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November 10, 2005

Via Express Mail and E-mail

Antitrust Modernization Commission
Attention: Public Comments
1120 G Street, N.W.
Suite 810
Washington, DC 20005

Re: Comments Regarding U.S. Merger Enforcement Policy and the *Horizontal Merger Guidelines*

Ladies and Gentlemen:

On behalf of the Section of Antitrust Law of the American Bar Association, I am pleased to submit the enclosed comments to the Antitrust Modernization Commission in response its request for comments regarding U.S. Merger Enforcement Policy and the *Horizontal Merger Guidelines.*

Please note that these views are being presented only on behalf of the Section of Antitrust Law and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

If you have any questions after reviewing this report, we would be happy to provide further comments.

Sincerely,

Donald C. Klawiter

Donald C. Klawiter
Chair, Section of Antitrust Law

Comments of the Section of Antitrust Law
of the American Bar Association
in Response to the
Antitrust Modernization Commission's
Request for Public Comment
Regarding U.S. Merger Enforcement Policy
and the *Horizontal Merger Guidelines*

The Section of Antitrust Law ("Antitrust Section") of the American Bar Association ("ABA") is pleased to submit these comments to the Antitrust Modernization Commission (the "Commission") in response to its request for public comment dated May 19, 2005 regarding specific questions relating to U.S. Merger Enforcement Policy selected for study by the Commission. The views expressed herein are being presented on behalf of the Antitrust Section. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

Summary of Contents

These comments address two questions posed by the Commission: First, has current U.S. merger enforcement policy been effective in ensuring competitive markets without unduly hampering the ability of firms to operate efficiently and compete in global markets? Second, do the *Horizontal Merger Guidelines* accurately reflect how the federal agencies analyze mergers?

As to the first question, the Antitrust Section believes that, generally speaking, federal merger policy has been effective without unduly limiting the ability of firms to achieve efficiencies and expand internationally. Still, there is room for improvement. The agencies too often focus on a static view of the marketplace that overemphasizes near-term price concerns as opposed to a longer view that considers innovation competition and efficiencies. In some cases, consumers may be better off in the long run even where there is some risk of a short term price increase -- the agencies should have the flexibility to clear such mergers, particularly as the world becomes more global and consumers increasingly benefit from the march of technology. Having said that, the Section acknowledges that the effectiveness of current U.S. merger policy is difficult to gauge. Because U.S. merger enforcement policy has not fundamentally changed in the last few decades, it is difficult to compare differing enforcement regimes to measure their effectiveness. Instead, these comments recommend a "case study" approach that would allow for retrospective assessments of the competitive effects of past merger enforcement.

In response to the second question -- whether the *Horizontal Merger Guidelines* accurately reflect agency enforcement policy -- the Section believes the *Guidelines* do indeed accurately reflect agency policy. In fact, they have stood the test of time and provide valuable guidance to the bar and business community. The one glaring exception, however, is the agencies' notable movement away from reliance on the Herfindahl-Hirschman Index as a central

tool in making a determination on mergers. The index levels in the *Guidelines*, as data released by the agencies clearly show, bear little relationship to actual enforcement decisions. The agencies should consider revisions to the *Guidelines'* HHI provisions to reflect reality, or some policy statement to clarify the role HHIs actually have in their thinking. In addition, a more detailed description of the competitive effects analysis would be welcomed.

I. THE EFFECTIVENESS OF HORIZONTAL MERGER GUIDELINES IN ENSURING COMPETITIVE MARKETS

The Antitrust Modernization Commission ("AMC") has asked whether current U.S. merger enforcement policy -- including as those policies is expressed in the *Horizontal Merger Guidelines* -- has been effective in ensuring competitively operating markets without unduly hampering the ability of companies to operate efficiently and compete in global markets. The question goes to the core of what the policy considerations behind merger enforcement are today or should be in the future.[1] Generally, we believe the agencies "get it right" most of the time but in practice may end up limiting some firms' ability to compete more effectively because of a static view of the marketplace and an overemphasis on price, combined with a lack of attention to the ability of the merged firm to produce better products and to innovate. In addition, there is a need for more empirical research to better measure the effectiveness of merger policies.

Most antitrust merger enforcement is based upon application of a structural paradigm that assumes a direct correlation between industry concentration and competitiveness (i.e., price). While most economists accept that some such relationship exists, there has been insufficient empirical research to create confidence that particular merger enforcement decisions (and the *Merger Guidelines*) are based upon accurate assumptions about the relationship between concentration and performance of the market.

A. A Dynamic View of the Market Place

Optimal merger enforcement policy should take a dynamic viewpoint in order to minimize the sum of the costs that can arise in three circumstances in particular. First, there are costs associated with merger enforcement that inappropriately blocks and deters efficiency-enhancing mergers (so-called Type-I errors). These are costs that would be attributable to a merger policy that is "too strict" and would result in the prevention of combinations that actually would have fostered efficiency, reduced costs, improved rate of innovation, or resulted in overall productivity gains. While these costs reside in the future, and their magnitude is inherently speculative, it would only take a small cost reduction or innovation improvement, conferring benefits for an extended period of time to a potentially large number of consumers, to

[1] It is worth noting at the outset, however, that traditionally, the focus of antitrust enforcement has been on "consumer welfare." For that reason, we submit that allowing U.S. firms to compete more effectively in non-U.S. markets, or against non-U.S. firms, should <u>not</u> take precedence over the preservation of U.S. competition which speaks most directly to U.S. consumer welfare. Nevertheless, we believe that the suggested policy goal is appropriate -- notwithstanding the fact that some say the agencies have not adequately articulated an underlying policy. Perhaps a stronger articulation of policy by the enforcement agencies, consistent with the question posed by the Commission, is warranted.

overwhelm the short run exercise of market power associated with a particular transaction.[2] The cost of deterring efficient transactions implies that discussions regarding optimal merger policy must incorporate analyses of efficiencies and the interface between antitrust and intellectual property issues.

Second, there are costs associated with inappropriately permitting transactions that reduce competition, either currently or in the future (so-called Type II errors). These would be costs associated from a merger enforcement policy that is "too lenient," resulting in the creation of firms with market power and higher prices and other anticompetitive outcomes, such as foreclosure or inefficient reduction in the pace of innovation. We believe that costs associated with overly lenient policies, however, could be short-lived if entry and innovation by others can restore competition.

And finally, there are costs associated with administering and complying with the institutional structure that reviews and regulates mergers.[3] Both the International Bar Association and the Antitrust Section of the ABA commissioned PricewaterhouseCoopers LLP in June 2003 to study and survey precisely these types of costs.[4]

B. Non-Price Factors Should Be Considered

In keeping with our belief that optimal merger enforcement has to be dynamic in order to minimize the costs of misapplication of policy, we believe that merger policy must consider whether current merger enforcement can be applied effectively to innovation markets. More generally, an effective merger enforcement policy should address the concerns of non-price factors that often motivate competition in these markets.

For instance, with respect to innovation versus non-innovation markets, an effective merger enforcement policy should address the concerns of both types of markets. It is not clear that the harms the *Merger Guidelines* presumptions are designed to prevent (for example, higher prices) are still valid concerns in innovation markets where competitive characteristics unique to these markets often exist (e.g., "race to market" incentives that have an impact on innovation markets but not on non-innovation markets).[5] As such, we believe clarification in this area is

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[2] One example of the simple mathematics underlying this proposition can be found in Joseph Simons, "Unified Merger Analysis: Integrating Anticompetitive Effects and Efficiencies, and Emphasizing First Principles," submission to FTC/DOJ Joint Workshop on Merger Enforcement, February 19, 2004, available at http://www.ftc.gov/bc/mergerenforce/presentations

[3] Paul L. Joskow, "Transaction Cost Economics, Antitrust Rules, and Remedies," The Journal of Law, Economics, & Organization, Volume 18, Number 1 (April 2002), at pp. 99-100 ("… the test of a good legal rule is not primarily whether it leads to the correct decision in a particular case, but rather whether it does a good job deterring anticompetitive behavior throughout the economy given all of the relevant costs, benefits, and uncertainties associated with diagnosis and remedies."); *see also* Frank H. Easterbrook, "Ignorance and Antitrust," in Antitrust, Innovation, and Competitiveness, Thomas M. Jorde & David J. Teece, eds. (1992).

[4] PricewaterhouseCoopers LLP, "A Tax on mergers: Surveying the time and costs to business of multi-jurisdictional merger reviews," submission to IBA/ABA Antitrust Section, June 2003, available at http://www.pwcglobal.com/uk/eng/about/svcs/vs/pwc_mergers.pdf.

[5] Chairman Timothy J. Muris addressed some of these concerns in the *Genzyme/Novazyme* case. Statement of Chairman Timothy J. Muris in the Matter of Genzyme/Novazyme Pharmaceuticals, Inc. ("[N]either economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation ... based simply on

warranted, notwithstanding the fact that the *Guidelines* do address non-price benefits by accounting for the fact that "price" under the *Merger Guidelines* is understood to be a "quality adjusted" price that includes the entire bundle of goods and services being bought.

Another important consideration for the AMC is that the costs of short-term anticompetitive pricing can quickly be overwhelmed by the benefits provided by even small efficiencies, as these benefits can be expected to be long-lived and potentially widely distributed. Thus, the agencies should continue to be attentive to merger-specific efficiencies and be willing to look out longer than two years, as this often is when the benefits from these efficiencies are realized.

With regard to the efficiencies that deserve to be "counted" in merger analysis, there is a preference for those that reduce marginal costs rather than fixed costs, because the former have a direct link in economics to consumer prices and consumer welfare. But, given the importance of innovation to the economy's overall productivity, the ability of firms to compete globally, and the fact that merger-related R&D savings tend to fall into the fixed cost category rather than the marginal cost category, there might well be benefit in expanding the efficiencies that are recognized to include those that allow the combined firm to conduct R&D more efficiently, even when the savings involved fall into fixed cost categories that historically have been given less credence.

The overall effect of the merger on consumers also should be considered. As generally articulated and enforced now, potential mergers are challenged if competitive problems are detected in any one of many potential markets that a company competes in. The agencies should consider the overall net effect of the merger on consumers. For instance, while there may be competitive concerns in one area, there might be enhanced competition in other areas. If divestiture is not adequate to solve these issues (if, say, the goods are jointly produced), then the agencies should consider the net effect of the merger on consumers. Simply put, under current enforcement policies, a merger normally will be challenged if it is likely to be anticompetitive in any relevant market, regardless of the size of that market (recognizing, of course, that the *Guidelines* do note that the agencies may, in their prosecutorial discretion, choose not to challenge a merger that may have an anticompetitive effect in a small market where large and inextricably linked efficiencies will be generated in another market).

Some believe that a total welfare standard can be justified. Without disputing the fact that this standard is justifiable, others believe that the actual implementation of a total welfare standard might be impractical. This long-standing debate between the total welfare standard versus consumer welfare standard should be addressed.

C. Measuring Effectiveness

With respect to how the AMC could measure the effectiveness of current policies, as we stated in the introduction, whether current merger enforcement is "too lenient" or "too strict" or

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observing how the merger changed the number of independent R&D programs. Rather, one must examine whether the merged firm was likely to have a reduced incentive to invest in R&D, and also whether it was likely to have the ability to conduct R&D more successfully…. The adoption of presumptions without economic foundation would constitute a major step backward in antitrust law."), *available at* http://www.ftc.gov/os/murisgenzymestmt.pdf.

"just about right" is extremely difficult to determine because alternative enforcement regimes and their effects on competitive outcomes cannot be observed. Traditional economic analysis of regulatory efficiency does not lend itself easily to assessing U.S. merger regulation. Economists typically seek to measure the effectiveness of a regulatory regime either by comparing different regimes in different jurisdictions (e.g., studies have identified the effects from state-level regulations on long distance telephone rates, trucking rates, and retail gasoline prices) or by assessing how competition changes when a particular jurisdiction changes its regulatory regime (e.g., changes in ocean shipping rates before and after the implementation of the 1984 Shipping Act). These traditional economic approaches, however, do not work for our purposes because alternative enforcement regimes are not readily available for assessment of U.S. merger regulation which, as Commissioner Leary pointed out, has not changed dramatically over at least the past twenty years or so.[6]

For example, Crandall & Winston developed an econometric model that attempted to assess the empirical relationship between the intensity of antitrust regulation and industry profits. Robert W. Crandall and Clifford Winston, "Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence," Journal of Economic Perspectives, Volume 17, Number 4 (Fall 2003). The authors hypothesized that if antitrust regulation is working properly, one should observe lower price-cost margins in industries with more antitrust regulatory activity. While an interesting empirical effort, the Crandall & Winston model attracted significant criticism on both the underlying conceptual model and the statistical implementation of the model.[7] The shortcomings of the Crandall & Winston approach are significant not the least of which is their claim that 2-digit SIC code industries provide a workable proxy for antitrust markets. This assumption is particularly suspect and effectively strips the model and its results of any practical significance.

Perhaps a more practical alternative would be the case study approach. This approach would involve the examination of the market effects from particular mergers that were cleared by the antitrust agencies to see if they led to neutral or procompetitive outcomes in the relevant industries (suggesting a sound enforcement decision), or to higher prices/less innovation/etc. (suggesting a poor enforcement decision). While it is true that such "case studies" do not provide evidence on the important deterrent effects from merger enforcement, an accumulation of case studies across various industries would nevertheless provide some indication of whether enforcement is "too strict," "too lenient," or "just about right."[8] To date, empirical review of

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[6] Thomas B. Leary, "The Essential Stability of Merger Policy in the United States," 70 Antitrust Law Journal 105 (2002).

[7] *See* , *e.g.*, Jonathan B. Baker, "The Case for Antitrust Enforcement," Journal of Economic Perspectives, Volume 17, Number 4 (Fall 2003); John E. Kwoka, "The Attack on Antitrust Policy and Consumer Welfare: A Response to Crandall and Winston," mimeo (March 2003), and Gregory J. Werden, "The Effect of Antitrust Policy on Consumer Welfare: What Crandall and Winston Overlook," DOJ Antitrust Division Economic Analysis Group Discussion Paper (January 2003).

[8] Calls for additional empirical work on the effects of consummated mergers are sounded regularly. See, for instance, Timothy J. Muris, Chairman, Federal Trade Commission, Improving the Economic Foundations of Competition Policy, Remarks at the George Mason University Law Review's Winter Antitrust Symposium (Jan. 15, 2003). ("The most important area for further research is empirical study to improve our understanding of the nature of competition and of how and why horizontal mergers affect competition."); and David Scheffman, "Efficiencies/Dynamic Analysis/Integrated Analysis," submission to FTC/DOJ Joint Workshop on Merger Enforcement, February 19, 2004, available at http://www.ftc.gov/bc/mergerenforce/presentations

mergers has tended to focus primarily around industries where data are available to researchers --—such as airlines[9], hospitals,[10] banking,[11] beverages (beer, soft drinks),[12] and petroleum products.[13]

D. Conclusion

Overall, we believe that these analyses suggest that sometimes the government reaches incorrect enforcement decisions (the bulk of the evidence suggests that the Northwest/Republic and TWA/Ozark mergers resulted in higher fares, the Santa Cruz hospital merger in 1990 led to higher prices), while in other occasions the correct outcome was to take no action (e.g., the evidence suggests that the Marathon-Ashland joint venture did not raise retail gasoline prices). It is difficult to reach firm conclusions from the existing set of case studies regarding the "appropriateness" of the agencies' merger enforcement regime due to the limited number of careful empirical studies, and due to the importance of the regime's deterrence effect, which by its very nature cannot be observed.

Whether or not firm conclusions can be reached based on specific studies, though, we believe the agencies should consider articulating what is their core goal in merger enforcement. If part of it, at least, is to ensure the ability of firms to compete globally — which we support — then the agencies should consider making it clearer that innovation and efficiencies are important factors in the analysis and that effect on price need not always be the sole focus. At the same time, the agencies should work with the private antitrust community to develop better ways to measure the effectiveness of merger policy.

If merger policy is changed in substantial ways to affect the global competitiveness of companies, the effects of these changes may be dampened for mergers between companies with a global presence, as they must seek approval in multiple jurisdictions of which the U.S. is just one. The agencies should continue their cooperation with other antitrust enforcement agencies and seek to promote a similar approach in merger evaluations.

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[9] *See, e.g.*, for instance, Werden, Joskow, and Johnson (1991), Borenstein (1990), and Kim and Singal (1993) for studies showing a positive price effect from the mergers of Northwest/Republic and TWA/Ozark. Morrison (1996) reached the opposite conclusion, i.e., he found that the mergers led to lower airfares.

[10] See Pautler (2003) for a collection of papers that reviewed the aftermath of hospital mergers. Most of these studies examined their effect on costs as opposed to prices. Vita and Sacher (2001) conducted a case study of the 1990 merger of two of the three hospitals in Santa Cruz, CA.

[11] *See* Pautler (2003) for a collection of papers examining the aftermath of banking mergers. As with the reviews of hospital mergers, most of these studies focused on costs not prices so they were not designed to examine the competitive effects of the mergers.

[12] *See* Saltzman, Levy and Hilke (1999) for an examination of the FTC's antitrust activities in the carbonated soft drink industry from 1980 to 1999, and Tremblay & Tremblay (1988) for a study of horizontal mergers in the brewing industry.

[13] The FTC and the GAO reached very different conclusions regarding the price effects from the FTC's merger enforcement decisions in the petroleum industry in the 1990s. The back and forth became quite heated. See, for instance, Statement of Federal Trade Commission Chairman Timothy J. Muris on the GAO Study on 1990s Oil Mergers and Concentration Released Today (May 27, 2004). Two economists at the FTC performed a case study of the Marathon-Ashland joint venture that was not blocked by the agency. *See* Taylor and Hosken, "The Economic Effects of the Marathon-Ashland Joint Venture: The Importance of Industry Supply Shocks and Vertical Market Structure," FTC Bureau of Economics Working Paper #270 (March 17, 2004).

II. THE *HORIZONTAL MERGER GUIDELINES*—DO THEY ACCURATELY REFLECT HOW THE FEDERAL AGENCIES ANALYZED MERGERS?

The *Horizontal Merger Guidelines* provide a useful template that identifies the key issues in horizontal mergers. As a result, communication with the agency is improved, parties know the sorts of issues and analyses that the agencies will need to consider, etc. The *Merger Guidelines* are key to minimizing overdeterrence and therefore, reducing Type I error. The *Guidelines* must handle a trade-off between certainty and flexibility. Increased certainty is beneficial for companies evaluating their options and flexibility is beneficial to consumers once a merger is filed.

A short answer to the question is that the *Merger Guidelines* generally do reflect how the agencies analyze mergers, with the notable exception of the role of the HHIs. As Chairman Muris said in discussing the agencies' release of merger data statistics in December 2003, "I hope the data we released and the breadth of the analysis we will hear [at the follow up hearings] will finally put to rest the notion that HHI levels have any specific significance, except at very high levels."[14]

For instance, the *Merger Guidelines* states generally that horizontal mergers that result in a Post-Merger HHI above 1,800 are considered highly concentrated and that mergers producing an increase in the HHI of more than fifty in these markets raise significant competitive concerns.[15] In actuality, however, the FTC is unlikely to take an enforcement action unless the post-merger HHI exceeds 2400 and the change exceeds 500.[16] Since 1996, 87% of the FTC's merger enforcement actions came only when the post-merger HHI reached 2400 or more, and when there were deltas of over 500.[17]

Also, between 1996 to 2003, the FTC rarely investigated mergers unless the market in which the merger took place was highly concentrated. Out of the 573 relevant market analyses that were done in 151 investigations, 451 (or 79%) of them were conducted in markets that were highly concentrated (where the number of significant competitors went from 4 to 3, from 3 to 2, or from 2 to 1). Further, out of the 441 enforcement actions taken as a result of those analyses, 386 (or 88%) were in highly concentrated markets.[18] During this same period, the Commission brought investigations in 108 markets where the Commission staff failed to find any "hot documents" (party documents clearly predicting merger-related anticompetitive effects). 84 of these 108 were in highly concentrated markets.[19]

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[14] Chairman Timothy J. Muris, Prepared Remarks at the Workshop on Horizontal Merger Guidelines (Feb. 17, 2004), available at http://www.ftc.gov/speeches/muris/040217hmgwksp.htm.
[15] Federal Trade Commission, *1992 Horizontal Merger Guidelines*, 1.51, (with Apr. 8, 1997 revisions), available at http://www/ftc.gov/bc/docs/horizmer.htm.
[16] Malcolm B. Coate & A.E. Rodriguez, *Pitfalls in Merger Analysis: The Dirty Dozen*, 30 N.M. L. Rev. 227, 228-29 (Spring 2000) (citing Malcolm B. Coate, *Merger Enforcement in the Reagan/Bush FTC*, *in* The Economics of the Antitrust Process, at 135-51 (1996)).
[17] Federal Trade Commission, *Horizontal Merger Investigation Data*, Fiscal Years 1996-2003, Table 3.1 (Feb. 2, 2004) (revised Aug. 31, 2004), available at http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf.
[18] *Id.*
[19] *Id.* at Table 6.2.

Economists have not been overly concerned about the practice of not following the concentration thresholds in the *Merger Guidelines* because (1) the empirical link between concentration and prices (the evidence is somewhat mixed but leans toward the conclusion that a link does exist) typically kicks in at concentration levels higher than those in the *Merger Guidelines*[20] and (2) the economic analysis in merger reviews properly moves beyond HHI calculations very quickly, has become increasingly sophisticated over time, and shows that assessing whether a particular merger might lead to higher prices depends crucially on the details of the industry (buyer power, contracting practices, entry conditions, importance of R&D and innovation, efficiencies, imports) not captured by simple concentration statistics.[21]

Nevertheless, there remains a significant gap between the current *Merger Guidelines* and actual agency enforcement which leads us to believe that the Guidelines should be updated to reflect the actual practices of the agencies.

Finally, it is clear that modern merger analysis focuses increasingly on explaining and articulating the competitive effects of the transaction in question. In this regard, while the *Guidelines* explain in broad terms the concepts of unilateral and coordinated effects, we believe it would be of significant benefit if the agencies were to articulate in significantly greater detail how they approach the issue of competitive effects and, based on their significant experience in applying the *Guidelines*, what are the most significant factors that bear on this analysis.

[20] For a relatively recent review of this literature, *see* Jonathan B. Baker and Steven C. Salop, "Should Concentration be Dropped from the Merger Guidelines?" UWLA Law Review 33 (2001). For a distinctly contrary assessment of the literature that examines the empirical relationship between concentration and prices, *see* Craig M. Newmark, "Price-Concentration Studies: There You Go Again," Prepared for the DOJ/FTC Merger Workshop, Concentration and Market Shares panel (February 14, 2004).

[21] For a relatively recent statement that the agencies need not be concerned in many circumstances about mergers in concentrated industries *see* William Kolasky, Prepared Remarks to the FTC/DOJ Merger Workshop (February 19, 2004), available at http://www.ftc.gov/bc/mergerenforce/presentations (making the point that high margins may be needed to fund important R&D efforts).