting with this 1992 special case generalization of the standard SSNIP, it is possible to consider the implications of the Lerner index analysis for market definition when only one price is increased by the SSNIP. The variable SSNIP modeling structure allows the prices of the other products in the market to rise by a de-minimis amount—or even by nothing at all—once one price has increased by the SSNIP and, thus, a single-firm SSNIP merits consideration. Moreover, holding the prices charged for rival products constant would rehabilitate Farrell & Shapiro's mathematical concept, because the math defines the adjustment in the single firm Critical Loss Analysis required for diversions to closely related products.[35] As Ten Kate and Niels have proved, aggregate diversion only needs to be greater than the ratio of the SSNIP to

[31] Ordover & Willig, *supra* note 10

[32] *Id.* at 140.

[33] The reader might find a geographic market analysis more convincing. For example, in the suburbs of Washington D.C., the price of gasoline in Annandale is constrained by the price in Fairfax, Springfield, and Falls Church. These prices are constrained by pricing in communities such as Vienna, Arlington, and Burke. This chain could easily expand to cover the entire Washington D.C. area and might even chain north to Boston and south to Richmond. Abstracting from the fact that the function of cars is to drive around (and thus the consumer can buy gas whenever they are in a distant, low-priced community), a variable SSNIP market might be sustainable with a standard SSNIP for Annandale and smaller price increases in the surrounding communities of Fairfax, Springfield, and Falls Church.

[34] Only one possible example of this analysis has been identified in a review of FTC mergers and even this example seems better understood as an "in the alternative" market definition argument, so the situations envisioned by Ordover and Willig turn out to be extremely rare. See, Coate & Fischer, *supra* note 16 , at fnt 57.

[35] Here, the analyst relaxes the Guidelines' requirement of profit maximization by using the breakeven critical loss structure.

the margin for a single-firm SSNIP to isolate a narrow market.[36] In this theoretical SSNIP world, markets are almost always narrow, even for relatively low-margin industries. The math works, and the analyst needs only to parameterize the model.

Recycling the German car example, assume a number of potential BMW customers would likely substitute to Mercedes or Audi, given the prices of these products do not materially change in response to the SSNIP affecting the price of BMWs. Thus, predicted Actual Loss in the German luxury car market would need to be adjusted to reflect the sales retained by competitors in the narrow market. Virtually any diversion to products within the proposed market could easily reduce the predicted Actual Loss to a level below the Critical Loss and support a narrow market. Moreover, the model does not even require high margins. If the margin is only 20 percent, the Ten Kate & Niels formula shows that the narrow market would be upheld as long as 25 percent of the lost customers choose the in-market substitute products. It seems quite reasonable to expect one in four disgruntled BMW customers to pick Mercedes or Audi and thus substantiate the narrow German luxury car market.

There are problems with any variable SSNIP approach. To be most useful, the theoretical version of the variable SSNIP must serve to focus the competitive analysis in both collusion and unilateral effects situations. For collusion analysis, the flaw is obvious—only one price must materially increase to define a market. To be credible in a variable SSNIP market, the collusion story must include some type of side-payment mechanism that allows the merged firm to share its profits with competitors that basically hold prices constant. Most, if not almost all side-payment schemes require explicit collusion and thus would be very unlikely to occur after a merger. In effect, the variable SSNIP structure appears likely to preclude collusion analysis.

For unilateral effects analysis, the problems are more subtle. While a variable SSNIP would focus the analysis on a particular theory of concern, it would also artificially narrow the scope of competition within the market. These restrictions are based on the parameterization of the price model, so the exclusion of somewhat distinct rivals would not distort the estimation of a unilateral price effect.

However, modeling the price increase is not the end of the unilateral analysis. Repositioning issues are crucial and the variable SSNIP market is also used to address this problem. Firms selling somewhat similar products can be excluded from the market, because a sufficient number of the merged firm's customers purchase other products in the narrow market in response to the variable SSNIP such that the price increase is profitable. Thus, the repositioning of the firms selling somewhat similar products is never considered in the competitive effects analysis, but put off until the overall entry analyses.[37]

In theory, sophisticated entry analyses could address this point, but the exclusion of the affected firms amounts to burden shifting.[38] Moreover, the Guidelines' likelihood of entry

[36] Ten Kate & Niels, *supra* note 8 at equation 6.

[37] If the repositioning could occur within one year, with minimal expenditure on sunk costs, the excluded demand side rivals would need to be included in the market on the supply side. In this case, the variable SSNIP analysis would generate the same market as the standard SSNIP.

[38] It is well known that merger law requires the plaintiff to substantiate an anticompetitive effect stemming from a merger. By using a variable SSNIP to artificially exclude competitors from the market, the plaintiff avoids bearing its full burden.

analysis models sales opportunities available from the incumbents, while repositioning analysis could consider some of the repositioning firm's current sales as available to build an efficient scale operation. Likewise, an incumbent firm repositioning its product might be expected to capture a larger share of the market growth. By artificially excluding somewhat similar firms from the relevant market, the variable SSNIP structure generally biases the analysis in favor of finding a competitive concern.[39]

While we admire the mathematical elegance of the theoretical single-firm SSNIP implementation of the Guideline's variable SSNIP construct, the methodology suffers from a collection of disadvantages associated with firm-specific price increases. At best, these methodologies can offer only a special case customization of the standard market definition analysis. No commentator has described the use of any variable SSNIP for market definition by the FTC or the DOJ in any investigation, and we're not aware of one.[40] Markets should be defined to allow the evaluation of any competitive effects concern and, as we show, the variable SSNIP model often generates narrow markets with very limited usefulness. Thus, a variable SSNIP methodology is not likely to be relevant in the Critical Loss debate.

[39] Theorists are likely to observe that the market definition process does not aid the analysis when the unilateral effects of a merger can be estimated directly. It is important to note that market analysis plays an important role in the choice of the priced-based modeling structure. As Coate and Simons point out, competitive analysis can also proceed under the assumptions of either product homogeneity or dynamic differentiation. (Coate & Simons, *supra* note 14). Either structure may identify problems with the performance evidence used to identify a competitive concern and thus it is necessary to fully evaluate the competitive environment.

[40] One possible exception is the recent case involving the FTC and Whole Foods where the FTC's expert, Professor Murphy, arguably advocated the aggregate diversion ratio approach in conjunction with a variable SSNIP. To the extent Murphy proposed such an approach, it does not appear that the judges or the lawyers involved recognized that he was doing anything out of the ordinary. Ilene K. Gotts, Joseph J. Simons, George T. Conway, & Aidan Synnott, *Recent DC Circuit Decisions in Whole Foods Leave Standard for Future Mergers Unsettled*, 12 COMPETITION L. INTERNATIONAL 2009.

CERTIFICATE OF SERVICE

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