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DEPARTMENT OF JUSTICE
FEDERAL TRADE COMMISSION

MERGER WORKSHOP

DAY THREE

THURSDAY, FEBRUARY 19, 2004

9:00 a.m.

FTC Conference Center
601 New Jersey Avenue, N.W.
Washington, D.C.

Reported by: Rita M. Hemphill, C.V.R.

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1 PARTICIPANTS:

2 Panel I: Efficiencies/Dynamic Analysis/
3 Integrated Analysis

4 Moderators: Alden F. Abbott and Mary T. Coleman(FTC)

5 Panel: J. Mark Gidley (White & Case)

6 Ilene Knable Gotts (Wachtell, Lipton,
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Welcome and Introduction

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Panel I: Efficiencies, Dynamic Analysis
Integrated Analysis

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Panel II: Economists and Lawyers Roundtable

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1 **P R O C E E D I N G S**

2 MR. ABBOTT: Good morning. Welcome to the
3 third day of a Joint FTC/DOJ Workshop on Merger
4 Enforcement. I'm Alden Abbott, Associate Director for
5 Policy and Coordination in the FTC's Bureau of
6 Competition.

7 I am joined here by the co-moderator for our
8 panel, Dr. Mary Coleman, Deputy Director of the FTC's
9 Bureau of Economics.

10 Thus far, workshop panels have focused on
11 discrete parts of the Guidelines: Market definition,
12 concentration, competitive effects and entry. Several
13 commentators, however, have noted that it would be a
14 mistake to view individual Guidelines provisions in
15 isolation.

16 However, the implications of such statements
17 that the Guidelines provisions should be viewed
18 holistically, to use the New Age term, with simultaneous
19 consideration of different factors that enter into a
20 Guidelines analysis, have not been developed.

21 The aim of this morning's panel, entitled
22 Efficiencies, Dynamic Analysis and Integrated Analysis,
23 is to explore what it means to carry out such a holistic
24 or integrated analysis. The panel will also focus on
25 efficiencies and dynamic considerations, with particular

1 attention to their role in the overall competitive
2 assessment of a proposed merger.

3 We are fortunate to have a true all star cast
4 assigned to assist us in carrying out our daunting task.
5 Their academic and professional laurels are so
6 impressive, we could take up the entire morning
7 recounting them. Given the time constraints, however, I
8 will refrain from doing so. But I will note their key
9 affiliations.

10 Our first speaker will be Dr. David Scheffman,
11 who is a recidivist, already having served on the panel,
12 former Director of the FTC's Bureau of Competition,
13 currently a director at LECG and Adjunct Professor at the
14 Owen Graduate School of Management at Vanderbilt
15 University.

16 Dave, I hope, will tell us what this integrated
17 approach is all about and help dispel the fog and give us
18 a clear sky. Dave will be followed in order by Joe
19 Simons, former Director of the FTC's Bureau of

Competition, and currently co-chair of the Antitrust

~~16~~ Dave, I hope, will te08 order by Joe

1 Mark will be followed by Ilene Gotts, a partner
2 at Wachtell, Lipton, Rosen & Katz, who has held various
3 ABA Antitrust Section leadership positions, including
4 membership on the section counsel currently.

5 Bill Kolasky, co-chair of Wilmer, Cutler &
6 Pickering's antitrust and competition practice group, and
7 a former Deputy Assistant Attorney General for antitrust,

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1 say that, because Bob did promulgate, you know, was an
2 instigator of the '97 revision and does believe in
3 efficiencies. So I'd be interested in what he has to
4 say.

5 There are some good things about baby food, I
6 think, such as it's good to have a clear decision that
7 when three to two is a real three to two. It is a very
8 high hurdle, and I think most economists in the
9 mainstream would agree that that's where the really high
10 hurdle should be. I think as Chairman Muris has often
11 said, and he worked on baby food, his concern with baby
12 food was that it wasn't really three to two. It was
13 really like one to two or 3.1 to two, 2.1 to two.

14 What I've heard from the parties, but I don't
15 know a lot about this, is the ex poste story is not a
16 pretty one. I know the FTC is engaged in various
17 retrospectives on hospitals. I urged them to look at
18 some of these cases where efficiencies were a significant
19 issue and look at what happens.

20 My favorite case, one in which I was an expert
21 soon after leaving the FTC and was one of the FTC's and
22 Ann Malester's best cases, was the tank ammo case. This
23 was the two to one defense merger case, a big victory for
24 the FTC. Everyone has known after that it turned out
25 exactly opposite from what the FTC said it would. And so

1 I think my view of the track record, from anecdotal
2 evidence, on how the agencies have treated cases that had
3 serious efficiency claims is not good. But, you know,
4 the research has yet to be done.

5 However, the record is not as bad on
6 efficiencies as all that. Efficiencies are important.
7 They're more important than people and counselors think
8 they are, but not in the Guideline's sense. One thing is
9 that much more the case now than it was in the '80s, is
10 that the agencies rely on customer opinions. And so in
11 industrial mergers in which you have a relatively small
12 number of sophisticated customers, even in a pretty
13 concentrated merger, if the customers say we're not
14 concerned, it's unusual that the agencies will challenge.
15 That has locked into it efficiencies and other
16 considerations. I think those are the mergers which I'm
17 quite comfortable the agencies almost always get right.

18 So in those cases I'm not so worried about the
19 efficiencies. Another way you could say it, if the
20 suppliers can't convince the customers of the
21 efficiencies when they have big, sophisticated customers,
22 then they haven't fulfilled their burden and the merger
23 is likely to be challenged and it probably should be.

24 The real problems are in the cases, all the
25 cases where you don't have a relatively small number of

1 sophisticated representative customers -- the oil
2 industry, branded products mergers, supermarkets, et
3 cetera. Those are cases where you have middlemen or lots
4 of customers, where you don't really have sophisticated
5 customers to speak for the benefits or potential costs of
6 the deal. I think that's where the real problem is. I
7 think what we've done in oil for 20 years, and it's been
8 going on a long time, in the way efficiencies have been
9 treated has really been quite counterproductive. I think
10 everyone, including FTC staff, believes that there have
11 been substantial efficiencies gained from a lot of the
12 oil mergers. Nonetheless, the efficiencies are usually
13 not given much weight in oil merger enforcement. It's
14 still, as it has been for 20 years, largely a structural
15 enforcement policy.

16 I will say, the other way that efficiencies
17 count is that, it affects remedies, which I don't think
18 is really recognized. When staff and the agencies think
19 that, well, actually this is a good deal, in a general
20 sense not in specific Guideline sense, and are crafting
21 remedies that may impact the achievement of the benefits
22 in the deal, you'll see in lots of consents kind of
23 exotic, flexible consents at the agencies. In some
24 cases, my view of that of what's going on is the agencies
25 are crafting things to alleviate the competitive problems

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1 but in a way that allows the potential benefits of the
2 deals to go forward.

3 But efficiencies can be very important.
4 Efficiencies sometimes, are part of the reason why you
5 don't get a second request. And in close cases, in cases
6 in which it's really just a structural case where you
7 could go forward because it's a five to four merger, but
8 where you don't have complaining customers. If you've
9 got a good story about why the merger is taking place,
10 that can be part of the reason why either you don't get a
11 second request or why a case is closed. And a good
12 example of an interesting case on efficiencies is drug
13 wholesalers II, which was an interesting situation where
14 the Commission had a prima facie case to be able to block
15 the merger that came back second time, and for lots of
16 complicated reasons which I don't fully understand and I
17 was there near the end -- the Commission did not block
18 it. But certainly part of it was a belief within the
19 Commission staff that there were benefits of the mergers,
20 that just having two mergers in that industry going from
21 four to two in the case that was litigated was a no go
22 proposition. The efficiencies were clearly a significant
23 part of the reason why drug wholesalers II matter was
24 cleared.

25 And I'll get to the integrated analysis, along

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1 with the argument and belief that the merger really
2 wasn't going to be anticompetitive anyway, in part
3 because it was going to be efficient. It was going to
4 strengthen the smaller competitor.

5 Okay. How do the agencies actually do things?
6 Well, they do it really the way the Guidelines say, which
7 is part of the problem. There really is a sliding scale
8 in which if you've got a case where the staff has a
9 pretty strong belief that the matter is anticompetitive,
10 there's no efficiency is going to turn that round. It
11 really has to do with the stronger the belief by the
12 staff, and their decisions are usually ratified, and
13 obviously the belief by the ultimate decision maker about
14 the likely anticompetitive effects of the deal, the less
15 weight efficiencies get.

16 So efficiencies really are in play in the gray
17 area where you've got a case where there isn't a strong
18 belief and basis for believing the merger is
19 anticompetitive.

20 This is the reason why we need to get more
21 integrated analysis because the way the efficiencies
22 actually get treated in the more difficult cases, it's
23 not really the proper way. That is, you know, one of the
24 reasons why the merger might not be anticompetitive is
25 because it's efficient. Talk about that in a minute.

1 What's happened with the Merger Guidelines, I
2 think it's probably more at the FTC, because the FTC has
3 litigated the efficiencies provisions probably more than
4 DOJ, is unfortunately is the staff builds a prima facie
5 case that the parties can't win on the Merger Guidelines
6 efficiencies checklist. It's not cognizable, it's not
7 merger-specific, it's not variable cost. Gabe Dagen
8 leads that effort for the financial analysts, and he does
9 a very good job on that, that's his job in a way for the
10 client. But if we have to go to court we have to be able
11 to show that, you know, they're not going to be able to
12 get through the Guidelines efficiencies checklist.

13 The problem with that is that gets the focus on
14 the efficiencies on litigation and disproving the
15 efficiencies. The question is, is anyone really looking
16 at whether there are some real efficiencies here, folks?
17 And that was something I tried to do at the FTC, with
18 mixed success.

19 There aren't procedures and incentives really
20 to look for real efficiencies, at least within the FTC.
21 I don't know about the DOJ. I don't say it doesn't
22 happen, but it happens sort of depending on which
23 staffers you get on a case. Because otherwise, again,
24 what the staff is mainly looking, and that's partly on
25 the basis for the client, to be able to show that you can

1 disprove the efficiency claims of the parties if you have
2 to go to court.

3 And with the emphasis on disproving
4 efficiencies, not surprisingly, there's not a lot of
5 emphasis on finding efficiencies. But is this really a
6 good merger? Even if we maybe could disprove the
7 efficiencies under the Guidelines test, is this really a
8 good deal, okay?

9 And we are proud of transparency, and this is a
10 real benefit of the transparency that we tried to
11 increase, the Commission tried to increase. But this is
12 the part where it's been least successful. In my
13 experience, there's the least communication between the
14 parties and the staff about the efficiencies claim. What
15 happens is, and I don't think the outside understands
16 this, the staff looks at the documents, deposes the
17 people, gets enough so that they think they could
18 disprove the efficiencies claim under the Guidelines.
19 And there's usually nothing comes back over the net from
20 the parties. It's like the other side doesn't even know
21 what's happened, right? Your opponent has made a prima
22 facie case that your efficiencies don't count.

23 Now, what we found in a couple of instances
24 where we actually required some transparency between the
25 staff and the parties, is that the staff didn't always

1 have it right, particularly on whether the efficiency was
2 merger-specific or what would happen but for the merger.
3 But the efficiency arguments, often really don't get
4 tested. And that's a fault of the parties, in part.
5 It's a fault of the staff in not always being open, but
6 the parties have to push.

7 They really have to be serious -- they have to
8 say, okay, what is your basis for thinking that this is
9 not merger specific, that something's going to happen
10 independent of the merger, et cetera. The parties have
11 to test that to understand what the basis of the staff's
12 opinion is in order to come back with an answer. This
13 is the one situation in which the parties actually have
14 information that the staff doesn't, which is usually not
15 the case on competitive effects. But the staff doesn't
16 get this information. So the parties really have
17 to engage the staff and to the extent they can, request,
18 demand transparency. What is staff's real basis for its
19 conclusion this efficiency isn't merger specific, et
20 cetera? Because when you press on it, you might find
21 that the basis isn't there, even though the staff has
22 good reason to believe what they believe, they might not
23 have the facts right.

24 Okay. We learned a lot from the efficiencies
25 roundtable. I don't know that it's had any effect, but I

1 think we learned, you know, the merger consulting
2 companies have certainly not helped the consideration of
3 efficiencies with all the articles arguing that the
4 typical merger is not, quote, "successful." Well, I
5 think -- I don't know that it came through in the
6 roundtable, but Paul Pautler has a good paper on that
7 issue, and I've looked at lots of literature, and it's
8 important to understand what that literature means. I
9 think that literature is right, but you have to be
10 careful about what you think it means for what we do in
11 antitrust.

12 That is, clearly the leading reason why mergers
13 aren't successful is because the acquirer pays too much.
14 That's not an antitrust issue. You can have a perfectly
15 efficient merger. They may have paid too much. It's the
16 winner's curse sort of thing. That's the primary reason
17 why mergers are not "successful." That's the main
18 reason.

19 But another important reason, which is related
20 to what we actually do, has been recognized in recent
21 years. Another important reason why mergers are not
22 successful is that the mergers lose revenue that they
23 didn't expect. That is, they lose customers and
24 business. In a horizontal merger, why? Well,
25 it might be because it's anticompetitive or could be

1 anticompetitive, but it could be because the customers
2 actually react adversely to the merger for other reasons.
3 That's related to reliance on customer opinions and
4 things like that, so that reason is important. It does
5 fit with what we do. It does indicate how -- it
6 reemphasizes how important sophisticated customer
7 opinions are.

8 The roundtable clearly indicates, other things
9 equal, that horizontal mergers are more likely to be
10 successful and efficient, you know, if there is "fit" --
11 all the stuff about fit and being in a similar business,
12 da, da, da. The literature is very clear and always has
13 been on that, and that goes back to the Scherer and
14 Ravenscraft papers.

15 The other thing which is true, if you listen
16 carefully, and it's that straightforward cost savings are
17 generally realized. If you look at what companies report
18 to the shareholders, what they report to the 10-K, what
19 they report to the street, you know, they say we're going
20 to reach these cost reductions. And on average, in fact,
21 much more than on average these days, they do, if those
22 are costs savings which aren't pie in the sky but
23 standard sort of consolidation savings. So the cost
24 savings that we worry about, cost reductions we worry
25 about, in horizontal mergers, they're, you know, you need

1 a basis for believing that they're there, obviously, and
2 how they're going to achieve them. But they're going to
3 do so -- you can have pretty high confidence if you have
4 some basis that they're going to actually be realized.

5 The other thing from the efficiencies
6 roundtable is that planning and implementation is really
7 important. That's a leading reason why mergers aren't
8 successful. That has something to do with what we do.
9 Gun jumping is a problem despite -- I don't think that
10 the efficiencies roundtable was successful in explicating
11 that issue. Gun jumping I continue to believe is a
12 significant issue. It is why companies can't do as much
13 planning as probably even they could do if they didn't
14 have such conservative counseling. And it also indicates
15 what the agencies should be looking at in terms of some
16 evidence of serious planning of how the merger is going
17 to be implemented to believe that the efficiencies are
18 going to be realized.

19 Okay. How do efficiencies fit into the
20 analysis? This gets to the integrated approach.
21 Efficiencies are related to -- a merger that's in a five
22 to four industry without unilateral effects is
23 significant -- one point of the merger is to become
24 significantly more efficient, and not dominant. This is
25 almost a prima facie case for economists. Why isn't the

1 industry going to be more competitive? I mean, it might
2 not be. But you need a pretty convincing story about why
3 not. So efficiencies obviously impact the competitive
4 analysis. The ideal case, and one I think, that will get
5 a merger through, where both staffs at both agencies,
6 lawyers and economists, say, well, yes, that's a pretty
7 good efficiency story is where you've got a manufacturing
8 merger with a combination of batch and continuous
9 production processes, so you can do lots of interesting
10 things in terms of getting more output out of the same
11 facilities, et cetera. You can get higher capacity if
12 it's an industry where there is not a viable theory that
13 you're going to significantly reduce capacity utilization
14 because the costs of reduced capacity utilization are too
15 small, or too large. This is like the oil industry, but
16 that's not batch and continuous.

1 First what we have to remember -- and this is not the way
2 the law works at all, and it's not the way the
3 enforcement agencies really work in practice, is that we
4 define markets in antitrust and then we do the analysis
5 after that.

6 Well, not all markets are alike, and the real
7 basis of the market is not equally strong. This is not
8 recognized. The markets are taken as given to us
9 clearly. This is the way the courts decide, although
10 sometimes the reason why the courts reject cases based on
11 market definition is for squishy reasons that probably

1 going to occur.

2 Okay. What efficiencies should count? I have
3 long believed -- going back to the '80s and the papers
4 that were written at the FTC, like Fred Johnson's paper -
5 - that this whole idea of passthrough incremental costs
6 and passthrough is a whole red herring. I don't think it
7 should be important in how the agencies think about
8 things -- it's of some relevance, but it's not the key
9 issue. The key issue in the way the agencies look at
10 efficiencies is really the sliding scale.

11 Joe Simons is going to talk more about a more
12 sophisticated, in my view sensible approach. Should
13 fixed costs count? Of course. Bill Kolasky will talk
14 about that. Dave Painter has a nice presentation at the
15 efficiencies roundtable about exactly why anyone who
16 works with real world companies and looks at their pro
17 formas include fixed costs. I teach MBAs and work with
18 lots of companies, do they count their fixed costs in
19 their pro formas and in their decisions? Of course they
20 do. There are good economic, sound economic reasons for
21 that, and other people will talk more about that.

22 Joe Simons will talk more about the integrated
23 approach.

24 Let me finally talk about dynamic competition,
25 which hasn't been so prominent lately. It is an

1 important issue, and it's going to come back. I think
2 it's very interesting to look at what happened to
3 dot.com. There were all sorts of consolidations in
4 dot.com mergers that, you know, if the agencies wouldn't
5 have been so busy when the mergers happened, they would
6 have stopped them. There were a lot of two to one and
7 three to two mergers that looked, you know, pretty
8 problematic based on the way the agencies look at things.

9 They were let go just because the mergers were
10 small and the agencies were very busy. Those mergers
11 present dynamic competition issues. The Commission faced
12 these issues in Monster/Hot Jobs, which I think was
13 probably a good case but presented some very difficult
14 issues. We'll see other deals involving these dynamic
15 competition issues, because the industry is based on IP
16 and in dynamic economy. We're going to see more of
17 these, and the agencies really don't know how to analyze
18 them, in my opinion. And I've more than used my
19 time. Thank you.

20 MR. ABBOTT: Thank you, Dave. You've certainly
21 given us a lot of food for thought and digestion. And
22 now Joe Simons will tell us -- give us a chart which will
23 explain all future efficiency analyses and solve our
24 problems, we hope.

25 MR. SIMONS: Well, that's a little ambitious, I

1 think. First, I just want to thank Alden and Mary for
2 putting this panel together. I know they put in a lot of
3 hard work, and I just want to thank them for that and for
4 inviting me to appear here today.

5 What I'm going to do, what I have in mind
6 really is to present what I think is actually a fairly
7 simple and straightforward way of doing an integrated
8 approach to analysis of anticompetitive effects and
9 efficiencies in mergers. And here's what I have in mind.

10 Let me be very specific about the first
11 principle applied. I think that's really important. If
12 you don't know what it is you're looking for, it's kind
13 of hard to find it. So the first principle is really
14 important, and it is prohibiting mergers that reduce
15 consumer welfare. That principle applies equally to
16 competitive effects and efficiencies. And the ultimate
17 exercise basically is to make a judgment or prediction
18 about the overall effects of a merger over a reasonably
19 foreseeable period of time, two, three, five, years
20 something like that.

21 Now, you know, based on what Dave said just a
22 few minutes ago, obviously this is not an easy thing to
23 do in practice. But at least if you know what direction
24 you're moving in and you know where you're supposed to be
25 going, then you have a better chance of getting there.

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1 Even if you can't get really close with the
2 tools at hand that you have today, it's better to create
3 a framework and to develop the tools over time. I think
4 that has really been shown to work with respect to the
5 Guidelines that were issued in 1982. For those of you
6 who are old enough to remember, when those Guidelines
7 first came out, there was a hue and cry that those
8 Guidelines were way too theoretic, particularly the
9 market definition paradigm, too theoretic, completely
10 nonoperational.

11 Today, with the advancements that we've seen in
12 merger analysis, I would say that the market definition
13 paradigm is probably the most practical tool in all of
14 antitrust, and when it started out, it was nothing. So
15 the only improvement area is fairly theoretical, but I
16 think it can be used in practice, at least as a tool is a
17 type of a sensitivity analysis to see how things fit in
18 and the relative importance.

19 So purely from a theoretical point of view
20 then, the way to determine whether the overall effect of
21 a merger is to reduce competition, or reduce consumer
22 welfare, is to perform what I refer to as a risk-
23 adjusted, net present value calculation. In other words,
24 what we do is we estimate the magnitude of any price
25 effect, and by "price effect," I'm including quality-

1 adjusted price, innovation, et cetera. You estimate the
2 magnitude of that price effect, the probability that it's
3 going to be realized, its timing and its duration, and
4 you do the same for efficiencies. So that is, you
5 estimate the magnitude of the efficiencies, their likely
6 effect on price, the likelihood that those efficiencies
7 are going to be realized, their timing, and their
8 duration. And then you see what the expected costs and
9 the expected benefits to consumers are over time, and you
10 make a net present value calculation.

11 So whether the merger is challenged or not
12 depends on whether the NPV is positive or negative for
13 the consumers. It's fairly straightforward. It's a tool
14 that's used every day in the business world. And I have
15 an illustration if we can put that slide up.

16 (Slide.)

17 Okay. This is just a spreadsheet, and it
18 involves the following example. Suppose we are presented
19 with a potential merger of to widget producers and we
20 conclude as follows. After a lengthy investigation of
21 witnesses, documents, third parties, everybody, we
22 conclude that the market is widgets with an 80 percent
23 probability.

24 We conclude that entry will not occur for two
25 years, also with an 80 percent probability, and we

1 conclude that the anticompetitive effects given the
2 market definition and the entry conclusions, are that
3 we're expecting a 10 percent rise in price for the first
4 two years, and we expect that within 80 percent
5 probability.

6 On the efficiency side, we are expecting that
7 marginal costs will decline and impact price by 2
8 percent. We're expecting that with a 70 percent
9 probability and that begins in year two and continues
10 through year 5.

11 We concluded that pecuniary costs would decline
12 and impact price by 1 percent, with a 70 percent
13 probability beginning in year one and continuing through
14 year 5. Then we also concluded that fixed costs would
15 decline and impact price by 1 percent with a 70 percent
16 probability, that beginning in year three, and continuing
17 through year 5.

18 All right. So these assumptions are all
19 summarized on the spreadsheet, which performs the net
20 present value calculation for that flow of positive and
21 negative benefits to the consumer that result from this
22 hypothetical transaction.

23 It shows that even though the merger is
24 projected to raise price by 10 percent for two years, the
25 net projected effect on consumers is actually positive.

1 So we'll just through this. If you look on the left-hand
2 side, you see we have competitive effects, market
3 definition, entry, anticompetitive effects, all with
4 probabilities of .8. Those are determined by each other,
5 so the probabilities add up, and the total probability is
6 51 percent. The potential harm is 10 percent. Multiply
7 that by the probability and you get an expected harm to
8 the consumer of 5.1 percent, and that appears over the
9 first two years so you see the columns on the right, year
10 one has a negative 5.1 and year two has a negative 5.1,
11 and then years three, four, and five shows zeroes.

12 In efficiencies the same thing. The marginal
13 cost probability is 70 percent. The same for pecuniary
14 benefit and the same for fixed cost. The expect harm is
15 2 percent from marginal costs and pecuniary benefits is 1
16 and fixed costs is two, and then the expected value of
17 those benefits given the risk, and then the columns to
18 the right show how those play out over time, given the
19 assumptions in the hypothetical.

20 And then just adding up the total effects down
the columns for year one, lay out over time, given the
the columns for yeasnd

1 And when you do a net present value
2 calculation, you see at the bottom there in the lower
3 left-hand corner, if you can see that, it's positively
4 slightly about 1 percent, or .68.

5 One thing more, I took a discount rate of 10
6 -- I basically just picked that out of the air.
7 Obviously that has a significant impact on whether the
8 result is positive or negative. I haven't thought real
9 hard about, you know, what the discount should be, except
10 for the fact that it probably relates to the market in
11 question and who the consumers are. Different consumers
12 are going to have different discount rates applicable to
13 them probably.

14 I don't mean by putting this chart up here and
15 having, you know, somewhat precise numbers like 5.1, to
16 suggest that, you know, we should do a calculation with a
17 great degree of mathematical precision. We don't really
18 have the tools to do that, at least not yet.

19 On the other hand, what I think this allows you
20 to do is to see in a broad way what's going on, to be
21 cognizant of the ultimate purpose of this exercise, and
22 perhaps most importantly, be transparent about the
23 assumptions that we're making in the analysis. And by
24 being transparent, I think we can expose some
25 inconsistencies in what we may be doing and not realizing

1 some flaws, and I think we can also provide incentives to
2 develop new techniques that will make this kind of
3 framework more practical.

4 Among other things, I think what this approach
5 does or this structure does is help to define what

1 the more likely, and the longer must be the offsetting
2 efficiency effects, and the weighting is then determined
3 by the NPV calculation.

4 One of the things that is demonstrated by this
5 type of example is fixed costs. If you look at the fixed
6 costs, you see that they're occurring by assumption here
7 in years three through 5, and what it shows is they
8 really can be determinative, and they shouldn't be
9 ignored or treated with the back of the hand, which I
10 think is the tendency now.

11 I mean, basically, what would happen is, people
12 would say yeah, we got these big fixed cost savings, and
13 the agency folks will say, yeah, that's really nice and
14 maybe you do, but, you know, those really get little
15 weight. Well, you know, how much weight should they get?
16 There's really no mechanism to kind of figure out how
17 important they are. And so, I think this really helps
18 with that.

19 And the other thing that this kind of focuses
20 your attention on -- and Dave made a reference to this --
21 is the probabilities of the anticompetitive effect,
22 particularly if you're talking about analysis that's kind
23 of like compartmentalized.

24 So we do a market definition, then we do a
25 competitive effects analysis, assuming that market

1 definition, and there's some risk associated with each of
2 those, and I think that kind of tends to get lost, that
3 once we conclude the market is X, we're making kind of
4 like a subconscious assumption that it's X with 100
5 percent probability, and that's really not the case.

6 So I think this type of analysis kind of helps
7 to expose what's really being assumed, and then the
8 magnitude of the effects versus the efficiencies. And I
9 think something like this would really help get us over
10 the hump that we find ourselves at now. What happens
11 today basically is when somebody comes in with a merger,
12 they do their efficiencies analysis, the parties do, and
13 as Dave said, it goes over the net to the staff, and it
14 really never comes back. And I think the parties don't
15 really pitch it that much, and I think that's true for
16 the following reason.

17 I think they intuitively understand that it's
18 not going to save an otherwise anticompetitive merger.
19 By the same token, they don't understand that if the
20 staff has some serious doubts about the confidence of,
21 you know, their projection of an anticompetitive effect,
22 the fact that the merger has efficiencies associated with
23 it will make the staff feel more comfortable about not
24 challenging the merger. And so there's really no need in
25 that kind of a circumstance to go back and forth over the

1 net.

2 The problem, though, is that the efficiencies
3 really are playing a very little role in the merger
4 investigation, and I think that's something that needs to
5 be rectified. And hopefully, this type of structure, you
6 know, can provide some context in which to do that.

7 Thanks.

8 MR. ABBOTT: Thank you, Joe, for that succinct
9 presentation. And it's the first time I've seen such an
10 effort, as I say, to rank the probabilities of the
11 different factors going into net consumer welfare
12 analysis in sort of a simple manner. So we'll see if
13 that inspires some of our speakers.

14 Now we turn to Mark Gidley, who is borrowing
15 from Voltaire and Professor Pangloss. I know he has a
16 paper for distribution you may want to pick up outside at
17 the entrance entitled "Misuse of the 'Merger-Specific'
18 Requirement: Merger Analysis is Not the Search for the
19 Best of All Possible Worlds."

20 Mark, on that literary note, please proceed.

21 MR. GIDLEY: Thank you very much, Alden. And
22 let me say, first it's good to be amongst you. I see a
23 lot of old friends. I've had the pleasure of litigating
24 five merger cases since I left the DOJ, with some success
25 and with some failure, and I may acknowledge that as I go

1 the 1997 Guidelines as something of an obstacle course
2 out of the Marine Corps. You know, your efficiency
3 argument and your beautiful spreadsheet that actually
4 analyzed the merger on going out five or 7 years, the
5 nail has to go through the rope that's hanging over the
6 net, and it's got to go over the 30-foot wall of merger
7 specificity. It's got to go meet this, it's got to meet
8 that to become cognizable. And in the real world,
9 they're just efficiencies, and they're either likely or
10 they're unlikely. And undoubtedly, people will from time
11 to time bring to the agencies efficiencies that aren't
12 real world or that they don't tell their businesspeople
13 or that they didn't get board approval for, and all of
14 that is relevant.

15 But what I'd like to focus today on is the
16 language of merger specificity, and in my own work on
17 this paper, I found that the actual language of the 1997
18 Guidelines is not the way we practitioners or the
19 government officials use the phrase "merger-specific."

20 In general, the phrase "merger-specific" is
21 really used as an epithet. You might have very good
22 efficiencies that your deal really will cause, that will
23 really cause these efficiencies. But somebody will say,
24 well, they're not merger-specific. And that's it. And
25 with the back of the hand, that invocation phrase,

1 oftentimes even private practitioners back-off bona fide
2 efficiencies. I hope to back-off of that phrase
3 ourselves today in the discussion.

4 I start by acknowledging my own sinfulness in
5 words. I sat at the Justice Department when we did the
6 1992 Guidelines, and I think we really punted on
7 efficiencies. We took on our clear and convincing
8 evidence, but we really didn't analyze efficiencies. All
9 of our efforts and brainpower -- and there was a lot of
10 brainpower applied -- was on competitive effects, and I
11 think that was probably all the bandwidth the human
12 beings at the agencies had in 1992. We really didn't
13 have the bandwidth to take on efficiencies.

14 So my compliments to Chairman Pitofsky and
15 others for in 1997 trying to explicate what efficiencies
16 we're going to recognize. So I think to that extent, the
17 1997 Guidelines were a good evolution, but I think
18 they're a stopping point on the journey. And now, with
19 seven years of experience, particularly with merger-
20 specificity, we can really say what's worked and what's
21 not worked.

22 I have a slide that's just the language, Alden,
23 of paragraph three from Section four of the Guidelines
24 that I thought I would just put up.

25 Because as I prepared my remarks, I actually

1 found language in there that I haven't been using as a
2 private practitioner. And I'll warn the agencies that I
3 may start doing so.

4 (Slide.)

5 It's up. I'll read it for those of you who
6 believe in an oral tradition. Paragraph three says:

7 The Agency will consider only those
8 efficiencies likely to be accomplished with the
9 proposed merger and unlikely to be accomplished
10 in the absence of either the proposed merger or
11 another means having comparable anticompetitive
12 effects. These are termed merger-specific
13 efficiencies. Only alternatives that are
14 practical in the business situation faced by
15 the merging firms will be considered in making
16 this determination; the Agency will not insist
17 upon a less restrictive alternative that is
18 merely theoretical.

19 And if you just take a look at this first sentence, it
20 seems to me, just doing a little bit of jurisprudence on
21 the first sentence, there are really two elements. One
22 is that the efficiency that we're going to talk about in
23 Section four is caused by the merger. So I would call
24 that "merger-caused efficiencies".

25 But there appears to be a subset of

1 efficiencies that are merger-intrinsic or not merger-
2 intrinsic. In other words, if the efficiency is not

1 paper between merger-caused efficiencies and merger-
2 intrinsic efficiencies. And just so I'm provocative and
3 hopefully clear, I reject the merger-intrinsic concept.
4 I don't see it as necessarily a useful concept, because I
5 think in practice, what happens is, you wind up battling
6 against theoretical alternatives, and that that last
7 sentence in the Guidelines, which is a good, laudable
8 sentence in practice has not materialized in the
9 conference rooms at either agency.

10 It's also interesting to me that the sentence
11 that reads, "only alternatives that are practical in the
12 business situation faced by the merging parties." That
13 phrase has not been quoted by any of the cases decided
14 since 1997 that have dealt with efficiencies. The courts
15 don't discuss it, and there is no clear allocation of
16 who's got the burden.

17 In other words, if the merging parties can
18 demonstrate likely efficiencies, shouldn't the agency
19 have to say there exists a practical alternative, and
20 it's X, and actually produce some evidence about a
21 practical alternative? But that's not what's done today.

22 Now where did we get this notion of a less
23 restrictive alternative? It's imported from joint
24 venture law where we're trying to figure out what
25 restraints are reasonable. But the courts in joint

1 venture law, in a decision that I like very much, the
2 American Motor Inns case, have really discredited the
3 notion of trying to find the least restrictive
4 alternative, and I go through that in the paper.

5 I think that the problem with the way merger
6 specificity gets interpreted today in the conference room
7 of the agencies is that it really does devolve into,
8 well, that's just not merger-specific. And it's a back-
9 of-the-hand kind of statement rather than a real debate
10 over any practical alternative that someone would
11 propose.

12 Let me turn to, I think, what is the typical
13 back-of-the-hand speculation, which is why don't you do a
14 production joint venture? And probably any of the
15 panelists that have worked in the private sector with
16 parties that have done 50-50 joint ventures could
17 probably tell you, maybe but for the attorney-client
18 privilege, about the horror stories of trying to advise
19 clients on 50-50 joint ventures. And I'll just try to
20 highlight what I think in general led to the skepticism
21 of them.

22 I think the first is, typically joint ventures
23 that are set up 50-50 between two competitors have the
24 problem of being orphans. Because there's a 50-50 split
25 of the management of the joint venture, the joint venture

1 is really an orphan. It's not really owned or dominated
2 by one firm. They wind up having, at least in my
3 experience, they have these large meetings that really
4 become management-by-committee, rather than a straight
5 linear model. That may seem trivial, and we might all
6 conceive of, well, they could come up with all kinds of
7 tie-breaking mechanisms, but in the real world, that's an
8 issue.

9 The second is, I think, the formation of 50-50
10 joint ventures takes two, three, four times what it takes
11 to put together a merger. Mergers in general are very
12 simple, very direct, very linear. I own you. That's it.
13 I know there are complications. I know sometimes the
14 target actually takes over the acquirer in the long run,
15 but in general, they don't suffer from the lack of a
16 pyramidal structure. And third, in a joint venture, both
17 of the parties to the joint venture are over time going
18 to have to contribute intellectual capital and real
19 capital to the joint venture. And there tends to be a
20 reluctance to do that if it's a 50-50 joint venture.

21 Now I'm mindful that you could have a 60-40
22 joint venture and other ways that might somehow get
23 around this, but I think that those are real world
24 issues. Sitting in the conference room at one of the
25 agencies, oftentimes the time difference between the

1 merger that you have today, the bird in the hand, versus
2 two in the bush, can be quite extreme.

3 Now one thing that I will fault the merging
4 parties and their lawyers for is, I don't think we make
5 good enough use of the Guidelines' 1997 language about
6 timing, and we've got that on the next slide.

7 Just the next page, David.

8 (Slide.)

9 Footnote 35 says "If a merger affects not
10 whether but only when an efficiency would be achieved,
11 only the timing advantage is a merger-specific
12 efficiency."

13 I think most of the time, practitioners and the
14 staffs at the agencies trying to build a case only see
15 the word "only" and they kind of blow by the fact that
16 the 1997 revision at least acknowledges the very
17 important element of time, and I think it relates to a
18 lot of what Joe Simons was saying earlier.

19 There are huge timing advantages, maybe of two,
20 three and four years, and those time advantages can add
21 up to in some mergers tens of millions or hundreds of
22 millions of dollars in difference between cost savings
23 between different practical alternatives.

24 I'll also credit the current Commission for the
25 Novazyme decision, which is a recent decision where

1 Chairman Muris in his statement made a very good and
2 reasoned decision of LRA analysis, Less Restrictive
3 Alternative analysis, and stressed the efficiencies that
4 were the bird in the hand rather than going for two in
5 the bush.

6 I would like to talk briefly about some of the
7 decisional case law, only some of which I have the scars
8 from. I will, simply because Chairman Pitofsky is here,
9 talk a minute about Staples. Staples is a good
10 illustration of a really flat out war between the merging
11 parties and the agency with the judge giving us the
12 benefit of his courtroom for a week. It was really a
13 wonderful thing.

14 And Staples probably had one of the biggest
15 battles over efficiency. I think there really were
16 serious efficiencies, and the staffs that I've talked to
17 over the last seven years -- I can't believe it's been
18 seven years since Staples -- have acknowledged that the
19 efficiency arguments in Staples were very serious, very
20 compelling and kept people up late at night. And in
21 fact, the 1997 Guidelines came out during some of the
22 agency consideration of Staples.

23 One thing I would point out, and again, maybe
24 the fault comes back to me for not focusing on footnote
25 35, one of the arguments that appears in Judge Hogan's

1 opinion is, well, Staples and Office Depot are going to
2 continue to grow organically, and the agencies told us in
3 their deliberations, well, Staples will double over the
4 next seven years.

5 But the argument we made, but we didn't make it
6 forcefully enough for Judge Hogan, is, yeah, but you get
7 the merger efficiencies today. You don't have to wait
8 seven years. And seven years times these numbers add up
9 to very, very large numbers. And it's interesting. We
10 probably should have beaten more on footnote 35. I think
11 we were just shocked that Guidelines that came out in
12 April would be used by a judge in June. But that was one
13 of the learning experiences of Staples.

14 Staples is an important decision on
15 efficiencies simply because it really, I think, creates
16 the modern era where efficiencies are serious. I think
17 that's one of the good things from the 1997 Guidelines,
18 is the agencies are really taking on efficiencies and
19 saying, at least in the text of the Guidelines, they're
20 important, and certain efficiencies we'll credit.

21 My criticism is that we're putting the
22 efficiencies through too much of an obstacle course and
23 not comparing the likely post-merger world with the
24 likely world without the merger.

25 Tenet Health is another case where the case was

1 reversed on efficiencies. The other case that I talk
2 about in the paper, and I'll let you read the paper, is I
3 have a brief discussion of the Heinz baby food decision.
4 I think it's quite possible that this case ultimately

1 Nut have very efficient distribution? But there's no
2 evidence produced by the opponents of the merger as to
3 what practical steps could have been done Beech-Nut to
4 improve the efficiency. And I think that the onus should
5 have been on the staff and on the Commission to do that.

6 And there have been decisions that have been
7 very favorable to what I call merger-caused efficiencies.
8 I'll let you read those in the paper. University Health,
9 which predates the 1997 Guidelines revisions.
10 Butterworth, and a 1990 case with the DOJ, the Country
11 Lake Foods case.

12 In those decisions, what I liked from those
13 decisions is that the court really seems to get down to
14 the bottom line, just the effect of the merger versus the
15 nonmerger world, rather than using hypothetical
16 alternatives in a less restrictive alternative way, which
17 is, I think, what the phrase "merger-specific" has
18 devolved into.

19 Now where do we go from here? It seems to me
20 that where we are today is that we really are doing less
21 restrictive alternative analysis even though we say that
22 we're not. Really, in the conference rooms, it can
23 sometimes work that if somebody postulates a theoretical
24 alternative, that's really the end of the discussion, or
25 at least the end of the discussion that you experience.

1 A couple of practical things that I would do.
2 First, I think that I would put the onus on the staff to
3 come up with practical alternatives. There are
4 investment bankers out there. There are management and
5 business gurus out there. If there really is such a
6 solid, practical alternative, let's get testimony about
7 it. Let's test that hypothesis with actual evidence.
8 That has not occurred in any merger case that I've been
9 involved in, and certainly not in any merger trial that
10 I've seen.

11 I think second, ultimately we are going to in
12 the next revision of the Guidelines or the next step in
13 the evolution of considering efficiencies, I think we'll
14 move more away from whether or not an efficiency is
15 merger-intrinsic, and we'll really look at whether the
16 merger causes the efficiency, and we'll especially look
17 for whether that merger-caused efficiency feeds back into
18 competitive effects.

19 The net assessment of the merger comes in
20 Section two, and those efficiencies that directly improve
21 competitives and rivalry in the industry should already
22 be considered today in the Section two analysis.

23 Let me just conclude with a couple of where we
24 go from here observations. I think the first is, we
25 private practitioners who are on the outside, I think

1 need to push efficiencies. I think it's a very well
2 taken criticism that the treatment in the conference
3 rooms of efficiencies has led attorneys to focus much
4 less on the real world efficiencies and synergies and
5 styles of management.

6 I think a second observation I would have is,
7 that our economy continues to move to a service and
8 virtual economy. Even the companies that sell products
9 like Dell, really are virtual companies. They acquire
10 and really excel at production logistics and distribution
11 rather than physical manufacture of products. And I
12 think that has certain implications for merger-
13 specificity.

14 For instance, the 1997 Guidelines take a dim
15 view of certain logistics and purchasing synergies. I

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1 very meaty paper by Ilene Gotts. I've been going through
2 her slides. And she's going to give us insight on a
3 number of issues raised by Section four of the
4 guidelines. Her slides are entitled "The Role of
5 Efficiencies in Integrated Merger Analysis." And
6 although there's a lot to be covered, as Ilene was
7 reminding me, she's a New Yorker, and she can talk fast.
8 Ilene?

9 MS. GOTTS: And I'm going to trust Dave with my
10 slides. We're going to test his technical capabilities
11 here.

12 I will handle this very fast. And there's also
13 a paper that I worked on. One of the advantages of the
14 business downturn last year was it allowed me to take
15 some time to read some of the legal, economic and
16 business literature that was out there to get a sense on
17 how the rest of the world is viewing efficiencies and
8 then I comparegooi7108 -2D0.001 Tc(I will handle this very fast. Ar

1 things like procurement, management and capital cost
2 efficiencies, these are thought to be less likely to be
3 merger-specific or substantial, which as you'll see as I
4 go through this, is almost directly opposite the business
5 literature that's out there.

6 When you look at why deals are announced,
7 they're very much in this last category of procurement,
8 management and capital cost efficiencies. And indeed,
9 some of the presumptions that we build in throughout to
10 be skeptical about these efficiencies seem to be contrary
11 to the obligations that directors and management have
12 under Sarbanes-Oxley. If anything, they have to be very
13 careful about what they publicly announce as
14 efficiencies, because if they're wrong at the end of the
15 day, they lose their jobs. They have shareholder suits.

~~10 ask! the board of directors can't help it. Deals are announced by the~~

1 look at the EU Guidelines, which don't seem to draw as
2 much of a distinction -- we'll probably hear a little bit
3 more about this from Vincent -- in that it says that you
4 consider any substantiated efficiency claim in the
5 overall analysis of the merger.

6 Productive efficiencies, as we said, are the
7 least controversial. One aspect that remains
8 controversial is, I think it should include fixed costs,
9 not just variable cost. Because at some point in time,
10 especially when you start talking about distressed
11 industries where the whole industry is not producing
12 well, these efficiencies are very important. They can
13 have an effect by just increasing cashflow, making it
14 more possible to get significant nonprice benefits to
15 consumers, such as to fund innovation.

16 And in marketplaces that are changing, either
17 they're distressed and you need to realize it, or where
18 market definition is changing, convergence markets, high
19 technology markets, these fixed cost savings are just
20 critical to the bottom line and to whether or not the
21 great new products of the future will be realized.

22 Also, distribution and promotional
23 efficiencies. The 1997 revisions are silent on these.
24 The global staff report, which is 1995 -- which is
25 wonderful to read, by the way. It is just full of

1 information -- unfortunately find that these types of
2 efficiencies are less likely to be substantial and often
3 likely to be difficult to assess.

4 Just because distribution and promotional
5 efficiencies are less likely to be substantial and might
6 be hard to assess doesn't mean that they don't count. We
7 should try to, wherever we can, to factor it in.

8 Dave mentioned that when you look at the
9 quirkiest remedies -- I think that would be the way I
10 would phrase what you were saying, and hopefully I'm not
11 mischaracterizing it -- when they carve out various
12 things that are novel, that's because there's been an
13 effort to save efficiencies.

14 I would make one other note about when I look
15 at remedies. When I've been in here on Nestle/Dryers or
16 what I've seen from Exxon/Mobil or even in the General
17 Mills/Pillsbury thing, I have found that the staff is
18 thinking about distributional efficiencies in what
19 they're demanding I'd make sure is in the divestiture
20 package. So if it's something that I have to put in, and
21 in that case they think it's for real, why isn't it for
22 real when as a merger party I assert it? To me, we
23 should be consistent in the approach we take and we
24 should recognize these.

25 Dynamic or innovative efficiencies. The 1997

1 procurement management and capital costs. 1997 revisions
2 are very, very resistant to recognizing these. And yet,
3 in every deal I've had just about, procurement savings,
4 reducing the number of suppliers, going to best
5 practices, coming up with a way to reduce costs are
6 always a factor for why businesspeople are doing a deal.

7 Managerial savings. The merger specificity
8 part of this. The reality is, it is very hard when you
9 have an entrenched management because of not only the
10 fact that they're there, but because of labor law,
11 because of tax law, to just say you're out. A merger
12 provides a perfect excuse for doing what you might
13 otherwise want to do. And, therefore, we shouldn't tilt
14 it and say we're not going to recognize it.

15 Capital cost savings. The G.E./Honeywell
16 decision from what I can see in the EU seems to view this
as a negative. The reality is, again, this can make a

1 at what is currently the case. When you look at the
2 Merger Guidelines and the case law, you see efficiency
3 claims will not be considered if they are vague or
4 speculative or otherwise cannot be verified by reasonable
5 means.

6 You see statements in there about a sliding
7 scale that Dave was mentioning. The greater the
8 concentration or the greater the concerns of more burden
9 that's put on the parties.

10 As Joe noted, and this is very important, we're
11 making guesses as well for market definitions and other
12 things. I don't quite understand why once you make a
13 guess or put a probability on one side it becomes the
14 case. It's per se. It's presumptive. And then all of
15 the burden shifts.

16 When we look at concentration analysis, there's
17 a lot now in the literature to suggest that there aren't
18 these bright lines in the rules. It depends on the
19 industry as far as when the concentration is too much and
20 how competitive it's really operating. So again, putting
21 huge presumptions on parties and tilting the sliding
22 scale, changing the playing field on the basis on these
23 sorts of things, suggests a precision with respect to the
24 anticompetitive effects that is unfair and can lead to
25 really bad Type II decisions.

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1 The case law. Heinz is going to be great. We
2 might have lost the battle, but we might win the war
3 because of that case. That is a bad case. As I
4 understand it, Heinz now is pretty much -- one of the
5 companies is not in the business. The anticompetitive
6 effect we thought of didn't happen because, you know, of
7 the fact that the merger didn't go through. But, the
8 company doesn't exist anymore. And to have imposed such
9 a huge burden and thrown out of consideration huge,
10 substantial efficiencies just was wrong.

11 When we look at the EU Guidelines, again, we
12 see some learning in many areas, but we still see this
13 tendency to say that efficiencies must be substantial
14 enough to counteract a merger's potential harm. And
15 again, this suggests that there's some precision
16 mathematically that I don't think exists. I think Joe's
17 model goes a long way in helping us to start thinking
18 about how you look at this, and especially in building in
19 the probabilities, but the math is not there.

20 So I would really suggest as a result that we
21 really step back and we really stop putting in so many
22 presumptions and tilting the balance so strongly and
23 maybe look at this like we do in other areas, like
24 Section I. Initially you start out where the plaintiff
25 has to show there's some possibility of an

1 anticompetitive harm. Then the parties have to show
2 there's some legitimate purpose for it, i.e., like
3 efficiencies, and then it shifts back to the plaintiff
4 again to show why that's not the case.

5 Per se rules and presumptions built in where
6 they can't come back is just really wrong.

7 To save some time, I would like to skip up to
8 slide 12, if you wouldn't mind, Dave.

9 (Slide.)

10 And basically remind everyone that when we're
11 talking about Clayton Section 7, we're talking about
12 probabilities, not possibilities, and that's really what
13 the standard should be here, and that when we look at
14 this, the other problem I have is, I find the agencies
15 are wonderful. You can come in and you can talk to them
16 about efficiencies, and in close cases, I think they go
17 the right way. Their gut says, okay, this is a deal we
18 shouldn't block.

19 But when they go to court, it's like all bars
20 are off. The agency all of a sudden goes back to Brown
21 Shoe and Vons or anything else they can dig up with these
22 horrible presumptions to concentration, because they're
23 out to win the case.

24 And when you look at what the role of an agency
25 is, I love this seminal case, the Berger v. United States

1 Government. The government is supposed to govern
2 impartially. Criminal prosecution is not that it shall
3 win a case but that justice shall be done. And to me,
4 justice is not done by going to a bunch of legalistic
5 presumptions and tilting the case so that Type II errors
6 are made, but by applying the same standards at the
7 agency and then going forth to the court with the exact
8 same standards and letting a judge weighing the evidence
9 and decide where the probabilities really stand.

10 When we weigh efficiencies effects in declining
11 industries, this is what I'm up at night thinking about
12 these days, because I really do want to try to get it
13 right. To me, there are certain things in the Guidelines
14 today that seem to recognize that declining industries,
15 these are industries where the price is really below
average total cost. So we're basiclly bw0.-5.710-5.7a5oD0 Tcd 1 Tf-

1 that is there, but in the long term, the potential harm
2 to the industry from ignoring two efficiencies and
3 whether consumers actually benefit consumers from
4 efficiencies being realized by new products being
5 transitioned is really great.

6 So I would really like to see something more
7 explicit in the Guidelines to recognize declining
8 industries and how we might look at it. I'm not at the
9 stage where I even feel I could draft what that should
10 be, but something should be done on this.

11 In conclusion, I think the Guidelines should
12 clarify that the competition authorities will consider
13 all types of efficiencies as long as they are verifiable,
14 substantial and likely to be realized. We should stop
15 this idea that some count more than others.

16 Efficiencies should be subject to the same
17 standard of proof, and that should be as clear as
18 evidence relating to a likelihood of anticompetitive
19 effects, both during the agency review and then in the
20 court challenge. Then finally, that when considering a
21 merger in a failing industry that we'll be even more
22 receptive and we'll give more weight to potential dynamic
23 or innovation efficiencies that could help to sustain the
24 industry or to transition it into the new products and
25 services that it needs to offer.

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1 I stayed within my time.

2 MR. ABBOTT: Thank you, Ilene. You certainly
3 did, and very provocative remarks. And you hit a lot of
4 topics. And now I'm pleased to turn to Bill Kolasky, who
5 I know has given speeches and written on efficiencies,
6 and I'm particularly interested in hearing what he might
7 have to say about how lessening of competition in one
8 market might be justified by efficiencies in other
9 markets, sort of another aspect of Section IV of the
10 guidelines that perhaps has not received all that much

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1 one of the best articles on efficiencies that I think has
2 appeared, by Joe Farrell and Carl Shapiro in the
3 Antitrust Law Journal shows, the most important
4 efficiencies are not production cost savings and other
5 forms of cost savings, but rather the synergies that come
6 from combining complementary assets, complementary
7 strengths.

8 To some extent, you may be able to quantify those
9 efficiencies, but often you are not able to quantify
10 them, and you have to evaluate them more qualitatively.

11 Let me take four or five cases that I've been
12 involved in to illustrate what I mean and why I think we
13 need to change our thinking about this.

14 The first one, interestingly, was a case way

1 the business very long.

2 We hired George Stigler to work with us on this
3 merger, and with Stigler's help, we persuaded Bill Baxter
4 to allow a merger of the foreign producer, and it was the
5 leading producer in the world of these rechargeable
6 batteries, to merge with the number two company in the
7 United States.

8 The efficiencies that we saw from that deal had little to

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1 would have one Survivor type show and a new show, and
2 together, that would actually increase output and allow
3 them to sell more advertising. But they wouldn't have
4 the incentive to do that kind of complementary program
5 unless they were commonly owned.

6 And in the final case which came out the other
7 way is the Direct TV/Echo Star merger which was reviewed
8 by Justice about a year ago. There too the efficiency
9 argument that was being made by the parties had nothing
10 to do with cost savings. It was that the combination of
11 these two direct broadcast satellite companies would
12 allow them to offer local into local program, which
13 neither of them would have sufficient channel capacity to
14 do independently.

15 The reason the Justice Department rejected that
16 efficiency was because they ultimately found that it was
17 not merger-specific, that because of advances in
18 technology, there would be sufficient channel capacity
19 within the next two years to offer local into local
20 program without the merger, and that is in fact what has
21 happened.

22 The Heinz/Beech-Nut case, I agree with all the
23 negative things that have been said about that decision,
24 is probably going to become the Procter & Gamble/Clorox
25 of our generation. And it's a good case that illustrates

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1 the importance of integrating efficiencies into your
2 competitive effects analysis.

3 At bottom, the reason the D.C. Circuit found that
4 merger unlawful was because they viewed it as a three to
5 two merger that was likely to lead to a greater
6 coordination and higher prices. They pushed aside very
7 significant efficiencies, and again, there weren't just
8 the production cost savings that Mark referred to, but
9 there was also the importance of being able to combine
10 the strong Beech-Nut brand with the lower Heinz
11 production cost in order to compete more effectively
12 against the dominant Gerber.

13 The facts of that case in fact show that you
14 already had coordinated pricing going on, but there was
15 the leader-follower pricing, and Gerber basically was
16 able to price at a high level under the umbrella created
17 by the fact that its rivals were so much higher cost
18 producers. (AUDIO GAP) merger, because the rival would
19 have costs comparable to Gerber, there was every reason
20 to believe that even if they continued to coordinate as
21 they had been, prices would be lower, and consumers would
22 be better off. The D.C. Circuit never even thought about
23 that issue, or at least if they did, they didn't write
24 about it.

25 Let me move on quickly, because I have a

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1 limited amount of time, to my second issue. But I hope
2 what I've illustrated by this is that we need to get away
3 from thinking about efficiencies just in terms of cost
4 savings. Think about them principally in terms of
5 combining complementary assets and whether that is going
6 to allow the merged firm to produce a higher quality

5

1 A good book, I think, on this subject is
2 William Baumol's book, The Free Market Innovation

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1 Bobby Willig, that the model, the economic model that
2 should be used for evaluating competition in these
3 industries is not the traditional price theory model, but
4 rather the contestability model. Because what he argues
5 basically is that what determines price in these
6 industries is the level at which prices will attract new

1 would work. Obviously, we've gained a great deal of
2 experience with that approach over the last 20 years. I
3 think as a practitioner, that one of the things that has
4 been most striking to me over the last five to seven
5 years is that as we have applied the hypothetical
6 monopolist market definition test more rigorously,
7 markets have come to be defined more and more narrowly.

8 Second, as we've moved away from homogeneous
9 commodity-type products, more and more markets are
10 characterized by price discrimination. And in markets
11 characterized by price discrimination, you could, as a
12 theoretical matter, define virtually each customer as a
13 separate market. And in fact, at the Justice Department
14 at least, when they analyze mergers, that is in fact how
15 they look at them as they try to evaluate the likely
16 price effects of a merger.

17 They may not define the market that way when
18 they go to court. I think that's Ilene's point. But
19 even then, the market definitions are much narrower today
20 than they were a generation ago. Look, for example, at
21 the Justice Department's complaint in the First
22 Data/Concord merger case where they defined the relevant
23 market as "processing PIN-debit cards at point-of-sale."
24 And certainly in the similarly narrow market definition
25 in the merger case where Mark was successful in beating

1 back a challenge, because the judge simply didn't
2 understand what role price discrimination plays in
3 defining the relevant market.

4 As we move to increasingly narrow market

1 competition between these two systems, whereas there were
2 hundreds of wells that were going to benefit from the
3 cost savings resulting from consolidating the two
4 systems, they granted early termination of the second
5 waiting period.

6 The efficiencies were outside the relevant
7 market in which the anticompetitive effect would be felt,
8 and yet nevertheless, they were recognized as swamping
9 the potential anticompetitive effects, so the merger-to-
10 monopoly was allowed.

11 Another very good example of this, but a more
12 controversial one, is the Surface Transportation Board's
13 decision in the Union Pacific/Southern Pacific merger
14 case where I was one of the opponents. There, there were
15 a large number of routes from the Gulf Coast to the
16 Chicago-St. Louis area that were basically two -- or the
17 merger was a two to one merger. It was a merger-to-
18 monopoly. The Surface Transportation Board was
19 convinced, however, that there were very substantial
20 efficiencies from combining the networks of the Southern
21 Pacific and Union Pacific roads that would benefit all of
22 their shippers on all of their lines. And, therefore, in
23 order to remedy the anticompetitive problem, rather than
24 ordering divestitures, they structured a trackage rights
25 remedy that would give a third carrier the rights to use

1 the UPSP tracks to service these customers. And I think
2 that's a good illustration of how efficiencies factor
3 into the choice of remedy.

4 But, again, the point I'm making here is that
5 that was a case where the agency found that the out-of-
6 market efficiencies were inextricably intertwined with
7 the negative competitive effects, and therefore tried to
8 structure a remedy that would fix the competitive problem
9 without sacrificing the efficiencies.

10 I think one of the things that concerns me
11 about the new EU draft -- EU Notice on Horizontal Mergers
12 -- it's now final -- is that, at least as I read it, the
13 European Commission does not have the same flexibility
14 that our agencies have to take into account those out-of-
15 market efficiencies. And I'd be very interested to hear
16 from Vincent on how the Commission would deal with cases
17 like the two that I've just discussed.

18 Thank you.

19 MR. ABBOTT: Thank you, Bill. Some more
20 provocative remarks. And now I turn for a magisterial
21 overview to Chairman Pitofsky, who was around when
22 Section IV of the 97 -- Section IV of the Guidelines was
23 revised in 1997 to give us the current treatment of
24 efficiencies.

25 Chairman Pitofsky was also around, of course,

1 for the Staples case and the Heinz/Beech-Nut case, which
2 a number of practitioners here have trashed. And I'm
3 sure that Chairman and Professor and Dean Pitofsky will
4 give us a magisterial overview and maybe some rebuttal as
5 well. Bob?

6 MR. PITOFSKY: Thank you. It's good to be back
7 here in this unfamiliar but familiar FTC. This building
8 is unfamiliar.

9 You know, magisterial oversight is a little
10 different. I thought what we were going to have is that
11 we have three or four speakers on one side saying the
12 Merger Guidelines should be expanded, two or three
13 speakers saying they should be left where they are or
14 contracted, and then I would stake out a middle ground.

15 That's not it. Everybody who's spoken so far
16 has said the Merger Guidelines -- the efficiency defense
17 in the Merger Guidelines should be expanded, even made
18 primary.

19 It's interesting. Historically, it was Bork,
20 Posner and Baxter who felt so strongly that the
21 efficiencies defense was a wrong idea. And you would
22 think they'd have some influence today, but not on this
23 issue. And it was Areeda, Turner, Broadly, Muris, who
24 does have efficiency credentials, and shyly, myself, who
25 wrote that an efficiency defense has to be included in

1 the Merger Guidelines. And it was the Clinton enforcers
2 who introduced it formally into the statute.

3 Let me just say a few general things and then
4 some specific things about the cases that were brought
5 up. There is a general thread here that the conditions
6 that are imposed to successfully assert an efficiency
7 defense are too narrow.

8 Let me start at a different place. It is not
9 my intention to defend every word and every concept in
10 these efficiency guidelines. I heard a couple of things:
11 Ilene's notion that declining industry aspects should be
12 brought into your consideration of efficiencies.
13 Absolutely. I think that's a good idea. Bill's thought
14 that fixed and variable are unnecessarily, treated
15 unnecessarily differently from the point of view of the
16 Guidelines, I agree with that. Businesspeople don't make
17 the kind of distinction that theoretical economic
18 analysis does. And Bill's suggestion, I just want to
19 associate myself with him, that the staff does listen to
20 efficiency claims. The idea that they're only there to
21 debunk the claim, that's not the agency I was at. They
22 are there and they work hard on these things.

23 All right. Narrow conditions. It is true, the
24 conditions are narrow. The efficiency must be
25 substantial, merger-specific, timely, clear and

1 convincing evidence, can't reduce output, et cetera, et
2 cetera, but that's what was intended. The idea is that
3 in a close case, efficiencies can be a tiebreaker. The
4 idea was not that efficiencies ordinarily will allow you
5 to merge three to two, or two to one. That's not what
6 American antitrust is about. That's not what this
7 statute, which says "tend to create a monopoly" is about.

8 On producer surplus, I'm sort of agnostic. If
9 the producer surplus were enormous and the
10 anticompetitive effect were tiny, I guess anybody would
11 take it into account as a matter of prosecutorial
12 discretion. I'm pretty sure you would do that.

13 As to some of the proposals, exceptional
14 effort, thoughtful, creative. My question is going to
15 be, Joe Simons and others, can we do it? And you make a
16 very fair point. A lot of people said that about the
17 definition of relevant market. And now we've learned how
18 to do it, and we can.

19 But I'm worried about this one. Antitrust is a
20 practical enterprise. It's not the development of a
21 dissertation. And I just keep thinking to myself --
22 well, let me take as an example, the claim is that, yes,
23 the merger will lead to higher prices now, but down the
24 road, three years, four years, five years, the efficiency
25 will produce lower unit costs and perhaps, maybe even

1 probably, lower prices. And I keep wondering, what will
2 the subpoena look like that tries to get at the question
3 of whether or not five years down the road there will be
4 lower prices, that the efficiencies will kick in.

5 Look at how many times people have claimed
6 efficiencies and they never kicked in. What are you
7 going to do with the company five years later when it
8 turns out that prices are still higher and the
9 efficiencies haven't kicked in. You can't break up the
10 company, not if it's a horizontal merger. So there are
11 practical problems here.

12 There are also technical problems. It's
13 contrary to the statute, which says in any line of
14 commerce. It's contrary to the spirit of the Guidelines,
15 and it produces the odd situation where one set of
16 consumers who buy today are financing lower prices for
17 another set of consumers who buy later. But my main
18 concern is, could you possibly do it?

19 Let me raise a question for all of you. Do you
20 believe in British Oxygen? Do you believe the court when
21 it said that it will not let the plaintiff get away with
22 coming in and making the anticompetitive case in some
23 speculative way? Well, judge, I can't tell you that
24 there will be an anticompetitive effect now, but I can
25 tell you eventually there will be an anticompetitive

1 effect, and you ought to strike down the merger. And
2 what was it, the 2nd Circuit? FTC. FTC got thrown out on
3 their ear on grounds that you can't come in here with
4 that kind of speculative talk and expect to block a
5 merger.

1 account. That's fair enough. That's fair enough.

2 Okay. Now, let's see. Shots at the
3 Commission. Look, baby food you say will live in infamy.
4 It's a tough sell and similar mild comments. It's the
5 Procter & Gamble of the new generation.

6 (Laughter.)

7 Let's put this into context. A hundred and
8 fifteen years, and no court has ever approved a three to
9 two merger unless there were low barriers to entry and a
10 failing company assertion. A hundred and fifteen years.
11 So it was hardly a departure. Unanimous Court of Appeals
12 affirmed what the Federal Trade Commission said.

13 Now since the deal, I'm not even sure what's
14 happened, but I gather Gerber has grown and one of them
15 has gone out of business.

16 Heinz sold out. They exited the market.

17 MR. PITOFSKY: Okay. I guess I have to think
18 about this one. But, you know, you play the cards you're
19 dealt with. At the time of the merger it was three to
20 two, the two, the two smaller ones were competing with
21 each other, fairly and vigorously, and it seemed to me
22 the case was justifiable. And I don't recall -- and
23 somebody may make me eat these words -- I don't recall
24 either of the merging parties coming in and saying we're
25 going out of business. They might say we will never be

1 efficient and we'll curtail our activities. I don't
2 remember anybody saying they would go out of business.

3 Now, does that mean the Commission will never
4 take a three to two, never allow a three to two? No. I
5 think we've done it a fair number of times. I think
6 immediately of Boeing/McDonnell Douglas where we thought
7 it was two to two, because McDonnell Douglas such a weak
8 player.

9 Chairman Muris told me that there have been
10 several instances. It's hard sometimes to make public
11 prosecutorial discretion decisions. But we have allowed
12 three to two mergers. He is allowing -- his Commission

1

And the other issue is much more complicated,

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1 shot very soon, because the agencies are very sensitive
2 to claims of efficiency.

3 I think some excellent deals have gone through
4 by emphasizing the efficiency. I think that's
5 particularly true in the high tech R&D drug area, and the
6 country is better off for that. And as far as global
7 competition is concerned, the efficiency section put the
8 spotlight where it belongs -- not on the size of the
9 competitor, but on the efficiency, its unit cost, the
10 quality of its product, the quality of its research. And
11 I think for all those reasons, we're better off.

12 Thank you.

13 MR. ABBOTT: Thank you, Bob, for a very good
14 overview and putting things in context, as you always do
15 so well.

16 Finally we're going to turn to Dr. Vincent
17 Verouden of the European Commission, DG Comp. And again,
18 he has honored us with his presence earlier in the
19 workshop, and he will be focusing on the treatment of
20 efficiencies in the new European Merger Guidelines.

21 MR. VEROUDEN: I would like to talk about
22 merger analysis and the role of efficiencies in the
23 European Union.

24 Before going to the specific topic of
25 efficiencies, it may be good to provide some background

1 on what has been going on in recent months or years in
2 the EC merger control system.

3 As you may know, this merger control system,
4 which is in place since 1990, has been the subject of a
5 review process, a reform process you could say. And this
6 has resulted in a new merger regulation which was adopted
7 last month by the member states of the European Union.
8 It will be applicable as of the 1st of May, 2004, so in
9 three months' time.

10 It has also produced Horizontal Merger
11 Guidelines which accompany this new merger regulation.
12 So much what I'm going to tell now or today is relating
13 to, you know, what will be the system in three months'
14 time.

15 There were a couple of issues that kind of
16 spurred this reform process. There were procedural
17 issues, jurisdictional issues, but also substantive
18 issues. The two main substantive issues that were being
19 debated in this reform process were first of all, what is
20 the scope of the existing dominance test that we have in
21 the European Union in Article II of the EC Merger
22 Regulation? And the second was the role of efficiencies
23 in merger analysis, what should be the proper role of
24 efficiency considerations in merger analysis?

25 Just to say a few words about the test, because

1 that's, of course, the main tool that we have to use in
2 the coming years, and it's difficult to speak about
3 efficiencies and integrated analysis without also knowing
4 what your substantive test for review is.

5 And it has often been put in terms of the
6 comparison of the dominance test versus SLC test,
7 Substantial Lessening of Competition. Is there a
8 difference? And the question that arose in our context
9 with the dominance test -- by the way, I should read out
10 what the dominance test is. It's whether a merger
11 creates or strengthens a dominant position as a result of
12 which effective competition would be significantly
13 impeded. That's our current test, and it's called the
14 dominance test.

15 And the question was, well, does it cover all
16 mergers that produce anticompetitive effects? Does it
17 deal with mergers that produce a company with significant
18 market power, but which only is, for example, number two
19 in the market, and, therefore, not, let's say, dominant
20 in the usual meaning of the word?

21 Anyway, this resulted after, well, quite a long
22 debate in a clarification of our test. It's now called
23 the SIEC test. It's quite similar to the SLC test, of
24 course, and it's also, well, normal that it's pretty
25 similar. Namely, the test is now whether a merger leads

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1 And -- well, I've written down here what was
2 the conclusion of this internal reflection, well,
3 internal and external reflection process. We really said
4 at some point that, well, there are compelling reasons to
5 give more explicit consideration to efficiencies in
6 merger control. And this from the understanding, of
7 course, that efficiencies may bring more competition to
8 the market rather than less, if anything.

9 I've written a few reasons, maybe not necessary
10 to say a lot about that. I think it's well understood.
11 Efficiencies are a natural element, although not the
12 easiest in any competition analysis. If you want to
13 determine whether the merger will increase or reduce
14 competition in the market, it's kind of hard to do that
15 in an accurate or proper way without also looking at
16 efficiencies or possible efficiencies.

17 And in this sense it's also in line with a more
18 effects-based or call it economics-based approach to
19 merger control.

20 (Slide.)

21 Now, the treatment of efficiencies in the new
22 merger regulation, I think it's good to start out by
23 saying that there was no need to change our test for the
24 sole purpose of looking at efficiencies. Actually, given
25 the reasons in the small bullet points down there, first

1 of all, we were always of the opinion that the existing
2 test in Article II of the merger regulation, even though
3 it had, you know, the dominance wording and so on, was a
4 pure competition test.

5 And so the moment you say that, yes,
6 efficiencies must be considered in merger analysis, well,
7 actually, they should be part of an integrated
8 competition analysis. So there was no real need to kind
9 of have a separate sentence in Article II on
10 efficiencies.

11 I must say, by the way, that Article II
12 comprises a number of paragraphs, and so paragraph two
13 and three have this test that I just said. Paragraph one
14 of this article actually says all the factors that we
15 have to look at when looking at the likely impact of
16 mergers, and so it refers to entry barriers and buyer
17 power and so on, but also to the technical and economic
18 progress that is likely to be achieved through the
19 merger, provided it is to the consumer's advantage. And
20 that is wording that has been in the test in Article II
21 since the very beginning. It hasn't received much
22 emphasis, as I said before. But we still believe that
23 this is a sufficiently worded text for Article II.

24 And, however, to signal the change in emphasis
25 a little bit, I think there are two things that I can

1 say. First, the new wording that we have that actually
2 focuses on, you know, whether there will be a significant
3 impediment to effective competition and does not put that
4 much emphasis anymore on the dominance aspect, probably
5 better allows for, you know, a proper inclusion of
6 efficiencies.

7 It better expresses that our test is an
8 effects-based competition test so that instead of looking
9 in an almost static way to whether post-merger the new
10 entity will have a dominant position, which is a bit of a
11 snapshot analysis post-merger, the emphasis with the new
12 wording of the test is more towards what will change from
13 pre- to post-merger. So efficiencies maybe will find a
14 somewhat more natural place in the new wording of the
15 test.

16 In addition, we have what we call recitals in
17 our legislation, and those are kind of sentences that
18 precede the operational part of the regulation, and they
19 kind of give the intent of the legislation, and you can
20 find here in the text that we have put, or that the
21 member states have put, I must say.

22 So, in order to determine the impact of a
23 concentration on competition, it's appropriate to take
24 account of any substantiated and likely efficiencies put
25 forward by the undertakings concerned.

1 It is possible that the efficiencies brought
2 about by the concentration counteract the effects on
3 competition, and, in particular, the potential harm to
4 consumers that it might otherwise have.

5 Let me turn to the treatment in the Guidelines.
6 The regulation, of course, is all at a rather general
7 level and so on, but the Guidelines, they kind of provide
8 the analytical approach that the Commission intends to
9 take in the analysis of individual cases.

10 As I said, the Guidelines were adopted a few
1 weeks ago, 30 January, and, well, if there is any

1 Commission can take efficiencies into account. I'll come
2 to that on the next slide as well.

3 But the focus lies on the ability and incentive
4 of the merged entity to act pro-competitively for the
5 benefit of consumers. So while this is a consumer
6 welfare objective, the Guidelines are rather explicit
7 about what is the relevant benchmark in the assessment of
8 efficiencies, and for that matter, in the assessment of
9 possible adverse effects of a merger.

10 This consumer welfare objective actually
11 doesn't come falling out of the air. It's derived from
12 our Article II that we have which refers to that we
13 should look at technical and economic progress, provided
14 that it is to the consumer's advantage. So it's already
15 in the regulation, and it was in the regulation already
16 10 years ago.

17 It's also consistent, by the way, with other
18 articles or sections in our antitrust legislation. For
19 example, Article 81, which also has this consumer
20 objective in the end.

21 I guess it's more for the discussion afterwards
22 whether the benchmark is the right one, of course, that
23 you can always discuss. But a good thing, I guess, about
24 the Guidelines is that it spells out in a rather visible
25 way and, also, hopefully clear way what are the three

1 conditions for efficiencies to be taken into account in
2 order to clear a merger for the Commission.

3 So the first one -- actually, there are like
4 headings, and then the things are further developed. The
5 first heading is Benefits to Consumers, and the relevant
6 benchmark in assessing efficiency claims is that
7 consumers will not be worse off as a result of the
8 merger. This sentence is literally in the Guidelines and
9 it's pretty clear.

10 In principle, this concerns consumers in the
11 relevant market. You will note that words "in principle"
12 here, and attentive readers can see that the "in
13 principle" was not in let's say in our draft notice, our
14 draft Guidelines. It is in our final Guidelines. So
15 what this means is that the focus is not entirely and
16 completely on consumers in the relevant market, but it's
17 in principle.

18 I think this is also part of our open approach,
19 given that we have not spent so much emphasis on
20 efficiencies in the past, I think it's better to leave
21 things open while giving clear directions, but leave
22 things open. I think this is more or less the exercise
23 in the Guidelines.

24 Efficiencies may take various forms. Cost
25 savings leading to lower prices or synergies leading to

1 new or improved products. We say in terms of guidance,
2 that variable costs are more likely to be relevant than
3 fixed costs, but this does not exclude anything. So in
4 that sense, it's open as well.

5 Then there are two things which are very
6 familiar to you. There is maybe not much reason to
7 expand a lot on this. Efficiencies must be merger-
8 specific, which means that they are relevant when they
9 are a direct consequence of the notified merger. So it
10 must be a causation there.

11 And on, you know, the set of alternatives, so
12 to speak, that you look at, you know, are there less
13 restrictive alternatives and so on. On that debate, I
14 think what we did try to do in our Guidelines is to tie
15 very much the relevant comparison with, okay, this is
16 what the merger will produce and how would it likely be
17 in the relevant counterfactual, so in the absence of the
18 merger? So that in theory should give two things to --
19 two situations to compare. It's not -- it's a bit
20 constrained in that respect.

21 Finally, verifiability. Well, since most of
22 the information is in the hands of the merging parties,
23 when we speak of efficiencies, I mean, it's also
24 incumbent upon them to provide relevant information
25 demonstrating that the efficiencies are merger-specific

1 and likely to be realized, and it's also upon them to
2 give a first shot or show to what extent consumers will
3 benefit.

4 I think I will just leave it here for the
5 moment and leave other points or questions to the
6 discussion afterwards.

7 MR. ABBOTT: Thank you, Vincent, for that very
8 good overview and introduction for all of us to the new
9 European Guidelines.

10 I'd like to take a brief break to allow -- no
11 longer than 10 minutes. We will be starting up again in
12 10 minutes time exactly. So if you're late, we'll
13 already be going.

14 Thank you.

15 **(A brief recess was taken.)**

16 MR. ABBOTT: If people could try and take their
17 seats, please. Let me turn things over for the question
18 and answer session to start out with, Mary Coleman.

19 MS. COLEMAN: Thank you, Alden. I'll start off
20 asking a question, and I'm going to direct it towards Joe
21 but then more towards the panel generally and in part
22 working a bit off of what Chairman Pitofsky had said in
23 terms of this integrated approach and this sort of
24 formulaic approach.

25 You had said that, you know, it may be

1 difficult to have mathematical precision in doing this,
2 but it's sort of an approach that could get people
3 thinking about weighing the different elements of the
4 case. But to try and get to how practical, even in a
5 back-of-the-envelope sense, could the agency do this kind
6 of approach or the parties do this sort of approach? How
7 do you come up with probabilities? How do you come up
8 with reasonable discount rates to actually try and get
9 some numbers?

10 MR. SIMONS: Well, I think in actual practice,
11 I think companies are doing this already, and the staff
12 is actually doing it already, but it's being done
13 subconsciously. Anytime you evaluate the claims, the
14 efficiency claims of one of the parties, that's what
15 you're doing. You are saying to yourself, okay, what are
16 the chances, how much do I believe this? And sometimes
17 what happens, or I think probably what happens mostly is
18 it's kind of a -- people have in their minds like a
19 binary type of decision or a binary way of thinking.
20 It's either on or off. It's either yes or no, when in
21 reality it's something, you know, largely in-between.

22 And so, I think, you know, subconsciously, this
23 is being done already and the only thing I'm really
24 suggesting we do is to kind of think about it more
25 consciously, more explicitly. And the place where I say

1 this coming in is kind of like in a sensitivity analysis.
2 You know, you don't have to know exactly what the chances
3 are that the efficiency is going to be realized or
4 exactly how big it's going to be. But, you know, you can
5 kind of set the parameters. You can do a sensitivity
6 analysis and see how much it makes a difference and in
7 what regard.

8 And I think people kind of do that
9 subconsciously already. And I think if you just put it
10 down on paper, it just clarifies the thinking.

1 something that is, you know, is going to occur with some
2 reasonable probability, maybe in two or three years or
3 four years even, then I think, yeah, you should factor
4 that into your analysis. It should go into the whole
5 calculation, and if the efficiencies occur earlier than
6 the anticompetitive effect and there's a price drop,
7 yeah, earlier, then that gets more weight than the
8 anticompetitive effect. But I don't see any reason why
9 you wouldn't consider it.

10 MR. PITOFISKY: On both sides?

11 MR. SIMONS: On both sides. I don't see any
12 reason why it shouldn't be done equally.

13 MR. SCHEFFMAN: Let me say, can you do this?
14 Of course. The FTC, both agencies are incredibly
15 sophisticated and talented in what they do. The problem
16 is the decision making is very ad hoc.

17 Now, if you take an agency which has much less
18 talent, you know, top to bottom, like the EPA, and you
19 look at the -- and I'm not saying that if you look at
20 their actual decision making there's hot politics and all
21 sorts of complicated things involved -- but they're
22 dealing with weighty tradeoff issues of health versus
23 costs and other sort of things.

24 They have formal procedures like this to do it. There
25 are well known procedures. Government agencies do it.

1 Businesses do it in much less complicated and -- much
2 more complicated and contentious situations than we're
3 dealing with in antitrust.

4 The problem is it's very ad hoc now. There's
5 really no common agreement within the antitrust agencies
6 and within the staff even what the standard is for
7 efficiencies and how they should be weighted.

8 So it's true that something's going on in
9 different people's heads, but knowing makes them
10 accountable for it. So you can't just -- I don't think
11 Joe is proposing, well, here is the particular analysis.
12 You have to have an agreement. Well, what is the
13 analysis? How are things going to work -- can you come
14 up with programs? Absolutely. You can buy programs, you
15 can buy consultants. We'll tell you how to do that. EPA
16 and other agencies do that all the time.

17 Is it science? Is it hard science? No. Is it
18 less science than the way we make decisions now? No.
19 It's just making -- it makes a more transparent and
20 rigorous sort of approach.

21 MR. KOLASKY: If I can just add one comment on
22 this. I think one case that's worth following, because
23 it's directly relevant to this, is the G.E./Honeywell
24 merger case, which is now pending in the Court of First
25 Instance in Europe. Because that, of course, is, in

1 fact, the central issue in that case where the, you know,
2 Commission's decision found that the merger would make
3 the combined firm more efficient, lead to lower prices,
4 but that would ultimately drive out rivals, after which
5 they would be able to raise prices.

6 And so it basically is the paradigm example of
7 this issue, and it's going to be very interesting to see
8 how the CFI deals with it.

9 MR. PITOFSKY: Good point.

10 MR. KOLASKY: And I'm sure Vincent will
11 probably disagree with my characterization about the
12 reliance on efficiencies, but.

13 MR. SCHEFFMAN: Let me pick up first, because I
14 don't -- I said something which was -- I didn't mean, and
15 I think was misinterpreted. The agencies take
16 efficiencies very seriously. I don't doubt that. But if
17 you look at process-wise what happens, the only clear
18 guidance staff has is the case law.

19 The lawyers know they have to be prepared to
20 show your client you can rebut the efficiencies cases
21 that the parties will put forward, particularly in the
22 FTC where you never know whether you have a case for sure
23 until the Commissioners vote. They take it very
24 seriously because they've been very important in Staples
25 and Drug Wholesaling, et cetera. And so there's a lot of

1 focus on that.

2 And because of the sliding scale, okay, there's
3 a lot less focus on, well, is the deal really good or
4 not, because in reality, it often doesn't count much. It
5 counts a lot in a gray area. It doesn't count much in a
6 matter in which the legal staff believes they've got a
7 strong case.

8 Even the economists in that case aren't going
9 to fight much about the efficiencies, because that's not
10 where the game is. The game is whether you can rebut the
11 anticompetitive theory of the lawyers case if you
12 disagree with it. If you win on the efficiencies, you're
still not going to win because of the sliding scale.

1 MR. VEROUDEN: Yes. Just to react on Bill's
 2 comment, of course. Well, I'm not here in a position to
 3 really say a lot about the GE/Honeywell case. It's also
 4 pending in front of the court. But, certainly, the issue
 4 was broader than whether, you know, the issue

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1 for the effects versus efficiencies? And I'd open that
2 to the panel for people to comment on.

3 MR. GIDLEY: Well, let me field that first. I
4 think, first of all, there is a certain amount of
5 inherent factual difference between industries and
6 between deals.

7 So some deals and some mergers, I think, truly
8 are permanent in the sense that, you know, you do --
9 Boeing/McDonnell Douglas, the chance of somebody else
10 getting into commercial aircraft manufacturing on large-
11 scale jets is very small. On the other hand, McDonnell
12 Douglas maybe was already out by the time of the deal.

13 So I think it depends a little bit on the
14 industry. I think in some service and retailing
15 industries, I think there's a more dynamic process where,
16 you know, mail order and internet compete more and more
17 for dollars. So I think the first observation about time
18 frame is, it depends, meaning it depends on the industry,
19 it depends on the product, it depends on the firms and
20 what's likely down the road.

21 I think the second thing, and frankly, I hadn't
22 focused on it as a practitioner, is, from the standpoint
23 of time frame on efficiencies, that footnote 35
24 explicitly says that timing matters, I think, is under-
25 emphasized by the merging parties in their defenses. And

1 so that's an example of good text that's in the 1997
2 Guidelines, and that again, Chairman Pitofsky, is
3 something where I credit the Clinton Administration for
4 improving on the '92 Guidelines.

5 There is some explicit recognition that timing
6 should matter. I think those of us who counsel Boards
7 and CEOs and management see spreadsheets that go out five
8 to 7 years as just being the normal horizon for
9 evaluating a merger, and I think that's a data point that
10 we shouldn't explicitly just ignore in the analysis.

11 MR. SIMONS: I was just going to say, it really
12 does depend, and there are some firms that do -- are very
13 acquisitive, and, you know, they have histories of having
14 achieved cost savings. And for those, you know, it's
15 basically whatever you can prove. And if you can't prove
16 it, you can't prove it. The fact that you think it's
17 going to occur, you know, six years out is kind of
18 irrelevant if you can't prove it. You have to have some
19 -- you have to have good evidence. You have to have
20 evidence.

21 MS. GOTTS: But your model, Joe, actually takes
22 into account the idea that it's a longer term and
23 appropriately discounts it, and that's the way it should
24 be done. They shouldn't be thrown out because it could
25 take a while to be able to integrate the two companies

1 and really realize those, and those are benefits to
2 society.

3 MR. SIMONS: Right. And the timing, the risk
4 adjustment should also take into account not only the
5 chances that -- well, I guess what's going to happen is
6 the longer out in time, just as a general rule, the
7 chances that the efficiency is going to be realized are
8 probably lesser. But, you know, you can just figure that
9 into the calculus.

10 MR. ABBOTT: Bill, you raised the issue as to
11 the tradeoff between producers and consumers' surplus.
12 Do we have a true pure consumers' surplus standard? Or
13 are there situations in which, say, a diminution of
14 consumers' surplus in one market can be traded off
15 against a countervailing gain in producers' surplus
16 that's so large, that swamps the loss in consumers'
17 surplus, and you would allow the merger to go ahead? How
18 -- what standard would you apply, or is that consistent
19 with the case law? Can you apply such a standard?

20 MR. KOLASKY: I think I'd give both a lawyer's
21 answer and maybe a prosecutor's or economist's answer.
22 Certainly, under the statute, as Bob correctly points
23 out, the standard is whether the merger is likely to
24 substantially lessen competition in any line of commerce
25 in any section of the country.

1 And so what you are looking at is what is the
2 impact going to be on consumer welfare? Is this merger
3 going to lead to higher prices and lower output, and if
4 it is, then it should be found anticompetitive. I think
5 in making that determination, obviously you have to take
6 into account efficiencies, including those, as we've been
7 saying that will kick in over the long term and outweigh
8 any immediate impact on short-term prices.

9 The harder question is, and I think producer
10 surplus is relevant there because, to the extent the
11 merger increases producer surplus, that is likely to make
12 this market one which, you know, may be more attractive
13 to entry from others because it's now suddenly a more
14 profitable market. And so this may actually over the
15 long term stimulate competition and stimulate entry. And
16 therefore, you know, I think that's the point that was
17 being made by footnote 37.

18 I think it's also very important as we think
19 about this to have a very clear understanding of what we
20 mean by "competition." And this goes to Bob's point.
21 Many mergers that we might characterize as a merger-to-
22 monopoly because it's a two to one merger or near
23 monopoly because it's three to two, do not in fact lessen
24 competition in an economic sense.

25 They may reduce the number of rivals. But as

1 Baumol makes very clear, you can have a very competitive
2 market with two rivals, or actually in some cases even
3 with one rival, where that rival has to constantly
4 improve its product and innovate in order to get people
5 to abandon the product they bought in the past and buy
6 their new product. Your revenues are going to go away if
7 you've got software that lasts forever and you don't
8 improve it so that you give people an incentive to buy
9 the latest version of it. And we have to take into
10 account that kind of competition with the installed base.

11 The other point, though, is even if you have
12 pure producer surplus that is not going to inure to the
13 benefit of consumers, why wouldn't you take that into
14 account in exercising your prosecutorial discretion as to
15 whether or not you're going to bring a close case? If
16 the potential anticompetitive effect seems to be quite
17 minor, if the probabilities are in doubt, as Joe was
18 pointing out, but you know there are going to be very
19 substantial producer's surplus created by the merger,
20 maybe that's one that you ought to just take a pass on as
21 a matter of prosecutorial discretion.

MSt fnatter of prosecutorial discretion.

1 effects. It's not common, but when it's there, when
2 that's the case, absolutely right.

3 On out-of-cross-market efficiencies, let me
4 tell you, with the privilege of someone who was there at
5 the drafting. You couldn't say, look, if you let us
6 merge, prices will go up here but we'll be better
7 competitors in Europe or better in Florida, or better in
8 California. The statute doesn't allow that, and the cases
9 interpreting the statute don't allow that.

10 On the other hand, as a matter of prosecutorial
11 discretion, we kept thinking to ourselves, suppose the
12 advantage of one market is enormous and the disadvantage
13 in the other market is slight. So we stuck in a line
14 with a very felicitous phrase, something about
15 inextricably interwoven, which nobody has a clue what we
16 meant there.

17 (Laughter.)

18 We said rarely -- I think we used the word
19 "rarely" twice. It's just a question of leaving some
20 discretion to the Commission in the most extreme of
21 cases.

22 Now, one might say, well, if you're going to
23 trade off anticompetitive effects in New York for pro-
24 competitive effects in Florida, why won't you trade off
25 anticompetitive effects now for pro-competitive effects

1 four years from now? It's a close call, and it's a good
2 question.

3 But I think when we're doing New York versus
4 Florida, it's right in front of us. This is all
5 predictions, by the way. Everything about merger
6 analysis is prediction. But I think you can make a more
7 confident production, New York/California, as of the time
8 of filing the suit or letting the deal go, than you can
9 higher prices now, but, oh, four or five years from now,
10 prices will be lower.

11 That's my definition of speculative, uncertain,
12 clearly not allowed by the statute, not by the
13 Guidelines. The Guidelines never thought of that being
14 an elaboration of an efficiencies defense, and I'm still
15 there. It's true, it's close to cross-market, but it's
16 enough different that I think it throws you into a kind
17 of a never neverland of speculation.

18 MR. SIMONS: Let me just respond for a second.
19 I could make the argument that the cross-market thing, as
20 you've said basically, does not -- is not permitted by
21 the statute. But that the temporal tradeoff is, because
22 the statute says substantial lessening of competition in
23 any market in any part of the country. It says nothing
24 about time frame.

25 So, I don't know, I could come out the other

1 way.

2 MR. ABBOTT: One issue that underlies some of
3 the discussion is burden. What burden should the merging
4 parties have to meet to prove up their efficiencies? I
5 mean, we know they must be merger-specific, cognizable,
6 the buzz words, but as we've heard some critics have
7 talked about a chicken-and-egg problem; the fact that
8 poor efficiency arguments are made or developed because
9 parties don't think staff will treat them seriously, or
10 alternatively, staff doesn't spend as much time on them
11 because they're not well made and documented.

12 What is it? And as practitioners, what
13 standard do you think should apply? Should better
14 guidance be given by the agencies as to what degree of
15 specificity needs to be met or proven by the parties?

16 MS. GOTTS: Actually, during the break, Marius
17 and I were talking a little bit about not only that, but
18 one other aspect of it, which Dave Scheffman in an
19 article touched upon.

20 Unfortunately, when we do deals, when you start
21 out a lot of times the group that is able to be in the
22 know about the possibility of the deal is very limited,
23 to a CEO, maybe a chairman of the board. And so that
24 might be why, before the deal is announced, you get two X
25 in efficiencies that are alleged.

1 After the deal is published -- out there in the
2 public domain -- you can do a little bit more work, but
3 there are still limitations which we impose as antitrust
4 lawyers in how much the companies can get together and
5 really drill down in understanding how much the
6 efficiencies will be from a deal.

7 And as you get closer and closer to the deal, maybe we
8 loosen up a little bit, but we still are concerned,
9 especially in deals where they're among competitors.

10 And so this really adds to the difficulty in
11 saying the parties should have some real strong burden of
12 proof and that somehow it should be that you give less
13 credibility to the efficiencies that are discovered by
14 the parties after the deal is announced than what the
15 board considered as you went forward in doing it.

16 So this makes it more complex than even just
17 who has the burden of proof in front of the agencies.

It's also a timing issue and a difficulty issue-18/F1 1 Tf-5.7108 0

1 access to.

2 So it really has to be not so much the burdens
3 of proof, but we're all trying to get to an answer here,
4 a sense of whether or not this deal is going to be good
5 or bad to consumers, and you as the agency should be
6 using whatever power you can, the parties should, as much
7 as they can within the confines of antitrust
8 restrictions, be trying to get you the information you
9 need.

10 MR. KOLASKY: If I can add just one thought to
11 that, and this comes back to the title of this panel, and
12 again, this is based both in my private practice
13 experience and my time at the agency, and that is that I
14 think the private bar needs to understand better that
15 efficiencies really have now been integrated into the
16 merger analysis that they are not just a quote/unquote
17 "defense." In fact, they're not a defense at all. They
18 may be used to rebut inferences of anticompetitive effect
19 arising from other factors.

20 But my experience now is that, as the agencies
21 have focused more attention on efficiencies, if you don't
22 have any efficiencies but you've got a horizontal merger
23 between major competitors, that is actually a major
24 negative now. And in fact, in G.E./Honeywell, coming
25 back to that, one of the arguments that Gerte Strauss and

1 others have made is that in that case, the parties didn't
2 argue any efficiencies, and that was held against them.

3 I think that the message that the agencies
4 should be sending through speeches and otherwise is, if
5 you have a horizontal merger between two major
6 competitors, you'd better have some efficiencies to talk
7 about. Because if you don't, we're going to be very
8 skeptical as to whether or not your real motive is to
9 gain market power and increase price.

10 MR. SIMONS: Can I say something on the burden?

11 MR. ABBOTT: Sure.

12 MR. SIMONS: When you raised the question about
13 the burden, who should have the burden of doing what, the
14 following example occurs to me. Greg Werden actually has
15 a really nifty article. It's like seven or eight years
16 old now, in which he shows, he says, okay, if you think
17 what's going on here is unilateral behavior a la
18 Bertrand, here's the cost savings, the marginal cost
19 savings that have to be realized in order to offset the
20 price effect. And he does it by -- you've got a table.
21 It's by margin, and it varies by diversion ratio.

22 And suppose you had a situation in which, okay,
23 the staff thought that was the type of model that was

1 place, and there's no effect, all right? And you
2 presented that to a court. And that's all that was
3 there. What would the court do? Well, it would seem to
4 me the court would have to conclude there was no effect.

5 And so the burden would seem to be on the
6 government to come back and say, yes, but this effect
7 could be achieved a different way, and here's the way in
8 which it would be achieved and here's the time period
9 over which it would be achieved.

10 So in terms of what would happen in court, I'm
11 just visualizing that kind of circumstance, it seems the
12 burden really has to be on the government.

13 MR. SCHEFFMAN: Let me mention the burden, and
14 I've written on this. People in business don't write
15 100-page single-spaced memoranda analyzing things. Now,
16 that's not to say the government should take things, you
17 know, whatever is proffered. But there has to be, and I
18 think there is, some amount of sophistication,
19 particularly by the financial analysts, about what you
20 should expect to see in a deal.

21 We tend to think that there's things there and
22 you push buttons and things happen, and that's the way
23 business works. That's not true. So you might in a
24 consolidation merger say we're going to get \$50 million
25 in cost savings. Where does that come from? Okay. Well

1 it comes from some sort of analysis or explanation, but
2 what it is, is a goal that some manager has to meet. At

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1 mean by competition.

2 MR. SCHEFFMAN: Let me just say, I have to
3 attack Bob.

4 (Laughter.)

5 He said something that just drives
6 businesspeople and a management professor crazy.
7 If there's one thing that's clear about the evidence and
8 research, it is by far the most important reason for a
9 company's success is organizational excellence, not
10 leadership, not CEO, which can be pretty important. If
11 you got Jack Welch as the head of K-Mart seven years ago,
12 it would be better off. It might still be out of
13 business. I guarantee you, if Wal-Mart would have bought
14 it, it would be very different.

15 It's not just about changing the leader. It's
16 about changing the culture and the middle management, the
17 whole system. You can't take that on spec. But if you
18 can show they did it before in similar circumstances and
19 it worked, that should be very compelling evidence. And
20 it's quite undeniable as a matter of research in
21 management that that's probably the realest sort of
22 efficiency and the realest basis for competitive
23 excellence is organizational excellence, and the hardest
24 thing by far to create.

25 MR. PITOFSKY: I respectfully dissent.

1 (Laughter.)

2 MR. ABBOTT: On that happy note, we've got
3 alternative views of efficiency, competition, and enough
4 to keep us here for an additional week. But we have to
5 close down. I want to thank all of our panelists for our
6 a great discussion and provocative and excellent papers,
7 which will be posted on the FTC's web site very shortly.
8 Yes, shortly. Time horizon is important. We must keep -
9 - we're not predicting the exact date.

10 And this afternoon, of course, we have a great
11 treat. We have Assistant Attorney General Hew Pate will
12 be moderating a final roundtable.

13 So thank you again for attending, and have a
14 good day.

15 (Applause.)

16 **(Whereupon, at 12:02 p.m., a luncheon recess**
17 **was taken.)**

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AFTERNOON SESSION

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MR. PATE: Good afternoon. I'd like to welcome everyone to the Attorney and Economists Roundtable session of the Joint FTC/DOJ Merger Workshop that's been occurring over the last three days.

Tim Muris and I, in talking about the arrangements for this panel, thought that it might be a good idea for he and I jointly to moderate this last session, and we were set to do that until his travel schedule took him out of Washington, so you've been pretty bitterly shortchanged on the moderator, but you've been left with an excellent panel.

I'm going to introduce them briefly and then we'll move into questions and discussions -- what I hope will be a very lively exchange on the topic of merger enforcement. I expect that we'll go until right about three o'clock and then maybe take a brief break and resume say around 3:15.

I want to welcome and thank all the people here, both people from the agencies and outside parties who are interested in this topic and also welcome our FTC colleagues who are listening on the web, and those who joined us on the dial-in number for today's session.

I think for anyone who cares enough about any of this to turn up on as beautiful an afternoon as this

1 knows who all the people are on the panel. Nonetheless,
2 I'll go through and give a brief introduction in
3 alphabetical order. I'll also disclaim any
4 responsibility for the seating order. On a panel with
5 this much expertise and ego, it would be very dangerous
6 to take credit for doing that.

7 (Laughter.)

8 And so I have no idea how it's been done, but
9 I'm sure it was after extensive and thoughtful study.
10 Alphabetically, Bill Baer is the head of the antitrust
11 practice in Arnold & Porter and served as director of the
12 FTC Bureau of Competition from 1995 to 2000 and held
13 other positions prior to that at the Trade Commission.

14 He is a frequent advocate before the agencies
15 and in court. He has been rated by one publication at
16 least as quote/unquote "the best" antitrust lawyer in the
17 United States and has appeared on two American Lawyer
18 covers.

19 Going next alphabetically, Jonathan Baker is a
20 professor of law at American University. He was director
21 of the FTC Bureau of Economics from 1995 to '98, was a
22 senior economist at the President's Council of Economic
23 Advisers from 1993 to '95. He's the author of numerous
24 articles on topics pertinent to today's program,
25 particularly entry and empirical analysis in the

1 evaluation of mergers.

2 Dennis Carlton is also with us, who is a
3 professor at the University of Chicago, professor of
4 economics, previously taught at MIT and is well known to
5 many of us through his work at Lexicon in analyzing a
6 number of very significant transactions that have
7 appeared before the enforcement agencies.

8 He is the author of numerous academic papers,
9 two books, and has won a lengthy list of academic prizes,
10 and we're very fortunate to have him here today.

11 Dale Collins is an antitrust partner at Sherman
12 & Sterling. He's also someone to whom I am indebted for
13 having sent two of the best young lawyers I've had the
14 opportunity to work for to the antitrust division as
15 counsel, Dave Wales and Jim O'Connell. Most people try
16 to send you the folks who are really not quite the best
17 ones in their practice, and Dale actually had the
18 goodness of heart to send us some terrific people, and
19 I'm going to be grateful for that for a long time.

20 He was a White House Fellow, was a Deputy in
21 the Division under Bill Baxter, has taught at Yale and
22 has appeared in a very large number of major transactions
23 at the agencies as well.

24 Next to dale is Jim Loftis, of Gibson, Dunn &
25 Crutcher. His 25-year career has included a stint as

1 head of the ABA Antitrust Section. He has truly been
2 involved in all aspects of antitrust litigation and
3 counseling from mergers to criminal antitrust
4 enforcement. He's a frequent lecturer, a contributor to
5 over 20 publications, and is also a professional race car
6 driver, which is certainly the most interesting thing I
7 can say about anybody on the panel.

8 (Laughter.)

9 Jim Rill, of course, is a predecessor of mine.
10 He served as Assistant Attorney General of the Antitrust
11 Division and also has previously served as chair of the
12 ABA Antitrust Section. He now is co-chair of Howrey &
13 Simon's leading antitrust practice. He has
14 served on numerous committees dedicated to advancing the
15 thoughtful enforcement of antitrust, including serving as
16 co-chair of the so-called ICPAC Commission, which has had
17 great effect in terms of the international spread of
18 antitrust enforcement and increasing the rigor and the
19 soundness hopefully of that enterprise. He has appeared
20 in numerous cases both here and abroad before antitrust
21 enforcement agencies.

22 Dan Rubinfeld is a Robert L. Bridges professor
23 of law and economics at Balt Hall, where he's been since
24 1983. He taught at Michigan prior to that. He likewise
25 has served as a Deputy Assistant Attorney General at the

1 Antitrust Division in charge of our EAG shop.

2 He has served in numerous capacities as well,
3 including with the Council of Economic Advisers, the
4 National Academy of Sciences, the National Bureau of
5 Economic Research, is the author of a number of books and
6 numerous articles on a wide range, not just of antitrust,
7 subjects, but also other public policy issues.

8 And last but certainly not least for today's
9 topic, Bobby Willig is a professor of economics and
10 public affairs at the Woodrow Wilson School at Princeton.
11 He is the former supervisor of economic research at Bell
12 Laboratories, has authored a number of significant works,
13 including welfare analysis of policies affecting prices
14 and products, contestable markets and the theory of

He is th3mr sMahzlGw (122)Tj mof significant works,

1 And what I want to do first is throw out a very
2 general question which I would put this way. I'm
3 interested in knowing what single change the panelists
4 would most like to see in terms of merger enforcement in
5 the next decade, and that could include either suggesting
6 that the agencies should do something differently than
7 we're doing now, that we could be more transparent about
8 the fact that we're doing something that we're already
9 doing, or literally anything that you think would be
10 responsive to that question.

11 And with that, I hope maybe I could get a brief
12 reaction to that question from each of the panelists, and
13 then we'll move on to some other questions after that.
14 Does anyone want to take a first stab at it, or should we
15 go back to the alphabet?

16 VOICE: Reverse order.

17 MR. PATE: Reverse order.

18 (Laughter.)

19 MR. PATE: Bobby, do you want the first word?

20 MR. WILLIG: Absolutely. I thank you for that.
21 Because I can't tell you how often it is that chairpeople
22 of important panels cite alphabetical order as the
23 natural way to order participants without underscoring
24 the assumption that alphabetical order starts at the
25 beginning of the alphabet. That is completely arbitrary

1 and unfair. But never mind.

2 (Laughter.)

3 I think the biggest change, and this is a setup
4 for the question about the next set of changes over the
5 next decade, but the biggest change in the analytic
6 framework used for merger enforcement has been the advent
7 of simulation analysis.

8 And as you all know, that's the systematic use
9 of analytic methods to actually try to quantify the
10 impact of a proposed merger where the simulation machine
11 is based on economic logic and also on some calibration
12 of the parameters either derived econometrically or
13 through other sources of information.

14 That's been the biggest change, and the change
15 that I'd like to see most going forward is first a
16 continuation of that trend, but more major progress on
17 our capabilities of using those tools well and reliably
18 for public policy purposes.

19 An important part of that for the agency is to
20 try to be within the bounds of confidentiality, try to be
21 more interactive with the parties in terms of sharing the
22 analytics, because they are in such an evolutionary phase
23 of their development. They're so uncertain.

23

1 a consumer interest standard or a broader social welfare
2 standard. And while there's a lot of debate, it strikes
3 me that most of the time ultimately, partly because of
4 the law and partly because of internal policy decisions,
5 the consumer standard wins out.

6 And I would like to see more thinking about
7 taking a broader social welfare perspective in looking at
8 mergers. The easiest case to make for that, but it's
9 only the easiest case, would be in cases that involve
10 possible increases in monopsony power, where arguably the
11 effect of the merger could be to lead to lower prices or
12 inputs to production. And it seems to me in that
13 particular case it's easy to argue that we ought to
14 balance the benefits of those lower costs to producers
15 with possible higher costs down the road. And more work
16 in thinking through how to do that tradeoff and make it
17 practical I think would be a nice change.

18 MR. PATE: Okay. Thanks. Jim Rill?

19 MR. RILL: Thank you. I think perhaps the most
20 significant evolutionary change since the '92 Guidelines,
21 one that was well underway since the 1968 Guidelines, and
22 punctuated dramatically in the 1982 Guidelines, is the
23 trend away from reliance on structural formulations for
24 merger decisions.

25 And I think that with the '92 Guidelines and

1 the developments since the '92 Guidelines and the
2 increasing willingness of the courts to go beyond
3 structural analysis, we're getting into a full blown and
4 healthy analysis -- quasi rule of reason analysis -- of
5 horizontal merger decision making.

6 Having said that, I don't think it's time to
7 change the Guidelines' numbers, because I don't think the
8 numbers mean a hell of a lot anyway, other than perhaps a
9 trigger towards further analysis. But I do think perhaps
10 it's time to consider whether or not the presumption
11 itself is a realistic presumption and whether structural
12 analysis should only be a gateway to further analysis
13 without the incubus of a presumption it still has an
14 opportunity to cause mischief in some cases, not so much
15 looking at the outcome, for example, but the rationale of
16 cases such as Swedish Match, in which I hasten to add I
17 wasn't involved.

18 I do want to address for a second Bobby's
19 comment on the trend toward simulation analysis, which is
20 certainly there and a recognizable trend. I'm concerned
21 that an early and overly romantic grasp through
22 simulation analysis in the absence of strong empirical
23 evidence that supports the analysis, or which in fact I
24 would prefer to see the analysis support, could lead to
25 false conclusions based on a false recognition of

1 quantitative accuracy, which I don't think necessarily
2 would be borne out if we have the full, rich empirical
3 basis that would support that kind of an analysis.

4 Finally, just a quick pitch for the ICPAC. It
5 seems to me that one of the salutary developments that's
6 taking place as a result, I think, of the U.S. Guidelines
7 and outreach effort has been greater convergence of
8 antitrust merger analysis recently, for example,
9 evidenced by the EC's merger regulation and guideline
10 revisions, which I won't say it is attributable in
11 measure to the U.S. effort, but certainly reflects a
12 convergence of the analysis between the jurisdictions.

13 MR. PATE: Okay. Well, there's a lot in there,
14 and it's all very polite, but maybe the makings of at
15 least some pointed discussion later. Let's see. Why
16 don't we move to Jim Loftis.

17 MR. LOFTIS: Well, let me touch on what others
18 have identified as subjects of interest. On simulations,
19 I think that to the legal community, simulations are not
20 well understood and tend to be viewed as unreliable. So
21 I would very much agree with Bobby's observation that
22 that is an area that needs additional work, additional
23 exploration, and considerably more than just refinement
24 before it's going to be well accepted, at least in the
25 legal community.

1 I would very much agree with the observation
2 that R&D markets are not well understood. They're not
3 well handled under the existing Guidelines in times where
4 there's not a plethora of transactions going on. We are
5 seeing transactions in high tech markets and we're seeing
6 lots of transactions in the defense industry where
7 concentration is high and R&D on new products is
8 critical.

9 So there's a lot of action in that area, and
10 the guidance that's being given is largely transaction
11 specific and therefore invisible to the community.

12 Monopsony is an intriguing problem that doesn't
13 get much attention because there aren't many cases.
14 People just don't have the occasion to give it very much
15 thought. And so I'm not sure that I would devote a lot
16 of resources to worrying about it, but I certainly would
17 agree that it is an area that's poorly understood.

18 And on Jim's comment about the trend away from
19 structural analysis, I would certainly agree that that is
20 a trend, but I would question whether it has had as
21 widespread an impact as I think we all would hope. And I

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1 And with that, I'll pass.

2 MR. PATE: Okay. Dale?

3 MR. COLLINS: Well, I think as far as the
4 biggest change is concerned, and you have to recall or
5 remember, I'm from the outside sort of looking in. I
6 haven't been on the inside in a long time. But I think
7 if we go back to around 1992, the years before that, and
8 you look what's happened since then, I think around 1992,
9 the Guidelines actually did provide a fairly accurate
10 description of the analytical paradigm that the agencies
11 went through when they were analyzing cases.

12 I think today it provides no description of
13 what the agencies actually do in coming to the
14 prosecutorial decision. It does provide a vehicle for
15 them to explain what they've done. But if you're on the
16 outside and you're looking in, one of the things you'd
17 like to have is you'd like to have a good predictor,
18 okay, to be able to test whether or not a particular deal
19 that you're thinking about, that your clients are
20 thinking about doing, how it's going to be analyzed at
21 the agencies. And I'm happy to discuss this at length if
22 anybody wants to.

23 I don't think that the Guidelines are a good
24 predictor at all, and I don't think descriptively they
25 actually convey what is going on in the agency. So

1 that's what I think the biggest change has been.

2 Now as far as what I would like to see, first
3 of all, I'm not going to say what I'd like to see is a
4 rewrite of Guidelines. I still have an open, quite an
5 open mind on that, because as I say, I think the
6 Guidelines provide a very good analytical tool for
7 explaining decisions that have already been made. And it
8 does force some discipline into the explanations.

9 So the question of whether or not you have to
10 have Guidelines that both describe the decision making
11 process as well as, if you will, the rationalization of
12 the decision, I'm not sure the two have to be the same.

13 The thing I would love to see, which I beat up
14 on Joel Klein to do, Joel, you'll remember, when he first
15 came in said there's this big divergence between what the
16 courts have to say about merger law, about antitrust law
17 generally, but about merger law in particular, and what
18 the agencies are actually doing. And he says what I'd
19 like to do is bring more cases in mergers so we could get
20 more convergence. I said I've got the tool for you. Do
21 contingent consent decrees. That's what I'd like to see.

22 A contingent consent decree is a consent decree
23 where the parties agree on relief but the relief is
24 entered only on the condition that the court finds
25 there's liability. And I can tell you from some personal

1 experience that if the agencies were willing to do
2 contingent consent decrees, they would find themselves in
3 court more often than they do today.

4 (Laughter.)

5 MR. PATE: Dennis?

6 MR. CARLTON: Well, I agree with a lot of
7 what's been said, but I also disagree a bit with some of
8 it. So let me just briefly summarize. I think I agree
9 with Dan that there should be more thinking about what
10 the goal is, whether it's a total efficiency standard or
11 a consumer welfare standard.

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1 there has been a body of work that I really think needs
2 more attention in the application of antitrust, and it's
3 work by -- and the reason I know is I just revised my
4 textbook again, and when you revise your textbook, you
5 always try and put in what you think are the most
6 important developments. And I think the work of John
7 Sutton is very important. And let me just illustrate two
8 points that I think are related to some previous
9 comments.

10 Sutton shows that there are some industries in
11 which competition is naturally vigorous, all else equal.
12 They're just naturally more competitive for whatever
13 reason. In game theory terms, they're playing a more
14 competitive game.

15 In those industries, there is an inverse
16 relationship between, or can be, between concentration
17 and price. It completely reverses our usual notions of
18 price and concentration. The more concentrated the
19 industry, the lower the price.

20 Second, he emphasizes that in some industries
21 there is another dimension to the product -- R&D,
22 advertising, quality -- and you get exactly the wrong
23 intuition if you ignore that other dimension. And that
24 is related to the earlier comments about better
25 understanding dynamic efficiency, better understanding

1 the incentives for technological change.

2 It's a hard question. Economists don't know as
3 much as we should about that question, but I'm always
4 worried when you're analyzing a dynamically changing
5 industry with static tools that you're going to get the
6 wrong answer. And indeed, one of the interesting
7 findings in Sutton's research is that as markets get
8 bigger, you don't see more firms. You may see just the
9 same number of firms, but they invest more and more, so
10 they get higher quality products.

11 That's something I've not seen really absorbed
12 yet by the agencies. I think that innovation markets are
13 a very bad way to go in terms of analyzing mergers. I was
14 involved in one of the early cases with innovation
15 markets, and it's easy to show that they're
16 unpredictable. If you ever do a retrospective asking
17 five years ago, who did I think would make major
18 innovations, you're invariably wrong when you ever test
19 your intuition, or how well you were doing.

20 As far as merger simulation, this has been an
21 innovation in practical enforcement. I think we have to
22 be very careful here. I like it. On the other hand,
23 there are big red flags. Let me explain why. When you
24 do a merger simulation, there are two things that are
25 done that are dangerous. You start out with an

1 econometric estimation. There are possible problems with
2 that.

3 If you get the form right and work hard enough,
4 that's very informative. And then what you do is, you
5 estimate costs. How do you estimate costs? You kind of
6 invert the equilibrium condition based on some assumption
7 of how competitive the industry is. Where does that
8 assumption come from? Usually out of thin air. So
9 you're estimating cost from demand information and a
10 guess about competition. That could lead to great
11 errors.

12 But then the next thing you do is you simulate.
13 You simulate what happens when two firms merge. What's
14 going to happen? You must make an assumption about
15 competition that's current and that will occur after the
16 merger. But competition that will occur after the merger
17 is exactly what we mean by coordinated effects. And
18 these merger simulations always take that as constant,
19 okay.

20 So I think it's very dangerous. I think it's a

1 it's not the same way Jim has used the term --
2 estimation, in which you estimate demand parameters and
3 supply parameters in great detail and then simulate.

4 I want to point out, the question an antitrust
5 authority wants to ask is, what happens to price if two
6 firms merge? That is what economists call a reduced-form
7 question. You can indirectly answer that by a merger
8 simulation. But if you ever have an experiment where you
9 see price in one area with fewer firms versus price in
10 another area with more firms, as long as you can control
11 for the reasons why you have more firms in one area than
12 another, that is the direct question an antitrust
13 authority wants to answer. And I have been worried that
14 there's a trend away from such analysis.

1 unilateral effects.

2 And my concern for the future is to revive
3 unilateral effects, particularly the loss of localized
4 competition analysis among sellers of differentiated
5 products. Every serious antitrust enforcer, as far as I
6 know, accepts that the theory makes sense and that it was
7 an appropriate addition to the merger Guidelines in 1992,
8 and a host of legitimate technical issues have been
9 raised about the application of some of the tools,
10 particularly during the current administration, including
11 discussions of simulation models which I'll get to in a
12 moment.

13 But Greg Werden and Luke Froeb and others have
14 responded appropriately by working to improve the tools
15 and develop ways of testing their robustness to potential
16 problems. And a healthy debate about methods of analysis

1 the problem is that unilateral effects having nothing to
2 do really with market share. So when you have this 35

1 of assumptions, and we have to defend the assumptions
2 with evidentiary support. It doesn't have to be -- it
3 could be econometric, but it could also be documents and
4 testimony.

5 And we also have to employ robustness tests and
6 understand which of these assumptions really matter to
7 the outcome, to which is it sensitive to and which are
8 the results not, and then work harder when we find that
9 there's some assumption that's really important to make
10 sure we really believe it.

11 But with those kinds of caveats, this is a
12 potentially very useful tool and has been so so far and
13 is worth pursuing going forward.

14 MR. PATE: Okay. Back to the end of the
15 alphabet. Bill Baer.

16 MR. BAER: I should say as a preliminary matter
17 that as a product of the Catholic elementary education
18 system where the nuns sat us and called upon us
19 alphabetically, I used to go to bed at night praying my
20 name started with a W.

21 (Laughter.)

22 It's nice to be able to go last for a change.

23 VOICE: Was your prayer rewarded?

24 (Laughter.)

25 MR. BAER: No. Just today. A couple of points

1 I'd make is -- we're going to talk more about modeling
2 merger simulations, and in terms of looking forward as to
3 whether we should be changing our approach to analysis,
4 this is obviously going to be an incremental, gradual
5 process as the lawyers become more familiar with the
6 concepts, as the enforcers test out their systems or not.

7 It is not something that I think anybody on
8 this panel is suggesting is a breakthrough that ought to
9 radically alter the way enforcement ought to be taken
10 going forward.

11 I'll leave that and go to a couple of process
12 things that I think actually the agencies ought to be
13 focusing on in the next couple of years. One is the
14 chronic problem of the burdensomeness of second requests.
15 I would love to see some of the wonderful energy that's
16 been put into developing the joint concentration studies
17 that were released in December in terms of merger
18 challenges and the FTC data put out two weeks ago on what
19 seemed to influence decision to take a enforcement action
20 or not, into looking at what value comes from the volume
21 of production that is associated with the typical large
22 second request.

23 I'd like to know the percentage of boxes that
24 are never opened, much less read. And I say this as one
25 who failed to get control of the process when I was in an

1 enforcement role at the FTC. But it is costly. It is
2 burdensome. I don't think this process actually in terms
3 of the volume of materials coming in is in any way
4 materially improving the quality of merger analysis.

5 I had a little study done shortly before I left
6 the FTC of the 10 most recent big deals and where the
7 good documents came from, the important documents that
8 were cited in the memo that made an impact, and they come
9 from the same files. They come from the strategic plans.
10 They don't come from the e-mails. They don't come from
11 the seller invoices. Obviously, if we're going to do
12 quantitative work, we need to find a way to get our hands
13 on data, but that's a separate point.

14 So that's one process issue that I think is
15 really important. It does tax mergers -- slow things
16 down that otherwise ought to be speeded up.

17 The whole problem with clearance remains an
18 issue. Hew and Charles and Tim did a great job in terms
19 of trying to come up with a system. It fell apart
20 because of some concerns, arguably legitimate, about
21 whether the allocation was right, but finding a way to
22 make more productive use of that first 30-day period
23 continues to be a challenge for the agencies. And if
24 they could come up with a system two years ago that got
25 the average clearance time down to a day and a half, they

1 ought to be able to come up with something that reduces
2 it from its currently 10, 12, 13 business days.

3 And then a final point that I'd just throw out
4 is, if you look at divergence between the agencies in
5 terms of enforcement, probably the most significant one
6 is with respect to approach to merger remedies and the
7 FTC's insistence, in which I was a major part in terms of
8 advocating, on finding buyers up front before the deal
9 closes, and the Antitrust Division's significant
10 reluctance to pursuing that approach.

11 You have right now as big a divergence in terms
12 of approach to merger remedies as I've ever seen. And it
13 would be, I think, helpful and productive for the
14 agencies to focus on that going forward and see if they
15 couldn't come up with a more consistent, coherent
16 approach. You should not be as affected as you
17 potentially are today as merging parties by that kind of
18 divergence in approach.

19 MR. PATE: Okay. Good. A lot of themes. I'd
20 like to follow up. It seemed that simulation analysis
12 maybe was the most frequently mentncitolid. Aa 0 TD0 Tc(5)Tj/TT2 1

1 to what's been said. It is true that to do a simulation
2 analysis requires an enormously long list of assumptions,
3 and it's true that for an economist seeking to be true
4 colleagues with our lawyerly counterparts and teammates,
5 it takes a really long time to explain all this.

6 It also takes a long time to explain it to each
7 other, but we've got the benefit of some common textbooks
8 like Dennis's to fall back on, with a lot of shorthand.
9 But if you go back to how long it took us to establish
10 that language, productively or not, there really is a
11 whole lot of communication necessary to work through the
12 meaning of the particular framework of simulation.

13 But the very, very important point, and if I

1 need assumptions are the very same areas that come in
2 simulation where it matters. There's no getting away
3 from it.

4 Dennis, back to you on the question of whether
5 other forms of empirical studies should have equal or
6 even greater validity where they are informative. In
7 these areas of the country where there's three stores,
8 prices are lower than other areas of the country where
9 there are only two stores, Office Depot and so forth,
10 that's not exactly a simulation study, and it's a very
11 clear way to organize the data.

12 But at the end of the day, someone is going to
13 pop out of the woodwork and in some halfway credible
14 sense, going to point to some efficiencies that go along
15 with the accumulation of office superstores in different
16 areas. And the only form of analysis that we know that
17 enables an integrated approach to the assessment of
18 direct price effects together with the other effects of
19 the deal, purported efficiencies, to say nothing of R&D
20 and dynamics, things that Dennis and I try to talk about
21 in our own way, the only framework that begins to permit
22 the integration of those different sides of the analysis
23 is some sort of simulation.

24 So those are the two huge benefits of the
25 simulation approach, and that's why I'm rooting for it

1 going forward. It allows integration, and it forces us
2 to confront the assumptions that we need to be making in
3 one form or another anyway.

4 MR. PATE: Dennis, I know you wanted to
5 respond.

6 MR. CARLTON: I just have two points. First, I
7 think Bobby is exactly right. If you read the Guidelines
8 and you apply market definition and HHI analysis, you are
9 doing a crude merger simulation. You are assuming a
10 particular type of behavior Cournot and with constant
11 returns to scale, and we probably all know that's not a
12 very good assumption for many industries.

13 So the notion that you can define markets
14 precisely and then do a better analysis than a merger
15 simulation, I agree. That's entirely wrong. And
16 therefore, merger simulation should be viewed as a more
17 sophisticated way of doing the Guidelines. And in fact,
18 it avoids drawing market definitions that we all know are
19 just very, very crude and actually very hard to
20 implement.

21 Having said that, the danger of merger
22 simulation is that it, although I agree it can allow you
23 to calculate efficiencies, it enables you to predict
24 price increases only indirectly based on a lot of
25 assumptions, and a more direct test, to take Bobby's

1 example, three stores versus two, can precisely answer
2 the question you're worried about.

3 Now it doesn't answer the question about
4 efficiencies. So then the question is, how do you answer
5 that question? And that's a hard question, I agree. I
6 think it's going to be hard in any event, and if you had
7 a total efficiency standard, I think you would have
8 enforcement difficulties trying to figure out what are
9 the real efficiencies that are likely to occur.

10 And we know from people who have studied
11 mergers that it's pretty hard to predict. And if you go
12 back and ask those -- based on the predictions of the
13 expected efficiencies, how many are achieved, you are
14 really speculating. Now, I don't mind speculation, I
15 suppose on the other hand it raises issues about
16 enforcement.

17 But if you're using merger simulation to
18 calculate efficiencies, that is the part of the merger
19 simulation that is most in need of improvement. The
20 errors you make when you estimate cost, marginal cost, by
21 inverting a demand elasticity, is premised on the
22 assumption you're making about competition. And if
23 that's all the information you're using and you're not
24 using any cost information, which people don't usually
25 use, you're likely to get a very misleading estimate of

1 efficiencies.

2 So I'm just afraid that the most direct way of
3 answering the question, is price going to go up, is
4 something I don't want to discard. I agree simulation
5 can help us, and I think it's a useful tool. I'm just
6 worried I see it getting pushed out, pushing out these
7 what I would call sometimes natural experiments that
8 often allow you to precisely answer the question what
9 happens if I have one less competitor.

10 MR. PATE: Dale?

11 MR. COLLINS: I'd like to echo a little bit
12 what Dennis just said. I mean, as a practitioner, first
13 of all, let me say that I think that simulation in the
14 way it's been described here, I mean, what Dennis is
15 talking about when he's talking about simulation,
16 including the econometric estimation of the demand cross
17 elasticities, I think this is a great tool, but it's a
18 tool sort of still being promised as opposed to being
19 delivered.

20 And I think if you ask yourself the question,
what do you do with it? Okay, 05rcet men-5.7108 0 TDluhin toon1

1 with merger simulation today. One is you could use it to
2 predict just qualitatively whether or not the prices are
3 likely to up. My guess is that that's a question that's
4 not particularly interesting to ask of simulation
5 modeling generally.

6 You probably already have a pretty good idea,
7 you know, from other tools whether or not you think that
8 the prices are going to go up. And I suspect, although I
9 don't know this, that the number of times in which you
10 sort of change your mind as a decision maker in a
11 prosecutorial setting from either they weren't going up
12 and now you've seen the simulation model and you decided
13 they are, or they were going up and now you've seen the
14 simulation model and you decide they're not going up, I
15 think those cases are almost nonexistent, okay, at least
16 today. It may not have been true a while ago, but I
17 think it's true today.

18 So then the next question, if you don't need it
19 to predict what the direction of the prices are, also
20 recognizing to some extent if you're not packing the
21 efficiencies into the model, I believe the models almost
22 always predict that there will be a price increase, so
23 you've got to worry about that a little bit.

24 So, what do you use it for? If it's not
25 qualitative, then it goes in the direction that Dennis

1 was just talking about. Now, you're making it more
2 quantitative. You want to make a more quantitative
3 prediction about whether the prices are going up and by
4 how much. And indeed, what you'd really like to do is
5 trade it off against efficiencies.

6 And I think there, too, the models right now,
7 sort of the development of the science, if you will, and
8 the informational requirements that have to be met in
9 order to do actually pretty good modeling, are just so
10 demanding. Because you usually don't get very good
11 results. And "very good" in the sense that it doesn't
12 change prosecutorial decision maker's minds about what's
13 going on. They're actually making their decision on
14 other bases.

15 They're getting some comfort from the fact that
16 the simulation model is coming out the same way, but the
17 thing is, my point is, I don't believe that the decision
18 making would change if you just eliminated simulation,
19 you know, from the investigation today.

20 Now, I think it might change in the future, and
21 that's why I'm a big proponent in seeing a lot more work
22 done on this. But, as I said, I just don't think it's
23 having much of an impact today.

24 MR. PATE: Dan?

25 MR. RUBINFELD: I'm not going to go over

1 everything that was said before. I'll just see whether I
2 can add some new thoughts to what was said.

3 First of all, compared to the work that's been
4 done in coordinated effects, I think the science of
5 unilateral effects is further along. It's still got a
6 long way to go, as was suggested, and we certainly should
7 be careful about being too quick to dispense with it. I
8 think we ought to pursue some of the kinds of problems
9 people have been talking about here today, and I think 10
10 years from now we'll see techniques for doing demand
11 estimation and simulation that are even more
12 sophisticated than what we're seeing now.

13 We'll see more and more people being aware and
14 sensitive to some of the problems we've talked about,
15 other problems, such as what to do when you're looking at
16 a wholesale merger but you're relying on retail data and
17 things of that sort. But the fact is, we're doing well.

18 The other area I think interesting work is
19 going on, and I happen to be interested in it, responds
20 to Dennis's concern that we seem to rely heavily on
21 estimating costs from demand elasticities. I've always
22 had the view that we ought to actually be going both
23 ways, so I've been actually working hard on thinking
24 about how to look at accounting data on cost and to use
25 that to infer elasticities and then to figure out what's

1 going on when the two don't seem to gel, which is often
2 the case, as Dennis suggested. So you really can go both
3 ways. There's interesting work to do there.

4 The other thing is that my work has suggested
5 to me, perhaps surprisingly, that when markets are not
6 totally differentiated and they're not really unusually
7 situated products, that market share is actually a
8 reasonable predictor of the likely price effects. This
9 may support what Dale is saying. Maybe you need to go
10 through this exercise in certain kinds of markets because
11 the Herfindahls matter. I wonder if you remember that
12 later when we talk about the value of concentration
13 numbers. I think they actually do give you a first-order
14 prediction even in unilateral effects cases.

15 Furthermore, I think there's interesting work
16 to do in thinking about how merger simulation can be used
17 to think about the likely effect of divestitures, an area
18 where I think we have not done much work. There's a lot
19 of potential. And it is possible with the simulation
20 framework to actually do hypothetical simulations as to
21 the likely effect of different divestitures, and that's
22 an area I think there's great promise in.

1 to reiterate, I think, what Bobby said, or maybe it was
2 Dennis or both. No one of us who does the technical side
3 of this work has ever believed I don't think that this
4 stuff works on its own; that you should rely entirely on
5 a simulation. It's a framework for analysis. You really
6 have to couple it with information that comes from the
7 documents, from the record and make sure that the two
8 really make sense.

9 And I would never want to testify myself about
10 a simulation unless I was convinced I had seen enough of
11 the record to make me believe this w1 0ja -2enol o reiy

1 you're doing forecasting generally, and I can tell you
2 about this, because I write about how to do it at least
3 more than I do it. It's easier to explain as a professor
4 how to do things than it is to do things.

5 If you actually at -- if you look at, say, my
6 textbook on forecasting and you look at macro
7 forecasting, and you actually ask yourself, when errors
8 are made in forecasting, what's the source of the errors?
9 And the source can come from at least three different
10 components. It could come because the model -- the
11 framework you're using -- is the wrong one. It could
12 come because of the inputs to the model, what we
13 economists call the exogenous or predictive variables,
14 turn out to be badly forecasted, or it could be just some
15 random event, act of God, whatever, 9/11, something like
16 that, that no one could possibly hope to explain.

17 With macro models, if you really talk to the
18 people who do this and they look back, two-thirds roughly
19 of the errors that are made in forecasts come not from
20 the model itself but from these factors, the predictions
21 of what goes into the model and acts of God and so on.

22 We've been finding the same thing with merger
23 simulation. No one expects merger simulation to be very
24 accurate in predicting all effects of a merger, because
25 too many other things are going to be going on at the

1 same time.

2 So I encourage analysts when doing this
3 evaluation to be careful when the merger simulation
4 doesn't work well to tease out whether that's the
5 framework, whether it's because in fact we were assuming
6 Bertrand behavior and in fact the world turned into a
7 collusive world that we didn't predict, or is it the fact
8 that some of the inputs, some of the cost numbers turned
9 out to be wrong.

10 I think we're likely otherwise to be too
11 critical of merger simulation. We shouldn't expect
12 anything of these models beyond what a reasonable person
13 could expect.

14 MR. PATE: Okay. Good. I'd like to move to
15 what I think was the panelists' favorite question in the
16 little pre-meeting, which is this: What merger
17 enforcement decisions -- and I'll include decisions to
18 challenge or decisions not to challenge a merger, and
19 include agency decisions and court cases, and I won't
20 limit this to present company -- which of these decisions
21 would you point out is the best or the worst of the past,
22 well, let's just say in recent years without defining it
23 any more specifically, and why do you think those were

1317

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1 MR. BAKER: My favorite is Staples I think.

2 That's good.

3 (Laughter.)

4 Maybe, Greg, in your role, you have favorite
5 things that are bad. But when I say "favorite" -- of
6 course, I worked on this, but, as Greg is essentially
7 pointing out, it reinforced unilateral effects analysis,
8 although the opinion reached the unilateral effects by
9 defining a submarket rather than directly through
10 competitive effects analysis, I understand it as
11 substantively the same thing as a unilateral effects

1 litigating contested mergers. And plus I got to work,
2 you know, closely with, what did you call him, Hew? The
3 best in America? What's not to like?

4 MR. PATE: It sounds pretty good. I never
5 dreamt anybody would start out with a favorite that they
6 thought was good, but that's one way to do it. Who else?
7 Jim?

8 MR. LOFTIS: Well, I'll take the other side of
9 that. A favorite that I think was unhelpful would be the
10 baby foods case with the reemergence of interest in
11 concentration and what it really means. There I think we
12 have an example of the use of concentration, and
13 particularly I'll refer again to the agency brief that
14 argued that an HHI of 510 presumptively entitled it to an
15 injunction which, of course, would end most any
16 transaction.

17 I think that that was a very --

18 MR. BAER: You said this before. Did you mean
19 the delta?

1 I think some of the vertical cases that were
2 brought in the early part of the '90s were particularly
3 unhelpful, both from the standpoint of their rationale
4 and the standpoint of the relief, I think that the DOJ,
5 the Rube Goldberg kind of structures that followed
6 ATT/McCaw and BT/MCI were monstrously complex, and I
7 think just to be equal on the other side, some of the
8 firewall cases that came out of the FTC early on --
9 Merck, Medco and its predecessor, the PCS.

10 MR. COLLINS: The only reason why I was shaking
11 my head was Merck/Medco actually came first and got
12 through without a --

13 MR. RILL: Well, it got through without it, and
14 then they tagged on a firewall to Merck/Medco after the
15 PCS case, so Merck/Medco followed PCS in technique.

16 Good, I think I want to pick the cruise lines
17 decision for a variety of reasons -- for the
18 comprehensiveness of the analysis, for the competitive
19 effects review, for the relegation of structure in the
20 proper role.

21 I don't want to get too close into whether or
22 not airplanes or hotels were in the relevant market, but
23 they were certainly considered as part of competitive
24 effects, and I think that was an appropriate
25 consideration, and I think the transparency that the

1 Commission majority exhibited in describing the basis for
2 that decision was a real step forward towards an
3 explanation of merger review.

4 MR. PATE: Bill?

5 MR. BAER: Dale, did you want to go --

6 MR. COLLINS: No, that's fine.

7 MR. BAER: The category of cases that I would
8 cite as failures, as bad outcomes, as favorite bad
9 things, is the inability of the government to win a
10 hospital merger case. You know, I think at the end of
11 the day, some of the hospital consolidation we've seen
12 across the country has in fact had serious
13 anticompetitive effects, and the inability of the
14 government, both the Department of Justice and the FTC,
15 to convince local district court judges that in fact
16 there really are potentially bad outcomes here, has
17 basically almost created an exemption to the Section 7
18 for a major part of the health care industry, and I think
19 that's unfortunate.

20 MR. PATE: Dale, you wanted to comment?

21 MR. COLLINS: Yes. I'm not -- my judgment on
22 what, if you will, a really good case was, unlike, I
23 think, what most people, you know, have said here, which
24 went to sort of what the outcome was or the analytical
25 tools that were employed in order to reach the outcome,

1 I'm going to step back. I think the case is Baker-
2 Hughes.

3 And the reason why I think it's Baker-Hughes is
4 Baker-Hughes made the analytical framework for merger
5 analysis really clear in the following sense. It said
6 that there was a presumption. The Supreme Court had said
7 it before, but, it made clear that there was a
8 presumption -- that the plaintiff could basically on the
9 basis of market shares have a presumption that satisfied
10 their burden of establishing a prima facie case.

11 It also put the burden then in that particular
12 case on the defendant to go forward with evidence in
13 rebuttal, and in that case, it happened to do with entry.
14 But it was only the burden of going forward. Baker-
Hughes

12 Hughes

Hughes

12

Hughes

1 always bears the burden of persuasion, it makes a lot of
2 this analysis a lot clearer.

3 It tells you, for example, if you're going to
4 have an entry defense, you know, who's got to go forward
5 with the evidence but who bears the burden of persuasion.

6 More importantly, if you're going on
7 efficiencies, I mean, it tells you a lot there too. I
8 think it's a simple extension from the Baker-Hughes
9 analysis of the burdens on a quote "entry defense," which
10 is really a negative defense, not an affirmative defense,
11 into other things like efficiencies.

12 I think it was a great case as far as the
13 allocations of the burdens of proof are concerned, and
14 you just don't see it very much in the case law.

15 MR. PATE: Well, you seem to have a lot of your
16 fellow panelists nodding with what you've had to say
17 about Baker-Hughes. Are there other cases? All right,
18 Bobby, go ahead.

19 MR. WILLIG: A couple of my favorites from the
20 methodological point of view. First, American Electric
21 Power buying CSW, Central and Southwest. Two big electric
22 utilities. You know, not front page stuff, not all that
23 exciting. Who cares? This is not like baby food or
24 something that we consumers really understand a little
25 bit, if you've been parenting.

1 But rather this was a case where the utilities
2 were quite separated geographically, but nevertheless
3 they were interconnected electrically. And the question
4 was whether having the generation decisions were
5 coordinated between the two sets of sources of power
6 after the merger, would that yield new opportunities to
7 increase market power? And there was no way anybody
8 could just intuit that answer. Various technologists
9 thought they could, but never in a persuasive way,
10 certainly not to me and not to the agency either.

11 And so the agency and the parties worked
12 together over a long span of time, step by step, to lay
13 out an analytic framework using appropriate models of
14 simulation and the like, but always with a mutual
15 concurrence about the appropriateness of the tool, and
16 then marching along with new questions being raised, and
17 then working through the answers to those questions in a
18 complete bilaterally transparent way.

19 I liked it because I was working for the
20 parties and I came out for the deal. So it was a happy
21 ending as far as everybody was concerned, I think.

22 But the process to me was a real role model for
23 other cases where the analytics of the econometrics or
24 the simulation are difficult, why can't we kind of work
25 together along the lines of that same example?

1 Another case that I always just love to talk
2 about in class is Microsoft and Intuit. Remember that?
3 Microsoft had Microsoft Money. Intuit has Quicken. And
4 they sought to merge. And the agency hated Microsoft so
5 much, or so it appeared from the outside view, that, of
6 course, they weren't going to be allowed to merge with

1 advantage.

2 And I'm not sure that was the right answer.
3 There's lots of other competing platforms for competitive
4 advantage in that space that have emerged since. I don't
5 know if it was a good decision or not, but I love the
6 analytic framework, and I would recommend it.

7 MR. PATE: Dale, I'm not sure you're buying all
8 of this.

9 MR. COLLINS: That's not the only legal
10 framework, okay. At least from the outside. I think the
11 way the case is best explained, and certainly the way I
12 think that all the practitioners read it was, Microsoft
13 did a preemptive divestiture of Microsoft Money to a
14 company whose CEO said they weren't going to run it as a
15 product, okay. So in effect what they did was they just
16 killed the product that created the overlap. And that's
17 what killed the deal.

18 That coupled with, if you read the complaint,
19 there are just enormously great statements that if you
20 ever teach a class, you want to read to your students,
21 particularly if you teach MBA students, on how not to
22 write memos.

23 (Laughter.)

24 There are, as I said, they're just unbelievable
25 statements that the government could quote. So maybe

1 that's the way the government inside, you know, viewed
2 Microsoft. If it did, they created an extremely
3 complicated theory on what was an extremely easy case on
4 the facts.

5 MR. PATE: Dennis, do you want to comment on
6 the best and worse case question?

7 MR. CARLTON: Yes. Let me just sort of echo
8 one thing Bobby said, and that is it actually fits into
9 an earlier question. The transparency that's used at the
10 agencies now, I think, is really a credit to them. And
11 I've been involved in several mergers in which the
12 concentration numbers looked terrible, but you present
13 them some data, you do some econometrics and give them
14 the data and then you collaborate actually in a process,
15 and if you're right, they'll recognize it, and they'll
16 understand the issue.

17 So, you know, there are smart guys at the
18 agencies, and when you can collaborate and get a merger
19 through, in particular I'm thinking of some mergers in
20 the movie industry, I think it works great. So that's to
21 their credit.

22 I would say the one case that's always stuck in
23 my mind is a mistake in part because it introduced a new
24 concept was the GM/ZF case. That was a case brought in
25 the early '90s. There was a proposed merger between ZF,

1 which is a German company, and General Motors
2 transmission business, and one of the allegations in that
3 case was that it would concentrate innovation markets. I
4 believe this was one of the first times the concept of
5 innovation markets had been used.

6 I thought it was a bad concept then and
7 subsequently I've convinced myself it's a bad concept.
8 It's very hard to implement what you mean by the
9 resources that can be brought to bear to innovate in an
10 industry. And as a general concept, I think, except
11 maybe in some industries like pharmaceuticals where
12 there's a pipeline and you can predict exactly what's
13 coming along over time, in most industries, it's very
14 hard to make predictions where technological innovations
15 are going to come from.

16 So as a general principle, I thought it was
17 bad. As a specific example, I've stayed in contact with
18 General Motors. They still own this transmission
19 business. And anytime I'm going to talk about innovation
20 markets or I'm going to see either Steve Sunshine or Rich
21 Gilbert, who played a large role in developing the
22 concept, I call my friends at General Motors. And I
23 said, well, have you innovated like the Justice
24 Department was suggesting you would if there weren't a
25 transaction? And the answer always is no. So, you know,

1 10 years later, about 10 years later, we haven't gotten
2 the benefits of innovation. We've lost the benefits of
3 the efficiencies that I think many people recognized
4 would occur. So I think that I would put high on my list
5 of cases that I wish hadn't been brought.

6 MR. PATE: Okay. Well, I'm going to follow up
7 on both transparency and innovation markets. Dan, do you
8 have a best and worst case you want to point out?

9 MR. RUBINFELD: It's not quite a best and worst
10 case. But I realize in listening to the group that
11 sometimes a series of cases come along that create
12 frustration on one's part, whether you're inside or
13 outside. And I had some of Bill's similar frustration
14 about hospital mergers, and I think Bill's
15 characterization was right there.

16 Another area that's similar to me is the area
17 of acquisitions involving journals. If you look over
18 time in the last 10 or 15 years, the prices of academic
19 journals have gone up on the order of 10 or 15 percent a
20 year. And my belief is that at least some explanation
21 for that has been the acquisitions that occurred, several
22 of which occurred on my watch.

23 The problem that we have in looking at these
24 kinds of acquisitions is, we tend in my view to
25 scrutinize it too much. We want to go through the usual

1 sort of market definition, competitive theory, and we end
2 up defining markets extremely narrowly. No book competes
3 or no journal competes with any other journal, and it's
4 very hard to conclude that any merger would be a problem.
5 Yet the fact is that there have been extremely high
6 increase in prices, and my belief personally is that it
7 has a lot to do with the fact that the major concentrated
8 ownership publishers have had really bargaining power
9 with respect to university libraries because demand for
10 products are highly inelastic.

11 And none of that is really reflected as well as
12 I think it should be in the analysis. And the agencies,
13 while getting divestitures in some cases, I think have
14 not been nearly as aggressive as they should have been.

15 Sorry, Dale.

16 MR. COLLINS: What can I say? I mean, I think
17 the best case -- I've talked about one -- but I think the
18 best cases are all the ones I got through.

19 (Laughter.)

20 MR. PATE: Yeah, I think we're getting a little
21 of that around the panel. Let me ask -- turn to
22 transparency and ask about that. I'd be curious to get
23 reactions about whether the agencies should be more
24 transparent about what they do and how. I know it's easy
25 for you, particularly in the businesses you're all in, to

1 say, yes, of course, you should be much more transparent.
2 But some of you have been in positions in these agencies
3 before, so I hope you'll give a thoughtful answer that
4 takes into account some of those interests.

5 And also, we could expand that maybe to talk
6 about the Guidelines question -- divergence of practice
7 from the Guidelines. Some folks have suggested that it's
8 not a great use of agency resources to revise the
9 Guidelines. It's very time consuming and that the people
10 who really do this know how it's really done, and there
11 isn't a lot of value. There's a countervailing view that
12 in fact the agencies are obligated to try to make the
13 best expression they can about what really goes on.

14 And I'd be curious to get your thoughts on both
15 of those aspects of transparency, or others. Jim?

16 MR. RILL: Thanks for the lead. Those of us
17 who have sat there who have not done nearly so well as
18 those of you who sit there now. It's a continuing
19 process.

20 One of the things that concerned me going in
21 was the need to be more transparent, to explain more what
22 we did and what we refrained from doing. And Bobby and
23 I, and Judy Whalley and others attempted to work out ways
24 where we might do that. You'll recall trying to explain
25 the accounting merger, the non-challenge of the 8 to 6,

1 and the non-challenge of the tire merger.

2 You run into a couple of problems in doing it
3 which I think are fairly obvious. One is confidentiality
4 restrictions on information that can be divulged. The
5 parties aren't thrilled about the notion even if they've
6 been given a pass about having their information spread
7 on the record.

8 The other is a reason with less rectitude, and
9 that is, I think, an institutional fear of being boxed
10 in. We let this merger take a pass because of X. The
11 next 10 parties coming into your office have an X merger.

12 (Laughter.)

13 Or at least one so labeled. That's not a very
14 good reason not to be transparent. I think the
15 Commission has made really good strides, starting with
16 some of the work that Bill Baer did, maybe before that,
17 but certainly starting with some of the work that Bill
18 Baer did in pharmaceuticals and in, I think, grass at one
19 time. That's the stuff you grow on greens.

20 I would have to say the Division always sort of
21 had a not self-imposed, but extrinsically imposed leg up
22 because it had to do Toney Act statements in settlements
23 at least which had to pass muster sometimes with a rubber
24 stamp and sometimes not so much with a rubber stamp,
25 though. And one never knew ex ante whether you were

1 going to get a challenge or not and then had to explain
2 yourself pretty thoroughly.

3 I think in a nonmerger case, one of the most
4 thorough explanations of settlements I saw was in the
5 ATP, Airline Tariff Publishing settlement, which went
6 through a lot of explanation.

7 The work needs to go forward, I think. You had
8 a second question, though, and I'll comment on it
9 briefly, and that was?

10 MR. PATE: The Guidelines and transparency as
11 it relates to the Guidelines.

12 MR. RILL: Yeah. I think there may be a point
13 there. I'm not so emphatic about it as Dale is. I think
14 that if I had to point to one issue the way I think that
15 it's somewhat highlighted by the recent FTC report, and
16 that may be an ex-guideline reliance on customer
17 complaints.

18 Now, customer complaints, of course, can relate
19 to the Guidelines, but customer complaints can sometimes
20 relate to totally non-guideline concerns that customers
21 might raise -- customers, not competitors now --
22 customers might raise in challenging the merger. And one
23 only hopes that the agencies can take a look at those
24 statements and fit them into what's truly a competitive
25 analysis and not engage in a numbers count. So I would

1 say when you look at the FTC report, one hopes that the
2 word "serious complaints" and "substantial complaints"
3 really mean serious and substantial complaints.

4 MR. PATE: Jim Loftis?

5 MR. LOFTIS: We talk about transparency with
6 kind of an aura of apple pie and goodness to it, which
7 deservedly to an extent it has. But largely the reason
8 we are here are clients. And by and large, clients hate
9 transparency as to their deals. They're interested in
10 transparency only as to other people's deals. And the
11 only thing worse than transparency is the notion of a
12 look back.

13 (Laughter.)

14 So, you know, I think we've got it just about
15 right.

16 MR. PATE: Okay. Dale?

17 MR. COLLINS: Two points on transparency. And
18 both a little bit definitional. I think there are two
19 kinds of transparency. The first one is, if you will,
20 the after-the-fact transparency. The agency is
21 explaining what they did or, whether or not they're
22 actually really capturing everything they did is a
23 different point, but at least there's a coherent story
24 about why they made a prosecutorial decision that they
25 made. That's one kind.

1 I think there's been great strides, again, as
2 Jim has pointed out, in that aspect. I think where the
3 record is a lot more mixed, and to me as practitioner,
4 this is pretty much what Jim was saying, too. For those
5 of us who represent clients, the transparency we're
6 interested in more than anything else is the transparency
7 that goes on in the course of an investigation.

8 And there are some people within the staff, and
9 this is true on both agencies, that are, if you will,
10 extremely transparent. They'll come up to you and
11 they'll say almost from the beginning, these are the
12 theories of anticompetitive harm we're testing. If you've
13 got an argument that says this theory is not a viable
14 theory, we want to hear it. We may believe the argument,
15 we may not, but we're going to keep in front of you what
16 our theories are and give you the opportunity to address
17 them.

18 I've got one case, for example. I won't tell
19 you quite what the time frame is. We've been in
20 investigation for two-and-a-half years. We still don't
21 know the theory of anticompetitive harm that the staff is
22 testing, okay. We've got another one where the staff
23 didn't start to reveal what they were testing as far as
24 theories of anticompetitive harm in any explicit sense,
25 until what, five months after we complied with the second

1 think the parties have got to learn that lesson, that
2 they can't go to the front office and basically be
3 telling the front office, well, the staff was telling me
4 this, you know, at an early part in the investigation,
5 and now they've changed their mind and we've been
6 prejudiced.

7 MR. PATE: Well, it seems like a bad idea for
8 me to follow up, but I'm going to do it anyway. When
9 Charles James came in a couple of years ago, we began
10 working at the division on a merger process improvement
11 initiative.

12 The Trade Commission has been working at that,
13 so I'll give you a free shot. Are we making any
14 improvements? And before you answer, I will say that I
15 think it's been my observation at least that Charles'
16 comment that it takes two to tango has not been taken to
17 heart universally, and we certainly continue to see a
18 number of parties who don't reciprocate the staff's
19 willingness to say here's the theory. We'd like you to
20 provide the following information promptly to test it.
21 But with that defensive caveat, what's your experience?

22 MR. COLLINS: Let everybody else talk on this.
23 My experience is, I've seen no changes. I think that the
24 people who were pretty good before Charles made his
25 statements about being forthcoming on the theories of

1 anticompetitive harm that they were testing -- they
2 continued to be good. The ones who weren't good, you
3 know, aren't good today.

4 I think there are lots of institutional reasons
5 for that, but I think it is a serious problem.

6 As far as the parties are concerned, I couldn't
7 agree with you more. I mean, I think that there are some
8 counsel who come in and say, look, what we want to do
9 from day one is join the issue. Now, there are some of
10 us who believe that that's actually very much in our
11 advantage to do that.

12 There are other people who believe, and I've
13 had them to talk to me -- I sort of fall into the first
14 category, as you might imagine -- who come in and say --
15 and we have these huge fights in the beginning of a deal,
16 a joint defense of a deal. And they say, look: We don't
17 want to talk to the agencies at all. We want to wait
18 until we get to the deputies meeting is the first time
19 we're really going to make a defense of the transaction.

20 I think that's crazy, personally. But there
21 are people out there who believe that.

22 MR. PATE: So you rely on Tony Soprano for
23 saying most business problems are people problems?

24 (Laughter.)

25 MR. PATE: Other comments on transparency?

1 Anybody else who's had experience recently? Bill?

2 MR. BAER: I think it is marginally better in
3 terms of that individual case process, and even the

1 be changed, updated -- I think those of us who endorse
2 transparency have to think long and hard about whether
3 supporting the retention of Guidelines that have
4 numerical standards in there that have no relation to
5 current enforcement postures is a good thing.

6 To have a document out there that is a stated
7 guideline as to merger enforcement that doesn't come
8 close to reflecting over the last 10 or 12 years merger
9 enforcement experience, is something that I think on
10 balance you ought not to support.

11 You could raise the safe harbor to 12 - 1400,
12 and get rid of the notion that 100 point increase above
13 1,800 is presumptively unlawful, that's just not right.
14 I mean, there are little changes you could make that
15 could make that document a little more current. You
16 could also consider, and I know Jim and Bobby and Jon,
17 when they were there, ran out of time to do this, whether
18 or not we want to update guidance on vertical mergers as

1 terms of the analytic framework question, which is the
2 Guidelines point. On the whole, I think the Guidelines
3 are still useful in helping explain the theory, the
4 analytic process the agency goes through, the theories
5 that they pursue, the kind of evidence that might be
6 relevant.

7 It's, of course, important for good government
8 reasons for agencies to advise all of those on the
9 outside about various sorts of twists and turns and how
10 they're thinking about matters. For example, some of
11 what I think it was Jim who was pointing out, customer
12 complaints or competitor complaints and how that's being
13 thought of today. That's appropriate for speeches, it
14 seems to me, by agency heads.

15 Revising the Guidelines is a big deal. It's
16 hard. It's hard on the agencies. You've got to be
17 really careful about how you say everything, and I don't
18 object to good government improvements, but if you

1 Chicago school thinking about antitrust in the context of
2 merger analysis? It was already transforming antitrust
3 in the courts and the agencies had to understand what
4 that meant for merger analysis. That was the motive,
5 perfectly good motive, for revising the Guidelines.

6 The 1984 Guidelines responded to a big fuss
7 about some steel mergers that was a very hot political
8 issue at the time about the role of global competition
9 where there was an unusual spat between members of the
10 cabinet in the Reagan Administration.

11 VOICE: I thought it was about the role of Mac
12 Baldrige.

13 MR. BAKER: Well, yes. But it was -- but
14 that's a good reason to take another look at geographic
15 market definition the way that it had been.

16 The 1992 Guidelines essentially -- and Jim's
17 not going to like this -- but essentially took into
18 account the reworking of industrial organization of
19 microeconomics around game theory and oligopoly theory
and took what io1EitTf1097 1 Tf5.7108 -2 TDc,F1 tfromn.

1 analyses that had become important in lots of ways and
2 were growing in importance in antitrust thinking, and it
3 was time to kind of address in Guidelines.

4 If there's a comparable motive for revising
5 Guidelines now, it seems to me, and I think it's
6 something that Bobby hinted at earlier, it has to do with
7 innovation competition. There's been a lot of discussion
8 about innovation competition, particularly the recent
9 hearings of the two agencies. There are disputes about
10 innovation markets that Dennis has been talking about
11 today. We could talk in detail about how we think about
12 them now, but we don't have good analytic frameworks
13 worked out. I'm not sure whether we really understand
14 the analysis well enough to do that.

15 But that's the area where if there's a good
16 reason to revise the Guidelines comparable to what we've
17 seen in the past, that would be the motive. And then
18 while you're doing that, you could think about Bill's HHI
19 tweaks and the like.

20 MR. PATE: Dale, you had a response?

21 MR. COLLINS: I think this follows on what Jon
22 was saying, and it goes to Bill's point about the HHI
23 tweaks, and that is, to the extent that what you're
24 interested in doing is counseling your clients, okay. I
25 think now we've got something that's more valuable, at

1 least as far as the front section of the Guidelines, and
2 that's the release of the data.

3 I think the best way to look at the Guidelines,
4 the front end of the Guidelines, is that this is purely
5 just a screen. And maybe there was, in retrospect, an
6 unfortunate choice of words on safe harbors and things
7 like that, but it's really just, you know, are we going
8 to now make the decision to invest some significant
9 prosecutorial resources into investigating the
10 transaction?

11 My personal view is, and it's not just because
12 I've got a couple of kids that are going to college, is
13 that, you know, you'd have a relatively low screen on
14 that. But then you don't go to the clients and tell them
15 that, if you don't come under what is colloquially called
16 the safe harbors, right, then you guys are dead. I mean,
17 that's malpractice, okay, because a lot of the deals
18 don't pass the safe harbors, and most of them get through
19 without any trouble.

20 But it's this new data that'll really help you
21 on that. And if I could just ask you, Hew, to think
22 about one thing with respect to the release of the data.
23 The way the data is organized in part, it tells you, you
24 know, where there was an enforcement -- the number of
25 enforcement actions within a cell in a matrix and the

1 number of things which were closed. The stuff that's
2 closed is probably pretty confidential.

3 MR. PATE: You mean the FTC data?

4 MR. COLLINS: The FTC data. Excuse me. And
5 the real question, I think, what I would like to see is,
6 which should be a matter of public record, and it's just
7 a matter of matching it up, is on the enforcement actions
8 which were public, which of the things -- when I see a
9 number in a cell that there were three cases, okay, or
10 two or whatever it was, when there was a challenge when
11 it was the HHI, the post-merger HHI was like 1,800 or
12 1,900 and there was a change between zero and 99 and
13 there's actually some positive enforcement cases there, I
14 would love to know what they were. And that should be a
15 matter of public record and I'd love to see it disclosed.

16 MR. PATE: Dennis, I think you were next.

17 MR. CARLTON: Let me just briefly address the
18 two issues. On the first, on the Guidelines, I think the
19 Guidelines are pretty broad right now to encompass sort
20 of new theories and their implementation.

21 In terms of the numerical Guidelines, I
22 actually think they serve a very good purpose from the
23 point of view of good government in letting people know
24 what constraints are placed on government so that if
25 someone comes up with some crazy theory of

1 anticompetitive harm that's purely theoretical, they have
2 some protection. I think that's very important.
3 Assistant professors, even full professors, get paid to
4 think up complicated theories that get published. But
5 the ratio of our theories to empirical testing is
6 probably too high. And you want some protection against
7 someone doing that.

8 Having said that, I've always found it very
9 interesting, and I did work on the previous Guidelines in
10 '92, that the empirical support for these breakpoints is
11 surprisingly weak, and you'd think that everybody would
12 be wanting to write a dissertation on where are the real
13 breakpoints and where do they jump, and are there jumps?
14 But there is virtually no literature on that. I mean,
15 I've searched to try and find published articles that
16 people frequently cite for this, and it's pretty hard to
17 find any such evidence.

18 On the other hand, I do think it's a protection
19 against unconstrained government action.

20 On transparency, the only thing I would say is
21 this. Obviously the lawyers have a particular
22 perspective, but as an economist going in, one thing I'd
23 ask you to think about is the following. I've certainly
24 noticed increased transparency over the last several
25 years.

1 One of the things that often makes my client
2 sometimes nervous, but also makes the DOJ or FTC nervous
3 is when I say, well, if you have any questions, just give
4 me a call. You know, sometimes I often check it with my
5 client, and I'll say it's really in our interest. It is
6 really in our interest for the staff to know exactly what
7 we're doing. And I can answer questions to an economist.

8 But then if the FTC or DOJ says that's great,
9 we're going to have an army of lawyers on the call when
10 the economist calls you, my clients, say oh, no. No, no,
11 we're going to have our army of lawyers. And then you
12 have an army of lawyers saying that's not a good
13 question, that is a good question. So if you're really
14 interested in transparency, I'm always happy to speak
15 with the economists at the FTC and DOJ, and I think most
16 of them would be happy to speak to me. But sometimes I
17 sense they're very nervous. And you might think about
18 how you want to deal with that.

19 MR. PATE: Well, I think those of us who are
20 responsible for cases that go to court are all in favor
21 of economist-to-economist dialogue within reason.

22 (Laughter.)

23 MR. PATE: Jim, a couple of quick points.

24 MR. LOFTIS: Just a quick point on transparency
25 in the decision making process. It is curious, and I'm

1 not sure what it tells us, but it's curious that there is
2 an enormous amount of transparency into the decision
3 making process on both sides where the industry and the
4 clients that are proposing a transaction are repeat users
5 of the system.

6 If you've been a proponent of defense industry
7 mergers you've been going steady with the same folks at
8 your agency, Hew, you know, for the last half a dozen
9 years, and it almost becomes like the story of the
10 comedians who would exchange jokes by saying number two.

11 (Laughter.)

12 I guess what it tells me is that transparency
13 works. There's no reason not to have that kind of
14 visibility.

15 MR. PATE: Dan, did you want to make a comment?

16 MR. RUBINFELD: A couple of comments. On
17 transparency, I recently shared a very nice experience
18 with the FTC staff on a merger where they were very
19 transparent and so was I, but I have to say -- I hope my
20 client doesn't get upset at this -- that the hardest part
21 of the battle was convincing my client to let me be
22 transparent.

23 So once I had achieved that and I could talk
24 seriously with the staff, it was actually easier going.
25 So it's a problem on both sides. And in this particular

1 case, convincing the clients to let me talk without an
2 army of lawyers watching every word I said was the
3 hardest part of the case. I probably didn't tell you
4 folks that before.

5 But going back to the Guidelines, having been

1 where the delta by my calculation, was 96. The state
2 thought it was 102, and that led to a huge battle.

3 (Laughter.)

4 And it just seemed weird to me because at the

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1 their own fears and concerns, which may or may not be
2 warranted from my point of view. I don't really
3 understand the litigation side from counsel's
4 perspective.

5 But all this good talk about transparency runs
6 into litigation concerns quite routinely all the time on
7 the hot case list, which is where it matters the most.
8 So I would love to hear counsel with inside experience
9 speak to that after the break perhaps.

10 MR. PATE: Okay. We'll pick up on that, and
11 then shortly after the break, I also want to get to the
12 question of these grids, the data that's been released
13 and what surprises, if any, are in the data or what
14 conclusions do you think can be drawn from the data.
15 We'll talk about innovation markets, transparency, maybe
16 a little bit about customer complaints.

17 So let's take approximately 10 minutes and
18 reconvene at 3:20.

19 (A brief recess was taken.)

20 MR. PATE: I want to follow up with something
21 that Dan and Bobby commented on -- Lawyers as an
22 impediment to good, honest economist-to-economist
23 communication.

24 (Laughter.)

25 And I guess the better question might be: would

1 we be better off if we just handed antitrust over to the
2 economists and got the lawyers out of the room? And a
3 different way of asking that, though, is how realistic is
4 any of that, given the fact that we have a court system
5 which is ultimately where the agencies are going to have
6 to go either to enforce in the first instance or have an
7 enforcement decision upheld. What is the future of the
8 economist/lawyer balance of power in antitrust?

9 And I know, Jonathan, you're both. Maybe I can
10 start with you on that. Others too.

11 MR. BAKER: Thank you. My experience is that
12 when you're talking about individual cases and you ask
13 what's really important, sort of the economists or the
14 lawyers, and particularly in driving an agency decision,
15 that's really where the lawyers are important. Case by
16 case, the lawyers are thinking about evidentiary
17 questions, about burdens of proof. They're negotiating
18 details of divestitures. The lawyers are really, it
19 seems to me, using the economists to help shape thinking.
20 But a lot of the case-by-case work is really driven by
21 the lawyers.

22 But if you think about how antitrust has
23 changed decade by decade, that's really all about
24 economists. It's economic ideas, economic thinking, new
25 approaches, new tools, new perspectives that shape how

1 antitrust changes in the long run.

2 So I think that in some sense antitrust lawyers
3 are ready to hand it over to the economists, you know,
4 from the long-term point of view. But we give it back to
5 you every day.

6 (Laughter.)

7 MR. PATE: Maybe. Lewis Powell wasn't an
8 economist I guess. Jim, were you first?

9 MR. LOFTIS: Well, to tag onto that, what in
10 turn drives the lawyers are the clients. And what the
11 clients are interested in is getting the deal done, which
12 means either through the agency process or through the
13 court process. And as long as that's the determining
14 factor, then the lawyers are going to have the
15 predominant say.

16 But I certainly would agree with the
17 observation that we are increasingly being ruled or at
18 least influenced by economists.

19 MR. PATE: Dale? All the lawyers had their
20 hands up on this one.

21 (Laughter.)

22 MR. COLLINS: I had a couple of things. One, I
23 think that there should be ways for the economists to
24 talk to one another that don't give rise to a lot of
25 problems later on, particularly in light of what might

1 happen in litigation and things. You can use
2 stipulations or whatever.

3 I think the reason why the lawyers, if you
4 will, want to be present, at least the reason why I want
5 to be present on those phone calls, is not so much out of
6 a litigation concern. Because quite frankly, I don't
7 have much of a litigation concern. None of my cases seem
8 to go to litigation, although I'd love to get these
9 contingent consent decrees up so I could get some into
10 litigation.

11 But, you know, they tend not to go into
12 litigation, and if they were to go into litigation, I'm
13 using a different economist to litigate it anyway, and
14 that's not because I don't have a great deal of respect
15 for the ones I bring into the agencies. What it really
16 is is just the opposite. What I want to be able to do is
17 have a really free and open conversation with my
18 economist about all the various theories that could be in
19 the case, walk down lots of what will eventually end up
20 to be blind alleys with him or her, and I don't want to
21 be worried about what's going to come back to haunt me
22 with that economist in litigation later.

23 So the economist that I bring into the
24 agencies, you will never see, or almost never see as
25 testifying experts in a litigation. And I think that

1 solves a lot of the problems. But I do want to be on the
2 phone just to hear what's going on, because that helps
3 inform me. My constant quest as defense counsel in this
4 is trying to figure out what are the operative theories
5 of anticompetitive harm that the agency is testing, and
6 I'll take every opportunity I can to try to figure that
7 out.

8 Now just one last quick thing. On what
9 Jonathan said, I think something very interesting has
10 happened at the agencies. I think the cases dichotomize.
11 I think there are some cases where the economists are
12 very interested, particularly front office economists are
13 very interested, and you see basically a lot of economic
content in the invf5.ts are

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1 outside, making any contribution in the case.

2 And I think there is a lot of internalization
3 that's going on, and I think in a lot of cases, the
4 economists basically are not players.

5 MR. PATE: Other comments? Dan?

6 MR. RUBINFELD: Well, in answering your
7 question I always look for a natural experiment that will
8 help me to tease out the answer to the question, and the
9 natural experiment is to compare the level of analysis
10 here in the U.S. to, say, the level at the European
11 Union.

12 As you know, the European Union really has, at
13 least as I see it, has lagged behind the U.S. because
14 they have not until relatively recently really fit the
15 role of economic analysis into a central place in their
16 decision making. And I think for me that's part of the
17 explanation for some of the problems the EU had in the
18 cases that were overturned at the CFI over the last year
19 or two.

20 So I think generally among the players,
21 including folks around here, the economists and lawyers
22 really handle the sharing of decision making analysis
23 quite well. The EU is really in a starting plane, and I
24 think that's part of the difference. We're able to
25 incorporate much more rapidly our knowledge about

1 industrial organization and about empirical methods here
2 just because we have economists as well as lawyers making
3 key decisions.

4 In the sharing of the decision making, at least
5 during my experience, was not a problem at all. It
6 worked very well.

7 MR. PATE: Jim Rill?

8 MR. RILL: Yes. Certainly I don't disagree
9 with Jonathan's premise that a large part, most of the
10 foundation theoretical work that's been done over the
11 last couple of decades, has been generated out of
12 economic discipline.

13 I think, though, the best and most effective
14 economists that I've worked with, and it would certainly
15 include everyone at this table, are the ones that
16 recognize that it's important not merely to talk econo
17 babble to the other economists who will speak that same
18 language in the same obscure dialect, but recognize that
19 at the end of the day, it is the lawyers who will be
20 making the decision in the front office, and it is the
21 lawyers down below the front office and throughout the
22 chain that need to understand and work jointly to develop
23 a comprehensive matrix of decision making process that
24 brings the economic thinking into terms that's
25 manageable, practicable to legal thinking, not only for

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find that the sophistication of the arguments you can use

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1 from things. I always get nervous if some lawyer is
2 saying, well, you can't see that, you can't see this. I
3 say why not? I want to know everything about the case.
4 I want to find out all the facts.

5 Now therefore, I'm much less concerned about
6 saying something that will be used against me in
7 litigation. Because presumably, as an expert, if I'm in
8 litigation, I should have thought that through.

9 So I know there's this concern on both clients'
10 part and agencies' part to let economists talk, and it
11 certainly should be only reasonable discussion, not
12 shooting the baloney. But I think there can be, you
13 know, a lot of gains from trading can streamline
14 processes by eliminating misunderstandings.

15 MR. PATE: Dale, a quick follow-up on Dennis's
16 point?

17 MR. COLLINS: Yes. Just real quick. I don't
18 disagree with anything Dennis has to say. My point was
19 slightly different. And that is that I view economists -
20 - you put them in sort of two camps, okay. There's the
21 testifying economist and the strategic ones, the ones
22 that are helping you think through lots of things.

23 My only point really is that on the testifying
24 economist, absolutely. You want to make sure that they,
25 you know, have all the facts, that they've thought

1 through things. But, you know, there's thinking through
2 things and there's thinking through things. If I've got
3 a strategic economist who has gone down a lot of blind
4 alleys with me, and we've figured out what works and what

1 MR. BAER: I'll start. Briefly, I've talked
2 about it a little bit before, I thought the things that
3 were -- the fact that the challenges were associated with
4 much higher HHIs and deltas than the Guidelines said, it
5 really surprises no one who has followed this. And that
6 really, I think, results from the discipline of the '92
7 Guidelines and the requirement that enforcers tell a
8 story upon, that it becomes more nuanced and not just a
9 numbers game.

10 I was a little surprised to find that with
11 respect to the FTC data, that hot documents were
12 important in such a small percentage of the case. I
13 think that may reflect better counseling going in,
14 because I think in the mid-'90s when I was there in fact,

1 process is increasingly, once you get the numbers out of
2 the way, if you have what documents you have, that if the
3 customers are telling a credible story of harm, the
4 agencies seem anecdotally now in connection with the FTC
5 data release, very, very much inclined to weigh that and
6 to bring the challenge. That was really the most
7 interesting thing, I thought.

8 MR. PATE: Jon?

9 MR. BAKER: I read the numbers slightly
10 differently than you, Bill.

11 MR. BAER: It's not the first time, Jon. It's
12 just been a couple of years.

13 (Laughter.)

14 MR. BAKER: This time the Commission is going
15 to be with me. I focused on the FTC data, and looking at
16 those, and I was particularly interested in the other
17 markets, not the industries where the repeated play was
18 the groceries and the oil and where you wonder whether
19 the standards are different in those industries.

20 And the message that I got was that the hot
21 documents and the customer complaints mattered, but only
22 in the cases that were close.

23 (Interruption to the proceedings.)

24 MR. BAKER: My problem was a lot of those cases
25 where the hot documents matter and the customer

1 complaints matter were cases that would have been brought
2 anyway based on the concentration. That's what I'm
3 really trying to say.

4 And what was interesting was where things
5 mattered in looking at those other markets, the four- to-
6 three mergers were the ones that could have come out
7 either way based on these numbers. And there, when you
8 had hot documents and customer complaints, it made a
9 giant difference. It was the ones that the concentration
10 put it in an iffy area for the agency where the documents
11 and customer complaints mattered.

12 MR. WILLIG: As usual, with numbers like these,
13 there's the question of the exogeneity or endogeneity of
14 the characterizations of the fact of the case.

15 MR. PATE: Isn't that what I said earlier?

16 (Laughter.)

17 MR. WILLIG: Was it?

18 (Laughter.)

19 MR. WILLIG: If there's a case there, all of a
20 sudden there's going to be a lot of very credible
21 customer complaints. But if there's reasons that the
22 staff chooses not to bring the case; customer complaints,
23 no valid ones that I've seen. So it's the cart before
24 the horse problem with data analysis.

25 MR. PATE: Fair enough.

1 VOICE: That's why you should look at the BE
2 memo.

3 MR. PATE: The admonition from the conference
4 call operator to please talk into the mike. Dale, do you
5 have a follow-up?

6 MR. COLLINS: Yeah. Actually just to Bobby's
7 point, I think there are things you want to think about
8 with the data. I mean, one of the things that certainly
9 I see in negotiation of consent decrees is that sometimes
10 the way the staff has defined the markets, I really don't
11 care how they define the markets, right, once I've
12 negotiated the relief. But sometimes you get sort of
13 surprised at the way some of those markets may have been
14 defined.

15 But leaving that, I don't think that's a
16 problem that's sort of endemic through this. I think
17 that the most interesting thing is -- and I think a
18 number of counselors have been saying this for a while --
19 but there's a pretty good predictive test when you're
20 talking to the clients right in the beginning to figure
21 out what's likely going to happen with your transaction.

22 And that is, you don't ask them questions about
23 market definition or anything like that. What you do is
24 you ask them let's talk about your significant
25 competitors, and you're presumably acquiring one of them.

1 If you've got five significant competitors and you're
2 going down to four, the chances that that deal is going
3 through is probably pretty high. I mean, you know, not
4 always, but by and large, you can bet a lot that that
5 deal is likely to go through.

6 If it's four to three, it's going to be a
7 battleground of sorts. If it's three to two it's going
8 to be even more of a battleground, but if you've got good
9 efficiency arguments and you don't have any customer
10 complaints and your documents are under control, you've
11 got a fighting shot on that. You've certainly got more
12 than a fighting shot if you're on four to three. And if
13 it's three to two, you've got to have a really, really
14 good story and you really can't count on it.

15 And with that, that pretty much captures the
16 whole analysis. You know, you don't need to discuss a
17 whole lot of things more with your clients. And this
18 data bears that out.

19 MR. PATE: Jim Loftis?

20 MR. LOFTIS: And all of that is done, you know,
21 virtually in the wink of an eye without a simulation
22 analysis.

23 (Laughter.)

24 MR. LOFTIS: And before the second request.
25 I've done very much the same thing Bill Baer was talking

1 about, which is to look at the documents that I used for
2 the initial analysis that Dale has just described and
3 looked at the documents that were relevant after the
4 agency investigation, and by and large, they're the same.

5 MR. PATE: Other comments on the data?

6 MR. WILLIG: I look at the data and I'm happy
7 about the Guidelines, and I'm happy about enforcement
8 decision making. It shows by and large that
9 concentration is taken seriously, and when we get up to
10 the ranges that we've all experienced theoretically and
11 experientially to be really dangerous ranges, there's a
12 lot of enforcement action. And yet the numbers are not
13 followed slavishly. There's lots of variation around
14 that.

15 The safe harbor seems to be taken very
16 seriously with I think the right measure of caution, so
17 it's not exactly 1,000. There's kind of an extension of
18 the relatively safe harbor above that. It's a very
19 healthy picture alongside of the Guidelines, I think.

20 MR. PATE: Let me ask about customer
21 complaints. We talked about that in the context of the
22 data, and I'll make the not very shocking revelation that
23 customer complaints do matter inside the agencies; that
24 if we're seeing customer, not competitor complaints,
25 where a substantial story is being told, particularly of

1 specific instances where competition between the merging
2 parties has been of value in terms of price or quality,
3 that it does make a difference.

4 MR. PATE: But the question I wanted to ask is,
5 are there areas in which the economists, the lawyers,
6 think the agencies are not taking customer complaints
7 into account properly ways in which you've seen that
8 factor being misapplied. Jim Rill?

9 MR. RILL: As one who opened the question, I
10 don't think there's any serious disagreement. I don't
11 think there can be any disagreement with the notion that
12 serious, credible customer complaints are certainly
13 revealing as to the possible likely anticompetitive or
14 competitive dynamic of the transaction. I certainly
15 don't disagree with that.

16 I'm concerned with the possibility at least of
17 the caveats -- of the conditions, the qualifications --
18 what are serious and credible customer complaints. Are
19 they complaints that are genuinely revealing of a
20 potential anticompetitive consequence of the transaction
21 based on the customer's independent look at the issue, or
22 are they -- and this is not a comment on agency lawyering
23 at all -- I'm sure none of us have ever done it -- but
24 those people out there who might be opposing the merger
25 often can generate paper, statements, declarations to

1 provide to the agency from customers who are concerned
2 with the transaction, whose concern maybe they don't like
3 change. They don't like one of the acquired companies.

4 Those concerns, however, can be phrased by
5 someone, by counsel opposing the transaction, into a
6 statement that sounds like a competitive-based customer
7 complaint. It's incumbent on the agencies, and I'm sure
8 this is preaching to the converted, but it's incumbent on
9 the agencies, I would think incumbent on good lawyering
10 in opposition as well, to sift through the surface of
11 those complaints, to focus, in the words of the report,
12 on "serious and credible" concerns with anticompetitive
13 consequences of the transaction.

14 MR. PATE: Dan, you had a comment?

15 MR. RUBINFELD: I actually want to just take
16 what Bobby said about what he described as the
17 endogeneity of the customer complaints and sort of expand
18 on that.

19 Bobby was describing the fact that the study
20 itself may involve reinterpretation of what's an
21 important complaint or not, and beyond that -- it goes to
22 the strategy the customers might be using when the deal
23 is either announced or about to be announced. And I
24 think it just means we have to be careful about
25 interpreting complaints.

1 The examples I have in mind are Customer A is
2 unhappy with the deal they have with the acquiring
3 parties, so they either complain directly or make it
4 clear they're going to complain, and lo and behold, they
5 have a five-year contract to get a lower price on their
6 product. And in fact, it may be that their complaint is
7 not valid at all.

8 Now you can take that several ways. It could
9 be that you hear a complaint that's not valid, it could
10 be there's a real complaint out there, but you're not
11 hearing about it because the customer has been, let's
12 say, compensated ahead of the time.

13 MR. RUBINFELD: Exactly. And I have to confess
14 that I've seen that happen in a couple of deals I've been
15 involved in.

16 So that means that for the agencies, the issue
17 of how to process these complaints is an important one,
18 and it has to be done with great care.

19 MR. CARLTON: I think that's likely to become
20 an increasingly serious problem now that it's known how
21 important customer complaints are.

22 MR. RUBINFELD: Right.

23 MR. CARLTON: In other words, at the beginning,
24 I think it's absolutely right you want to be very
25 cognizant of customer complaints and then once it's

1 known, that that can have an enormous impact, customers
2 realize how much power they have.

3 So it's really going to be a touchy issue going
4 forward, I think, to sort out the real ones from the ones
5 that are just strategically designed to get a better
6 deal.

7 MR. PATE: Dale?

8 MR. COLLINS: I think that, obviously, customer
9 complaints are important. But even from a defense
10 counsel's perspective, I think we should recognize that
11 they are properly important to the decision making at the
12 agencies.

13 But having said that, I'm just really going to
14 repeat some things that have already been said. I think
15 it imposes an enormous obligation and responsibility on
16 the agencies to properly sift through those customer
17 complaints.

18 And let me suggest that there are two problems
19 that you need to watch out for, those of you who are in
20 the agency.

21 MR. BAER: Dale, can I interrupt? Do you think
22 there is actually a problem historically? I mean,
23 looking back the last four or five years where the
24 agencies have not properly valued complaints? I mean, is
25 there a systematic problem?

1 MR. COLLINS: No, I don't think it's a
2 systematic problem. I think it is an occasional problem,
3 but given the importance that the complaints have in the
4 decision making process, I think the obligation on the
5 agencies is extremely high to make sure that the
6 complaints are properly vetted.

7 It's particularly true since the biggest
8 frustration I have as a defense counsel is I can't get to
9 the people who are complaining and cross-examine them. I
10 mean, in a lot of these cases, I am convinced to a moral
11 certainty, probably wrongly, but still convinced to a
12 moral certainty: give me five minutes with the witness
13 and I can turn 'em.

14 MR. RUBINFELD: Can I interrupt just to liven
15 the conversation? How about sending affidavits to your
16 client? Have you ever had that happen?

17 MR. COLLINS: Oh, yeah. Yeah. Oftentimes what
18 will happen is that a complaining party, a customer, has
19 gone in, gotten an affidavit with the agency, and we
20 don't know about it, number one. And moreover -- and
21 I've got specific examples of this, we sort of found out
22 after the investigations were over, that they're coming
23 to us and saying we really love the deal, and they've
24 already got a complaint in at the agency saying they hate
25 the deal, okay. I would love to know about those cases,

1 just in order to sort of explore those issues.

2 (Laughter.)

3 MR. COLLINS: But let me go back to the
4 obligations on the agencies. And there's two kinds of
5 problems, one we talked about and one we haven't talked
6 about. The one we talked about is strategic behavior on
7 the part of some customers, and it's important for the
8 agency to find out about that strategic behavior.

9 The other one, I think, is far more pernicious
10 but thankfully it is extremely rare, but it is not
11 nonexistent. And that is, we will occasionally find, and
12 I find this out by representing third parties who have
13 been interviewed, particularly third parties that have
14 been interviewed when I'm not on the phone. And then an
15 affidavit comes across from the agency, and it says
16 please sign this affidavit. And you look at the
17 affidavit and the witness looks at the affidavit and said
18 this isn't what I said. First of all, it's far more
19 elegant than anything I possibly said in the
20 conversation, and it lays out a theory of anticompetitive
21 harm that I didn't articulate in the conversation.

22 And we've had one case, my sort of favorite on
23 this, but we've had one case where we took the affidavit
24 in, spent a lot of time with the witness -- we were a
25 third party, and we had no real interest in the deal, and

1 rewrote the affidavit that was sent to us or sent to the
2 client to be signed, in a form that the witness was far
3 more comfortable with. We sent that down signed to the
4 agency, and like three days later got hit with a CID to
5 go down and testify for a day on why we made the changes
6 to the affidavit.

7 I'm not saying that that shouldn't happen, but
8 I think the section chiefs should always be watchful that
9 the attorneys in their section when they're doing
10 affidavit work and they're talking to witnesses. It
11 takes a lot of training. If you're really, you know,
12 doing good government work to do that right. And one way
13 not to do it is to sit there and basically ask a series
14 of leading questions to the witness who just wants to get
15 off the phone, and then write up an affidavit that
16 basically is just the affirmative versions of your
17 questions.

18 And like I said, it doesn't happen much, but it
19 happens enough so you've got to keep a watchful eye for
20 it.

21 MR. PATE: Okay. Let's turn to innovation
22 markets. We've had a couple of comments, I think Bobby
23 making one that this might be one of the most important
24 topics to address going forward. I'd like to ask the
25 panelists, do you think that the agencies ought to bring

1 enforcement actions on the basis of innovation markets?
2 Would you be in favor of that/against it?

3 Secondly, in terms of the Guidelines, do you
4 think a future product or a potential competition
5 analysis suffices to deal with innovation market
6 situations, or do we need, as I think Bobby suggests,
7 some more explicit attention to how R&D and innovation
8 are handled in merger analysis? Jim?

9 MR. LOFTIS: I think the fundamental problem in
10 many situations is we don't understand what causes
11 innovation, and therefore, we don't understand very well
12 how it's going to be affected by a transaction. And if
13 any resources can be put towards studying, not just from
14 a legal or an economic point of view, but studying what
15 the foundations of innovation are, that would be
16 extremely helpful and maybe should be the threshold step
17 towards understanding how we go about dealing with it.

18 Because what happens if you put together two
19 firms that have fabulous brainpower in microbiology, I
20 mean, how do you know that that combination is going to
21 have anything at all to do with innovation? What do you
22 do with the outlier, the fellow in the garage, who comes
23 up with the next brilliant idea? How do you factor that
24 into your analysis?

25 I guess my point is we just don't know enough

1 at the threshold to go very far with this.

2 MR. BAER: When I came to the government in
3 '95, this was the hot topic. The first innovation market
4 case had been brought. The question whether you needed
5 to have this concept at all or you could rely on
6 potential competition.

7 I think the way it's played out, there isn't
8 much debate. The point Jim makes was a theoretical
9 concern a lot of people voiced, we're basically going to
10 be trying to handicap who has a better idea and whether
11 combining two bright guys is going to somehow basically
12 corner the market on good thoughts? But that hasn't how
13 it's been used.

14 I mean, it's basically, in the hypothetical,
15 Jim, you posed, where you had two people thinking about
16 good things, the fact that they get together doesn't
17 trouble me. The troubling fact would be that they
18 patented the whole field and between the two of them have
19 the patents which, if kept separate, would allow the IP,
20 would allow them to compete, that they're going to be put
21 in one pool and nobody else can get in, so you may lose
22 different lines of innovation -- that sort of stuff.

23 This was Ciba Geigy/Sandoz merger analysis. We
24 had this issue with gene therapy where the two entities
25 controlled most of the IP necessary to pursue gene

1 therapy.

2 So, for me, the concerns haven't really borne
3 out because it's largely been applied, innovation theory,
4 in the context of pharmaceuticals where you have a pretty
5 good idea what the pipeline is like, you can make some
6 judgments about how to handicap likelihood that there
7 will be other people in it, at least more informed than
8 in other non or unregulated markets, and whether at the

1 defense side, will it be increased? Will the pace of
2 innovation be increased by the transaction? That's a
3 discussion you can have totally apart, if you will, from
4 questions of the metes and bounds of the marketplace.

things off on the wrong foot. And if you read the

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1 It's a complex melange of forces, and we don't have
2 Guidelines to help us sort them out.

3 MR. PATE: Dennis?

4 MR. CARLTON: I would say that the innovation
5 market concept is a bad idea because it does suggest
6 you're going to take market shares and you're going to do
7 HHIs. To whatever extent you think the usual Guidelines
8 using HHI's are crude, these are completely without any
9 theoretical foundation.

10 I agree with Bill that in pharmaceuticals,
11 because there's a pipeline, you can predict what's coming
12 on line, and therefore you have better predictions about
13 future products. But I think that is actually an
14 exceptional case. In most industries, there's not
15 necessarily a time line, and it's actually very difficult
16 -- this is what I was alluding to earlier -- to predict
17 where innovations will come from.

18 Take the transmission case, the ZF case. There
19 were people who made transmissions for other products,
20 other than large garbage trucks, which was one of the
21 issues, or buses. And they were related. So if small
22 trucks, medium size trucks, and innovations in those
23 technologies were thought to be able to spill over, I
24 don't think the premise that innovation is necessarily
25 going to come from people in that market, that product

1 market, necessarily holds true.

2 But just to reassert something or confirm
3 something Bobby said, I think he's exactly right. We're
4 not sure. The evidence in industrial organization is
5 quite ambivalent as to exactly the effect of
6 concentration on R&D if you do cross-sections.

7 Now maybe in studying a particular industry,
8 that is, if there is a particular industry in which
9 there's a merger and you can say look, it got
10 concentrated. They did less R&D. It got concentrated.
11 You keep doing less R&D. Well, maybe you can make
12 specific observations there. But I think it's very
13 dangerous to have a generic rubric of innovation markets.
14 R&D is a concern.

15 We'd like to be able to say more -- I would
16 like to be able to say more about it. I agree with you,
17 it's an important area for study. We don't know a lot
18 now about it, it seems to me, that we can give general
19 Guidelines, other than studying a specific industry
20 that's under analysis, I'm not sure what else to suggest.
21 And I'm worried if you did something that would create a
22 new rubric, and people would take advantage of it, and I
23 think it would just lead to confusion.

24 MR. PATE: Dan, I think you were first and then
25 --

1 MR. RUBINFELD: I feel like I should say I
2 still like innovation markets, although I will agree that
3 the word "market" itself isn't very important. But I
4 think the really important point is really the one Dennis
5 just made.

6 It is true, and I think I agree with the
7 characterization that Bobby made, that if you look at the
8 empirical evidence in a typical cross-section, you're not
9 going to see a clear relationship between concentration
10 and innovation. But if you start looking deep down into
11 the numbers, I think in specific industries, in
12 particular types of situations, the data will tell you
13 and the economics will tell you a fairly coherent story
14 that links reduction in competition to less innovation.

15 One example I happened to think of was some of
16 the work the Division did involving some of the defense
17 mergers where there's a very, very specific theory laid
18 out of the way in which innovation occurs, and I think a
19 very compelling story about why three to two, for
20 example, will significantly affect innovation and harm
21 consumers.

22 So let's not take away from this message about
23 the lack of consistency of the cross-section the idea
24 that we can't develop for specific industries and
25 specific kinds of innovation a compelling story based on

1 the evidence.

2 MR. LOFTIS: Let me just take issue with that,
3 may I? Since you hit one of my favorite topics.

4 MR. RUBINFELD: You represented one of the
5 parties probably.

6 MR. LOFTIS: No, no, no. I think you need to
7 make a distinction as to the viability of the theory that
8 you're referring to between innovation in the sense of
9 advancement and innovation in the sense of overcoming
10 technologies. That really makes a huge difference in
11 what you're talking about.

12 MR. PATE: Jon?

13 MR. BAKER: Regardless of what the facts are in
14 the ZF case, I don't actually think we're disagreeing
15 over the principle there. That is, if there's certain
16 identifiable assets that the firms have that are
17 important to new process or product development, maybe
18 it's in the pipeline already. Maybe it's patents.
19 Conceivably, it's current generation products or
20 expertise and distribution or obtaining regulatory
21 clearance, but you'll want to debate that on the facts.

22 But if there are only a handful of firms with
23 the existing assets that you need to go forward and
24 you're having a merger among them, the agencies are right
25 to be concerned. The dispute about ZF that I'm hearing

1 is about whether the evidence that was pointed to by the
2 agency really falls in that category or not.

3 On the broader question that Dan and Bobby have
4 been on about -- and Dennis -- about the relationship
5 between R&D and concentration, the last time I looked at
6 the literature, and maybe it's been sufficiently long ago
7 that I'm not up to date, but when I looked through most
8 recently, what I thought I took from the literature, is
9 that, yes, if you look at these cross-sectional studies
10 it appears as though it's ambiguous as to whether
11 increased concentration is associated with more or less
12 R&D.

13 But if you control for appropriability, that
14 is, that there are some industries where it appears that
15 you need to have large shares of the existing products in
16 order to be confident that you're to be able to
17 appropriate the benefits of your innovation, the
18 intellectual property protections aren't good enough
19 there to guarantee appropriability, and once you control
20 for that for industry type, then the relationship comes
21 back. And so that it looks as though that increased
22 concentration is associated with less R&D, once you're
23 confident that the firms have some other way of
24 appropriating the benefits of their new ideas than merely
25 just being large.

1 So I think there's a basis for antitrust
2 enforcement from that literature, but I agree that it
3 takes some teasing out to get to my interpretation of it,
4 and that, you know, people could disagree about that.

5 MR. PATE: Other comments on innovation? If
6 not, Jim Loftis mentioned monopsony as a question going
7 forward the agency should pay more attention to.

8 MR. COLLINS: Could I just say something? I'm
9 sorry for interrupting.

10 MR. PATE: Sure.

11 MR. COLLINS: There's something in the
12 literature recently on patents that I think does merit
13 antitrust concern, and that's the following. There's
14 been a finding that the number of patents has
15 skyrocketed, and that the way people are using patents
16 are as like a medium of exchange, a currency, in which
17 I'll give you my patent if you give me your patent, and
18 does not explore the reason. It's just we agree to
19 share.

20 And, therefore, someone who doesn't have this
21 currency of patents sometimes may have difficulty
22 participating in these cross-licenses. I think that's an
23 interesting -- I just want to raise that. I think that's
24 an interesting phenomenon, and I think that's something
25 people should keep their eye on as to the antitrust

1 consequences of those practices.

2 MR. PATE: Well, it's a good point. I can put
3 monopsony aside for a moment. The agencies obviously
4 have been doing a lot of work on antitrust and
5 intellectual property, primarily focusing on patents.
6 Are there any issues that others on the panel would like
7 to comment on with respect to merger analysis and IP?
8 Any particular aspects of that that you think we ought to
9 be paying attention to?

10 (No response.)

11 MR. PATE: No.

12 (Laughter.)

13 MR. PATE: It's a topic that's been well enough
14 dealt with. All right. Let me take up monopsony
15 questions then. A frequently heard contention in this
16 field is that the agencies ought to be much more
17 concerned about monopsony at lower levels of
18 concentration than those about which we should be
19 concerned in the context of monopoly power.

20 Marius was on a panel earlier in this series
21 where he suggested he didn't think that current learning
22 really supported that assertion, but it is one that's
23 pretty powerful, and I'd like to know if there are any
24 reactions from the panelists on that point.

25 MR. WILLIG: I hadn't heard that strange idea

1 myself.

2 (Laughter.)

3 MR. BAER: Because if anything, the agency
4 guidance these days in health care, and other things
5 that, there is a threshold or a safe harbor in terms of a
6 buying cooperative. This is not the merger analysis, but
7 cooperative activity that you wouldn't be allowed to do
8 if it were a seller-coordinated effort. It would be per
9 se unlawful on the seller's side. You actually have safe
10 harbors up to 25 or 30 percent on the buyer's side.

11 My own sense on whether we need to do more or
12 whether we're going about it right on monopsony analysis
13 in merger cases, is that you go back to the Guidelines
14 requirement. You tell a story and understanding over
15 time how increased power on the part of the buyer is
16 going to distort the market, you know, and looking to
17 some sort of effect that is anti-consumer is the right
18 way to look at it.

19 I think just as in predatory pricing cases, you
20 want to be a little bit careful. You don't want to chill
21 lower prices. And so having that kind of slightly more
22 cautionary mode in mind is probably the right way to go
23 at look at monopsony, to my way of thinking.

24 MR. PATE: Bobby, let me make sure. Were you
25 incredulous at Marius's response or the theory to which

1 he was responding?

2 MR. WILLIG: No, at the idea that the agencies
3 had a different sense of concentration for those two
4 concerns. But if I can follow up on Bill.

5 MR. PATE: Sure.

6 MR. WILLIG: Just to lay it out a little bit
7 more, we frequently encounter the idea that among merger
8 efficiencies is the ability to buy more effectively,
9 i.e., cheaper. And of course that sounds a lot like
10 monopsony at the same time. How could a theory of
11 anticompetitive effect be indistinguishable from a theory

10

10

10

10

1 So we're back to output as the distinguishing
2 feature, but it's output upstream, not downstream.

3 MR. PATE: I think I have the advantage of
4 knowing Marius does agree. But let me ask about the time
5 frame. What would you suggest the agencies do with a
6 situation where there is a real efficiency in terms of
7 buying power that decreases price in the short term, if a
8 credible case were made that output would decrease in the
9 long term? That's another aspect of this argument that
10 gets presented frequently.

11 MR. WILLIG: Oh, the low price denies ability
12 upstream to invest?

13 MR. PATE: Right. That production choices are
14 altered because there's not a sufficient return.

15 MR. WILLIG: No, I worry about that, and I
16 would call that a possible exercise of monopsony power if
17 the investment base is removed from upstream supply
18 through procurement.

19 MR. CARLTON: I think there's a confusion
20 between monopsony and bargaining power. In terms of the
21 literature on the cases of monopsony and the
22 concentration levels of monopsony versus monopoly, as a
23 general rule, you can only have monopsony if you have an
24 upward sloping supply curve.

25 Now it's not clear that you have upward sloping

1 supply curves for most industries in the long run. In
2 the long run, a good first approximation for many
3 industries is the supply curve is pretty flat, so there's
4 nothing to monopsonize. It's only in industries where
5 there's specific capital -- rents or human capital --
6 that we think that there can usually be monopsony power,
7 and that's the reason I think that explains the relative
8 paucity of studies documenting monopsony compared to
9 market power.

10 Now even in those cases in which there is an
11 upward sloping supply curve, sometimes it is upward
12 sloping and then it's flat. Take the case of sports, the
13 supply of sports talent. There are some people who are
14 terrific, and then there are some people whose
15 alternative is, you know, doing nothing else but, you
16 know --

17 VOICE: Law school.

18 MR. CARLTON: Yeah. Law school. Okay.

19 (Laughter.)

20 MR. CARLTON: And what you've got to be careful
21 in those cases. If there's differential pricing, suppose
22 you pay different sports figures different prices, there
23 need not be a restriction of output. I agree with Bobby.
24 It's the restriction of output that matters, okay, so
25 that's often the case of monopsony, that people call

1 monopsony. It's really differentiated pricing and
2 doesn't lead to a supply restriction.

3 And in other cases, maybe in the short run
4 there's an upward sloping supply curve, but not in the
5 long run. So there's no restriction of output.

6 Bargaining theory is usually what's going on
7 when someone's complaining that someone's going to obtain
8 more power. That just means they're going to get a
9 better bargain. And again, the issue is, in the long
10 run, is that going to alter investment? And if it does,
11 then you should be concerned with the restriction of
12 output, but if it isn't, then it's just a reallocation of
13 the rents, from the transaction.

14 So I have always thought monopsony was less of
15 a problem than market power because of the shape of the
16 supply curves. And there's one error that's often made,
17 and that is that monopsony lowers price, that's true, but
18 it restricts output. And the lower price is not a
19 benefit. That shouldn't be counted as a benefit. That's
20 actually a cost to society because it creates a dead
21 weight loss.

22 So it really has to do with restriction of
23 output. And anytime there's a restriction in the input
24 market, that generally is going to lead to a restriction
25 in some output market because the input was being used to

1 produce some output.

2 MR. PATE: Dan?

3 MR. RUBINFELD: Just to follow up. I actually
4 have more of a question than a statement. It's related
5 but not quite the same point. We were talking about a
6 horizontal merger involving an output product, but the
7 merger happens to be in an industry where there is one or
8 two very significant buyers, very significant buyer
9 market power. I think one's natural reaction, but I'm
10 curious what you think.

11 We used to think of this as really a bargaining
12 issue and not a pure monopsony issue, but can you think
13 of situations in which you would think that the presence
14 of significant buyer power would be enough to counter any
15 possible adverse effects, price effects of the merger?

16 MR. WILLIG: We're not doing monopsony now?

17 MR. RUBINFELD: I'm just shifting over to a
18 slightly different question.

19 MR. WILLIG: Okay. But there's still things to
20 fight about on monopsony.

21 MR. RUBINFELD: Okay. We can move. Hew can
22 cut me off if he wants to.

23 MR. PATE: No. Anybody want to take up Dan's
24 question?

25 MR. WILLIG: For me, what buyer power is all

1 role in the defense of a transaction, but what's critical
2 and I think what so many defense lawyers fail to do is
3 explain the mechanism by which the buyer power is being
4 exercised.

5 They just say there are big buyers out there.
6 You know, that by itself, quite frankly, should get you
7 nowhere on the defense side. You need an explicit -- you
8 need to be explicit about the mechanism by which the
9 buyer, in the context of the industry and that particular
10 buyer's attributes, is actually going to be able to
11 effect a price change, if you will, in order to protect
12 itself.

13 And I think Dennis is absolutely right. When
14 you get into all the characteristics, you know, the
15 nature of the products, whether or not there's price
16 discrimination, there's going be a huge problem in these
17 buyer power defenses.

18 MR. PATE: Let me try to get some comments on
19 coordinated effects. A couple of years ago Charles James
20 suggested that perhaps unilateral effects had driven out
21 coordinated effects, and that outside of stylized
22 maverick stories, coordinated effects wasn't getting
23 enough attention.

24 Jonathan, I was interested by your comment
25 leading off that coordinated effects has been so

1 reinvigorated that you think it's driving out unilateral
2 effects. So let me just use that to solicit comments on
3 where we are in terms of use of coordinated effects
4 theories in merger analysis and where should the agencies
5 be, and where should they say they are for the benefit of
6 outside parties. Do you want the first shot?

7 MR. BAKER: Sure. I think what the agencies
8 have been doing the last few years in coordinated effects
9 has been very healthy and very interesting. And what's
10 been clarified are a couple things. One is that there
11 are two different questions that you have to ask. One
12 is, how do the firms in the industry solve their cartel
13 problems, reaching consensus, deterring deviation, by
14 detecting and policing cheating? And then how does the
15 merger matter? And that the factors in the merger
16 Guidelines aren't just some sort of checklist. They're
17 part of the way that integrated analysis that have to be
18 directed towards whether and how the firms solve their
cartel problems.F1 1 Tf-5.7108 0 TD0 Tc(18)Tju4rneir

1 story.

2 If you think the way coordination works is on
3 price, then issues about transparency might be important.
4 If you think it's a customer allocation, then it's a
5 transparency of customers, not the transparency of prices
6 that matters. But with that kind of a caveat, the
7 agencies have been very thoughtful and moving the ball
8 forward on doing empirics in the coordinated interaction
9 area.

10 And then in analyzing whether and how the
11 merger matters, I think that's what mavericks are all
12 about; that there's always a constraint on coordination.
13 Coordination -- you would generally expect if it exists
14 to be imperfect and incomplete. In that kind of a
15 setting, the issue is, well, why is it imperfect and
16 incomplete? What firm doesn't want to go along or can't
17 be, of course, can't be paid off with side payments or
18 punished more vigorously to force it to go along, and
19 then how does that constraint get changed by merger?

20 And I would incorporate a presumption that if
21 the merger involved a maverick, it would be harmful. And
22 if it didn't involve a maverick, then you need to analyze
23 how the merger affects the constraint, the mavericks.
24 And so that's how I think the agencies are evolving
25 towards understanding these coordinated effects cases,

1 and it's healthy.

2 MR. PATE: Jim Rill?

3 MR. RILL: Yes. I was with you up until the
4 presumption on the maverick. But, no, I think the agency
5 enforcement procedure and the Guidelines really are quite
6 good on coordinated effects.

7 When we developed them in the 1992 Guidelines,
8 there was some sort of criticism that there was a large
9 number of criteria and a large number of considerations,
10 a large number of elements that were thrown into the pot
11 to identify situations where coordinated effect might be
12 the basis for a challenge to the merger.

13 I know the ABA was somewhat upset: What are
14 you doing? You've given us a stew. You haven't told us
15 what the principal ingredients are. I think we did the
16 right thing, partly for the reason that Jonathan
17 suggested, that cases are so fact-specific, and in many
18 instances, so directionally pointed as to a particular
19 focus of analysis to say, well, the real issue here is
20 going to be heterogeneity. Well, in many instances, it's
21 not. The real issue may be conditions of the downstream
22 market.

23 So it has to be weighed on a case basis. And I
24 think the agencies have done quite a good job on that.
25 And I would not recommend, as some questions have

1 suggested, I would not recommend something to assign
2 priorities to the elements of the competitive effects
3 section of the Guidelines.

4 Presumption of illegality based on maverick, I
5 have trouble sometimes identifying the difference between
6 a maverick and a thoroughbred. And not being that good
7 of an equestrian, I'd have to say that to create such a
8 presumption, I think, would do considerably more harm
9 than good across the board, because the maverick may not
10 be so much of a maverick.

11 There may be a lot of considerations that makes
12 him or her not a maverick, but based on other factors
13 that make a somewhat difference from the basis of product
14 and the basis of cost, from the basis of position, from
15 the basis of influence in the market, that I think risks
16 severe damage by creating that -- well, how about
17 moderate damage, from establishing that kind of a
18 presumption.

19 MR. PATE: Dennis?

20 MR. CARLTON: One concern I've always had with
21 the quote, "maverick" theory is anytime you introduce new
22 terminology, it sounds like it's a new theory. And what
23 I've always preferred is to think of the maverick theory
24 not as, you know, this new word "maverick," but rather
25 the following. That the economic circumstances of a

1 particular company are such that they have the incentive
2 to be particularly competitive.

3 And I want to distinguish that from they have
4 some CEO who's off on a power trip and he's going to
5 affect price for his ego or some other idiosyncratic
6 reason. I don't think you want the identity of the
7 person running a company to be an issue in a merger case.
8 I think you want it to be the economic characteristics of
9 the company. Otherwise, you're going to run into the
10 problem that companies are going to have an incentive not
11 to be a maverick because they know that will hurt them
12 under the Guidelines. To have an innovative CEO who is
13 doing innovative things, if that's going to hurt them,
14 they won't have that type of CEO.

15 So I've always disliked the word "maverick"
16 because it suggests someone's off, he's kind of like a
17 wild man. And I don't like that. A wild horse. I don't
18 like that. I don't think it should be wild at all. I
19 think it's quite disciplined, quite predictable based on
20 the economic situation that the firm faces. Otherwise, I
21 think you're going to get into all sorts of puzzling
22 policy conundrums that, should it be an antitrust offense
23 if, you know, they fire Mr. X and hire Mr. Y? I mean, I
24 just don't think you want to go in that direction.

25 MR. PATE: Jim?

1 MR. LOFTIS: I would agree certainly with the
2 proposition that the agencies have gotten it about right
3 in what they're doing in practice and that the stew or
4 the checklist or whatever we wish to call it of the
5 coordinated effects section of the Guidelines has not
6 proved to be the gigantic problem that folks thought it
7 to be.

8 But it is interesting that to see how the
9 factors that are identified in the Guidelines under the
10 coordinated effects section, to see how they are playing
11 out in a slightly different arena. I would recommend
12 that you take a look at the recent case law in private
13 treble damage actions, largely on summary judgment, and
14 just subtract out of that Sherman Act equation the
15 consideration of agreement, and look at what they say
16 about exchanging competitor price lists, trade
17 associations. Every factor that is in the coordinated
18 effects section of the Guidelines has been dealt with
19 more than once by the courts to evaluate its significance
20 in a specific industry.

21 And it's not entirely unlike what the agencies
22 are doing in the merger setting.

23 MR. WILLIG: I thought where you were going,
24 Jim, was that -- and this is my experience -- that the
25 agencies are quite expert and responsible in sewing

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1 expired. What I think I'd like to do is go through and
2 give each of the panelists an opportunity for a parting
3 shot, one brief comment they'd like to leave us with as
4 part of these proceedings and I
5 guess to follow on our alphabetical theme, maybe I'll
6 start in the middle and try to work out and give Jim
7 Loftis --

8 (Laughter.)

9 MR. PATE: And, see, my name begins with "P" so
10 it's always been my desire to run it this way. Jim
11 Loftis, why don't you start?

12 MR. LOFTIS: All right. I just would observe
13 that Guidelines are so very hard to write that will work.
14 And what we have has gone through such a healthy process.
15 I would not suggest additional Guidelines or revising the
16 Guidelines, but I would suggest that resources be devoted
17 to understand better what the circumstances of innovation
18 are, both in the sense of improvement and in the sense of
19 superseding technologies.

20 MR. PATE: Dale Collins?

21 MR. COLLINS: Yeah, I agree with Jim. I don't
22 think the Guidelines should be rewritten. However, I do
23 think that through speeches and discussions of
24 enforcement decisions and the like, what should happen is
25 that, in large part, the Guidelines should collapse, if

1 you will, into Section II.

2 And as a particular example of that, I think
3 that the current structure of the Guidelines which I
4 think Baxter may have started, of isolating efficiencies
5 as a defense and suggesting that they are an affirmative
6 defense as opposed to a negative defense that should be
7 properly considered in Section II and not considered at
8 all as an affirmative defense, the Guidelines, you know,
9 the talk should be move it into Section II. Don't
10 consider it separately.

11 MR. PATE: Okay. Jim Rill?

12 MR. RILL: Very little to add to what's been
13 said by Jim and Dale. I think the Guidelines should not
14 be revised at this time. I think the Guidelines are
15 serving a very valid purpose in a progressive way. I
16 would only advocate more transparency in the direction
17 the agencies are taking now. I think the current release
18 of the DOJ and FTC and the current FTC study is
19 absolutely superb, and I think greater efforts to
20 identify the rationale for cases not brought and basis
21 for consent judgments would be very, very salutary.

22 MR. PATE: Dennis?

23 MR. CARLTON: Well, I echo everyone's
24 sentiments that I think the Guidelines are pretty good as
25 they stand. They're broad enough to incorporate a

1 variety of new approaches without having to rewrite the
2 Guidelines. I agree with Jim that more research on R&D
3 and dynamic efficiency is important.

4 In terms of the way the Guidelines are actually
5 implemented, and as you develop techniques or improve
6 techniques such as merger simulation or whatever, I think
7 it's very important to do retrospective studies to see
8 what has worked and what has not worked. And in doing
9 that, it's very important not just to compare the mergers
10 that you're blocking but also to see what happens to the
11 ones you've let go, to see whether your techniques are
12 able to distinguish between mergers that lead to price
13 increases and those that don't.

14 So I think retrospective studies are extremely
15 valuable for allowing us to assess where current practice
16 should go.

17 MR. PATE: Dan?

18 MR. RUBINFELD: We've done a lot, the agencies
19 and some of the folks out there, in developing empirical
20 techniques and applying them to help us better understand
21 how to distinguish mergers that are pro-competitive from
22 those that are not. And we need to keep doing more of
23 that, particularly actually in the area of coordinated
24 effects, which we're doing now, and that involves both
25 developing new techniques whenever possible, making data

1 public so that people can evaluate it, as well as doing
2 retrospective work.

3 And we should try to avoid trying to get too
4 simple rules of thumb that we think are going to apply
5 across the board to many industries, because it's just
6 not going to be the case.

7 MR. PATE: Jonathan?

8 MR. BAKER: I think Jim Rill's 1992 Guidelines
9 have been remarkably successful, and that they still are
10 what people on the inside and the outside rely on
11 routinely in understanding how to think about mergers.
12 And there's no real big reason to do much with them in
13 changing them.

14 If there's going to be a next round of
15 revisions, I think it's when we understand innovation
16 better than perhaps we do now and how to think about
17 mergers and innovation, but I'm not sure whether we've
18 gotten to that point yet.

19 So on the whole, I agree with everything that
20 everyone has said so far.

21 MR. PATE: Bobby Willig?

22 MR. WILLIG: Thank you. I think the Guidelines
23 are actually terrific.

24 (Laughter.)

25 MR. WILLIG: I would love to see the agency

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1 Commission and the Division who have done so much work to
2 put this conference together.

3 With that, we are adjourned.

4 (Applause.)

5 (Whereupon, at 4:37 p.m., the conference
6 adjourned.)

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1 DOCKET/FILE NUMBER: P019503

2 CASE TITLE: MERGER WORKSHOP

3 HEARING DATE: FEBRUARY 19, 2004

4

5 I HEREBY CERTIFY that the transcript contained
6 herein is a full and accurate transcript of the notes
7 taken by me at the hearing on the above cause before the
8 FEDERAL TRADE COMMISSION to the best of my knowledge and
9 belief.

10

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DATED:

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RITA HEMPHILL, C. V. R.

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C E R T I F I C A T I O N O F P R O O F R E A D E R

18

I HEREBY CERTIFY that I proofread the transcript for
19 accuracy in spelling, hyphenation, punctuation and
20 format.

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SARA J. VANCE

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