MEMORANDUM

From: AMC Staff[†]

To: Commissioners

Date: June 14, 2006

Re: Mergers—Substantive Issues Discussion Memorandum

The Commission adopted for study the following questions.

- Has current U.S. merger enforcement policy—including as expressed in the Horizontal Merger Guidelines—been effective in ensuring competitively operating markets without unduly hampering the ability of companies to operate efficiently and compete in global markets?

- Do the Horizontal Merger Guidelines accurately reflect how the federal agencies analyze mergers?

- Are the federal enforcement agencies and courts appropriately considering efficiencies expected to be realized from transactions?

These issues were recommended for study by, among others, the American Antitrust Institute, the U.S. Chamber of Commerce, and former Assistant Attorney General for Antitrust R. Hewitt Pate.[1]

The Commission sought comment on the following specific questions.

[†] This memorandum is a brief summary prepared by staff of the comments and testimony received by the AMC to assist Commissioners in preparing for deliberations. All Commissioners have been provided with copies of comments and hearing transcripts, which provide the full and complete positions and statements of witnesses and commenters.

[1] Chamber of Commerce of the United States of America, Re: Suggestions from the U.S. Chamber of Commerce Regarding Antitrust Issues that Are Appropriate for Commission Study, at 2 (Sept. 30, 2004); Comments of the American Antitrust Institution on the Issues to be

corrected: June 16, 2006

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.

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 antitrust 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.

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

C. *Efficiencies in Merger Analysis*

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

2. What types 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?

3. What is the appropriate welfare standard to use in assessing efficiencies—a consumer welfare standard, a total welfare standard, or some alternative standard?[2]

In addition, the Commission sought comment on several issues relating to antitrust in the "new economy." In particular, the Commission sought comment on the following questions that are relevant to merger (as well as non-merger) analysis:

Included on the Commission's Agenda, at 4 (Sept. 30, 2004); R. Hewitt Pate, Suggested Topics for Antitrust Modernization Commission Study, at 1 (Jan. 5, 2005).

[2] 70 Fed. Reg. 28,902, 28,906 (May 19, 2005).

A. *Antitrust analysis of industries in which innovation, intellectual property, and technological change are central features*

1. Does antitrust doctrine focus on static analysis, and does this affect its application to dynamic industries?

2. What features, if any, of dynamic, innovation-driven industries pose distinctive problems for antitrust analysis, and what impact, if any, should those features have on the application of antitrust analysis to these industries?

3. Are different standards or benchmarks for market definition or market power appropriate when addressing dynamic, innovation-driven industries, for example, to reflect the fact that firms in such industries may depend on the opportunity to set prices above marginal costs to earn returns? Or, are existing antitrust principles sufficiently flexible to accommodate the facts relevant to dynamic industries?

B. *Specific issues at the interface of intellectual property, innovation, and antitrust*

1. In what circumstances, if any, should the two-year time horizon used in the *Horizontal Merger Guidelines* to assess the timeliness of entry be adjusted? For example, should the time period be lengthened to include newly developed products when the introduction of those products is likely to erode market power? Should it matter if the newly developed products will not erode market power within two years? Is there a length of time for which the possession of market power should not be viewed as raising antitrust concerns?

2. Should antitrust law be concerned with "innovation markets"? If so, how should antitrust enforcers analyze innovation markets? How often are "innovation markets" analyzed in antitrust enforcement?[3]

The Commission held several hearings on these topics.

First, it held a hearing on merger enforcement on November 17, 2005, consisting of two panels. (A third panel that day addressed reform of the Hart-Scott-Rodino Merger Review process.) The topic for the first panel was "Assessment of U.S. Merger Enforcement Policy." The panelists were William J. Baer, partner, Arnold & Porter LLP (formerly Director, Federal Trade Commission Bureau of Competition, 1995-99, and Assistant General Counsel and other positions at the FTC, 1975-80); James F. Rill, partner at Howrey LLP (formerly Assistant Attorney General in charge of U.S. Department of Justice Antitrust Division, 1989-92, and Co-

---

[3] *Id.*

Chair of U.S. Department of Justice International Competition Policy Advisory Committee); David T. Scheffman, Director of LECG, and Adjunct Professor of Business Strategy and Marketing at the Owen Graduate School of Management, Vanderbilt University (formerly Director of Federal Trade Commission Bureau of Economics, 1985-88 and 2001-03); Robert D. Willig, Professor of Economics and Public Affairs at the Woodrow Wilson School, Princeton University, and Director of Competition Policy Associates, Inc. (formerly Deputy Assistant Attorney General for Economics in U.S. Department of Justice Antitrust Division, 1989-91).

The second panel addressed the "Treatment of Efficiencies in Merger Enforcement." The panelists were Jonathan B. Baker, Professor of Law at the Washington College of Law, American University (formerly director of Federal Trade Commission Bureau of Economics, 1995-98); George S. Cary, partner at Cleary Gottlieb Steen & Hamilton LLP (formerly Deputy Director, Federal Trade Commission Bureau of Competition, 1995-98); Kenneth Heyer, Acting Deputy Assistant Attorney General for Economics, U.S. Department of Justice Antitrust Division (Economics Director since 2001); Charles F. (Rick) Rule, partner, Fried, Frank, Harris, Shriver & Jacobson (former Assistant Attorney General in charge of U.S. Department of Justice Antitrust Division, 1986-89, Deputy Assistant Attorney General, Antitrust Division, 1983-86, and Special Assistant to Assistant Attorney General William Baxter, 1981-83); and Michael Salinger, Director, Federal Trade Commission Bureau of Economics.

Second, the Commission held an Economists' Roundtable, on January 19, 2006, to address the economic evidence supporting current merger policy. The panelists were Prof. Timothy F. Bresnahan, Landau Professor in Technology and the Economy, Graduate School of Business and Department of Economics, Stanford University (formerly Deputy Assistant Attorney General for Economics, U.S. Department of Justice Antitrust Division, 1999-2000);

Prof. Steven Neil Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, and Professor of Economics, Graduate School of Business, University of Chicago; Peter C. Reiss, Professor of Economics, Graduate School of Business, Stanford University; Prof. Daniel L. Rubinfeld, Robert L. Bridges Professor of Law and Professor of Economics, School of Law, Boalt Hall, University of California at Berkeley (formerly Deputy Assistant Attorney General for Economics, U.S. Department of Justice Antitrust Division, 1997-98); and Prof. Lawrence J. White, Arthur E. Imperatore Professor of Economics, Leonard N. Stern School of Business, New York University (formerly Director of the Economic Policy Office, U.S. Department of Justice Antitrust Division, 1982-83).

Third, the Commission held a hearing on antitrust in the new economy on November 8, 2005. The panelists were Daniel Cooperman, General Counsel, Oracle Corp.; Richard J. Gilbert, Professor of Economics and Chair, Department of Economics, University of California at Berkeley (formerly Deputy Assistant Attorney General for Economics, U.S. Department of Justice Antitrust Division, 1993-95); M. Howard Morse, Partner, Drinker Biddle & Reath LLP (formerly Assistant Director, Federal Trade Commission Bureau of Competition, 1992-97); James J. O'Connell, Jr., Counsel to the Assistant Attorney General, U.S. Department of Justice Antitrust Division; John E. Osborn, General Counsel, Cephalon, Inc.; and, Carl Shapiro, Transamerica Professor of Business Strategy at Haas School of Business, Director of the Institute of Business and Economic Research, and Professor of Economics at the University of California at Berkeley, and Senior Consultant with Charles River Associates (formerly Deputy Assistant Attorney General, U.S. Justice Department Antitrust Division, 1995-96).

The Commission also received 17 comments on these issues from members of the public, including the American Antitrust Institute, the Antitrust Section of the American Bar

Association, Sheridan Scott, Commissioner of Competition of the Canadian Competition Bureau, and the International Bar Association.[4]

I. Background

Federal antitrust merger enforcement has evolved since enactment of the Clayton Act from primarily a litigation-based system focused on judicial review of consummated deals to a substantially administrative regime in which two federal agencies, the Department of Justice ("DOJ") Antitrust Division and the Federal Trade Commission ("FTC") review mergers meeting

[4] Comments of The American Antitrust Institute, Working Group on Merger Enforcement (July 15, 2005) ("AAI Merger Comments") (the AAI Merger Comments had appended to it a document titled Albert E. Foer, Statement of the American Antitrust Institute on Horizontal Mergers and the Role of Concentration in the Merger Guidelines (Feb. 10, 2004) ("AAI Statement on Mergers")); Carl Lundgren, Economist and President, Relpromax Antitrust, Inc., Comments on Merger Enforcement (July 15, 2005) ("Relpromax Comments"); Sheridan Scott, Commissioner of Competition of the Canadian Competition Bureau, Evidence of The Commissioner of Competition (July 15, 2005) ("Canadian Competition Bureau Comments"); Charles D. Weller, Comments on Merger Enforcement (July 16, 2005) ("Weller Comments"); International Bar Association, Antitrust Committee, Working Group on U.S. Antitrust Modernization, Merger Enforcement (Oct. 26, 2005) ("IBA Comments"); Steven C. Salop, Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The *True* Consumer Welfare Standard (Nov. 4, 2005) ("Salop Comments"); International Chamber of Commerce, Comments on Selected Issues for Study (Nov. 5, 2005) ("ICC Comments"); Chamber of Commerce of the United States of America, Comments on Commission Issues Accepted for Study (Nov. 8, 2005) ("Chamber of Commerce Comments"); American Bar Association, Section of Antitrust Law, Regarding the Appropriate Role of Efficiencies in Merger Enforcement (Nov. 10, 2005) ("ABA Efficiencies Comments"); American Bar Association, Section of Antitrust Law, Regarding Merger Enforcement Policy and the Role of the Horizontal Merger Guidelines (Nov. 10, 2005) ("ABA Merger Comments"); American Public Power Association, Comments (Jan. 27, 2006) ("APPA Comments"); F.M. Scherer, Comments (March 1, 2006) ("Scherer Comments"); United Air Lines, Inc., Merger Review in the U.S. Airlines Industry (March 8, 2006) ("United Comments"); Michael Vita & Paul Yde, Merger Efficiencies and Pass-Through Analysis: Comment on Testimony of George Cary to the Antitrust Modernization Commission (March 16, 2006) ("Vita & Yde Comments"); Jason Beaton, Merger Efficiencies and the Problem of Static Welfare Analysis (May 18, 2006) ("Beaton Comments"); Thomas Hoar, The Role of Efficiencies in Merger Analysis in the Energy Industry (May 18, 2006) ("Hoar Comments"); American Antitrust Institute, Comments on Consumer Welfare (May 22, 2006) ("AAI Consumer Welfare Comments").

certain size thresholds[5] prior to consummation.[6] In recent years, the *Horizontal Merger Guidelines* of the Antitrust Division and the FTC have provided the broad analytical framework for merger enforcement.[7]

Section 7 of the Clayton Act is the primary statute governing federal antitrust merger enforcement.[8] The Clayton Act provides that

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole of any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section

---

[5] The FTC does not have jurisdiction to review mergers of certain common carriers, certain banks and financial institutions, and certain entities in the meat-packing business. *See* 15 U.S.C. § 45(a)(2). In addition, several regulatory agencies have principal or exclusive authority to review mergers in the industries they regulate. *See, e.g.*, 12 U.S.C. § 1228(c) (banks subject to Comptroller of the Currency); 47 U.S.C. §§ 214, 310(b) (FCC authority to review license transfers incident to mergers); 47 U.S.C. § 11321(a) (Surface Transportation Board exclusive jurisdiction over rail mergers). This allocation of merger review authority will be discussed in the memorandum summarizing regulated industries issues.

[6] Of course, the Antitrust Division or FTC must obtain a court order to stop a transaction (unlike in the European Union, for example, where a transaction may not proceed without European Commission approval). However, most merger challenges are settled through negotiated consent decree, "fix-it-first" remedies, or abandonment of the deal, rather than through injunction litigation. *See* Twenty-Sixth Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, at app. A (2004) (reporting that, for FY 2003, the agencies challenged 36 transactions, but only four led to preliminary injunction proceedings).

[7] U.S. Department of Justice, Antitrust Division, and Federal Trade Commission, *Horizontal Merger Guidelines* (as revised 1997) ("*Merger Guidelines*"). Unless otherwise specified or clear from the context, all citations to the *Merger Guidelines* (or "*Guidelines*") are to the *Horizontal Merger Guidelines* as revised in 1997 and currently in effect.

[8] 15 U.S.C. § 18. Mergers may also be challenged under Sections 1 and 2 of the Sherman Act, 15 U.S.C., §§ 1, 2, and, in certain regulated industries, under the relevant regulating statute. Federal Trade Commission merger enforcement is taken pursuant to the FTC Act, which authorizes the FTC to enforce the antitrust laws. *See* 15 U.S.C. § 45; *see also FTC v. Motion Picture Advertising Co.*, 344 U.S. 392, 394-95 (1952) (holding Section 5 of the FTC Act allows Commission to challenge conduct that violates the Sherman or Clayton Acts).

> of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.[9]

As originally passed, the Clayton Act did not apply to asset acquisitions.[10] The exclusion of asset acquisitions reflected Congress' desire primarily to address concerns about holding company acquisitions of the stock in several companies, which would allow a single company to align the interest of direct competitors.[11] However, asset acquisitions, and the ongoing merger wave and increasing concentration, also came to be viewed as potentially problematic.[12] At the urging of the Federal Trade Commission, in 1950, Congress amended the Clayton Act through the Celler-Kefauver Antimerger Act of 1950 to cover the acquisitions of assets.[13] Commentators explain that the legislative history of that Act responded to a variety of concerns, including "a fear of what was considered to be a rising tide of economic concentration in the American economy" and "the protection of small business."[14]

The Hart-Scott-Rodino Antitrust Improvements Act in 1976 ("HSR Act") was the next piece of legislation to effect a significant change in federal merger enforcement.[15] Prior to the HSR Act, federal merger prosecutions almost universally addressed already consummated

---

9 15 U.S.C. § 18. The Act contains several additional paragraphs of extending and limiting coverage in certain respects. *See id.*

10 *See* ABA Section of Antitrust Law, *Mergers and Acquisitions: Understanding the Antitrust Issues*, at 2-3 (2d ed. 2004) ("ABA, *Mergers and Acquisitions*").

11 *Brown Shoe Co. v. United States*, 370 U.S 294, 314 (1969); ABA, *Mergers and Acquisitions*, at 3.

12 *See* ABA Section of Antitrust Law, *Antitrust Law Developments*, at 318 (5th ed. 2002) ("*Antitrust Law Developments*"); *Brown Shoe*, 370 U.S at 315-16 (providing extensive description of legislative history of Clayton Act).

13 *Brown Shoe*, 370 U.S. at 314; ABA, *Mergers and Acquisitions*, at 3-4.

14 *Brown Shoe*, 370 U.S. at 315-16. *See generally* American Bar Association Section of Antitrust Law, *Monograph No. 12, Horizontal Mergers: Law and Policy*, at 9-18 (1986) ("ABA, *Horizontal Mergers*").

15 15 U.S.C. § 18a. *See generally* Mergers—Hart-Scott-Rodino Premerger Notification Discussion Memorandum (June 12, 2006).

transactions. Proceedings were often lengthy, and relief could be ineffectual years after closing. The HSR Act moved enforcement substantially from the courts and into the agencies, which gained greatly increased power to seek consent agreements before allowing a transaction to proceed.

In 1968, the Antitrust Division (under Donald Turner) issued its first set of merger enforcement guidelines.[16] The Department explained that its purpose in publishing the *Guidelines* was to inform business, counsel, and others of "the standards currently being applied by the Department of Justice in determining whether to challenge corporate acquisitions and mergers."[17] "The Justice Department's 1968 Merger Guidelines have been hailed as a "milestone of antimerger doctrine . . . [that] calibrated oligopoly learning into legal norms."[18] Indeed, their economic focus was not merely reflected in it provisions, but also declared at the outset:

> [T]he primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. … a concentrated market structure … tends to discourage vigorous price competition by the firms in the market and to encourage other kinds of conduct, such as use of inefficient methods of production or excessive promotional expenditures, of an economically undesirable nature.[19]

---

16 U.S. Department of Justice, *Merger Guidelines* (1968) ("1968 *Merger Guidelines*") *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101. The FTC neither participated in the issuance of these *Guidelines*. *Id.* at Introduction, ¶ 1(explaining that "these Guidelines are announced solely as a statement of current Department [of Justice] policy"). *See generally* Hillary Greene, *Agency Character and the Character of Agency Guidelines: An Historical and Institutional Perspective*, 72 Antitrust L.J. 1039 (2005) (contrasting the 1968 *Guidelines* (as well as subsequent guidelines and FTC statements) with prior and contemporaneous industry-specific guidelines promulgated by the FTC).

17 1968 *Merger Guidelines*, at Purpose, ¶ 1.

18 ABA, *Horizontal Mergers*, at 38 (quoting Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics,* 75 Geo. L.J. 1511, 1525 (1984)).

19 1968 *Merger Guidelines*, at Purpose, ¶ 2.

The *Guidelines* stood in some contrast to DOJ policy and court rulings earlier in the decade that took strong pro-interventionist perspective on mergers, consistent with the purpose of the Celler-Kefauver amendments to Section 7.[20] As discussed below, the 1968 Guidelines provided the foundation for later Guidelines and therefore influence merger enforcement policy to this day.

The 1968 *Merger Guidelines* explained that:

> with respect to mergers between direct competitors (i.e., horizontal mergers), the Department's enforcement activity under Section 7 of the Clayton Act has the following interrelated purposes: (i) preventing elimination as an independent business entity of any company likely to have been a substantial competitive influence in a market; (ii) preventing any company or small group of companies from obtaining a position of dominance in a market; (iii) preventing significant increases in concentration in a market; and (iv) preserving significant possibilities for eventual deconcentration in a concentrated market.[21]

The Guidelines had several notable aspects, including the following.

- They included a set of concentration and market share thresholds under which the allowable shares of the merging firms declined as market concentration increased.[22] For example, the *Guidelines* indicated that in markets with a four-firm concentration ratio of 75 percent or more, the Division would ordinarily challenge combinations of two firms with market shares of four percent each or ten percent and two percent. If the ratio were below 75 percent, somewhat higher firm shares (*e.g.* two firms each with five percent) would ordinarily draw challenges. One commentator opined that "[i]n large measure, the 1968 *Guidelines* adopted market share limits that could be inferred from recent merger decisions by the courts."[23]

---

[20] *See* ABA, *Horizontal Mergers*, at 37-38 (citing *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966) (combined shares of 4.49 percent), and *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966) (combined shares of 7.5 percent)). One Supreme Court justice concluded from this string of cases that the "sole consistency . . . is that . . . the Government always wins." *Von's*, 384 U.S. at 301 (Stewart, J., dissenting).

[21] 1968 *Merger Guidelines* § I, ¶ 4.

[22] *See id.* § 1, ¶¶ 5-6. The *Guidelines* used the "four-firm concentration ratio," which is the sum of the market shares (as a percentage) of the four largest firms in the relevant market.

[23] Oliver E. Williamson, *The Merger Guidelines of the U.S. Department of Justice—In Perspective*, paper presented at an Antitrust Division symposium, "20th Anniversary of the 1982 Merger Guidelines: The Contribution of the Merger Guidelines to the Evolution of Antitrust

- Under the 1968 *Merger Guidelines*, relatively small combined shares, in some cases below 10 percent, could make suit likely.

- The *Guidelines* explained that "rational appraisal of the probable competitive effects of a merger normally requires definition of one or more relevant markets." It defined a market in terms of substitutability, specifically as "a grouping of sales in which each of the firms whose sales are included enjoys some advantage in competing with those firms whose sales are not included." It identified the product and geographic dimensions of a market, but contained limited discussion of the principles underlying the method of defining a market.[24]

- The DOJ treated the *Guidelines* as nonbinding, and reserved the right to use alternative theories and evidence.[25]

In 1982, DOJ issued a revised set of merger guidelines, under the leadership of Assistant Attorney General William Baxter.[26] The 1982 *Merger Guidelines* were considered a "significant step in the evolution of merger policy" because they provided a framework for analysis of mergers and established a unified structure of rules.[27] Most notably the 1982 *Merger Guidelines*:

- Took as a premise that mergers generally were conducive to efficiency and posed little or no competitive risk.[28]

- Clarified the nature of antitrust concern about mergers (collusion, broadly conceived, either tacit or explicit, and dominant-firm behavior).[29]

- Introduced use of the Herfindahl-Hirschman Index ("HHI") to measure market concentration, and established revised concentration thresholds (those that are in

---

Doctrine, at 8 (June 10, 2002) (Williamson was Special Economic Assistant to the Head of the Antitrust Division of the U.S. Department of Justice in 1966-67, when the 1968 Guidelines were drafted) *at* http://www.usdoj.gov/atr/hmerger/11257.htm.

24 1968 *Merger Guidelines*, at Purpose, ¶ 3.

25 *Id.* at Purpose, ¶ 2; *see also* ABA, *Mergers and Acquisitions*, at 25 (noting courts were not bound by *Guidelines* but found them to be a "helpful analytical model").

26 U.S. Department of Justice, *Merger Guidelines* (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102 ("1982 *Merger Guidelines*").

27 ABA, *Horizontal Mergers*, at 45-46.

28 1982 *Merger Guidelines* § I.

29 *Id.* § III.A.

use today) that would make it unlikely a merger would be challenged unless the merging parties would have a combined market share exceeding 10 percent.[30]

- Set forth a unified methodology for assessing both market definition and entry, based on the behavior that would be profitable for a hypothetical profit-maximizing monopolist.

    - Defined a relevant market to be a product and geographic area that was *potentially* subject to significant anticompetitive effects from merger: a hypothetical monopolist of such a market would find it profitable to impose a "small but significant nontransitory increase in price" (a "SSNIP"), the profitability of which would not be defeated by customers switching to other products within a year.[31]

    - Entry was also to be assessed by a SSNIP test: entry could be expected to eliminate the anticompetitive effects predicted by the SSNIP test if such entry would render a SSNIP unprofitable with two years.[32]

- Retained a skeptical attitude towards efficiencies, providing that "[e]xcept in extraordinary cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged," citing the difficulty of proving their existence or determining their magnitude.[33]

- Addressed nonhorizontal mergers, including vertical mergers and mergers raising potential competition concerns.[34] These provisions, which were also included in the 1984 *Merger Guidelines*, have not been superseded.[35]

The background for these changes derived from a number of developments in law and in economics, including increased understanding of the role of mergers in promoting the efficient allocation of resources and reduced confidence in earlier economic literature, which had been

---

30 *Id.*

31 *Id.* § II.A.

32 *Id.* § III.B.

33 *Id.* § V.A.

34 *Id.* § IV.

35 ABA, *Mergers and Acquisitions*, at 20.

viewed as establishing a clear relationship between market concentration and competitive performance.[36]

The Federal Trade Commission did not join in the 1982 *Merger Guidelines*, but issued a statement outlining the main factors it considered in merger enforcement.[37] In particular, the FTC noted that recent empirical research, as well as practical experience, called for deemphasizing market concentration.[38]

The Department of Justice modestly revised these Guidelines in 1984 in response to criticism from some quarters, including from members of Congress and within the Reagan Administration, that: efficiencies should not be considered merely as a "defense" to mergers otherwise found to be anticompetitive; the HHI threshold presumptions were too rigid; the failing firm defense was too rigid and should include a "failing division" defense; and that insufficient consideration was given to competition from foreign firms in defining markets and assessing entry. The 1984 revisions were explained as an effort to update the 1982 *Merger Guidelines* with recent thinking and "to correct any misperception that the *Merger Guidelines* are a set of rigid mathematical formulas that ignore market realities, and rely solely on a static view of the marketplace."[39]

---

36 ABA, *Horizontal Mergers*, at 45 ("Ongoing economics research continued to cast doubt on the strength of inferences that could be drawn from concentration data.").

37 Federal Trade Commission, Statement Concerning Horizontal Mergers (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,200 ("1982 FTC Statement"). The FTC Statement provided that the Commission would "give 'considerable weight'" to the 1982 *Merger Guidelines*, it declined to endorse them, their analytical approach, or the numerical thresholds they contained. ABA, *Mergers and Acquisitions*, at 19.

38 1982 FTC Statement § II.

39 U.S. Department of Justice, *Merger Guidelines* § 4.1-4.2 (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103 ("1984 *Merger Guidelines*"). The 1984 revisions continued to cover nonhorizontal mergers of various types, including vertical mergers and those raising potential competition issues. ABA, *Mergers and Acquisitions*, at 20. Although not much used, these non-horizontal portions have not been superseded. *Id.* *But cf.* Anne K. Bingaman, Ass't Att'y Gen.,

The 1984 Guidelines described the thresholds with language that suggested that they less of an indicator of illegality than might previously had been thought, and incorporated some other changes:

- Unconcentrated industries (HHI below 1000): challenges would require "extraordinary circumstances;" in the 1982 *Guidelines* such challenges were "unlikely."[40]

- Moderately concentrated industries (HHI between 1000 and 1800): challenge was "likely" with HHI changes over 100, depending on factors affecting the likelihood of collusion, entry and efficiencies; in the 1982 *Guidelines*, challenge was "more likely than not for an HHI change above 100."[41]

- For "highly concentrated industries" (HHI above 1800) there was very little change in the thresholds or characterization of the treatment.[42]

- The 1984 Guidelines paid special attention to foreign firms, noting that they would be included in relevant markets based on the same analysis applied to domestic firm while recognizing that factors including quotas, other trade restraints, and exchange rates may limit their competitive significance.[43]

The Federal Trade Commission and the Antitrust Division issued the first joint merger guidelines in 1992.[44] The basic mode of analysis—the SSNIP test—continued to guide both market definition and entry analysis. The 1992 *Merger Guidelines* introduced two principal changes. First, the *Guidelines* distinguished between two mechanisms of anticompetitive effects: (1) coordinated effects, that is explicit or tacit collusion (which was the focus of the 1982 *Guidelines*); and (2) unilateral effects resulting from the relaxation of competitive constraints on

---

Antitrust Div'n, Antitrust Enforcement: Some Initial Thoughts and Actions, Address Before the ABA Section of Antitrust Law, at 5 (Aug. 10, 1993) (rescinding DOJ's Vertical Restraints Guidelines issued in 1985, explaining that the Vertical Restraints Guidelines "unduly elevate theory at the expense of factual analysis" and fail to reflect an optimal balancing of procompetitive and anticompetitive effects).

40 *See* 1984 *Merger Guidelines* § 3.11(a); 1982 *Merger Guidelines* § III.A.1(a).

41 See 1984 *Merger Guidelines* § 3.11(b); 1982 *Merger Guidelines* § III.A.1(b).

42 *See* 1984 *Merger Guidelines* § 3.11(c); 1982 *Merger Guidelines* § III.A.1(c).

43 *See* 1984 *Merger Guidelines* §§ 2.34, 2.4, 3.23; 1982 *Merger Guidelines* § IV.

the combined firm due to the acquisition of a close competitor. Second, the *Guidelines* refined the analysis of entry to focus on the potential entrants' need to sink costs in a relevant market as a key determinant of whether entry would be "timely, likely, and sufficient" to eliminate anticompetitive effects.

The 1992 Guidelines make the HHI thresholds carry even less of a presumption of anticompetitive effects, and place greater emphasis on the importance of considering the other factors set forth in the Guidelines. As Mr. Rill explained in his statement that the 1992 *Guidelines* "substituted the element of presumption at the highly concentrated level for the previous indication of likelihood of government challenge."[45] For example, the *Guidelines* provide that in moderately concentrated markets (HHI between 1000 and 1800) mergers producing an HHI change over 100, "potentially raise significant concerns depending on the [other] factors set forth in . . . the *Guidelines*."[46] Similarly, in highly concentrated markets (HHI above 1800) transactions causing HHI increases over 50 "potentially raise significant competitive concerns, depending on the factors set forth in . . . the Guidelines."[47] HHI increases over 100 in such highly concentrated markets are "presumed . . . likely to create or enhance

---

[44] United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992) ("1992 *Merger Guidelines*"), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104.

[45] Written Statement of James F. Rill and Christopher J. MacAvoy Concerning Antitrust Merger Enforcement, at 7 (Oct. 31, 2005) ("Rill Statement").

[46] 1992 *Merger Guidelines* § 1.51(b). These factors are those affecting the following: anticompetitive effects from coordinated effects (1992 *Merger Guidelines* § 2.1); anticompetitive unilateral effects (1992 *Merger Guidelines* § 2.2); whether entry will obviate potential anticompetitive effects (1992 *Merger Guidelines* § 3); whether cognizable efficiencies will obviate potential anticompetitive effects (1992 *Merger Guidelines* § 4); and whether failure or exiting assets are so likely that anticompetitive effects are not likely to occur (1992 *Merger Guidelines* § 5).

[47] 1992 *Merger Guidelines* § 1.51(c).

market power or facilitate its exercise," but this may be overcome by a showing based on the other factors in the Guidelines.[48]

The FTC and DOJ revised the 1992 *Merger Guidelines* in 1997 to include an elaboration on the treatment of merger-related efficiencies. The revisions did not change the basic antitrust analysis of market definition, shares and concentration, mechanisms of anticompetitive effects, and entry. The revisions made these primary points:

- The potential realization of efficiencies are the main benefit of mergers to the economy.[49]
- Merging parties must substantiate efficiency claims so that the enforcement agencies can reasonably verify them.[50]
- Efficiencies must be "cognizable": verifiable, not readily attainable by economically plausible alternative means with less anticompetitive effect, and not the result of anticompetitive output restrictions.[51]
- To avoid a challenge, parties must shoe that "cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, *e.g.*, by preventing price increases in the market."[52]

The *Merger Guidelines* have not been altered since 1997. However, DOJ and the FTC have used alternate mechanisms to explain refinements to their approaches and otherwise to clarify how they go about analyzing mergers. In late 2003, FTC and DOJ published a report summarizing data on market structure for the horizontal mergers they had opposed during Fiscal Years 1999-2003.[53] Some of the principal conclusions from the data are:

---

48 *Id.*

49 *Merger Guidelines* § 4.

50 *Id.*

51 *Id.*

52 *Id.*

53 Federal Trade Commission and U.S. Department of Justice, Merger Challenges Data, Fiscal Years 1999-2003 (Dec. 18, 2003). Mergers were deemed to have been challenged by the Commission if it voted to challenge the transaction (either in court or administratively). Mergers

- Most challenges take place at HHI and HHI change levels well above the thresholds in the *Merger Guidelines*. The lowest post-merger HHI for any of these markets is slightly above 1400, and the lowest HHI change is about 85. For most challenges, these figures are substantially higher.[54]

- The Federal Trade Commission challenged petroleum and retail grocery mergers at HHI and HHI change levels significantly below the HHI levels at which mergers in other industries typically were challenged by either agency.[55]

- Most challenges addressed one or a few relevant markets, while a few mergers were challenged in numerous relevant markets. The mergers with large numbers of markets tend to be concentrated in particular industries, such as dairy and telecommunications (for the Antitrust Division) and petroleum (for the Federal Trade Commission).[56]

During 2004, the Federal Trade Commission published a report containing similar, and some additional data, on nearly all of the mergers it had investigated through the issuance of a request for additional information and documentary materials, or "second requests" (whether challenged or not), covering Fiscal Years 1996-2003.[57] These data reveal the following significant findings:

- The Federal Trade Commission issued a second request in a significant number of mergers for which the relevant markets under investigation had HHIs below 1800 and HHI changes less than 50. These investigations were primarily in either the petroleum or grocery industries.[58]

---

were deemed to have been challenged by the Department if a complaint was filed in court or a press release was issued by the Department announcing that the transaction had been abandoned or restructured in response to the Department's concerns. In addition, mergers involving financial institutions subject to the Bank Merger Acts of 1960 and 1966 or the Bank Merger Holding Company Act were deemed to have been challenged by the Department if the transactions were restructured to satisfy the Department's concerns, even absent a press release. *Id.* at 2.

54 *Id.* at 2 & Tbl. 1.

55 *Compare id.* Tbls. 4-5 *with id.* Tbl. 1.

56 *Id.* at 2 & Tbls. 2-4.

57 Federal Trade Commission, Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (Feb. 2, 2004, revised Aug. 31, 2004).

58 *Compare id.* Tbls. 3.1, 3.2, & 3.3.

- Other than grocery and petroleum mergers, FTC investigations and challenges much more often than not target markets with concentration levels well above the *Merger Guidelines'* HHI thresholds.[59]

- Challenges were much more likely in markets with few significant competitors: the FTC challenged over 85 percent of the transactions which eliminated a competitor from a market with four, three, or two competitors pre-merger, but less than 54 percent of the transactions where there were five or six firms premerger.[60]

- The FTC was much more likely to challenge a merger when there were so-called hot documents (internal company documents appearing to evidence an intent or ability to raise price as a result of the merger), strong customer complaints, or more difficult entry conditions, at any given HHI level.[61]

Most recently, the agencies released a "Commentary on the Horizontal Merger Guidelines," which elaborates on key sections of the *Merger Guidelines*, including short discussions of illustrative transactions.[62] According to DOJ and the FTC, this document was issued principally to increase transparency, based on a recognition that "business leaders and their counsel would substantially benefit from a more elaborate and detailed articulation of how the agencies and their staff actually incorporate the Guidelines' framework when analyzing a merger's likely effect on competition and consumers."[63]

The *Merger Guidelines Commentary* does not alter the *Merger Guidelines* analysis. However, it does emphasize the agencies' more extensive use of econometric analysis to attempt to directly answer the market power question and the relative lesser importance of the HHI thresholds. The *Merger Guidelines Commentary* makes clear that the Agencies pursue an "integrated approach" in applying the analytic elements of the *Merger Guidelines* to review a

---

59 *Compare id.* Tbls. 3.1-3.6.

60 *Id.* Tbl. 4.1.

61 *See, e.g., id.* Tbls. 5.1 & 5.2 (hot documents), 6.1 & 6.2 (consumer complaints), 7.1 & 7.2 (difficulty of entry).

62 Commentary on the Horizontal Merger Guidelines, U.S. Department of Justice and Federal Trade Commission (March 2006) ("*Merger Guidelines Commentary*").

particular transaction. Specifically, "the Agencies do not apply the *Guidelines* as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets."[64] In particular, the agencies "integrate efficiencies into their assessments of competitive effects , . . . assess[ing] the effects of the elimination of competition between the merging firms in light of any cognizable, merger-specific efficiencies.[65] The *Merger Guidelines Commentary* identifies several cases in which cognizable efficiencies may have been influential on or determinative of the outcome.[66]

II. Overall Assessment of U.S. Merger Enforcement Policy

To gain insight into the broad question of the overall efficacy and efficiency of merger enforcement policy, the Commission convened a hearing panel of four lawyers and economists with extensive experience as government enforcers and private practitioners on November 17, 2005. To gain a better appreciation of the economic learning on these matters, the Commission convened a roundtable of economists with expertise in industrial organization and related areas on January 19, 2006. This section summarizes points from the hearing panel and roundtable, and comments received by the Commission on these issues.

---

63 Press Release, "Department of Justice, Federal Trade Commission Issue Joint Commentary on the Merger Guidelines" (Mar. 27, 2006).

64 *Merger Guidelines Commentary*, at 2.

65 *Id.* at 49. As discussed below, some argue that market definition should be deemphasized in certain types of cases in favor of direct economic assessment of market power; the *Merger Guidelines Commentary* maintains market definition as port of the integrated analysis. *Id.* at 5.

66 *See id.* at 50-59 (citing Nucor/Birmingham Steel (DOJ 2002); Fine Look/Snazzy (Disguised FTC Matter)); Genzyme/Novazyme (FTC 2004); Toppan/DuPont (DOJ 2005); PayPal/eBay (DOJ 2002); Gai's/United States Bakery (DOJ 1996); Verizon/MCI & SBC/AT&T (DOJ 2005); IMC Global/Western Ag (DOJ 1997)).

A. General Assessment

In general, witnesses strongly endorsed the current merger enforcement regime, advising that "merger enforcement has become increasingly predictable, transparent, and analytically sound."[67] Professor Willig, for example, characterized the *Merger Guidelines* as the "blueprint[] for the architecture" of a merger analysis that "functions well."[68] Similarly, participants in the economist roundtable generally agreed that current and recent U.S. antitrust merger enforcement policy was a policy they comfortably could recommend or defend.[69] Prof. Scheffman, however, expressed concern that "we are still applying models that are modestly updated versions of economic models more than 100 years old."[70] He, like others, advocated continued empirical work to improve our understanding of how markets work and the tools we use to assess the likely competitive effects of mergers.

Several commenters also addressed the general efficacy of current merger enforcement policy. The ABA expressed a generally positive view of current merger policy, while

---

67 Trans. at 26 (Baer); Prepared Remarks of William J. Baer before the Antitrust Modernization Commission, at 14 (Nov. 17, 2005) ("Baer Statement") ("Merger enforcement is more predictable, transparent and analytically sound than ever before."); Trans. at 16 (Rill) (opining that "the current merger enforcement regime is on the right track").

68 Testimony of Robert Willig Before the Antitrust Modernization Commission, at 1 (Nov. 17, 2005) ("Willig Statement"); *see also* Trans. at 22 (Baer) (commending agencies for achieving "better internal discipline about how you look at a merger"); Trans. at 23 (Baer) (the system "basically works well;" quarrels focus on particular decisions); Roundtable Trans. at 11 (Rubinfeld) ("My sense is that the merger laws, the Clayton and FTC Acts, really work well and that the level of enforcement has generally been good."); Roundtable Trans. at 72 (Comm'r Carlton) (summarizing much of the Roundtable discussion as follows: "I think everybody seems to agree around the table that the merger policies that the United States has been engaged in seem pretty sensible, not based on any particular study, but based on sort of everyone's individual judgment.").

69 Trans. at 112-13 (White, Rubinfeld, Reiss, Kaplan, Bresnahan); *see also* Trans. at 113 (Reiss) ("the alternative scares me").

70 David T. Scheffman, Assessment of U.S. Merger Enforcement Policy, at 11-12 (Nov. 17, 2005) ("Scheffman Statement").

acknowledging that it is "difficult to gauge" the actual effectiveness of that policy.[71] The ABA also cautioned that, "in practice [the agencies] 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."[72] AAI agreed that the agencies are operating effectively "in general, but with exceptions," related particularly to their "move to challenging only mergers with very high concentration levels."[73] United Air Lines criticized DOJ's "hostility" to mergers between airlines with significant route overlaps, arguing that such mergers were critical for U.S. network carriers to cut costs, achieve network efficiencies, compete with point-to-point and foreign carriers, and avoid or emerge from bankruptcy.[74]

Most witnesses and commenters advised against recommending any significant change, arguing that any modifications should be "at the margins."[75] AAI, however, expressed serious concern that current merger enforcement is too reluctant to challenger mergers other than "2 to 1 or 3 to 2 mergers."[76] United Air Lines recommended that DOJ should "retool" its approach to reflect competitive realities, including "greater competition, ease of entry, and more elastic

---

71 ABA Merger Comments, at 1.

72 ABA Merger Comments, at 2.

73 AAI Comments, at 1. AAI specifically expressed concern that "[i]t 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" and that "now seemingly a dominant reverse presumption—that mergers are almost always efficient even at high levels and changes in concentration—is justified." *Id.* at 3.

74 Comments of United Air Lines, Inc. to the Antitrust Modernization Commission: Merger Review in the U.S. Airline Industry, 2, 7-12 (March 8, 2006).

75 Trans. at 26 (Baer) ("the need for changes, really are at the margins"); Baer Statement, at 14 (cautioning about the effect of uncertainty resulting from change); Rill Statement, at 3 (while there are some "marginal criticisms that misjudge the flexibility of the *Merger Guidelines* to adapt"); Trans. at 21 (Rill) ("please, no" to the idea of "legislation in the merger area;" things are working well)

consumer demand."[77] Charles Weller argued that U.S. merger policy has been a failure and urged the AMC "recommend[] that . . . the current policy and guidelines based on static efficiency economic theory and concentration theory be replaced and evolve to a merger policy using dynamic economic theory based on productivity, [specifically] Prof. Porter's Theory of Productivity, Innovation, and Unique Value."[78]

Some panelists criticized prior eras of enforcement, while describing a number of ways in which merger enforcement has improved. Prof. Scheffman declared that "[t]here are few if any knowledgeable people that would defend the pre-1982 merger enforcement policy of the U.S."[79] and emphasized that "the change in policy in the '80s was absolutely important and undoubtedly procompetitive."[80] Professor Bresnahan found that there was "nothing as remotely troubling about merger review today as there was in the early 1980s."[81] Other panelists simply noted the absence of "silly cases" brought in previous periods.[82]

---

[76] AAI Comments, at 2-3.

[77] United Air Lines Comments, at 21-22.

[78] Weller Comments, at 2-3. Carl Lundgren also submitted a comment suggesting that the AMC recommend placing specific conduct requirements on merging firms to prevent collusion, which he refers to as "relative profit maximizing incentives." Lundgren Comments, at 1.

[79] Scheffman Statement, at 2.

[80] Trans. at 12 (Scheffman). Prof. Scheffman specifically cited the approval of the GM/Toyota joint venture as a landmark, and noted that the "statements of dissenting Commissioners in that matter are certainly instructive as to how far we have come." Scheffman Statement, at 2-3.

[81] Roundtable Trans. at 30 (Bresnahan).

[82] Trans. at 37 (Rill) (while the agency is losing some cases, these are not "the silly cases that might have been brought in the '70s"); Trans. at 35 (Baer) ("there do not appear to be lots of silly cases").

Some panelists applauded the fact that that merger policy has become stable and bipartisan, affording "a sense of gravity it was previously lacking."[83] The panelists acknowledged that members of the public may not share the panelists' general comfort with current enforcement policy, as evidenced, for example, by recent editorials and legislative initiatives characterizing current policy as both too relaxed and too restrictive.[84] In some instances, the public's perception may arise from insufficient communication about the goals of merger policy or the rationale of enforcement decisions, while in other instances it may simply reflect either a populist distrust for "big business" or an inherent skepticism of governmental intervention in the marketplace.[85] Panelists agreed that enforcers could improve the transparency of decision-making.[86]

Without citing specific cases or data, witnesses generally opined that enforcement errors appear to be relatively few and unsystematic.[87] To the extent mistakes occur, one panelist attributed them to cases in which the agencies move farther from customer complaints and economic evidence and analysis.[88] The Roundtable participants did not find reliable evidence of either over-enforcement or under-enforcement, either generally or because the agencies on

---

[83] Baer Statement, at 5-6 (citing similarities in policies pursued by Pitofsky and Muris); Trans. at 46-47 (Scheffman) (policy is clearly bipartisan); *see also* Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 Antitrust L.J. 105 (2002).

[84] *See, e.g.*, Trans. at 36-47 (Baer); Trans. at 48-49 (Rill) ("I was intrigued by the criticisms . . . ."); Trans. at 44-46 (Willig); Trans. at 49 (Baer).

[85] Trans. at 48 (Rill); Trans. at 46-47 (Scheffman) (noting that the United States has "strains of populism that may create a problem"); Trans. at 49 (Baer) (public may have false expectations about what the antitrust cop can do, *e.g.*, can keep gas prices law when supply shortages are causing the increase).

[86] Trans. at 45-46 (Willig) (in response to the public's concern, we could be more forthcoming regarding our reasoning); Trans. at 46-47 (Scheffman) (agreeing).

[87] Trans. at 39 (Willig) ("I don't see systematic errors" in merger enforcement); Trans. at 38 (Rill) ("I think the error rate is low").

[88] Trans. at 29 (Scheffman).

occasion lost cases.[89] The hearing panelists emphasized the importance of (i) transparency and (ii) retrospective studies of "close" mergers that were not challenged as a way to prevent under-enforcement or over-enforcement.[90]

Professor Kaplan stated that the financial economics literature on mergers was consistent with the conclusion that current enforcement policy is approximately correct, or perhaps slightly too restrictive of transactions that might yield efficiencies without increasing market power.[91] The basis for this assessment was that the financial literature on mergers did not provide clear evidence that mergers led to or were motivated by significant increases in market power; and that, on average, mergers increased the total economic value of the parties.[92]

Some commenters challenged the validity of Professor Kaplan's statement that, on average, mergers increased the total market value of the merging parties.[93] The American Antitrust Institute cited studies it interprets as showing that, in a substantial proportion of cases, mergers do not increase total market value and therefore cannot be assumed to be generally conducive to efficiency.[94] Because they believe the general efficiency rationale for mergers is

---

89 Roundtable Trans. at 11 (Rubinfeld) ("If the agencies are not out there aggressively pursuing mergers that they think are anticompetitive because they're afraid of losing a case, we're going to be having under-enforcement.").

90 Trans. at 72 (Rill) ("transparency in the decision-making process and whatever can be done with the retrospective reviews is probably the limit of practical application"); Trans. at 72 (Baer) (same); Trans. at 73 (Scheffman) ("retrospectives are very important").

91 Roundtable Trans. at 96-100 (Kaplan); Steven N. Kaplan, Mergers and Acquisitions: A Financial Economics Perspective, at 13-15 (Jan. 6, 2006) ("Kaplan Statement").

92 Roundtable Trans. at 24-29 (Kaplan); Kaplan Statement, at 11-15. This market power assessment is based on a number of stock-market "event" studies which examined the differential effects of merger (and merger challenge) announcements on the stock prices of parties, competitors, and others. *Id.*

93 *See* AAI Comments, at 3, 6-7; Scherer Comments, at 1-3. Charles Weller argued that most mergers are not successful. Weller Comments, at 2-3.

94 AAI Comments, at 6-7; AAI Statement on Mergers, at 19-20; *see also* Scherer Comments, *passim*; *cf.* Roundtable Trans. at 75 (Rubinfeld) (opining that many mergers

weak, these commentators also believe that current antitrust merger enforcement policy could beneficially be tightened, with more enforcement actions against mergers producing lower market share and concentration levels.[95]

B. The *Merger Guidelines*

Witnesses described adoption of the *Merger Guidelines* in 1982 (and their subsequent revision in 1992 and 1997) as a key turning point for merger enforcement.[96] They agreed that the *Guidelines'* framework is essentially sound,[97] providing useful guidance and transparency to the business community and antitrust bar.[98]

In particular, panelists emphasized the *Guidelines'* influence on judicial thinking, as reflected in their widespread acceptance by the courts.[99] Mr. Baer described how 20 years ago there was a "tremendous divergence" between courts relying on 1960s precedents and agency enforcement practice, but courts since then have largely adopted the *Guidelines'* approach.[100]

---

reviewed by DOJ during his tenure as the Economics Deputy were bad for the company but pursued due to "the stupidity or the egos of the CEOs of the two companies").

95 *See* AAI Comments, at 3, 6-9 (in part in light of "the literature casing doubt on the effectiveness of mergers in achieving their declared goal," AAI questions current merger policy).

96 Rill Statement, at 2 ("[T]he 1982 *Merger Guidelines* were a fundamental turning point in merger enforcement."); Baer Statement, at 2 ("Today's approach to merger policy largely dates to the adoption of the 1982 Guidelines."); Scheffman Statement, at 2 (merger enforcement policy has continued to improve since 1982 from the perspective of both economic efficiency and consumer welfare); Roundtable Trans. at 40 (White) ("[T]he Guidelines cannot always be applied fully . . . . I would hate to give up on the principle.").

97 Roundtable Trans. at 79-80 (White, Rubinfeld, Reiss, Bresnahan); Roundtable Trans. at 12 (Rubinfeld).

98 *See, e.g.*, Trans. at 22-23 (Baer).

99 Rill Statement, at 3-5 (citing cases); Baer Statement, at 6; Trans. at 17-18 (Rill) (U.S. courts and internationally).

100 Trans. at 78-79 (Baer); *see also* Trans. at 80 (Scheffman) (*Guidelines* provide judges with a "roadmap"); Trans. at 81-82 (Willig) (it is a slow process, but judges appear to be making "some pretty good decisions" on market definition (citing *Arch Coal* and *Oracle*)).

The *Guidelines* have also influenced the development of merger policy by jurisdictions outside the United States.[101]

Witnesses unanimously opposed recommending significant change to the *Guidelines*.[102] Several Roundtable participants did advocate limited changes to the *Guidelines*, to clarify the analysis of unilateral effects, for example.[103] Some commenters advocated major changes in the *Guidelines*, including AAI, which advised that the enforcement agencies should formally update their analysis of vertical mergers.[104]

1. *Market Definition*

Recently, some commentators have suggested that the formal definition of relevant markets is no longer important to merger analysis, particularly where the existence of market power may be measured directly through econometric analysis. However, several of the participants in the panel and the Roundtable emphasized the importance of defining markets in merger analysis. They advised that efforts to measure market power directly should be supplement *Merger Guidelines* market definition, rather than substitute for it. Professor Willig, for example, argued that requiring enforcement to be based on the "identification of relevant markets in which competition is predicted to be significantly weakened by the merger" is an

---

[101] Rill Statement, at 4-5 (citing the development of the Canadian and EU guidelines); Baer Statement, at 8 (focusing on the acceptance, by the EU and other jurisdictions, of a substantial lessening of competition standard for merger enforcement).

[102] Trans. at 88 (Willig) (advocates "[n]ot [changing] a word" of the *Guidelines*); Trans. at 89 (Scheffman) (advocates "elaborat[ing] better what the practice is," but not in *Guidelines*) Trans. at 90 (Baer) (agrees with Scheffman); Trans. at 89 (Rill) (would move one footnote on next-best substitutes in analyzing unilateral effects [*Merger Guidelines* § 1.11 n.9] into text).

[103] Roundtable Trans. at 9-10 (White).

[104] *See, e.g.*, AAI Comments, at 5 (advocating "formally updating the agencies' policy on vertical mergers . . .").

"[i]mportant discipline" for merger analysis.[105] Professor Bresnahan emphasized its utility in providing clarity: "It's extremely important that the plaintiff or prosecutor say with precision what competition is being harmed and how. And for better or worse, the *Merger Guidelines* and market definition are how we do that."[106]

Professor White argued that it is unnecessary to define markets is cases where the possibility of unilateral effects is being assessed. In his opinion, in those cases, the agencies need only be able to "make a fairly confident prediction that there are going to be significant price effects unilaterally because of this merger. And as long as these effects pass a *de minimis* test, that's the end of the story."[107] Prof. Scheffman and Mr. Rill disagreed.[108]

Finally, the roundtable participants considered the problem of the feasibility of implementing the *Guidelines* market definition paradigm, given the large amount of information that might be needed to make the determinations described in the *Guidelines*. A number of panelists argued that, for various reasons, the data limitations should not unduly burden the process of delineating markets. Most of the panelists opined that the data needed are typically available. Professor Bresnahan, for example, argued that "[s]ubstantial information is often available" to implement the *Guidelines'* SSNIP approach, adding that "[a]gencies actually do the

---

105 Willig Statement, at 4; Trans. at 9-11 (Willig) (natural experiments should be used not just as evidence of a merger's effects, but also as evidence about market definition). Prof. Scheffman agreed with this advice. *See* Trans. at 15 (Scheffman).

106 Roundtable Trans. at 44 (Bresnahan); *see also* Trans. at 19 (Rill) (arguing for the importance of market definition, citing its general acceptance, the fact that Section 7 requires demonstrating an effect in a "line of commerce," their utility in identifying competitors and assessing concentration, and the shortcomings of more sophisticated methods); Roundtable Trans. at 40 (White).

107 Roundtable Trans. at 9 (White).

108 Rill Statement, at 5-6; Scheffman Statement, at 8-9 (emphasizing importance of careful analysis of market definition over identifying theories of potential effects). Professor Rubinfeld argued that the market definition exercise may be unhelpful in some unilateral effects cases, but

right analysis and can and do estimate the shape of the demand curve facing the hypothetical monopolist."[109] He stated that he thinks that it has not "gone as well as we hoped," noting that now lawyers and economists argue about delineating the relevant market.[110] Professor Rubinfeld noted that econometric data is not essential; relevant information can come in the form of materials such as marketing documents and sales reports.[111] Prof. Scheffman emphasized the need to focus on marginal customers in market definition and the importance of critical loss analysis.[112]

2. *Concentration and Market Power*

In every revision of the Merger Guidelines since 1982, DOJ and (later) the FTC have attempted to make clear that the concentration and market share thresholds are screens indicating the need for further analysis, rather than hard rules for determining when a merger will be challenged. Thus, for example, the 1992 *Merger Guidelines* "substituted the element of presumption at the highly concentrated level for the previous indication of likelihood of government challenge."[113] This "made it clear that the higher post-merger concentration level did not suggest a 'guideline violation,' but rather dictated the need for further analysis of competitive effects, committed entry, and efficiency."[114] In fact, according to one witness, the

---

that frequently concentration based on market definition will be a "pretty good indicator." Roundtable Trans. at 13-14 (Rubinfeld).

109 Roundtable Trans. at 38-39; 44 (Bresnahan).

110 Roundtable Trans. at 43-44 (Bresnahan); *see also* Roundtable Trans. at 40 (White) ("the data needed are not . . . very complicated [or] hard-to-understand data.").

111 Roundtable Trans. at 39 (Rubinfeld) (citing Jonathan B. Baker & Daniel L. Rubinfeld, *Empirical Methods in Antitrust Litigation: Review and Critique*, 1 Amer. L. & Econ. Rev. 386 (1999)).

112 Scheffman Statement, at 8-9.

113 Rill Statement, at 7.

114 *Id.* at 8.

evidence on second requests and enforcement actions indicates that both early- and late-stage agency decisions are substantially based on far more factors and dimensions than concentration measures alone.[115] Witnesses generally agreed that current policy gives the appropriate weight to measures of concentration.[116]

Economist roundtable participants acknowledged that economic knowledge about the relationship between concentration and market power is limited. Current economic research does not provide knowledge about the levels of concentration at which market power emerges, increases substantially, or becomes problematic.[117] Some roundtable participants nevertheless opined that current merger enforcement policy is generally consistent with what literature there is on the relationship between concentration and market power.[118] According to Professor Bresnahan, for example, current economic literature suggests that concentrated industries exhibit market power "around the range that modern merger policy would intervene."[119]

Professor White observed that "three major sources of evidence" show "seller concentration matters": (i) studies of the relationship between industry profit and concentration, (ii) studies of the relationship between price and seller concentration, and (iii) auction studies.[120] The data do not, however, indicate at exactly what level "antitrust should bite."[121] He

---

115 Willig Statement, at 9.

116 *See, e.g.*, Daniel L. Rubinfeld, Testimony Before the Antitrust Modernization Commission, at 4 (Jan. 19, 2006) ("Rubinfeld Statement") ("As a general rule, I believe that the *Guidelines* place appropriate weight on measures of concentration.").

117 *See* Roundtable Trans. at 33 (Bresnahan).

118 *See, e.g.*, *id.* ("available information in the research literature would suggest a policy not unlike the one we have.").

119 *Id.*

120 Roundtable Trans. at 6-8 (White); *see also* Roundtable Trans. at 41 (White) ("[W]e now have 20 or so years of price-oriented data and studies that show that concentration matters and that show up as price effects."); Roundtable Trans. at 82 (White) (citing pricing studies).

121 Roundtable Trans. at 8 (White).

emphasized the need for further study.[122] He suggested that a "meta-study" should be conducted that would pull together all the price-concentration studies in an attempt to distill "global conclusions."[123]

Professor Bresnahan opined, however, that "[t]here's just too much heterogeneity in industries" to draw generalizations designed to identify industries that will present a competitive problem.[124] He argued that "[b]oth structure-conduct-performance and Chicago Economics, as efforts to do that broad sweep, were empirical disasters."[125]

Commenters joined the chorus suggesting the importance of economic study to help guide current enforcement policy. The ABA commented that "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 in the market."[126] AAI urged the Commission to pursue the concerns raised by the absence of challenges except at very high concentration levels by forming an independent body of experts to study use of the "'concentration presumption' and its reduced importance in current policy."[127]

AAI's Statement on Mergers argued that the "consensus conclusion from more recent studies using more sophisticated research tools is that increased concentration, at high levels, is

---

122 Roundtable Trans. at 8-9, 72-73, 82-83 (White); Lawrence J. White, Statement of Lawrence White Before the Antitrust Modernization Commission, at 7-8 (revised draft March 16, 2006) ("White Statement").

123 Roundtable Trans. at 82 (White); White Statement, at 8.

124 Roundtable Trans. at 32 (Bresnahan); *cf*. Roundtable Trans. at 66-67 (Reiss) (heterogeneity of industries and firms have led economists away from cross-industry studies of the effect of entry and to "within-industry studies").

125 Roundtable Trans. at 33 (Bresnahan).

126 ABA Merger Comments, at 2. Charles Weller argued that the *Philadelphia National Bank* presumptions cannot withstand scrutiny under *Daubert*. Weller Comments, at 3-4.

associated with higher prices, and is therefore a suitable proxy, at least in the first instance, for an expectation of market power."[128] AAI argued that "current economic thinking and evidence still support the presumption that concentration implies anticompetitive potential."[129]

3. *The Importance of Customer Opinions and "Hot" Documents*

Various witnesses affirmed the great importance that the enforcement agencies appear to attach to customer opinions in evaluating mergers, but underlined the need to ensure that those opinions actually address the correct competitive issues.[130] Mr. Rill stated a view that the enforcement agencies may in some cases place too great weight on customer complaints, arguing that the agencies should look for "informed customer testimony based on some kind of empirical analysis."[131]

Several witnesses agreed that the proverbial "hot" documents also play a significant role in agency and court decisions.[132] Others, however, argued that such internal company

---

127 AAI Comments, at 3.

128 AAI Statement on Mergers, at 14.

129 AAI Comments, at 3; *see also* AAI Statement on Mergers, at 14 ("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").

130 Scheffman Statement, at 3-4 (DOJ and the FTC "rightfully . . . rely substantially on customer opinions," but those opinions must be informed and "closely related to bona fide competitive issues."); *cf.* Trans. at 103-04 (Scheffman) (citing *Oracle* and *Arch Coal* as evidence that hot documents and customer complaints do not get too much weight from judges).

131 Trans. at 101-02 (Rill); *see also* Rill Statement, at 9 (*Arch Coal* and *Oracle* make clear that addressed the relevant issues for antitrust analysis—there market conditions conducive to coordination and market definition, repetitively); Trans. at 104 (Willig) ("the agencies themselves are very aware and very responsible" generally as to whether customer complaints and hot documents are "genuine, important sources," but noting that preparing for litigation can affect thinking).

132 Trans. at 13 (Scheffman) (along with hot documents, customer opinions "are the things the agencies rely on the most").

documents actually get less weight, or that they deserve to get less weight than they do receive.[133]

4. *Entry*

Professor Reiss was the principal witness addressing entry at the economist roundtable; the other participants did not address entry specifically. He testified that the conceptual framework of Section 3 the *Guidelines* is generally appropriate and consistent with accepted economic principles, particularly in emphasizing sunk costs in determining the competitive import of entry.[134] He noted that, in practice, however, it can be difficult to apply the *Guidelines'* framework for determining the potential timeliness, likelihood, and sufficiency of entry.[135] In particular, he expressed concern that it could prove very difficult for the courts to "wade through" the sophisticated analysis required.[136] He also observed that the determinants and effects of entry vary widely among markets and situations, making it difficult if not impossible, in his view, to reach valid generalizations as to the kinds of situations in which entry would reliably obviate competitive problems caused by a merger."[137]

---

[133] Trans. at 100-01 (Baer) (based on FTC merger enforcement data, hot documents were not nearly as important as "credible customer complaints"); Trans. at 102-03 (Rill) (hot documents often reflect the companies' "aspirational view"); Scheffman Statement, at 5 ("'hot documents' get more weight sometimes than they deserve").

[134] Roundtable Trans. at 17-19 (Reiss) (endorsing the conceptual correctness of the entry analysis in the 1992 and 1997 *Horizontal Merger Guidelines* in particular the focus on the importance of sunk costs in influencing entry decisions); Peter C. Reiss, Remarks Prepared for the Antitrust Modernization Commission's Economists' Roundtable on Merger Enforcement, at 2 (Jan. 19, 2006) ("Reiss Statement").

[135] Roundtable Trans. at 20-22 (Reiss).

[136] Reiss Statement, at 10; Trans. at 21-22 (Reiss).

[137] Roundtable Trans. at 18-22 (Reiss); Reiss Statement, at 8-9. For example, Professor Reiss noted that studies of generic drug markets generic drug studies have been informative about the importance of entry determinants such as of technology, replicating brand capital, cost structure, and distribution systems. Roundtable Trans. at 67 (Reiss).

C. Calls for Further Study of Agency Merger Enforcement Decisions

Witnesses suggested two types of retrospective studies of prior enforcement efforts that might be undertaken. First, they suggested studying cases where either the merger was cleared without challenge or the agency was unable to obtain a court injunction. Second, they suggested studies of merger decisions where one of the enforcement agencies had successfully blocked the merger or obtained structural relief.[138] Studies of mergers that were not blocked might be informative about such things as what levels of concentration or market shares give rise to competitive issues and the effectiveness of entry.[139] Rill, however, cautioned that studies will be useful only if the data are reliable.[140] Professor Rubinfeld stated that it may be worth considering limited authority to allow follow-up information gathering for selected mergers for the purpose of evaluating the actual competitive effects of consummated mergers.[141] Professor Willig noted the need to overcome substantial confidentiality problems surrounding data collected by the agencies so that outside researchers and the public could have access.[142] Several witnesses said they would not support legislation to enable the government to enable greater transparency.[143]

Witnesses also suggested that it might be useful for the enforcement agencies periodically to review data on their merger enforcement activity, similar to what was done for the merger

---

138 *See, e.g.*, ABA Merger Comments, at 1, 5-6 (recommending "case studies" examining "the market effects from mergers that were cleared by the antitrust agencies to see if they led to neutral or procompetitive outcomes in the relevant industries . . . or to higher prices/less innovation/etc."); Trans. at 66-67 (Scheffman) (noting similar FTC studies); Trans. at 69 (Baer) ("such studies are a good idea, and more ought to be done.").

139 Roundtable Trans. at 8, 72-73, 82-83 (White); White Statement, at 9-10.

140 Trans. at 68 (Rill).

141 Roundtable Trans. at 88 (Rubinfeld).

142 Trans. at 66, 74-75 (Willig).

143 Trans. at 87 (Rill); Trans. at 87-88 (Baer).

clearance data project. Congress could require the agencies to collect and publish such data, or it could be adopted as a policy by the agencies.[144] Such data analysis might be easier now than it has been in the past given that so much data is now collected and stored electronically.[145] Mr. Rill emphasized the importance of focusing data collection efforts on "decision-driving rationales."[146]

III. Treatment of Innovation in Merger Analysis

The Commission agreed to study two issues relating to innovation—the use of innovation markets and the *Merger Guidelines*' two-year benchmark for assessing entry. In addition, during the course of its study of the treatment of efficiencies in merger policy, several AMC witnesses and commentators submitted that the agencies did not adequately consider the innovation benefits that would likely result from a merger.

Witnesses broadly agreed about the overriding importance of innovation to consumer welfare. Several declared that, in effect, "innovation is king"—*i.e.* that innovation accounts for the lion's share of consumer welfare improvement.[147] Accordingly, they emphasized the importance of taking innovation into account in antitrust analysis—"[a]ntitrust law must focus on

144 Trans. at 91-92 (Willig) (favoring internal review, but not a Congressional mandate). In contrast, Mr. Baer agrees with having "[f]ederal mandates for systematic collection of information on enforcement." Trans. at 94-95 (Baer).

145 Trans. at 92-93 (Scheffman).

146 Trans. at 95-96 (Rill) (emphasizing the influence the AMC's recommendations could have in prompting the agencies to undertake such analysis).

147 Richard J. Gilbert & Willard K. Tom, *Is Innovation King at the Antitrust Agencies?: The Intellectual Property Guidelines Five Years Later,* 69 Antitrust L.J. 43, 43 (2001); Carl Shapiro, Antitrust, Innovation, and Intellectual Property, at 2 (Nov. 8, 2005) ("Shapiro Statement") ("the lion's share of consumer benefits associated with competition in our most dynamic industries results from innovation"); M. Howard Morse, Prepared Statement Before the Antitrust Modernization Commission, at 5 (Nov. 8, 2005) ("Morse Statement") ("small increases in productivity from innovation dwarf even significant reductions in static efficiency over time").

dynamic effects to be relevant in the 21st century."[148] They noted that the need is particularly true with respect to analyzing mergers.[149] The agencies have focused increasingly on innovation in recent years, with concerns about reduced innovation being a component of an increasing percentage of challenges since the early 1990s.[150] Yet, the *Merger Guidelines* mention innovation only in a footnote, and thus offer little guidance as to agency treatment of innovation.[151]

Although the arguments for greater attention were not necessarily couched in terms of refining innovation-market analysis or providing greater weight to innovation efficiencies, for convenience and clarity, these arguments are addressed variously in this section under those general headings.

---

148 Morse Statement, at 2; *see* ABA Merger Comments, at 2 ("Optimal merger enforcement policy should take a dynamic viewpoint."); New Econ. Trans. at 19 (Morse).

149 New Econ. Trans. at 27 (Gilbert) ("[I]t's correct for the antitrust agencies to take likely impacts on innovation into account when reviewing mergers or other firm conduct."); Shapiro Statement, at 9-10 ("[A]ntirust law should be (and is) very much concerned about *innovation competition*, *i.e.* competition to engage in research and development directed towards new and improved goods or processes."); *see also* New Econ. Trans. at 76 (Morse).

150 Richard J. Gilbert, New Antitrust Laws for the "New Economy"?, at 7, 19, Tables 2-4 (Nov. 8, 2005) ("Gilbert Statement") (the number of agency challenges alleging impacts on innovation increased from 3 percent of all merger challenges (4 matters) during 1990-1994, to 17.5 percent (47 matters) during 1995-1999, and then to 38 percent (41 matters) during 2000-2003) (citing DOJ/FTC Annual Reports to Congress, agency complaints, and news releases).

151 Morse Statement, at 4 (quoting *Merger Guidelines*, at § 0.1 n.6); M. Howard Morse, *The Limits of Innovation Markets*, 2 Antitrust & Intell. Prop. (ABA Section of Antitrust Law News) 22, 33 (2001) ("Morse, *Limits*") ("[T]he current *Merger Guidelines* are virtually useless as a guide or a predictor of agency treatment of this subject.").

A. Innovation Markets

Should antitrust law be concerned with "innovation markets"? If so, how should antitrust enforcers analyze innovation markets? How often are "innovation markets" analyzed in antitrust enforcement?

One significant mechanism by which the agencies have assessed the impact of a merger on innovation is the use of "innovation markets." Innovation markets consist of "the research and development directed to particular new or improved goods or processes, and the close substitutes for that research and development."[152] Such markets are to be delineated "only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms."[153]

Innovation market analysis had its origins in the early 1990s, when the FTC challenged Roche's investment in Genentech and the Justice Department challenged ZF Friedrichshafen AG's proposed acquisition of General Motor's Allison transmission business.[154] Roche was a leading producer of a vitamin supplement, while Genentech was developing a patented production technique for that vitamin supplement. Both GM and ZF were leading innovators in automatic transmissions for trucks. The agencies further developed the concept of innovation markets in their joint *Intellectual Property Guidelines*.[155] There is also a substantial body of literature assessing innovation market analysis.[156]

---

152 United States Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* § 3.2.3 (1995) ("*Intellectual Property Guidelines*").

153 *Id.*

154 Morse, *The Limits of Innovation Markets*, at 22-23.

155 *See Intellectual Property Guidelines* § 3.2.3.

156 U.S. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* 10-13 (1995); Ilene Knable Gotts & Richard T. Rapp, *Antitrust Treatment of Mergers Involving Future Goods*, 19-FALL Antitrust 100 (2004) ("Gotts & Rapp, *Future Goods*"); Robin Moore & Holly Vendova, *The Road to Genzyme: A Look at Competition in Innovation Cases at the Federal Trade Commission*, 5 Antitrust & Intell. Prop. (ABA Section of Antitrust Law Newsl.) 6 (2004); Douglas L. Wald & Deborah L. Feldstein,

Although the FTC and DOJ have alleged innovation markets, there is some question as to how much (it at all) the concept aids in assessing the likely competitive effects of a merger. Economic evidence does not provide clear guidance regarding the impact of concentration (or competition) on innovation.[157] Concentration may not have clear implications for the "output" of innovation.[158] By comparison, higher concentration in product markets (abstracting from efficiencies) is generally believed to reduce competition. In addition, it has been argued that "innovation was central to the enforcement decision" in only six to eight matters out of 49

Merger Enforcement in Innovation Markets: The Latest Chapter—Genzyme Novazyme, The Antitrust Source (July 2004); Ronald W. Davis, *Innovation Markets and Merger Enforcement: Current Practice in Perspective*, 71 Antitrust L.J. 677 (2003); Dennis W. Carlton & Robert H. Gertner, *Intellectual Property, Antitrust and Strategic Behavior*, Nat'l Bureau of Econ. Research Working Paper Series No. 8976 (2002) ("Carlton & Gertner, *Strategic Behavior*"), *available at* http://www.nber.org/papers/w8976; Morse, *Limits*, *passim*; Thomas N. Dahdouh, *The Shape of Things to Come: Innovation Market Analysis in Merger Cases*, 64 Antitrust L.J. 405 (1996) ("Dahdouh, *Things to Come*"); Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 Antitrust L.J. 569 (1995) ("Gilbert & Sunshine, *Dynamic Efficiency*"); Richard T. Rapp, *The Misapplication of the Innovation Market Approach to Merger Analysis*, 64 Antitrust L.J. 19 (1995) ("Rapp, *Misapplication*"); George A. Hay, *Innovations in Antitrust Enforcement*, 64 Antitrust L.J. 7 (1995); Richard J. Gilbert & Steven C. Sunshine, *The Use of Innovation Markets: A Reply to Hay, Rapp, and Hoerne*r, 64 Antitrust L.J. 75 (1995); Federal Trade Comm'n, Office of Policy Planning, *Anticipating the 21st Century: Competition Policy in the New High-Tech Global Marketplace*, ch. 7, at 33-44 (1996) *available at* http://www.ftc.gov/opp/hitech/global.htm. ("FTC, *Global Marketplace*").

[157] George S. Cary, Efficiencies in Merger Analysis: From Both Sides Now, at 13-14 (Nov. 17, 2005) ("Cary Statement") ("In some industries, it is quite plausible that 'R&D output' is highly correlated with R&D head count, such that a reduction in head count means less R&D. In other industries, combining institutional knowledge can result in fewer scientists achieving greater discoveries."); *see* FTC, *Global Marketplace*, ch. 7, at 16 (noting argument that "economic theory and empirical investigations have not established a general causal relationship between innovation and competition").

[158] *See* ABA Merger Comments, at 3 ("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).").

matters in which such effects were alleged between 1995 and 1999.[159] DOJ has brought only one case on that theory over the last ten years.[160]

Views on the relationship between concentration and innovation are conflicting. Some observers advocate the Schumpetarian hypothesis, maintaining that large and dominant firms provide a superior platform for innovation and mergers, by increasing the ability of the merged firm to appropriate the benefits form innovation, may increase incentives to innovate.[161] Others argue that more competitors, *e.g.*, a new entrant challenging an entrenched firm, can spur innovation, and that new entrants or niche firms are more likely to adopt "'leap frog' or 'paradigm-shifting' innovations."[162] On balance, the relationship between concentration and innovative competition is complex, and the economic evidence does not "support[] a general conclusion that competition always increases of always decreases incentives for innovation."[163]

---

159 Gilbert Statement, at 16.

160 Statement of James J. O'Connell on Behalf of the United States Department of Justice, at 7-8 (Nov. 8, 2005) ("O'Connell Statement").

161 Gilbert Statement, at 14, 16-17 (this is more likely to occur where appropriability is difficult); Shapiro Statement, at 12 (emphasizing that the difficulty of appropriability is a key issue).

162 Morse Statement, at 10 (monopolists tend to focus on incremental innovations to existing products and quickly copy innovations by others (citing C. Christenson, *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail* (1997)); J. Utterbach, *Mastering the Dynamics of Innovation* (1994); Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources to Invention, in The Rate and Direction of Inventive Activity* (National Bureau of Economic Research 1962); F.M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 630-60 (3d ed. 1990); Wesley M. Cohen & Richard C. Levin, *Empirical Studies of Innovation and Market Structure, in* 2 *Handbook of Industrial Organization* 1059 (R. Schmalensee & R. Willig eds. 1989)).

163 New Econ. Trans. at 24-25 (Gilbert); *see* New Econ. Trans. at 24 (Gilbert) (innovation "is not well served by enforcement actions that adhere categorically to one or the other polar view"); Shapiro Statement, at 11-12 ("there is no consensus among industrial organization economists about the general relationship between concentration and innovation competition"); O'Connell Statement, at 8 ("Predicting accurately the effects of a merger on the development of products that do not—and may never—exist is even more difficult" than predicting price effects in a static market."); Trans. at 57-58 (Scheffman) (it "is much more complicated" since we do not have a basis for a presumption that "reductions in the number of competitors will reduce

Several AMC witnesses and commentators argued that innovation markets can be a useful tool in analyzing the likely competitive effects of mergers in downstream goods and services markets, but that they have significant limits that must be recognized.[164] Witnesses and commentators identified the following "pros," "cons," and cautions relating to the use of innovation markets.

Pros

- Where firms are not already competitors, the impact of a merger on certain aspects of future competition can "be analyzed more directly by focusing on innovation markets."[165]

Cons

- More traditional analyses usually suffice to address innovation concerns.[166]

---

innovation competition"); Rapp, *Misapplication*, at 27-33; Carlton & Gertner, *Strategic Behavior*, at 13-16. *But cf.* Rubinfeld Statement, at 5-6 ("The fact that a market is innovative and dynamic should not give a merger a free pass. . . . [I]ndeed it is particularly appropriate to ask on the one hand whether the firm that is being acquired would have threatened the dominance of the acquiring firm, and on the other hand, whether other firms in the industry are likely to offer superior products or services with the potential to undermine the market power of the dominant firm.").

Some argue further that there is a lack of evidence that reduced R&D will reduce innovation. *See* Rapp, *Misapplication*, at 33-36; Shapiro Statement at 11-12. Similarly, others argue that it is unclear whether the reduction in R&D will reduce welfare. *See* Carlton & Gertner, *Strategic Behavior*, at 10-12.

164 Gilbert Statement, at 12 ("Innovation markets do have value in antitrust analysis as an analytic tool to predict changes in the price or output of goods and services in downstream markets."); New Econ. Trans. at 73-74 (Gilbert) ("[T]he innovation-market approach . . . [is] just a screen, just like a product market screen . . . . Once you've identified those transactions where you could either have price effectos or innovation effects, that's when the hard work starts."); *see also* Gilbert Statement, at 13 (innovation market analysis "can provide a useful screen to assess whether an arrangement may have a significant impact on R&D"); AAI Comments, at 19 (innovation markets are a "clearly helpful concept," but might be difficult to apply in practice).

165 Gilbert & Sunshine, *Dynamic Efficiency*, at 587; *id.*at 581-90; Comments of the Computer and Communications Industry Association, at 6 (suggesting that "to more effectively promote innovation, [the agencies] should examine innovation markets separately from affected product markets").

166 O'Connell Statement, at 7 (using an innovation market is needed only if the issues cannot be "adequately addressed by specifying goods or technology markets"); AAI Comments, at 19

- Delineating an innovation market requires identifying other firms that have the capability to undertake the R&D in the future. Unless there are few such firms, there is no plausible basis to conclude that the merger reduces competition in the particular innovative activity. But sources of future innovation are quite unpredictable—an idea developed by one firm may have an application in an entirely different industry.[167] And the longer the time horizon, the greater the difficulty of accounting for likely sources. Moreover, there is the difficulty associated with trying to predict future events that will take place, if at all, far in the future.[168]

- "[N]either economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation . . . based simply on observing how the merger changed the number of independent R&D programs.[169]

<u>Cautions</u>

- Innovation market analysis "is potentially useful but requires caution" and "should be used rarely, where the transaction has competitive effects on innovation that cannot be adequately addressed otherwise."[170]

- Although innovation-markets analysis is useful, the concept "must be used with caution," particularly in identifying whether the merger firms are "likely potential competitors that are currently exerting competitive pressures on each other" and the existence of other competitors.[171]

("much of the innovation market concept is well-captured by 'potential competition" theory, if one allows potential competition theory to include both perceived and actual potential competition."); Morse, *Limits*, at 27 ("Most of the innovation market cases brought since issuance of the *IP Guidelines* could have been brought under traditional potential competition theories."); Trans. at 60 (Rill) (innovation market cases generally brought by the agencies where there was a product in the market or would be very soon); Trans. at 61 (Willig) (often innovation will result in products that will compete with existing products, not necessarily a separate market).

167 Shapiro Statement, at 11; Carlton & Gertner, *Strategic Behavior*, at 15-17; O'Connell Statement, at 8-9; *cf.* Morse Statement, at 11.

168 Gotts & Rapp, *Future Goods*, at 100 ("Far harder to predict, however, is the performance of a market for goods that neither exist in the present nor are anticipated within a foreseeable time horizon.").

169 *In the Matter of Genzyme Corp. and Novazyme Pharmaceuticals Inc.*, FTC File No. 021-0026, Statement of Chairman Timothy J. Muris, at 5-6 (Jan. 13, 2004) ("*Genzyme/Novazyme*"); *see also id.* at 2-3; Scheffman Statement, at 9 (I agree wholeheartedly with former Chairman Muris's statement . . . about the untenability of "'innovation markets'" (citing *Genzyme/Novazyme*)).

170 O'Connell Statement, at 7, 9.

171 AAI Comments, at 19-20.

- "[I]nnovation-market analysis should really be rooted in what's going to happen in future product markets."[172]

- Such an analysis could be "improved by limiting it to foreseeable goods markets" thereby "rul[ing] out enforcement actions concerning future goods that are justified only by reference to the intentions of the parties or to their R&D facilities or expenditures, rather than be reference to forecasts of future goods markets."[173]

One witness suggested that merger analysis should include a rebuttable presumption that competition promotes innovation, arguing that such a presumption would "align antitrust policy with the bulk of empirical evidence."[174] Several witnesses agreed that one circumstance in which there should be concerns that a merger will reduce innovation is when there are only two firms pursuing a particular line of research and development.[175] Where there are more than two competing researchers, a merger between two of them is less likely to affect research and development due to "the difficulty of collusion in R&D."[176]

Some AMC witnesses called, at a minimum, for an update to the *Merger Guidelines* to address innovation. The following summarizes arguments for and against revising the *Merger Guidelines*.

---

172 New Econ. Trans. at 77 (Shapiro); Shapiro Statement, at 10.

173 Gotts & Rapp, *Future Goods*, at 103 (noting the possible exception for the "rare 2-player R&D race[]").

174 Gilbert Statement, at 1, 2, 8.

175 Morse Statement, at 10 ("Mergers of the only two firms in a market pursuing R&D would appear to raise serious antitrust concerns."); *cf.* Shapiro Statement, at 12 (such a presumption is "warranted at the very least in situations where the merger involves the only to firms who are pursuing research that will allow them to enter a future product market" and noting that a fact-based inquiry considering beneficial synergies is required); *see also Genzyme/Novazyme*, Dissent of Commissioner Thompson, at 1, 3 (applying a presumption of anticompetitive effects to "a merger to monopoly in the research and development of a highly specialized drug"); *Genzyme/Novazyme*, Statement of Commissioner Harbour, at 3 (although the literature may not support "a general presumption of anticompetitive effects in highly concentrated industries," in a merger to monopoly, the presumption "seems appropriate") (citing Suzanne Schotchmer, Competition Policy and Innovation: The Context of Cumulative invention, Hearings on Competition and I.P. (Feb. 26, 2002)). *But see Genzyme/Novazyme,* Statement of Chairman Muris.

Pros

- "It is time . . . to update the government's Merger Guidelines, which today focus primarily on the ability to maintain prices above competitive levels. . . . It's far from clear that the models set forth in the Guidelines to analyze price competition, including the close-substitutes paradigm, translate to innovation competition."[177]

- "The agencies should articulate as clearly as possible the models that they operate under . . . . [T]here is a need for broad principles to which the staff . . . [and] parties can look in doing the analysis."[178]

- The *Guidelines* could explain "why it would be rare . . . to have a coordinated effects case involving R&D or innovation."[179] For unilateral effects, R&D theories, the *Guidelines* could examine "the incentives to bring out new products, and how that would be changed by the merger."[180]

Cons

- There is need for greater learning regarding innovation.[181]

- The *Guidelines* are "not meant to address every possible theory or even every way of looking at a merger. . . . The Division does not believe that the *Guidelines* need to be amended to reflect or address additional theories, because we believe that those theories are already incorporated where appropriate in the analysis that we conduct."[182]

B. Treatment of Innovation Efficiencies

Several AMC witnesses and commenters identified what they characterized as the enforcement agencies' limited recognition of innovation efficiencies as an area for possible reform. The *Merger Guidelines* currently recognize that R&D efficiencies should be considered, but appear to view them with particular skepticism: "Other efficiencies, such as those relating to

---

176 New Econ. Trans. at 46 (Morse).

177 New Econ. Trans. at 22 (Morse); Morse Statement, at 2.

178 New Econ. Trans. at 46 (Morse).

179 New Econ. Trans. at 83 (Shapiro).

180 New Econ. Trans. at 84 (Shapiro).

181 Trans. at 59-60 (Rill); Trans. at 59 (Scheffman) (although the *Guidelines*do not provide guidance on analyzing innovation competition, they should not be changed).

182 New Econ. Trans. at 73 (O'Connell).

research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions."[183] This suggests that companies claiming efficiencies from innovation face greater burden than other firms claiming efficiencies.

Several witnesses argued that mergers often will provide innovation or R&D efficiencies.

- "[A] merger may increase efficiency of R&D by making it easier for the parties to combine complementary assets and know-how.[184] Two firms may be able to reduce costs by eliminating duplicative investments or enable them to better share risks associated with R&D activities.[185]
- Innovation efficiencies "often drive transactions in high-tech mergers," and, while not always easily measured, should be given greater credence in merger policy."[186]
- Mergers can "increase the odds of successful commercialization of the product" in the pharmaceutical industry and "are an integral part of the innovative process in life sciences."[187]

One witness testified that, despite the benefits to innovation that mergers can bring, FTC investigations have seemed "skewed toward opposition to the proposed merger without giving

---

183 *Merger Guidelines* § 4. Moreover, "Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of consumer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict."). *Id.* § 4 n.37.

184 Gilbert Statement, at 14 (but cautioning that it might be able to combine assets short of a merger); New Econ. Trans. at 92-93 (Shapiro) (must consider alternative ways that the smaller firm might have commercialized the technology).

185 Gilbert Statement, at 14; *cf.* Morse Statement, at 11 (a merger that reduces R&D expenditures with no reduction in innovation, should be viewed as efficient).

186 Morse Statement, at 4; *see also* New Econ. Trans. at 22 (Morse) ("[I]t is just such efficiencies from the combination of complementary expertise, while not easily measured, that drive many transactions and have great potential consumer benefit.").

187 New Econ. Trans. at 16, 18 (Osborn). Mr. Osborn explained that mergers enable "research-stage" firms with a innovative product to combine with commercial stage firms that have critical expertise (*e.g.*, regulatory, clinical, marketing, sales, or medical) necessary to develop a product, gain FDA approval, and commercialize a product. New Econ. Trans. at 16-17 (Osborn); *see also* John E. Osborn, Antitrust Law and the New Economy, at 4-6 (Nov. 8, 2005) ("Osborn Statement") (companies must deal with high developments costs and high probabilities that products will ultimately not be developed or commercially successful).

much weight to the value of our ability to leverage our firm's assets to effectively commercialize the product."[188] He testified that the investigating staff tended to resolve uncertainties against the proposed merger," without "putting a lot of value on the consumer benefits" from innovation.[189] Other witnesses testified that they had not observed similar hostility to asserted innovation benefits.[190]

Regardless of whether the enforcement agencies appropriately treat claims of innovation efficiencies, several witnesses called for more guidance from the agencies on how they assess transactions that could enhance innovation. Others did not support revising the *Guidelines* in this area generally.

The following is a summary of points made about innovation efficiencies.

- The agencies can weigh innovation effects "much as [they] weigh efficiencies and anticompetitive effects in a rule of reason analysis."[191]
- The agencies might recognize an "innovation-market defense" for transactions that reduced market competition but enhanced innovation.[192]
- "Further consideration should be given to efficiencies that lead to more rapid or enhanced innovation, including development of new or improved products."[193]
- "The Guidelines limit cognizable efficiencies to those that 'do not arise from anticompetitive reductions in output or services.' . . . . Distinguishing between

188 New Econ. Trans. at 49 (Osborn); Osborn Statement, at 3-4.

189 New Econ. Trans. at 18 (Osborn). For example, FTC staff managed to define the markets to broadly enough to include the merging firms products and yet to "exclude all other existing or potential products to treat breakthrough or severe pain." Osborn Statement, at 19.

190 New Econ. Trans. at 9 (O'Connell) ("Department does care about the effects of a merger on innovation."); New Econ. Trans. at 49-51 (O'Connell, Morse) (observing no general anti-merger bias at the agencies); New Econ. Trans. at 51 (Shapiro) (suggesting that appearance of such biases may reflect skepticism of staff as part of building its case).

191 New Econ. Trans. at 95 (Gilbert).

192 New Econ. Trans. at 83 (Gilbert).

193 New Econ. Trans. at 22 (Morse).

those cost savings that benefit and those that hurt consumers is particularly problematic in R&D."[194]

- The agencies should provide more information as to "what would count as a merger-specific R&D efficiency" since "combining complementary products . . . could be very procompetitive.").[195]

- The the *Guidelines* should be amended to acknowledge that mergers can foster further product development and more effective commercialization of products.[196]

- Updating the *Guidelines* would provide large benefits in educating businesses, the bar, and the courts.[197]

C. Two-year time horizon

In what circumstances, if any, should the two-year time horizon used in the Horizontal Merger Guidelines *to assess the timeliness of entry be adjusted? For example, should the time period be lengthened to include newly developed products when the introduction of those products is likely to erode market power? Should it matter if the newly developed products will not erode market power within two years? Is there a length of time for which the possession of market power should not be viewed as raising antitrust concerns?*

The *Merger Guidelines* provide that a merger is unlikely to harm competition where entry is sufficiently easy so that market participants cannot, collectively or unilaterally, raise prices from premerger levels.[198] To meet this requirement, entry must be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of

---

194 Cary Statement, at 13.

195 New Econ. Trans. at 84 (Shapiro).

196 New Econ. Trans. at 16-18, 67 (Osborn); *see also* New Econ. Trans. at 84-85 (Osborn). (*Guidelines* might be modified so that "specific consideration" is given to the ability of the transaction to improve the ability of the acquired company to effectively develop and market the product, at least for pharmaceuticals and biotechnology).

197 New Econ. Trans. at 76 (Morse) (arguing against "understat[ing] the importance of the *Merger Guidelines*" in counseling and litigation); New Econ. Trans. at 82-83 (Gilbert) (value of changing *Guidelines* is in educating the industry and practitioners about how the agencies might look at a transaction involving particular characteristics).

198 *Merger Guidelines*, at § 3.0.

concern."[199] As a general matter, FTC and DOJ will consider timely "only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact."[200] Some observers have argued that the two-year time horizon is inappropriately short. In particular, entry based on innovation and R&D efficiencies may not have an impact on a merger's anticompetitive effects (or benefit consumers) until after two years.

- Several witnesses and commenters testified that the existing two-year horizon is sufficiently flexible to account for innovation and other effects, so that no *Guidelines* change is needed.[201] The *Guidelines* statement in fact suggests that it represents an approximation, not a hard-and-fast rule.[202] Pursuant to the *Guidelines,* in the case of durable goods, entry that is expected to occur outside the two-year window will be considered timely "so long as it would deter or counteract the competitive effects of concern within the two-year period and subsequently."[203]

- Some witnesses argued that the agencies should not and no not necessarily disregard anticompetitive effects that would likely arise within the two-year time horizon, before entry is expected to occur. One witness explained that the Guidelines "do not establish a two-year horizon for examining competitive effects;" and that while "very short-lived market power" might not raise concerns,

---

199 *Id.*

200 *Merger Guidelines,* at § 3.2 (footnote omitted).

201 O'Connell Statement, at 5 (DOJ "certainly has considered competitive effects—both positive and negative—more than two years into the future in its merger analysis, particularly in matters involving the development of innovative, next-generation products.").

202 O'Connell Statement, at 4; *see* Kevin J. Arquit, Director, Bureau of Competition, Federal Trade Commission, Address at the Cleveland Chapter of the Federal Bar Ass'n. (Dec. 14, 1989) ("[T]here is nothing magical about the Guidelines' two-year horizon in the first place, . . . it is a useful device for simplifying our analysis, and not a substitute for analysis."); Shapiro Statement, at 9 ("there is nothing magical about the two-year time horizon in this calculus"); *see also* Gotts & Rapp, *Future Goods*, at 100 (noting that the FTC has departed from the two-year time horizon in challenging pharmaceutical mergers due to innovation-related concerns); Shapiro Statement, at 9.

203 O'Connell Statement, at 5 n.9 (quoting *Merger Guidelines* § 3.2); Morse Statement, at 9 ("[W]here later entry will deter anticompetitive effects, it should be considered timely."); *see also* Gilbert Statement, at 11 (recommending flexible application based on capacity to deter anticompetitive effects).

a challenge is likely "where the possible harm is potentially large and the period of harm is less than two years."[204]

- Another witness, however, advised that the adverse effects of a "fleeting" enhancement of market power is more likely to be offset by efficiencies.[205] Short-term market power might go unchallenged because the duration is so short that it does not justify enforcement effort or because the short-term impact stimulates dynamic or "disruptive" competition that would otherwise not have occurred.[206]

IV. Treatment of Efficiencies in Merger Analysis

The 1997 revisions to the *Merger Guidelines* added a section describing the circumstances in which the agencies would consider the procompetive benefits, or "efficiencies," of a merger.[207] The *Guidelines* recognize that

> mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction. Indeed, the primary benefit of mergers to the economy is their potential to generate such efficiencies.[208]

Nonetheless, "[e]ven when efficiencies generated through merger enhance a firm's ability to compete, . . . a merger may have other effects that may lessen competition and ultimately may make the merger anticompetitive."[209]

Merging parties seeking to establish efficiencies must show three general elements. First, they must show that the efficiencies are "merger specific."[210] That is, the efficiencies must arise

---

204 O'Connell Statement, at 5-6.

205 Shapiro Statement, at 9 (cautioning that it might be necessary to "heavily discount" benefits based on synergies in a dynamic setting).

206 Gilbert Statement, at 11-12.

207 *Merger Guidelines* § 4.

208 *Id.*

209 *Id.*

because of the merger, and cannot be obtainable without the merger.[211] Second, the efficiencies must be "verifiable," or sufficiently substantiated by the parties to enable the enforcement agency to be sufficiently confident that the merged firm will actually realize the asserted efficiencies.[212] Finally, the efficiencies must be "cognizable." Cognizable efficiencies are those that are both verifiable and merger-specific, and that do not arise from anticompetitive reductions in service, such as cost savings that might result from reducing output or staffing levels.[213] The *Guidelines* generally require that the savings from efficiencies be "passed on" to consumers; that is, they must be "sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market."[214]

The *Merger Guidelines* also explain how the agencies will consider cognizable efficiencies in relation to anticompetitive effects. The *Guidelines* explain that FTC or DOJ

> will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's

---

210 *Id.* (merger specific efficiencies are those "efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.")

211 *Id.* § 4 n.35 (efficiencies are not merger specific if they could also be obtained through licensing or other less restrictive "practical alternatives.").

212 *Id.* § 4 ("[T]he merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means.").

213 *See id.*

214 *Id.* The *Guidelines* provide that the agencies may also take into consideration efficiencies that do not have a "short-term, direct effect on prices in the relevant market." *Id.* The *Guidelines* call for giving such savings less weight because they are "less proximate and more difficult to predict." *Id.* § 4 n.37

> potential to harm consumers in the relevant market, *e.g.*, by preventing price increases in that market.[215]

As a general matter, sizable efficiencies must be presented to overcome an inference of sizable anticompetitive harm. Furthermore, efficiencies will "almost never justify a merger to monopoly or near-monopoly"[216]

A. General Assessment of the Agencies' Treatment of Efficiencies

> *Do the U.S. courts and federal antitrust enforcement agencies adequately consider efficiencies in merger analysis? Please identify specific examples, evidence, or analyses supporting your assessment.*
>
> *What types 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? Should courts and agencies evaluate claims of efficiencies? What should be the burdens of production and proof for establishing efficiencies?*

Witnesses and commenters generally stated that the agencies' current approach to assessing efficiency claims works well and is appropriate.[217] The agencies acknowledge that it is not possible to evaluate whether a merger will have anticompetitive effects without taking into

---

215 *Id.* § 4 (footnote omitted)

216 *Id.*

217 *See, e.g.*, Baker Statement, at 1; Trans. at 120 (Baker) ("[T]here's no serious problem involving efficiencies in merger analysis that would call for intervention by your Commission, and that, in particular, there's no need to recommend any legislation to address anything concerning efficiencies."); Cary Statement, at 2 ("The Agencies, by and large, have taken appropriate account of efficiencies in deciding whether to challenge mergers, and the courts have done quite well in evaluating efficiency arguments in litigation."); Trans. at 116 (Cary) ("[A]fter eight years of seeing the Guidelines in action, it's my view that the basic trade-offs made in the Guidelines were right . . . the process of actually doing the efficiency analysis . . . in the Guidelines is more manageable and more administrable than one might have thought going into the process of creating the Guidelines' analysis in the first place.").

account efficiencies that will result from the merger and the effect those efficiencies will have on a firm's incentives to reduce output or increase prices.[218]

One witness stated that the agencies currently do not properly analyze efficiencies. Mr. Rule argued that the current agency approach does not provide sufficient weight to efficiencies insofar as analysis focuses primarily on the likely price effects of a merger, including the effect of efficiencies.[219] As discussed more fully below with respect to the use of a total welfare standard, Mr. Rule argued that the agencies do not adequately consider "all cost savings—both fixed and variable—that a merger is likely to generate."[220] Similarly, as described above in Section III, several Commission witnesses and commenters testified that the agencies do not give sufficient credit to innovation and R&D efficiencies.

Witnesses and commenters generally agreed that the evidentiary burden imposed on parties to demonstrate or prove asserted efficiencies is proper. The following summarizes the tenor of the testimony and comments.

---

[218] Statement of Kenneth Heyer on Behalf of the United States Department of Justice, at 2-3 (Nov. 17, 2005) ("Heyer Statement") ("[T]he Merger Guidelines underscore the central role of efficiencies in the evaluation of the likely competitive effects of proposed mergers. . . . There is simply no way to evaluate whether a merger will give the merged firm the ability and incentive to raise prices, either unilaterally or in coordination with other firms, without examining the efficiencies a merger may produce."); *see* Prepared Remarks of Dr. Michael A. Salinger, Director, Bureau of Economics, Federal Trade Commission, at 2 (Nov. 17, 2005) ("Salinger Statement") ("As the merger guidelines have developed through their various iterations, efficiencies have moved, in part, from a possible 'defense' to part of an integrated analysis of competitive effects.").

[219] *See* Charles F. (Rick) Rule, Consumer Welfare, Efficiencies, and Mergers, at 13 (Nov. 17, 2005) ("Rule Statement") ("To the extent that merger enforcement continues to focus exclusively on price effects (and reductions in consumer surplus) and ignores the way in which increases in productive efficiency benefit consumers as whole even when such increases generate producer surplus, the thresholds for identifying anticompetitive mergers are likely to be too low and the explicit *and* implicit treatment of productive efficiencies is likely to be too limited.").

[220] *Id.*

- It is appropriate to require real evidence to support claims of efficiencies in a merger that might otherwise be "troublesome."[221]

- The parties have unique access to information concerning efficiencies. "Requiring the party with greater access to information to come forward with evidence of a proposition that is helpful to its position is not at all unusual in antitrust cases generally or merger cases particularly."[222]

- Although courts have thus far provided only limited guidance regarding where the burdens of production and persuasion should fall with respect to efficiencies, it is appropriate to allow the courts to weigh the pros and cons of the range of possibilities. "The law in this area is only just developing, and the decisions so far create no pressing need to rush that development."[223]

B. Welfare Standard

What is the appropriate welfare standard to use in assessing efficiencies — a consumer welfare standard, a total welfare standard, or some alternative standard?

The *Merger Guidelines* describe primarily a "consumer welfare" standard for use in evaluating efficiencies.[224] That is, the agencies will determine "whether cognizable efficiencies

[221] Trans. at 107 (Heyer) ("We actually need some evidence to support the fact that there may be efficiencies from what might otherwise be a troublesome merger."); *see* Salinger Statement, at 4 ("[W]e cannot conclude that a merger will generate efficiencies simply because the parties say it is so. Mere assertion is not proof or even, by itself, supporting evidence."). *But see* Trans. at 85 (Scheffman) (efficiencies claims are "speculative," but so are predictions of anticompetitive effects).

[222] Cary Statement, at 8-9; *see* Heyer Statement, at 4 ("[T]he information need to make an informed and reasoned judgment about such claims is almost always uniquely in the hands of the merging parties. We cannot verify efficiency claims without their cooperation.").

[223] Baker Statement, at 24; *see also id.* at 22 (courts might treat efficiencies as a defense if they were offered to demonstrate that prices would not rise, putting the burden of production, not persuasion on the parties; however, if efficiencies were assigned the larger role of excusing higher prices, they should be treated as an affirmative defense, so that the parties would bear the burden of both production and persuasion).

[224] There was considerable discussion at the hearing as to the definition of "consumer welfare." Mr. Rule argued that the term "consumer welfare" is properly understood to include both consumer and producer surplus, as used by Judge Robert Bork. *See* Rule Statement, at 2-5. Other witnesses generally used the term consumer welfare to refer to consumer surplus, and "total welfare" to include both consumer and producer surplus. *See, e.g.*, Baker Statement, at 10 n.24. For convenience and clarity, the term "consumer welfare" is used here to refer to consumer surplus.

likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market."[225] Put differently, if consumers in the relevant market will benefit directly from the efficiencies resulting from the merger, thereby overcoming the predicted anticompetitive effects, then the agencies will clear the merger. Efficiencies that merely reduce a company's costs in a way that are not passed on to consumers will not justify an otherwise anticompetitive merger.[226]

Most witnesses and commenters advocated retaining a consumer welfare standard.[227] Their arguments are summarized below.

- A consumer welfare standard reduces incentives for parties to propose potentially anticompetitive mergers that might, under a total welfare standard, be cleared due to potentially speculative or uncertain cost savings.[228]

- Using a consumer welfare standard strikes an appropriate balance between a total welfare standard, which could allow anticompetitive mergers, and an even more aggressive standard designed to "maximize choice or constrain wealth transfers."[229]

---

225 *Merger Guidelines* § 4.

226 *See id.* § 4 ("[T]he Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market."); *see also id.* § 4 n.37 ("The Agency also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of consumer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict."); *cf.* Heyer Statement, at 8 ("[T]he Agencies give most weight to those efficiencies that benefit consumers in the short term through lower prices, but will consider other efficiencies as well."); Trans. at 127-28 (Heyer) (similar).

227 *See, e.g.*, Trans. at 116 (Cary) ("[C]onsumer welfare is the appropriate standard. There is a consensus around that.").

228 *See* Baker Statement, at 13-18.

229 AAI Comments, at 10 ("A total welfare standard . . . 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. 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

- Competition agencies in many other countries have adopted the consumer welfare standard.[230]

- "Because case law and agency practice during the administrations of both parties are firmly based on the consumer welfare standard, it is unlikely that a total welfare standard will be adopted."[231]

- A "true consumer welfare standard would condemn conduct if it actually reduces the welfare of buyers, irrespective of its impact on sellers," while a total welfare standard also considers the welfare of competitors.[232]

One witness and one commenter advocated adopting a standard that is closer to a total welfare standard.[233] Mr. Rule argued that focusing solely on the welfare of consumers in merger analysis risks incoherence, because there is no basis for preferring surplus that accrues to consumers over that which accrues to producers—in either case society benefits from the improvement in allocative efficiency.[234] As a result, Rule argues, efficiency-enhancing mergers may be blocked or deterred.[235] Similarly, the International Bar Association argued that "merger

---

transfer/consumer choice oriented standards, in effect resulting in a balancing of these two general approaches.") (footnote omitted).

230 AAI Comments, at 10 & n.38 (citing E.U., Australia, and United Kingdom).

231 ABA Efficiencies Comments, at 2.

232 Salop Comments, at 1-3.

233 Rule Statement, at 1 ("[M]erger enforcement should only condemn mergers that have a *clear* potential for resulting in *significant* price increases (as a proxy for output reductions)."); *see* Trans. 112-15 (Rule); IBA Comments, at 47 ("In general . . . [we] recommend[] increased consideration of efficiency gains to the broader economy and producers. Under the current system, significant efficiencies to producers are ignored to the detriment of overall economic welfare unless the stringent pass-through test can be met.").

234 Rule Statement, at 3 ("[T]here is no coherent *a priori* basis for believing that consumers in any given market are inherently more deserving of surplus than the producers in that market. The social value of the surplus is the same."). Furthermore, use of a consumer welfare standard when consumers could acquire monopsony power would allow a merger that would create allocative inefficiency, yet increase consumer welfare through the use of monopsony power to obtain lower prices. *See* Rule Statement, at 6.

235 Rule Statement, at 13 ("To the extent that merger enforcement continues to focus exclusively on price effects (and reductions in consumer surplus) and ignores the way in which increases in productive efficiency benefit consumers as whole even when such increases generate producer surplus, the thresholds for identifying anticompetitive mergers are likely to be too low and the explicit *and* implicit treatment of productive efficiencies is likely to be too limited.").

efficiencies should not be disregarded if they provide benefit to many with relatively minor negative implications to few consumers."[236] Rule acknowledges, however, that although using a total welfare standard is the "ideal," it is "not entirely clear how best to make this ideal operational."[237]

For comparison, some countries, including Canada and New Zealand, use a total welfare standard in merger analysis.[238]

Although most witnesses and commenters rejected a shift to using a total welfare standard, several testified that the agencies did not give adequate credit to fixed-cost efficiencies. Basic economic principles provide that reductions in the marginal cost of production generally have the most significant effect on prices in the short run, whereas reductions in total costs (including fixed costs) have much less (if any) affect on pricing in the short run. In the longer run, however, some (if not all) reductions in fixed costs ultimately are passed on to consumers.[239]

---

[236] IBA Comments, at 47; *see also* ABA Merger Comments, at 4 ("This long-standing debate . . . should be addressed").

[237] Rule Statement, at 5.

[238] *See* Report of the Advisory Panel on Efficiencies, Submitted to Sheridan Scott, Commissioner of Competition, Canada, 51-56 (Aug. 2005) (recommending retention of standard generally using total welfare standard, but calling on Parliament to refine goals of competition act; recommending that any total welfare efficiency defense not be allowed in merger-to-monopoly cases); Competition Bureau of Canada, Evidence of the Commissioner of Competition (July 15, 2005) (summarizing Canada's process to study its efficiencies standard); IBA Comments, at 47 (In New Zealand "[t]he issue of merger efficiency has been litigated and it has been settled that the applicable standard is the total welfare standard. Under this standard, any wealth transfers between consumers and producers are regarded as neutral."); AAI Comments, at 9 n.31 (noting Canada and New Zealand). *See generally* IBA Comments, at 45-47 (summarizing rules in Canada, E.U., U.K., Australia, and New Zealand).

[239] This can occur for several reasons. First, over the longer run, costs which are at one time fixed (or sunk) become variable. Thus, savings in such costs could lower prices. Second, reduced unit fixed costs tend to reduce the cost of maintaining or adding capacity, potentially increasing industry productive capacity and lowering prices. *See, e.g.*, William J. Kolasky, *The Role of Economics in Merger Enforcement: Efficiencies and Market Definition under Conditions*

Several witnesses accordingly recommended that the enforcement agencies and courts should consider claims of fixed-cost efficiencies in assessing the likely competitive effects of a merger.[240] According to AAI

> 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. These efficiencies should not be limited to short run reductions in marginal costs. Since all costs vary in the long run, reductions in capital expenses or other costs fixed in the short run should also be considered, just as the agencies can be rightly concerned about reduction of competition in the longer run for products in development or R&D.[241]

Another witness explained that

> an increasing part of the economy is comprised of research-intensive products whose cost of duplication is trivial. Products such as computer chips, software, pharmaceuticals and media content have very high fixed costs, usually comprised of intellectual property, and very low marginal cost. The prices of

---

of Price Discrimination, at 10, presented at Charles River Associates Conference, "Current Topics in Merger & Antitrust Enforcement", Washington, D.C. (Dec. 11, 2002) ("[F]ixed cost savings matter. . . . First, which costs are variable depends in part on how long our time horizon is. With a longer horizon, costs that might otherwise appear fixed may indeed impact marginal pricing decisions.").

240 Rill Statement, at 14 ("'[A]n arbitrary exclusion of fixed costs from cognizable efficiencies is unwarranted because savings in fixed costs may affect competition and have an ultimate downward effect on price.'" (quoting FTC, *Global Marketplace*, ch. 7, at 34, ex. 132)); Rule Statement, at 13 ("Consumer welfare benefits from fixed cost savings just as much as variable savings."); Trans. at 86 (Scheffman) (courts should consider fixed-cost efficiencies and not "fall into this pass-through trap"); IBA Comments, at 47-48 ("For example, industries with significant R&D investments may have pricing unrelated to marginal cost, but rather geared towards recouping large investments in fixed costs. Large fixed cost efficiencies in such industries can directly affect price and should be given greater consideration where appropriate."); ABA Efficiencies Comments, at 6 ("Where fixed cost savings in a merger have the potential to lead to lower prices or will lead to reduced allocations of direct, shared or common fixed costs that are incorporated in the economic justifications underlying such investment decisions, fixed cost savings should be accorded specific credit in evaluating the benefits of the proposed merger or acquisition.").

241 AAI Comments, at 8-9 (footnotes omitted).

> such products often have nothing to do with the costs of producing each individual unit.[242]

As discussed above in connection with innovation, other witnesses similarly argued that greater consideration should be given in general to innovation and R&D efficiencies.[243]

Other witnesses, however, that little (or no) credit should be given to fixed-cost savings.[244] They argued that, in any event, the enforcement agencies do currently consider such cost savings in appropriate circumstances.[245] For that reason, they recommend that no change is needed to the *Guidelines* or current practice.

---

[242] Cary Statement, at 12 ("Competition takes the form of expenditures in R&D designed to differentiate the product from those of rivals and to increase the value of the product in terms of enhanced productivity for customers. In such a market, efficiencies that reduce already trivial marginal costs are irrelevant. . . . For example, even a small increase in the productivity of an oil refinery through better computer modeling can be worth hundreds of millions of dollars a year."); *see* Rubinfeld Statement, at 4 ("[M]any firms have relatively high price-cost margins, yet little or no market power in the antitrust sense. This is particularly true in high-fixed cost, low variable cost industries, including high technology, where incremental costs are low and profit margins are high (to cover the fixed costs).").

[243] *See* § III.B, *supra*.

[244] *See, e.g.*, Trans. at 128 (Salinger) ("[O]n the pass-through, we make a distinction between fixed-cost savings and marginal-cost savings, because we operate under a consumer welfare standard."); *see also* Trans. at 110 (Salinger) (overhead savings are often properly rejected, not because they are fixed costs (which they are not), but because they tend to bear the same ratio to total expenses for both large and small companies, meaning a merger will not likely create such savings).

[245] *See, e.g.*, Rill Statement, at 14 ("The *Merger Guidelines* do not preclude recognition of longer-term cost savings that are demonstrable and merger specific."); Trans. at 85 (Scheffman) ("The agencies take into account efficiencies in the general sense up front if the parties put them forward."). Indeed, the *Guidelines* do not rule out taking account of longer-run efficiencies; ordinarily, however, "the result of [the Agency's] analysis over the short term will determine the Agency's enforcement decision in most cases. The Agency also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market." *Merger Guidelines* § 4 n.37.

V. Transparency

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?

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

DOJ and the FTC have been criticized on two general grounds regarding transparency. First, the U.S. enforcement agencies do not routinely explain their reasons for declining to challenge transactions that have been investigated under the HSR Act. Although the agencies have issued such explanations with respect to transactions in the cruise line, airline, media, and telecommunications industries, as well as in the *Merger Guidelines Commentary* released on March 27, 2006, they do not publish decisions similar to those published by the European Commission under its merger enforcement regime. Second, some observers have argued that the *Merger Guidelines* do not accurately reflect agency practice, especially with respect to concentration screens. In both cases, it is argued that more, or more accurate, information would provide businesses with better guidance as to the agencies' enforcement policy. Improved transparency in these areas, it is argued, could increase the efficiency of the agencies' enforcement efforts by enabling antitrust counsel to advise clients more reliably as to whether their transactions would pass antitrust muster, potentially obviating extensive investigation and enforcement actions with respect to clearly problematic transactions.

A. <u>Explanations of Enforcement Actions</u>

Both DOJ and the FTC generally provide a statement of reasons as to why they are taking an enforcement action. If either agency seeks a preliminary injunction, the complaint and subsequent pleadings will spell out the agency's concerns with the proposed transaction.

Likewise, when either FTC or DOJ enters into a consent decree with respect to a merger it will provide a statement explaining the reasons why it sought relief.[246]

When either agency decide to close a merger investigation, whether after a second request or prior to issuing one, in the vast majority of cases, it provides no explanation as to why it did not seek relief. In many of those cases, the decision not to seek relief is non-controversial; over 95 percent of mergers that are notified to the FTC or DOJ are not found or deemed to pose competitive problems sufficient to warrant an extended investigation. Indeed, "there is no requirement that the agencies explain when they do not challenge a merger."[247] As a result, when DOJ or the FTC closes the investigation of a controversial merger, the public and antitrust bar may be left to speculate why the agency declined to seek relief. This has led some commenters to call for the agencies to make public the basis for their decisions not to seek relief whenever a transaction has been investigated through the second request process.[248]

One commenter proposed that the agencies commit to publish summaries of their findings in pre-defined categories of cases.[249] The categories could include, for example, all horizontal mergers resulting in HHIs above specified thresholds, vertical mergers resulting in

---

246 DOJ provides a statement pursuant to the Tunney Act. *See* 15 U.S.C. § 16(b). FTC provides an analysis to aid public comment pursuant to regulation. *See* 16 C.F.R. § 2.34(c). For examples of such statements, see, for example *United States v. Verizon,* No. 1:05CV02103 (D.D.C. Nov. 16, 2005) (Competitive Impact Statement), and *In the Matter of Proctor & Gamble Co. and Gillette Co.*, FTC Docket No. C-4151, FTC File No. 051-0115 (Sept. 30, 2005) (Analysis of Agreement Containing Consent Orders).

247 AAI Comments, at 5.

248 IBA Comments, at 4 ("FTC and DOJ should publish reasoned decisions (or summaries of their findings) in all cases where a Second Request has been issued."); *id.* at 15-16; Chamber of Commerce Comments, at 14; *see also* Chamber of Commerce of the United States of America, Suggestions from the U.S. Chamber of Commerce Regarding Antitrust Issues that are Appropriate for Commission Study, at 2 (Sept. 30, 2004); ICC Comments, at 6-7 (proposing that speeches, press releases and other communications be used to publish information about agency decisions in high-profile cases).

249 IBA Comments, at 17.

market shares above a certain threshold, or all cases in which the agencies issue a second request, as well as mergers the agencies seek to block or in which they agree to remedies.[250] The statements would include a description of the transaction, a description of the relevant markets considered, and the agency's conclusion as to why the transaction does not pose a competitive threat in that market.[251] The IBA suggests that confidentiality concerns can be addressed by allowing the parties to review the statement before its publication and designate confidential information.[252]

The "pros" and "cons" of such a recommendation are as follows.

<u>Pros</u>

- Most merger control regimes require the reviewing authority to provide a public statement regarding their reviews, including in instances in which they decide to take no enforcement action.[253]
- Publishing reasons for decisions benefits the merging parties, third parties, and the agencies themselves, by reducing uncertainty, increasing predictability, and promoting self-discipline.[254]
- The agencies are particularly well suited to explain the reasons for their decision when litigation is not at stake, including the procompetitive justifications offered by the parties that the agency found persuasive.[255]

<u>Cons</u>

- Such a requirement (or commitment) would place "burdens on agency resources and [create] potential tension with merger parties' confidentiality rights . . . too great to outweigh any marginal increase in transparency."[256]

---

250 *Id.*

251 *Id.* at 18. The IBA also calls for a description of the remedies, and the reason for the selection of a particular remedy in favor of those not sought. *Id.* As noted above, FTC and DOJ provide explanations for their justifications for remedies in matters in which they are obtained.

252 *Id.*

253 *Id.* at 15.

254 *Id.*; Scheffman Statement, at 7 ("more detailed explanations for agency decisions, as is routinely done in the EU . . . would clearly be beneficial.").

255 Chamber of Commerce Comments, at 14.

- The agencies have already begun to issue explanatory statements with respect to high-profile HSR Act merger investigations that are closed without enforcement action being taken and the FTC in particular has sometimes responded to objections to the terms of proposed consent decrees.[257] It is sufficient to encourage the agencies to continue to pursue such efforts to increase transparency.[258]

B. Merger Guidelines in Practice

The *Merger Guidelines* "outline the present enforcement policy of the Department of Justice and the Federal Trade Commission."[259] They describe "the analytical framework and specific standards normally used . . . in analyzing mergers."[260] They are intended to reduce uncertainty and improve predictability regarding the enforcement of the Clayton Act.[261]

In particular, the *Merger Guidelines* set forth market concentration/HHI levels at which transactions either warrant further investigation or may be presumed to create market power. The *Guidelines* also set forth how the agencies analyze potential adverse competitive effects (whether through coordinated interaction or unilateral effects), entry, and efficiencies. A number of observers have argued that the agencies rarely challenge mergers unless the resulting HHIs are well above the post-merger HHI and change in HHI thresholds identified in the *Guidelines*.[262] In

256 American Bar Association, Antitrust Section, Comments Regarding the Hart-Scott-Rodino Second Request Process, at 15 (Dec. 7, 2005) ("ABA Comments re HSR Process").

257 *Id.*; *see, e.g.*, *In the Matter of Comcast, Time Warner Cable, and Adelphia Communications*, FTC File No. 051-0151 (Statement of Chairman Majoras, Commissioner Kovacic, and Commissioner Rosch Concerning the Closing of the Investigation) (Jan. 31, 2006) (approving decision by Bureau of Competition to close investigation, and setting forth reasons); Department Of Justice, Antitrust Division, Statement on the Closing of its Investigation of Whirlpool's Acquisition Of Maytag (Mar. 29, 2006) (setting forth background on transaction and reasons for allowing the merger to proceed).

258 ABA Comments re HSR Process, at 15

259 *Merger Guidelines*, § 0.

260 *Id.*

261 *See id.*

262 *See* ABA Merger Comments, at 7.

addition, some observers have expressed concern that the *Guidelines* do not accurately describe how the agencies otherwise analyze mergers.[263]

1. *HHI Thresholds*

The agencies' own data demonstrate that the agencies seldom challenge mergers at the thresholds identified in the *Guidelines*.[264] In a report issued in December 2003, the FTC and DOJ provided extensive data summarizing merger challenges for the two agencies for fiscal years 1999-2003.[265] The data primarily consisted of tables showing the number of mergers challenged by the agencies for different levels of post-merger HHI and change in HHI, broken down by industry. The FTC subsequently released additional data on its horizontal merger investigations in which second requests were issued, covering Fiscal Years 1996 through 2003.[266] The report included data for challenged transactions on the number of rival firms, information on entry, hot documents, and customer complaints, in addition to HHI figures.

The data show, for example, that, during the relevant time period, the FTC has rarely challenged a merger unless the post-merger HHI exceeded 2400, and the HHI increase was greater than 500 points.[267] By comparison, the *Guidelines* state that mergers increasing the HHI by more than 100 points to a level above 1800 are presumptively anticompetitive, although the

---

263 William Blumenthal, *Why Bother?: On Market Definition under the Merger Guidelines*, Statement Before the FTC/DOJ Merger Enforcement Workshop, at 2 (Feb. 17, 2004) ("Blumenthal, *Why Bother*").

264 AAI Comments, at 5.

265 Federal Trade Commission and U.S. Department of Justice, Merger Challenges Data, Fiscal Years 1999-2003 (Dec. 18, 2003).

266 Federal Trade Commission, Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (2004). Scholars have analyzed this data to model the enforcement decision and estimate the likelihood of an enforcement action under various circumstances. *See* Malcolm B. Coate and Shawn W. Ulrick, *Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996-2003*, 73 Antitrust L.J. 531 (2006).

267 *See* ABA Merger Comments, at 7.

presumption can be overcome by a showing that factors set forth in Sections 2 through 5 of the *Guidelines* make it unlikely the merger would create or enhance market power or facilitate its exercise.[268] More generally, the large majority of challenges took place in highly concentrated markets (where the merger would result in three or fewer competitors).[269]

Two commenters called on the agencies to update the *Guidelines* to reflect the higher thresholds that they contend are actually used in practice. "Pros" and "cons" of this recommendation as expressed by witnesses and commenters are as follows.

<u>Pros</u>

- Updating the *Guidelines* to eliminate the otherwise significant gap between the HHI thresholds and actual agency enforcement would reduce confusion and uncertainty, eliminate the potential deterrence of lawful transactions, and improve enforcement efficiency.[270]

<u>Cons</u>

- Critics misunderstand the purpose of the HHI thresholds, which are used primarily to screen transactions that are not likely to be anticompetitive. It is therefore unremarkable that the thresholds at which the agency begins to have concern fall below the levels at which the agencies actually investigate mergers extensively.

- There is insufficient empirical basis for identifying different thresholds or for ensuring that higher screening thresholds would not result in under-deterrence. A better tack is to continue to release data showing agency practice and to explain the more complex analysis that is applied to transactions surpassing the screens in order to determine whether competitive effects are likely. [271]

---

[268] *See id.*

[269] *See id.*; *see also* IBA Comments, at 20 (noting that the *Merger Guidelines* misleadingly suggest that that "6 to 5 or 5 to 4 transactions run a serious risk of being challenged").

[270] ABA Merger Comments, at 8 ("[T]there remains a significant gap between the current *Merger Guidelines* and actual agency enforcement."); AAI Comments, at 4 (*Merger Guidelines* do not provide accurate guidance regarding the concentration levels that will result in agency action, and recommend "formal clarification" of the *Guidelines*).

[271] Roundtable Trans. at 84-85 (Rubinfeld) (current thresholds are "workable, even though these specific numbers may or may not be as meaningful as we would like . . . [since] the bar knows what the practices are and adapts quite well"); Trans. at 85 (Reiss) (agreeing with

2. *General Implementation of the* Merger Guidelines

As described above in Section II, some commenters and witnesses believe that the agencies do not in practice conduct their market definition and competitive effects analysis sequentially, as is suggested in the *Merger Guidelines*. Rather, the analysis tends to be simultaneous.[272] One commenter called on the agencies to "articulate in significantly greater detail how they approach the issue of competitive effects."[273]

The FTC and DOJ issued a *Merger Guidelines Commentary* in March 2006 "to provide greater transparency and foster deeper understanding regarding antitrust law enforcement."[274] That *Commentary*, which sets out brief descriptions of matters as they relate to particular parts of the *Guidelines*, has added substantial additional gloss to the agencies' merger enforcement practice.

AAI called for clarification of the *Guidelines* to recognize the relative importance of competitive effects analysis instead of market structure.[275] The ABA submitted that the *Merger Guidelines* generally "do reflect how the agencies analyze mergers," with the notable exception of the role of the HHIs.[276]

Rubinfeld); Trans. at 85-86 (Bresnahan) (the "thresholds are probably not particularly descriptive or accurate" but agreeing with Rubinfeld that "there's no serious loss of transparency"); *see also* Chamber of Commerce Comments, at 14 (agencies could revise *Guidelines* or "provide added clarity through other means").

272 *See* Blumenthal, *Why Bother?*, at 2.

273 ABA Merger Comments, at 8.

274 *Merger Guidelines Commentary*, at v.

275 AAI Merger Comments, at 4.

276 *See* ABA Merger Comments, at 7.