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The American
Antitrust Institute

COMMENTS OF THE AMERICAN ANTITRUST INSTITUTE

WORKING GROUP ON MERGER ENFORCEMENT

July 15, 2005

INTRODUCTION

These are the comments of a Working Group on Merger Enforcement established by the American Antitrust Institute for purposes of responding to the AMC's request for public comments. These comments reflect a consensus of the Working Group, but it should not be assumed that all agree with every statement or position herein. The Working Group is chaired by James Langenfeld (LECG and Loyola University Law School, Chicago). The other members are Joseph Brodley (Boston University), Robert Doyle (Sheppard Mullen), Albert Foer (AAI), John Kwoka (Northeastern University), Kevin O'Connor (Lafollette, Godfrey & Kahn), F.M. Scherer (Harvard University), Robert Steiner (Consultant), and James Tierney (Columbia University).

A. *Federal Antitrust Merger Enforcement Policy Generally*

1. Has current U.S. Merger enforcement policy been effective in ensuring competitively operating markets without unduly hampering the ability of companies to operate efficiently and compete in global markets? Please identify specific examples, evidence, or analyses supporting your assessment.

Yes, in general, but with exceptions relating to the agencies' prosecutorial discretion and court limitations. Accordingly, the Working Group does not recommend a change in the statutory framework.

The agencies have engaged in detailed reviews of many mergers under the Hart-Scott-Rodino pre-merger review process, and have challenged or obtained consents in the ones they believe reduce the number of competitors to a small number. For example, the FTC and DOJ Annual Report to Congress for Fiscal Year 2003 lists the cases challenged that year. Virtually all of the discussions in that report indicated the challenged mergers would have resulted in mergers leaving 3 firms or less, or would have resulted in the merged firm having a 60 percent market share or more.[1] These actions in general have prevented significant lessening of competition in many industries, without hampering companies' ability to operate efficiently and ability to compete in global markets.

However, the agencies have in general been reluctant to challenge mergers from 5 to 4 (or even 4 to 3) significant competitors in the markets. Some of these mergers have presented competitive problems according to the AAI.[2] In other instances the agencies have attempted to challenge arguably 3 to 2 mergers, but the courts have nevertheless permitted the merger.[3] It appears that enforcement policy has evolved to the point where 2 to 1 or 3 to 2 mergers are the only ones that the agencies will regularly consider dangerous to competition. The move to challenging only mergers with very high concentration levels can be clearly seen in Federal Trade Commission and U.S. Department of Justice, *Merger Challenges Data, Fiscal Years 1999-2003*, December 18, 2003.[4]

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[1] This pattern of enforcement has existed over the past few years. For example, in FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001) the Court of Appeals upheld the FTC's effort to block a three to two merger in the face of a determined efficiencies defense. See William Kolasky, *The Role of Efficiencies in Merger Review,* ANTITRUST 82 (Fall 2001) and Jonathan Baker, *Efficiencies and High Concentration,* in John Kwoka, Jr. and Lawrence White, eds., THE ANTITRUST REVOLUTION (4th ed., New York: Oxford Press 2004). However, on occasion there has been a reluctance to challenge 2 to 1 mergers. For example, the FTC closed the Genzyme/Novazyme merger investigation in 2004. The merger combined the only two firms engaged in research on Pompe disease, a life-threatening childhood ailment for which no treatment exists. In a split decision the FTC refused to apply the presumption of liability under the Merger Guidelines despite the fact that the acquiring firm had previously acquired the only two other firms engaged in Pompe research and there were no potential entrants. Instead the FTC applied an "empirical" approach, which emphasized the incentives of the merging parties. FTC press release available at http://www.ftc.gov/opa/2004/01/genzyme.htm.

[2] See, for example, the AAI's analysis of the cruise mergers, at antitrustinstitute.org/recent2/200.pdf.

[3] See, for example, the Oracle-PeopleSoft merger, U.S. v. Oracle, Northern District of California, No C 04-0807, at www.usdoj.gov/atr/cases/f205300/205388.pdf.

[4] Available at www.ftc.gov./os/2003/12/mdp.pdf. With the exception of the petroleum industry, there were only two mergers challenged below the highly concentrated HHI of 1800 from 1999 to 2003. However, the *Merger Guidelines* state that in the 1000 to 1800 HHI range "mergers producing an increase in the HHI of more than 100 points in moderately concentrated markets post-merger potentially raise significant competitive concerns depending on the factors set forth in Sections 2-5 of the Guidelines". (Section 1.51) The *Merger Guidelines* also state that mergers resulting in post merger HHIs over 1800 "producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines. Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise." (Section 1.51.) However, of the over 1200 markets with HHIs 1800 or more, the agencies challenged only 38 that had a change in the HHIs of 199 or less. For further discussion on the level of enforcement, see John Kwoka, *Some Thoughts on Concentration, Market Shares, and Merger Enforcement,* Presented at the FTC/DOJ Workshop on Merger Enforcement, Washington, DC, February 17, 2004. Kwoka also argues that enforcement, as described in the *Merger Guidelines*, needs to be modified to better address issues involving the unilateral effects and strategic behavior resulting from mergers

This evolution appears to reflect an informal policy determination that concentration short of these high levels and changes is seldom worthy of challenge. This de facto policy raises the critical question of justification for the change. Is this evolution based on empirical evidence, or has policy strayed from the evidence and reflects other considerations and preferences? AAI's detailed statement on mergers and concentration (attached) concludes that current economic thinking and evidence still support the presumption that concentration implies anticompetitive potential, and the use of concentration measures -- even at levels below those relied upon at present -- remains an efficient and effective enforcement tool.[5] AAI and members of the Working Group have always recognized that this presumption can be rebutted by a number of factors, including entry barriers, competitive effects analysis, and efficiencies. In this sense, the presumption is weaker than widely believed a generation ago. Nonetheless, in light of its predictive power and the literature casting doubt on the effectiveness of mergers in achieving their declared goals,[6] AAI has questioned whether the now seemingly dominant reverse presumption -- that mergers are almost always efficient even at high levels and changes in concentration -- is justified. Accordingly, there is a substantial question as to whether the agencies should relinquish the "incipiency" function of the Clayton Act by apparently paying less attention to concentration.[7] The Working Group suggests that the AMC pursue this question by forming one or more independent bodies of experts to study the question of the "concentration presumption" and its reduced importance in current policy.

The agencies in some situations are attempting to strengthen their ability to challenge anticompetitive mergers in the courts, and these efforts should be applauded. For example, the FTC is challenging the consummated Evanston Northwestern Hospital merger based on post merger price increase evidence,[8] in part to overturn what the Working Group believes to be unfortunate court decisions permitting hospital mergers based on incorrect economic analyses.[9]

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[5] http://www.antitrustinstitute.org/recent2/296.cfm.

[6] See discussion in response to C.2 below.

[7] Judge Posner in Hospital Corp. of America v. FTC, 807 F.2d 1381 (7th Cir. 1986), cert. denied 481 U.S. 1038 (1987) found that market concentration may justify a presumption of injury to competition. He wrote that Section 7 does not require proof that the merger had raised prices. All that is required is that the merger "create[s] an appreciable danger of such consequences in the future…", which appears to support an incipiency standard. However, in recent years the concept of incipiency appears to have been deemphasized by the enforcers -- and even more so by certain judges (such as the *Arch Coal* decision). The current standard in many ways seems to require the plaintiff convincingly prove the merger will cause anticompetitive effects, but scholars have argued that this is not the standard that Congress intended when it passed the Clayton Act. See Robert H. Lande, *Resurrecting Incipiency: From Von's Grocery to Consumer Choice*, 68 ANTITRUST L.J. 875 (2001).

[8] In the Matter of Evanston Northwestern Healthcare Corporation and ENH Medical Group, Inc., File No. 0011 0234, Docket No. 9315. Neither the AAI nor the Working Group are involved in this specific matter, and are offering no opinion on the merits of this specific case.

[9] See, for example, H.E. Frech III, James Langenfeld, and R. Forrest McCluer, *Elzinga-Hogarty Tests and Alternative Approaches for Market Share Calculations in Hospital Markets*, 71 (3) ANTITRUST LAW JOURNAL 921-947 (2004); James Langenfeld and Wenqing Li, *Critical Loss Analysis in Evaluating Mergers*, 46 (2) ANTITRUST BULLETIN 299-337, (Summer 2001)**;** Gregory J. Werden, *The Limited*

B. *Transparency in Federal Agency Merger Review*

1. Several commenters in the first phase of the Commission's work advised that the Commission should address whether there is sufficient transparency in federal enforcement policy. Do the *Horizontal Merger Guidelines* provide informative guidance to merging parties regarding the likely antitrust treatment of their transactions, and do they appear accurately to reflect actual current FTC and DOJ enforcement practices (for example, with respect to market definition and concentration threshold presumptions of antitrust concern)? Please support your response with specific examples.

The agencies have in recent years made progress in increasing transparency through their issuance of statements explaining not only when they decide to challenge mergers, but also when they do not.[10]

The FTC and DOJ have also greatly improved transparency through issuance of a report tracking various aspects of the mergers they have challenged, as discussed above.[11] However, that very report indicates that the current concentration levels embodied in the *Horizontal Merger Guidelines* do not provide an accurate picture of the levels of concentration that would predict agency responses, as can be seen in our comments on A.1.[12] Moreover, as also discussed in the response to A.1, the agencies' public statements on mergers have frequently focused on the number of competitors, rather than HHIs, as a key part of their analysis. Clearly, the *Guidelines* do not appear to reflect current enforcement policy, which gives much more weight to competitive effects analyses than market structure. Accordingly, formal clarification of the *Guidelines* on at least these points would be useful.

Importantly, there is also the question about whether to modify the *Merger Guidelines* to reflect actual practice, or to modify practice to reflect the *Merger Guidelines*. Although not reflecting the views of everyone on the Working Group, the AAI policy paper discussed in the response to A.1 sees no evidence supporting a

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Relevance of Patient Migration Data in Market Delineation for Hospital Merger Cases, 8 (4) JOURNAL OF HEALTH ECONOMICS 363-376 (Feb. 1990); and Kenneth L. Danger and H.E. Frech III, *Critical Thinking about 'Critical Loss'*. 46 (2) ANTITRUST BULLETIN 339-355 (Summer 2001).

[10] On the topic of transparency, which was the subject of an AAI conference, see Warren Grimes, *Transparency in Federal Antitrust Enforcement*, and responsive articles in 51 BUFFALO L REV (2003). Also see http://www.antitrustinstitute.org/recent2/217.cfm.

[11] Federal Trade Commission and U.S. Department of Justice, *Merger Challenges Data, Fiscal Years 1999-2003,* December 18, 2003. Available at www.ftc.gov./os/2003/12/mdp.pdf.

[12] See also John Kwoka, *Some Thoughts on Concentration, Market Shares, and Merger Enforcement,* Presented at the FTC/DOJ Workshop on Merger Enforcement, Washington, DC, February 17, 2004.

relaxation of standards from those promulgated in the *Merger Guidelines*. Therefore, although this difference is clearly a matter of consistency and transparency, it is also a matter of policy.

Additionally, the agencies have occasionally challenged vertical aspects of mergers.[13] To our knowledge, the agencies' formal policy on vertical mergers is only reflected in the *1984 Merger Guidelines*, and it is far from clear that these statements reflect current vertical merger policy. Formally updating the agencies' policy on vertical mergers would provide much needed guidance. Any consideration of a vertical mergers policy should take into account the recent articles on combining horizontal and vertical analysis in antitrust in the Winter, 2004, issue of *The Antitrust Bulletin*.[14]

2. Should the federal antitrust agencies provide more guidance regarding when their enforcement policies, including, for example, when they decide not to challenge a transaction?

See response to B.1 above. The agencies have made noticeable progress here, but more could be done.[15] For example, we applaud the agencies' occasional statements on mergers they do not challenge, the publication of *Merger Challenges Data*, and an expanded effort of the agencies in recent years to explain their decisions through speeches, articles, and presentations at "brown bag" lunches and teleconferences (often sponsored by the ABA Antitrust Section). On the other hand, there is no requirement that the agencies explain when they do not challenge a merger, and it is not clear when the agencies will chose to disclose information on why they do not challenge a merger.

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[13] See, for example, FTC Press Release, *Federal Trade Commission Seeks to Block Cytyc' Corporation's acquisition of Digene Corporation*, File No. 021-0098 (June 24, 2002), available at http://www.ftc.gov/opa/2002/06/cytyc_digene.htm.. See also United States v. Northrop Grumman Corp. and TRW Inc., No. 1:02CV02432 (D.D.C. filed Dec. 11, 2002). For a general discussion of policy, including vertical challenges, see William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377 (2003).

[14] Presents papers generated by an AAI conference on the implications of the work of Robert L. Steiner.

[15] See Warren Grimes, *Transparency in Federal Antitrust Enforcement*, 51 BUFFALO L REV (2003). Also see http://www.antitrustinstitute.org/recent2/217.cfm.

C. *Efficiencies in Merger Analysis*

1. Do the U.S. courts and federal antitrust agencies adequately consider efficiencies in merger analysis? Please identify specific examples, evidence, or analyses supporting your assessment.

No comment at this time.

2. What type of efficiencies should be recognized in antitrust merger analysis and in what circumstances should they be considered or not considered in determining the legality of a merger? How should courts and agencies evaluate claims of efficiencies? What should be the burdens of production and proof for establishing efficiencies?

Efficiencies from a merger, by their very nature, are forward looking in a Hart-Scott-Rodino pre-merger review, as are potential anticompetitive effects.[16] There is disagreement among scholars as to the efficiency consequences of consummated mergers.[17] However, most recognize that many mergers fail, either absolutely or relative to the goals set by the acquiring firm.[18] In many cases, the procedural exigencies of

[16] This is also in the nature of a statute with an 'incipiency' function based in tests of what 'may' occur in the future.

[17] In fact, some scholars have believed that it is too difficult for courts to assess the merits of efficiencies, and have opposed including them in competitive effects. See Judge Richard Posner, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE (2d. ed. 2001).

[18] See, for example, Raymond S. Hartman, *The Efficiency Effects of Electric Utility Mergers: Lessons from Statistical Cost Analysis*, 17 ENERGY L.J.401, 413-15 (1996); Richard E. Caves, *Mergers, Takeovers and Economic Efficiency* 7 INT'L J. INDUS. ORG. 151 (1989); Dennis C. Mueller, *Mergers and Market Share*, 47 REV. ECON. & STAT 259 (1985); F.M. Scherer, *Some Principles for Post-Chicago Antitrust Analysis*, 52 CASE WESTERN RES. L. REV. 5 (2001); and Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 ANTITRUST L.J. 575, 576 at note 7 (1996) (citing articles by Hartman, Ravenscraft & Scherer, Caves, and Mueller concluding that mergers were frequently unsuccessful ex post, which Hartman claims occurred 60 to 80 percent of the cases). But see Robert F. Bruner, DEALS FROM HELL: M&A LESSONS THAT RISE ABOVE THE ASHES (Wiley: 2005), at 7, 13, 341. However, there appear to be some serious problems in his survey. He accepts "event study" results uncritically; does not take into account important studies showing a decline in stock prices in the years following merger; and does not distinguish studies with effective industry, firm accounting method, and timing controls from the many lacking such controls. (See F. M. Scherer, *The Merger Puzzle*, in Wolfgang Franz et al., eds., FUSIONEN (Mohr Siebeck: 2002) at 1-22.) Among the five major surveys he cites as showing that M&A "does pay on average," two reach the opposite conclusion (those of Mueller (1979) and Richard Caves (1989)). Caves concludes at 167, for example, that "mergers not merely fail to warrant acquisition premia but actually reduce the real profitability of acquired business units...". Bruner also uses an inappropriate benchmark: new business start-ups, new product introductions, expansions to new markets, and investments in R&D and technology. M&A transactions preponderantly involve established enterprises that have proved their viability, whereas Bruner's proposed benchmarks all entail risky ventures whose market

merger-making prevent the parties from conducting a serious joint analysis of cost-saving possibilities. Given the uncertainties that pervade merger-making, it is not surprising that even the merging parties cannot predict confidently in advance whether their plans will unfold favorably.[19] Such uncertainty argues for caution is weighing efficiency claims.[20]

Moreover, there are informational asymmetries in merger efficiency defenses under Clayton Act Section 7. Much of the necessary information for determining the likelihood of efficiencies is in the merging parties' control,[21] with no penalties for puffery and speculation. Accordingly, the Working Group believe that it is reasonable for the merging parties to carry the burden of proof in showing the likelihood and magnitude of meaningful efficiencies, which should be spelled out in sufficient detail to evaluate the probability that a given efficiency will be realized within a particular frame of time.

Given the challenges of predicting the likelihood of anticipated efficiencies, the agencies should carefully consider any track record of merging parties achieving efficiencies in prior transactions as evidence of the companies' ability to deliver on their plans. The evaluation of efficiency claims should also be sought and weighed from independent observers, such as Stanford Research Institute on chemicals or Dataquest on electronics. Other third party sources to consider are securities analysts, competitors, suppliers, and customers.

Some members of the Working Group have argued that enforcement agencies should adopt and cautiously implement a two-stage, ex ante ex post, procedure in merger and joint venture cases.[22] In the first stage the agency would determine whether the transaction is likely to create efficiencies, and in the second, ex post stage the agency would examine the efficiency outcome. The procedure would be limited to cases where the agency has refused clearance because it is unconvinced by the efficiency justification,

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acceptance probes the frontiers of the unknown. (Bruner at 341.) Accordingly, one can only say with certainty that many mergers fail and others succeed, with the exact balance disputed and hence uncertain.

19 For a comparison of pre-merger predictions with actual outcomes in a merger that yielded substantial productivity gains, see F. M. Scherer, *Memorandum to Attorney General Griffin Bell on the Proposed Merger of two Steel Companies* (1978), reproduced in F. M. Scherer, COMPETITION POLICY, DOMESTIC AND INTERNATIONAL (Elgar: 2000) at 8 and 253-258; and David J. Ravenscraft and F. M. Scherer, MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY (Brookings: 1987) at 275-279.

[20] Although it is not possible to do any such evaluation with arithmetic precision, conceptually the appropriate calculation using a consumer welfare standard is estimating the expected net present value of the efficiencies passed on to consumers. (See comments on consumer welfare in C.3 below.) This approach involves estimation of the magnitude of such efficiencies multiplied by the probability of achieving them, net of any short term losses to consumers due to reduced competition until the efficiencies are achieved, appropriately discounted to their present value at the time of the merger. See, for example, Dennis Yao and Thomas Dahdouh, *Information Problems in Merger Decision Making and Their Impact on Development of and Efficiencies Defense*, 62 ANTITRUST L.J. 23 (1993).

[21] For a discussion, see Timothy Deyak and James Langenfeld, *Efficiencies in U.S. Merger Analysis*, 25 INTERNATIONAL MERGER LAW (September 1992).

22 See Joseph Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare and Technological Progress*, 62 N.Y.U. LAW REV., 1020, 1025-1032 (1987), Brodley, *Proof of Efficiencies and Joint Ventures*, 64 ANTITRUST L.J. 577-78, 585-94, 606-11 (1996), and F.M. Scherer, R&D Cooperation and Competition, Brookings Papers on Economic Activity (MICROECONOMICS) (1990).

but would be willing to clear the transaction if the parties agree that they will divest if efficiencies have not resulted in an agreed term of years. Other observers have also recommended such a procedure, including Robert Pitofsky in 1992 and 1995.[23] Such a two-stage procedure would to a large degree overcome the asymmetric information problem caused by the merging firms knowing best whether the merger will produce efficiencies, but at the same time possibly lacking motivation to be completely candid in an ex ante merger review. There are, however, disagreements among members of the Working Group as to the practicality and desirability of such an approach.[24]

The most important efficiencies in offsetting the potential anticompetitive effects from a merger are those that are likely to be passed on in part to consumers in the form of lower prices or an increase in product or service innovations.[25] These efficiencies should not be limited to short run reductions in marginal costs.[26] Since all costs vary in the long run, reductions in capital expenses or other costs fixed in the short run should also be considered,[27] just as the agencies can be rightly concerned about reduction of competition

23 Robert :Pitofsky, Proposals for Revised United States Merger Enforcement in a Global Economy, 62 N.Y.U L. Rev. 1020, 1048-53 (1992), and Pitofsky Explores Subsequent Review of as Approach to Antitrust Enforcement, 69 Antitrust & Trade Reg. Rep.(BNA) No. 1725 at 157 (Aug.10, 1995).

24 The obstacles to adopting the two-stage procedure are the difficulty of effective divestiture after "the eggs have been scrambled", the difficulty courts and agencies might have in dealing with the issue, the potential for substantial short run anticompetitive effects, and the potential for creating a new competitive dynamic in a market that could lead to reduced competition. The "scrambled eggs" issue is unlikely in a joint venture since the joint venture ordinarily remains a distinct entity and business. Moreover, this procedure would only be evoked where the merging parties had consented to it in advance, including identification of the relevant metrics and the subsequent relief if the agency found the efficiencies were unrealized. However, if a major merger is permitted because of potential efficiencies (even though the agencies are not convinced of these efficiencies) after the agencies determine the merger will have anticompetitive effects, then anticompetitive effects would be likely occur for some period of time. Moreover, many large mergers can change the strategic dynamics of an entire industry, often motivating other firms to undertake mergers or joint ventures in response. These effects will not necessarily be undone several years later if the first merger failed to produce its projected effects, and may occur even if the merging firms are completely honest in their efficiency projections.

[25] See comments on consumer welfare in C.3 below. For a discussions of how to identify what portion of efficiencies are likely to be passed through to consumers, see Gregory J. Werden, *An Economic Perspective on the Analysis of Merger Efficiencies,* ANTITRUST (Summer 1997); Werden *A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products,* 44 J. INDUS. ECON. 409 (1996); and Werden and Luke Froeb, *A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Homogenous Products,* 58 ECON. LETTERS 367 (1998). However, some have questioned the relevance of merger efficiencies being passed on to consumers. See, for example, Paul L. Yde and Michael G. Vita, *Merger Efficiencies: Reconsidering the 'Passing-on' Requirement,* 64 ANTITRUSTL.J. 735 (1996).

26 For the joining of a debate on what kinds of cost savings should be considered in what was probably the first litigated industrial merger case in which a full efficiencies defense was presented, see F. M. Scherer, *Affidavit on Efficiency Defenses in US v. Archer-Daniels-Midland Co et al.,* May 1987, reproduced in COMPETITION POLICY, DOMESTIC AND INTERNATIONAL 259-269. District Judge Vietor ruled in favor of a presentation on all aspects of efficiency, although in the end he rendered no decision on the efficiencies question. This approach contrasts with the April 8, 1997, *Horizontal Merger Guidelines,* which seem to discount efficiencies in capital investments and management.

27 As discussed in footnote 20 above, longer run efficiencies should be viewed as their discounted present value at the time of the merger. For example, if one uses a consumer welfare standard and the efficiencies are in part passed on to consumers only several years out, then any increase in consumer

in the longer run for products in development or R&D. Recognized efficiencies should include scale economies, economies of scope, and network, transactional, distribution,[28] and innovation economies -- if they can be shown. Absent a clear track record of efficiencies achieved in past mergers, the Working Group believes that management related efficiencies are likely to be difficult to document.

As appears to be the case under current policy, efficiencies that can be achieved by alternatives to merger should not be given weight,[29] unless there is a showing that these efficiencies can be realized substantially more quickly or cheaply through the merger.

3. What is the appropriate welfare standard to use in assessing efficiencies – a consumer welfare standard, a total welfare standard, or some other alternative?

Many economists see a total welfare standard as most appropriate,[30] and competition agencies in a few other countries have to some degree adopted this standard.[31] However, the *Merger Guidelines* appear to explicitly reject this standard.[32] Some scholars have argued that the basis of antitrust has been to constrain concentrations of economic power, to maintain choice,[33] to avoid transfers of wealth to firms with

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welfare would have to be discounted for both the time value of money and the uncertainty of achieving those benefits.

28 For discussion related to the impact of efficiencies that can affect suppliers as well as production of two merging firms, see Robert L Steiner, *Marketing Productivity in Consumer Goods Industries-A vertical Perspective*, 42 JOURNAL OF MARKETING 60-69 (Jan. 1978) and Robert L Steiner, *The Nature of Vertical Restraints*, 30 ANTITRUST BULLETIN 143-197 (Spring 1985).

29 See, for example, Joseph Kattan, *Efficiencies and Merger Analysis*, 62 ANTITRUST L.J. 513, 528-547 (1994).

30 See, for example, Oliver Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AMERICAN ECONOMIC REVIEW 18-36 (March 1968).

31 For a detailed discussion of efficiencies and mergers, see Irene Knable Gotts and Calvin Goldman, *The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?* Fordham Corporate Law Institute (2002), available at www.abanet.org/antitrust/pdf_docs/chapter 13.pdf. In addition, see the Canadian Merger Enforcement Guidelines (Sept. 2004), which explicitly state that efficiency gains and anticompetitive effects are to be "balanced" (Sec.8.1). These Guidelines also state that efficiency gains must be greater than the anticompetitive effects, must be appropriately discounted, and are to be balanced in accordance with unspecified weights (Sec. 8.31-8.35). See also Margaret Sanderson, *Competition Tribunal's Redetermination Decision in Superior Propane: Continued Lessons on the Value of the Total Surplus Standard,* 21:1 CANADIAN COMP. REC. 1-5. New Zealand's Guidelines state (Sec.7.4): "An efficiency gain could turn a price increase that would otherwise be regarded as lessening competition into one that is not." But: "The Commission is of the view that efficiency gains of the required magnitude and credibility will very rarely overturn a finding that competition would otherwise be substantially lessened."

32 "[T]he Agency will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies." Guidelines, Section 4.

33 See Robert H. Lande, *Consumer Choice as the Ultimate Goal of Antitrust,* 62 U. PITT. L. REV. 503 (2001).

market power,[34] or to execute a political bargain between consumers and producers.[35] Other scholars have advocated a consumer welfare standard.[36] There have also been many policy pronouncements that consumer welfare in one form or another is the appropriate standard,[37] and competition agencies in many other countries have adopted this standard.[38] Although a consensus exists today that solid economic analysis is indispensable to antitrust enforcement policy, it appears that no one standard is fully accepted within the antitrust community.[39]

The impact of these alternative standards in evaluating efficiencies can have a substantial impact on the degree of merger enforcement. A total welfare standard, depending on the evidence required, will allow more high-concentration mergers, since there can be a number of mergers resulting in increased prices to consumers that are offset by increased profits to the merged firm.[40] On the other hand, standards that maximize choice or constrain wealth transfers to producers will tend to discount wealth maximization efficiencies, and thus lead to more merger challenges. The existing consumer welfare standard places the level of enforcement between the total welfare standard and the more wealth transfer/consumer choice oriented standards, in effect resulting in a balancing of these two general approaches. Most in the Working Group believe that such a balance is appropriate and support a consumer welfare standard, although there are differences in opinions among some members of the Group.

D. *The Hart-Scott-Rodino Pre-Merger Process*

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34 See, for example R.H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS LAW JOURNAL 873 (1982), and the references it contains.

35 See Jonathan Baker, http://www.antitrustinstitute.org/recent2/382.cfm

36 See Joseph Kattan, *Efficiencies and Merger Analysis,* 62 ANTITRUST L.J. 513, 520 (1994).

37 The consumer welfare standard has been emphasized by former FTC Chairman Muris. "While there remain some differences, there is now general agreement that consumer welfare should be the touchstone of antitrust enforcement." Prepared remarks of Timothy J. Muris, "The Interface of Competition and Consumer Protection," Fordham Law Institute's Twenty-Ninth Annual Conference on International Antitrust Law and Policy, New York, NY, October 31, 2002 at 10. "As always, our [the FTC's] guiding consideration in developing policy is the impact on consumer welfare in both the short and long run." Prepared remarks of Timothy J. Muris, "Competition and Intellectual Property Policy: The Way Ahead," American Bar Association Antitrust Section Fall Forum, Washington, DC, November 15, 2001. See also Joseph J. Simons and David Scheffman, *Non-Merger Enforcement At The FTC: An Aggressive Pro-Consumer Agenda*, 49 (3) ANTITRUST BULLETIN 471-519 (Fall 2004).

38 For example, the new EU Merger Control Regulation: Section 79 states that "The relevant benchmark in assessing efficiency claims is that consumers will not be worse off as a result of the merger." The Australian Guidelines (Section 5.172) state: "If efficiencies are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition." The UK Guidelines (Section 4.31) state "efficiencies might also be taken into account where they do not avert a substantial lessening of competition, but will nonetheless be passed on after the merger in the form of customer benefits."

39 Even the terms consumer welfare and efficiency sometimes appear mixed. See William Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTIT. L. J. 377, 464 (2003).

40 See Timothy Deyak and James Langenfeld, *Efficiencies in U.S. Merger Analysis*, 25 INTERNATIONAL MERGER LAW (September 1992).

No comment at this time.

Additional Submission:

Statement of the American Antitrust Institute on Horizontal Merger Analysis and the Role of Concentration in the Merger Guidelines, http://www.antitrustinstitute.org/recent2/296.cfm

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Additional Submission

STATEMENT OF THE AMERICAN ANTITRUST INSTITUTE

ON

HORIZONTAL MERGERS

AND THE ROLE OF CONCENTRATION

IN THE MERGER GUIDELINES

February 10, 2004
Albert A. Foer, President

Introduction

Market concentration has often played a controversial role in merger law and policy. In the past, some have argued that "big is bad" and the government must use its antitrust tools to stop all trends toward concentration. On the opposite extreme, others have argued that concentration is never a problem as long as government is not creating or supporting entry barriers, because new competitors are always waiting in the wings, forcing even an apparent monopolist to behave in a competitive manner. Although debates about antitrust have moved beyond these older views, merger enforcement today has been criticized for giving concentration either too little or too much weight. A "post-Chicago" position on the proper role of seller concentration[41] and related issues in horizontal merger analysis that relies heavily on recent advances in empirical economic analysis has not yet clearly crystallized. The American Antitrust Institute[42] offers this

[41] We have not focused in this statement on concentration at the buyer level, which will be the subject of an AAI conference on June 22, 2004, exploring ways in which buyer power may differ from seller power.

[42] The AAI is an independent education, research, and advocacy organization, described on the Internet at www.antitrustinstitute.org. The drafting of this document has been a nine-month iterative process featuring very heavy input by a drafting committee of seven and repeated circulations to the full Advisory Board for comment. The author and the Board of Directors bear responsibility for the final version.

Statement, based on extensive conversations and debate within the AAI Advisory Board, as a contribution toward crystallization. While the document attempts to reflect a consensus, it cannot and should not be expected that every member of the Advisory Board necessarily agrees with every word or even with all of the general positions taken.

1. **Concerns with Mergers.**

(a.) Horizontal mergers can raise competitive concerns for a number of reasons. A merger may create opportunities and incentives for unilateral price increases, express collusion or tacit coordination and strategic behavior that artificially disadvantages rivals or suppliers. These effects may lead to higher prices, which are harmful because they transfer income away from consumers and undermine allocative efficiency. They may also lead to higher costs, including the possible creation of so-called x-inefficiency.

(b.) Mergers can also reduce competition along other dimensions, including quality, service, the development of new and better products and other areas that significantly affect consumer choice. In an industry with differentiated products, a horizontal merger may also lead to a reduction in the variety of products, which can also harm consumers.

(c.) Economic research indicates that monopoly slows the pace of innovation. Incumbents may ignore or discourage the development of new products and technologies, particularly radical innovations, and both market and technological uncertainties make it likely that innovations will be forthcoming more rapidly when there are multiple, independent sources of initiative. Enhanced opportunities for express or tacit collusion associated with higher levels of concentration can lead to a reduction in the incentives for innovation and may channel investment by fringe firms or prospective entrants away from projects that would compete against the leading firms.

2. **Concentration**.

(a.) Since the Supreme Court's decisions in cases like *Philadelphia National Bank*, the level of market concentration has played a central role in merger analysis. However, the economics literature of that era that related measures of concentration to profits has been criticized for its over-reliance on questionable measures of profits and its failure to account for factors other than anticompetitive behavior that could explain the correlation between profits and concentration across industries.

(b.) The consensus conclusion from more recent studies using more sophisticated research tools is that increased concentration, at high levels, is associated with higher prices, and is therefore a suitable proxy, at least in the first instance, for an expectation of market power. In particular, as an empirical matter, high seller concentration in a properly defined market with significant barriers to entry is associated with higher prices, all other things being equal, and increases in concentration, particularly substantial ones in markets that are already highly concentrated, may precipitate large price increases.

(c.) Even if one is not persuaded by the economic literature alone, where the literature is inconclusive (as is often the case) it is appropriate to take into account the underlying policies of the antitrust laws, as manifested in legislative history and more than a century of judicial explication, reflecting a preference for open markets and more than a handful of competitors, all other things being equal; and a trust in openness, diversity, and forces of competition.

3. **Presumptions Regarding Concentration**.

(a.) Neither economic theory nor empirical economic research supports a single "bright line" level of concentration that separates anticompetitive from benign mergers in all or even most industries. Nonetheless, empirical results are generally consistent with current merger law: namely, that in general a substantial increase in an already high level of seller concentration creates a *rebuttable* presumption that a merger transaction is likely to have anticompetitive effects. These empirical results also support the appropriateness of a flexible sliding scale approach. That is, the higher the degree of concentration and the larger the magnitude of increase in concentration, the stronger the rebuttal evidence that should be required to overcome the presumption of consumer harm.

(b.) As an empirical matter, small mergers producing a low level of concentration generally are unlikely to be associated with consumer harm. In this regard, cases like *Von's Grocery Company* obviously no longer reflect appropriate merger policy, despite the statute's incipiency mandate. Even though the Guidelines' statements that low-concentration mergers within their safe harbor are "unlikely" to have anticompetitive effects and "ordinarily" require no further analysis are correct, increased guidance could be provided by specifying those rare circumstances where a challenge might nevertheless be appropriate. These exceptions should be made explicit and transparent, and should be limited to situations involving an industry with a history of collusion, or mergers that involve the elimination of a maverick or a weakening of a maverick's behavioral incentives.

(c.) Another reason why presumptions drawn from high concentration should be rebuttable is the fact that market definition is an imperfect procedure and, as a related point, certain common market definition procedures create the potential for systematic errors in defining markets. Procedures deserving reconsideration include: the use of the prevailing price as the pricing benchmark for the *ssnip* test [“small but significant and nontransitory increase in price”] for measuring cross-elasticity of demand; the use of critical loss analysis; and the principle that the agencies will adopt the smallest market definition that satisfies the *ssnip* test. The smallest market principle should be deleted from the Guidelines entirely. The validity of the use of the prevailing price in the *ssnip* test and critical loss analysis should not be assumed, but rather should be carefully evaluated in every merger investigation.[43]

(d.) Though empirical research admittedly does not support a single “bright line” level of concentration or market share for determining when mergers are anticompetitive, the public identification of rebuttable threshold presumptions has served as a useful policy guide, channeling enforcement discretion and yielding an important degree of predictability for business planning. Recognizing that predictability is limited by the inherent vagaries of market definition and the difficulties of forecasting such factors as future market entry and competitive effects, merger analysis should be not so much a scientific endeavor as an administrable process of applying educated judgment to careful fact-finding within a commonly accepted, albeit ultimately imprecise, methodological framework.

4. **Incipiency.**

(a.) Merger enforcement, while emphasizing microeconomic analysis, must be carried out in light of the intent behind the antimerger statutes, and it is clear that Congress intended this enforcement to embody an incipiency doctrine. While the Sherman Act blocks mergers likely to lead to monopoly power or the dangerous probability of monopoly power, the Clayton Act is designed to block mergers the effect of which "may be substantially to lessen competition or to tend to create a monopoly." This means that increases in

[43] The AAI will conduct a symposium on “Combining Horizontal and Vertical Analysis in Antitrust: Implications of the Work of Robert L. Steiner” on June 21, 2004. This will explore whether the role of retailers gross margin is given adequate consideration in market definition and other merger-related issues that arise in the consumer goods sector.

concentration should be prohibited even if the anticompetitive effects might not be quite large enough or certain enough to constitute Sherman Act violations.

(b.) This statutory language and the intent behind the Clayton Act as well as Supreme Court precedent, also require a degree of careful, economically informed prediction on the part of enforcers and the courts. Under the circumstances, errors of both over-enforcement and under-enforcement are inevitable, and the underlying facts and economics will often be inconclusive. The incipiency doctrine means that in close cases decision makers should resolve doubts on the side of blocking mergers that might lead to a reasonable probability of market power.

(c.) Preserving multiple competitors is likely to be an efficient administrative rule in otherwise close cases because mergers, once consummated, are rarely undone. Enforcement policy almost never gets a chance to undo a merger that should not have taken place, but there almost surely will be future opportunities to permit consolidation in the industry in question.

(d.) In the absence of an "incipiency" policy, firms in an industry that might be contemplating consolidation may be induced into merging prematurely. When other large firms in an industry are merging, the firm that waits runs the risk of its later merger becoming the proposed merger that finally triggers agency opposition --even though in principle it is no worse or different from those mergers that preceded and thus got in under the wire. Enforcement decisions ought to take into consideration the likely strategic responses to a consummated merger by rivals and potential rivals.

5. **Coordinated Effects.**

(a.) At one time, the analysis of coordinated effects in mergers relied too heavily on the level and change in concentration. Expanding the analysis to include other factors has refined the analysis and made it more reliable. Further refinement of this analysis, including analysis of the pre- and post-merger competitive role of mavericks and other merger-induced changes in the likelihood of coordination, would improve predictions of likely merger effects.

(b.) This is not to say that coordinated effects prediction in the merger context should be identical with analysis of cartel incentives in a price-fixing context. The purpose of merger intervention is to prevent a situation that *may* be conducive to coordination from occurring in the future, not to demonstrate that coordination will inevitably occur.

(c.) With respect to potential coordinated effects, heightened concern has historically arisen around the point at which there will no longer be at least five strong competitors or when a dominant firm may enhance its price leadership role through a merger. We see no reason to revise this general benchmark at this time.

6. **Unilateral Effects.**

(a.) With respect to unilateral effects, the market shares of the merging firms can sometimes be used as a rough proxy of the closeness of substitution between the brands of the merging firms. However, market shares are at best a rough indicator of substitution and generally are inferior to careful factual and empirical analysis, including estimates of cross-elasticities.

(b.) The apparent minimization of unilateral effects analysis by the current federal enforcement agencies represents a step backwards. Unilateral effects analysis has a substantial history in industrial organization economics and represents a rigorous analytic approach. While there may be some basis for concern about over-reliance on simulation models in their current state of development, as a particular method of demonstrating the magnitude of unilateral effects, there is no good basis for

skepticism of unilateral effects analysis itself.

(c.) With respect to unilateral effects, heightened concern has historically arisen around the point at which the leading firm's market share is at least 35%. We see no reason to change this benchmark level at this time.

7. **Burden Shifting.**

(a.) When high market shares and concentration resulting from merger create a presumption of consumer harm, the burden should shift onto merger proponents to demonstrate one or more of the following factors[44]:

[44] Merger case law and the Horizontal Merger Guidelines also properly recognize a narrow failing firm defense.

(1.) Other reasons exist that demonstrate the inadequacy of measured market shares as a predictor of future competition;

(2.) Sufficient new entry or fringe expansion is likely to occur within a reasonable time to reverse or deter the probable competitive consequences of the merger;

(3.) The premerger degree of rivalry in the market is likely to be sustained or increased and the incentives of the merged firm to compete with incumbents are unlikely to be reduced;

(4.) The merger will permit cognizable efficiencies yielding potential benefits that outweigh the harms threatened by the transaction and thereby eliminate the likelihood of consumer harm.

(b.) If one or more of the above is established, the burden should shift to the government or other plaintiff to show that the merger would likely generate a net anticompetitive effect, taking into account all relevant evidence.

8. **Contestable Markets.**

There is reason to doubt the empirical significance of the strongest version of the 'contestable market' theory, which holds that potential entry can cause even a monopolist benefiting from significant economies of scale to price competitively. This theory wrongly assumes both that entry requires no significant sunk costs (i.e., the entrant's expenditures on inputs can be fully recovered if entry fails) and that the monopolist's price response to entry is delayed.

9. **Potential Entry**.

(a.) Despite the very limited applicability of the pure contestable market model to real world settings, the more general potential entry concept nonetheless is an important element in the analysis of the likely competitive effects of a merger. On the one hand, potential entrants can reduce the likelihood of anticompetitive effects from a merger, particularly where efficient small scale entry by multiple firms is possible and where entry can be secret or sponsored by large buyers. On the other hand, mergers between an incumbent and a potential entrant can cause anticompetitive harm. Accordingly, competitive concerns may arise from mergers that remove significant potential entry, both perceived and likely actual potential entrants. This is a particular concern in high technology markets, where significant competition may occur well before products are sold to consumers.

(b.) Because of the competitive importance of potential entry in many industries, merger policy should place more emphasis on preventing mergers that reduce potential competition. This is an area where the case law has moved too far in the direction of laissez-faire. Federal and state enforcement agencies should undertake greater efforts to bring appropriate enforcement actions, refine the analysis and educate the courts.

10. **Efficiency from Mergers.**

(a.) National merger policy since 1981 has rested on the assumption that most mergers generate important efficiencies and therefore significantly contribute to consumer welfare. This is reflected in the fact that, typically, only 2-3% of mergers large enough to require federal pre-notification are pursued to the second request level of investigation. Yet, respected economic research has found that many, perhaps most, mergers do not lead to significant reductions in cost, although a small proportion of horizontal mergers have led to very significant efficiencies. Many of the predicted efficiencies of mergers have failed to materialize.

(b.) The practical importance of this research is that it is time to re-examine the underlying assumption that allows such a high proportion of significant horizontal mergers to be consummated.

(c.) In the meantime, in specific investigations, claims of efficiency benefits arising from a merger should be viewed skeptically. This is particularly true of theoretical arguments for gains arising from consolidated management and marketing. Moreover, the empirical evidence supporting claims of efficiency gains should be based on the specific cost structure and technology of the firms, and should be accompanied by further evidence that demonstrates how these cost reductions will benefit consumers.

(d.) To be cognizable, efficiencies must be non-speculative, merger-specific, and provide substantial direct benefit to customers. Only efficiencies net of any higher costs caused by the merger represent potential consumer benefits. Claimed benefits that will only arise in the long run are often more uncertain and for that reason should be given less weight.

(e.) Because a high proportion of mergers fail to provide the benefits that were predicted by their proponents and because there are large costs for society when anticompetitive mergers occur, Congress should provide federal antitrust enforcers additional resources to permit more detailed scrutiny of more proposed mergers than is possible today. Enforcers should be encouraged to scrutinize more mergers that might currently be deemed marginal.

11. Research Topics.

Recognition of the failure of so many mergers to produce their predicted benefits suggests that more research be devoted to examination of:

(a.) consummated mergers to evaluate whether or not they led to significant savings and/or price increases;

(b.) proposed mergers that were stopped or restructured as a result of antitrust intervention in order to evaluate the effectiveness of the government's intervention, including the sufficiency of remedies utilized;

(c.) the effects of merger enforcement on innovation, including both the extent to which innovation concerns played a role in past enforcement decisions, and the extent to which merger enforcement and non-enforcement has affected various types of innovation; and

(d.) merger dynamics in network industries, where predictions of merger-enhanced tipping effects may deter entry by potential competitors.

12. Transparency and Evolution.

Greater transparency on the part of the government is a necessary foundation for the beneficial evolution of antitrust policy. Although the government has recently made positive strides toward increased transparency, there remains a need for more detailed explanations of the agencies' reasoning with respect to actions taken (and, in certain instances, not taken); for projects like the joint FTC/DOJ compilation of data on completed investigations; and for other initiatives that will facilitate research by the government and by academics. The history of antitrust should not be characterized as pendulum-like, but rather as an on-going dialogue, continually evolving toward a better understanding of markets and competition within the context of a politically-determined legal framework.