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DEPARTMENT OF JUSTICE  
FEDERAL TRADE COMMISSION

MERGER WORKSHOP

DAY THREE

THURSDAY, FEBRUARY 19, 2004

9:00 a.m.

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

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

For The Record, Inc.  
Waldorf, Maryland  
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## 1 PARTICIPANTS:

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

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

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

6 Ilene Knable Gotts (Wachtell, Lipton,  
7 Rosen & Katz)

8 William J. Kolasky (Wilmer Cutler  
9 Pickering)

10 Robert Pitofsky (Georgetown University)

11 David T. Scheffman (LECG)

12 Joseph J. Simons (Paul, Weiss, Rifkind,  
13 Wharton & Garrison)

14 Vincent Verouden (EC/DG Comp.)

15 Panel II: Economists and Lawyers Roundtable

16 Moderator: R. Hewitt Pate (DOJ)

17 Panel: William Baer (Arnold & Porter)

18 Jonathan B. Baker (American University)

19 Wayne D. "Dale" Collins (Shearman &

20 Sterling) James Loftis (Gibson, Dunn &

21 Crutcher) James F. Rill (Howrey & Simon)

22 Daniel L. Rubinfeld (University of  
23 California, Berkeley)

24 Robert D. Willig (Princeton University)

25 Dennis W. Carlton (Univ. of Chicago)

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Welcome and Introduction

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Panel I: Efficiencies, Dynamic Analysis  
Integrated Analysis

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Panel II: Economists and Lawyers Roundtable

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

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

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

16 Dave, I hope, will tell us what this integrated  
17 approach is all about and help dispel the fog and give us  
18 a clear sky. Dave will be followed in order by Joe  
19 Simons, former Director of the FTC's Bureau of  
20 Competition, and currently co-chair of the Antitrust  
21 Group at Paul, Weiss, Rifkind, Wharton & Garrison.

22 Joe will be followed, again in order, by Mark  
23 Gidley, co-head of White & Case's antitrust group, and a  
24 former Acting Assistant Attorney General and Deputy  
25 Assistant Attorney General for Antitrust.

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

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

9                   Then we're saving our superstar for near the  
10                  end, the Honorable Robert Pitofsky, former FTC Chairman  
11                  and Dean of Georgetown Law School, currently a professor  
12                  at Georgetown and of counsel at Arnold & Porter. And he  
13                  will give us the big picture to put everything together  
14                  for us, we hope.

15                  And then our panel will end on an international  
16                  comparative note with a presentation by Dr. Vincent  
17                  Verouden, who has been an economist at the European  
18                  Commission's DG competition since 2000, and Dr. Verouden  
19                  has already spoken, and we're delighted to have his  
20                  comparative perspective. And he will undoubtedly  
21                  enlighten us on EC Merger Guidelines issues.

22                  After our seven panelists have spoken, we will  
23                  have a brief 10-minute break followed by a discussion and  
24                  question-and-answer session among the presenters and  
25                  moderators. Given the fact that at least some of these

1 speakers I know are not shy, Mary and I look forward to a  
2 lively and thought provoking session.

3 So, Dave, will you lead off, please?

4 DR. SCHEFFMAN: Yes. I'll try and be a little  
5 thought provoking or obnoxious as I usually am, rather  
6 than just talk -- and I will talk about integrated  
7 analysis, but I'm going to first talk about efficiencies  
8 -- can we get this slide up so everyone can see?

9 I thought we'd give a report card since I left  
10 the agency not that long ago and talk about how I think  
11 the agencies are doing -- obviously, I have much more  
12 experience at the FTC -- with respect to efficiencies.

13 It's hard to tell, because you don't see many  
14 tough cases with efficiencies compared, say, to the '80s.  
15 I think that's because the outside believes that  
16 efficiencies aren't given much weight and they advise  
17 their clients not to try them. That's well known and a  
18 well-known problem.

19 With all respect to Chairman Pitofsky, who I  
20 have the highest regard for, baby foods was not a helpful  
21 development, and I'm sure he will respond. I wasn't  
22 involved in the case, and maybe I misunderstood the  
23 facts, but it's not surprising that it's not most  
24 economists' favorite case. Nor is it a favorite of those  
25 in favor of efficiencies, I don't think, although I can't

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

17 Then you've got, well, how is the merger going  
18 to be anticompetitive? The party is going to produce  
19 more almost surely as a result of the merger. That's not  
20 to say you might not have other reasons to believe that  
21 the merger is problematic, but you should have some  
22 strong reasons to believe, say, in a five to four merger  
23 why this merger is going to be problematic. So  
24 efficiencies are important.

25 Let me begin with the integrated analysis.

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

6 Well, not all markets are alike, and the real  
7 basis of the market is not equally strong. This is not  
8 recognized. The markets are taken as given to us  
9 clearly. This is the way the courts decide, although  
10 sometimes the reason why the courts reject cases based on  
11 market definition is for squishy reasons that probably  
12 don't have to do with market definition. But these  
13 things are all related. In particular, weaknesses in  
14 market definition will usually spill over into  
15 competitive effects. That was true in cruises, for  
16 example, and Joe will talk about this more in a minute.

17 All these things have to fit together. The  
18 weaknesses in market definition are important in  
19 competitive effects analysis. I think what people on the  
20 outside don't understand is that you're never going to  
21 win an argument with the staff on market definition in a  
22 hard case. It's not that you should give it up, but you  
23 will start talking about, well, if this is your market,  
24 given the defects in that market definition, this is why  
25 the competitive effects that you're worried about are not

1 going to occur.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

16 (Slide.)

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

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

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

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

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

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

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

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

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

20 And then just adding up the total effects down  
21 the columns for year one, two, three, four, 5, you see  
22 that the expected effect in year one is a 4.4 percent  
23 increase in price; for year two is a 3 percent increase  
24 in price; and then years three, four and 5, the benefits  
25 are to the consumers 3.5 percent each year.

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

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

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

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

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

4               Among other things, I think what this approach  
5       does or this structure does is help to define what  
6       efficiencies are cognizable, how to evaluate them, and  
7       more significantly, how to weigh them, which I think is  
8       something that's seriously missing now.

9               And just as importantly, it does the same thing  
10       for competitive effects. There's been this debate in the  
11       antitrust community about, well, what's the standard for  
12       proving efficiencies? But we've never really tied that  
13       to, well, what's the standard for proving competitive  
14       effects? And do the two relate to each other at all?  
15       And if you look at this type of analysis, you'll see that  
16       they directly relate to each other.

17               So it's not only the size of the competitive  
18       effect that's significant, it's the likelihood that it's  
19       going to occur and the duration. That then impacts well,  
20       how long, how high, how much passthrough does there have  
21       to be to make the efficiencies offset those perceived  
22       harms?

23               So I think what this type of analysis  
24       demonstrates really is the larger, the more likely, and  
25       the longer the adverse competitive effect is, the larger,

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

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

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

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

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

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

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

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

1 net.

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

7 Thanks.

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

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

20 Mark, on that literary note, please proceed.

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



1 through my remarks.

2 I would also say that I come down on the side  
3 of Spinoza on the issue posed by Candide, but I won't  
4 expound on that today. I do turn out to be an optimist.

5 My main point in citing Professor Pangloss's  
6 oft-attributed comment is that I don't contend, and I  
7 don't think most people contend, but unfortunately I  
8 think this is the way it plays out sometimes in the  
9 conference rooms of both agencies, that merger analysis  
10 is the search for the best sort of Platonic ideal  
11 transaction that the parties could ever enter into.  
12 Human beings will never get there, and I think that I  
13 really come down on the side of an analysis that's very  
14 similar to what Joe is proposing: A net assessment of  
15 the pro and anticompetitive effects with a serious  
16 consideration of efficiency.

17 Segueing into what I'd like to address for a  
18 few minutes today, I want to talk about the 1997  
19 Guidelines and the emphasis on merger specificity, which  
20 is really to my mind one of the new hallmarks of the 1997  
21 Section four.

22 And I was struck a little bit by our earlier  
23 panelist, David Scheffman. In my own experience and maybe  
24 in my own conference rooms as we prepare for meetings  
25 with the government, we've tended to see Section four of

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

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

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

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

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

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

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

25 Because as I prepared my remarks, I actually

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

4 (Slide.)

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

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

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

25 But there appears to be a subset of

1 efficiencies that are merger-intrinsic or not merger-  
2 intrinsic. In other words, if the efficiency is not  
3 unique to the merger, we'll ignore it. And I think it's  
4 in that sense that most of the time when people say with  
5 the back of the hand, well your efficiencies are not  
6 merger-specific, you could go buy another company and get  
7 the same purchasing efficiencies. And it's that element  
8 that I think has devolved into a violation of the last  
9 sentence, which is that the agency will not insist on a  
10 less restrictive alternative that is merely theoretical.

11 In my experience in the last seven years,  
12 oftentimes people in a conference room will posit a  
13 theoretical alternative and no one will debate whether  
14 it's practical or not, or whether the managements could  
15 ever really go there, or the time difference between  
16 abandoning this merger and the time cost of trying to do  
17 something else. For instance, in a merger people will  
18 say do a production joint venture, and there are a lot of  
19 reasons for why a 50-50 production joint venture starting  
20 today from the time that we're talking in the conference  
21 room, could be three to five years away from realizing a  
22 fraction of the same synergies and cost savings that a  
23 merger can efficiently realize maybe in a matter of  
24 months or weeks, depending on the closing date.

25 So there's a distinction that I draw on in the

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

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

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

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

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

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

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

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

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

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

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



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

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

7 Just the next page, David.

8 (Slide.)

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

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

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

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

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

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

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

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

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

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

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

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

25 Tenet Health is another case where the case was

1 reversed on efficiencies. The other case that I talk  
2 about in the paper, and I'll let you read the paper, is I  
3 have a brief discussion of the Heinz baby food decision.  
4 I think it's quite possible that this case ultimately  
5 will live in antitrust infamy, maybe much more so than  
6 any other case that I've seen.

7 The production efficiencies were quite  
8 considerable. The competitive effects, I think, might  
9 have been very questionable. I will hasten to add, I  
10 reviewed none of the evidence. I wasn't the decision  
11 maker, so I won't put myself in the shoes of the decision  
12 maker. But just analyzing the D.C. Circuit's opinion, it  
13 seems that the Circuit opinion is very cavalier about the  
14 efficiencies. And, for instance, a 22.3 percent  
15 efficiency improvement in total variable manufacturing  
16 cost, which would be stunning, is considered a  
17 triviality. I think, to any business executive, the  
18 notion that you could have a 2,200 basis point  
19 improvement in manufacturing efficiency, and that that  
20 would just be cast aside as, well, that's not that  
21 significant, or that's not merger-specific, you can do  
22 something else is stunning.

23 There's another passage on distribution and  
24 logistics where the point is made by the court, well,  
25 Heinz has very efficient distribution. Why can't Beech-

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

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

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

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

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

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

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

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

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

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

14             For instance, the 1997 Guidelines take a dim  
15      view of certain logistics and purchasing synergies. I  
16      think that's unwarranted in today's economy. In an  
17      economy that's dominated by firms like Wal-Mart, I think  
18      the Wal-Mart's of the world need to be challenged by  
19      smaller firms that may actually get themselves larger by  
20      combining.

21             And so those are some of my observations, and I  
22      leave to you my paper and Voltaire and Spinoza.

23             MR. ABBOTT: Okay. Thank you for that literary  
24      and philosophical set of insights, Mark. And now we're  
25      going from literary and philosophical approach to a very,

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

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

12 I will handle this very fast. And there's also  
13 a paper that I worked on. One of the advantages of the  
14 business downturn last year was it allowed me to take  
15 some time to read some of the legal, economic and  
16 business literature that was out there to get a sense on  
17 how the rest of the world is viewing efficiencies and  
18 then I compared it a little bit to the Merger Guidelines.

19 The Merger Guidelines state that certain types  
20 of efficiencies are more likely to be cognizable and  
21 substantial than others. There's a real clear bias  
22 towards production efficiencies, that these are thought  
23 to be cognizable and substantial.

24 Innovation efficiencies are thought to be  
25 substantial, but less verifiable. And when you get into



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

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

17 So, you know, that's just the backdrop from  
18 which I come from as I look at this.

19 What kind of efficiencies should be recognized?  
20 Although the agencies might have more experience dealing  
21 with certain types of efficiencies, such as when we look  
22 at productive efficiencies, other types of efficiencies  
23 should not be excluded or handicapped on a generic basis.

24 And I think some of what we've seen develop in  
25 our understanding has actually come to fruition when you

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

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

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

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

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

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

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

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

25 Dynamic or innovative efficiencies. The 1997

1 revisions indicate that claims relating to research and  
2 development are potentially substantial but are generally  
3 less susceptible to verification and may be the result of  
4 anticompetitive output reductions. The global report  
5 also acknowledges that they may be -- innovation  
6 efficiencies may make a particularly powerful  
7 contribution to competitive dynamics.

8 At the same time, when you come in, you get hit  
9 over the head by the staff saying verify them. We should  
10 consider dynamic efficiencies in the integrated merger  
11 analysis, as Joe has noted in his talk, he's tried to  
12 factor it in. These are harder to quantify. We're not  
13 talking about mathematical precision in any of what we  
14 do. But you can build on whatever assumptions you want,  
15 a range of assumptions, and in your gut get a sense  
16 whether they're for real or not, whether they're  
17 powerful, and whether they're something we should  
18 therefore use to allow the deal to go through.

19 Transactional efficiencies, the elimination of  
20 the middleman and the double marginalization. These are  
21 important. These are really bottom line numbers which  
22 then can flow through and allow for there to be new  
23 products to be offered. And, therefore, they should  
24 definitely be included in the integrated merger analysis.

25 And then my favorite area, which is the

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

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

15 Capital cost savings. The G.E./Honeywell  
16 decision from what I can see in the EU seems to view this  
17 as a negative. The reality is, again, this can make a  
18 huge difference if you can somehow improve the balance  
19 sheet a larger amount and borrow money at a lesser  
20 amount, if you've got an industry that's going through  
21 change or is distressed, these are very important to the  
22 ongoing competitiveness of the company and should not be  
23 at all thrown out as not recognized.

24 This gets me then to what burden of proof  
25 should be imposed upon the parties. Let's look quickly

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

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

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

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

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

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

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

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

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

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

9                       (Slide.)

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

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

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



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

10 When we weigh efficiencies effects in declining  
11 industries, this is what I'm up at night thinking about  
12 these days, because I really do want to try to get it  
13 right. To me, there are certain things in the Guidelines  
14 today that seem to recognize that declining industries,  
15 these are industries where the price is really below  
16 average total cost. So we're basically -- price might be  
17 covering the variable costs, but no one is investing in  
18 the future. This is an industry that is going to be  
19 really declining and dead for a long time.

20 In my heart, there's some need in that sort of  
21 market to look at being more receptive to arguments about  
22 potential dynamic or innovation efficiencies, to really  
23 be more willing to accept the fixed cost sort of  
24 arguments, because the end of it all is, yeah, maybe in  
25 the short term you might be limiting some competition

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

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

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

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

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1 I stayed within my time.

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

12 Bill?

13 MR. KOLASKY: Thank you very much, Alden. I'm  
14 going to focus on three main issues. The first one is  
15 what is a cognizable efficiency? The second is, to what  
16 extent should "fixed cost" -- and I put that in quotation  
17 marks -- savings that do not reduce marginal costs be  
18 taken into account? And then the final subject is the  
19 one that Alden alluded to, and that is, to what extent  
20 should efficiencies in other markets be found to justify  
21 a merger that reduces competition in a particular market?

22 In my comments, I want to make it clear that  
23 I'm not offering fully formed views, much less  
24 recommendations. What I'm trying to do is stimulate some  
25 discussion and debate.

1 I'm going to start out by turning the criticism  
2 not on the agencies but on us practitioners. Based on my  
3 year and a half at the Justice Department, I think it's  
4 fair to say that there is more serious and critical  
5 thinking going on within the agencies about the role of  
6 efficiencies in merger analysis than there is in the bar  
7 at large.

8 I think one of the problems is that the  
9 agencies do not hear enough well thought out and well  
10 presented efficiencies arguments. So to the extent that  
11 they can be criticized for not taking efficiencies  
12 sufficiently in account in their merger review, the fault  
13 lies in us, the practitioner, not in the agencies. And  
14 I'm hoping my remarks will start us down the road of  
15 trying to address that problem.

16 Focusing first on what is a cognizable  
17 efficiency? While I think that the basic analytical  
18 framework in the 1997 revisions is sound, as Ilene's  
19 summary of it, I think, reflects, that framework is to  
20 some extent mired in the old economy, smoke stack  
21 industry paradigm, and I think our thinking about  
22 efficiencies is likewise mired in that paradigm.  
23 We try to put them cubbyholes like productive  
24 efficiencies, innovative efficiencies, procurement,  
25 management, purchasing. As a very good article, in fact,

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

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

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

14 The first one, interestingly, was a case way  
15 back in 1983, shortly after Bill Baxter took over as head  
16 of the Antitrust Division, involving two companies that  
17 make rechargeable nickel cadmium batteries.

18 Interestingly, the market structure in that case was  
19 virtually identical to the market structure in the baby  
20 food merger case. You had one dominant supplier, G.E.,  
21 with about a 65 percent share. You had a second company  
22 with about a 20 percent share, and you had a new entrant  
23 with maybe between a 3 and 5 percent share, which was a  
24 foreign manufacturer, and then you had a declining, you  
25 know, fourth company that clearly was not going to be in

1 the business very long.

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

8 The efficiencies that we saw from that deal had little to  
9 do with production cost savings, but were simply that the  
10 foreign producer had the best technology and this number  
11 two company in the United States had a well established  
12 distribution network in the United States, so that the  
13 combined firm would be able to go head-to-head with the  
14 leading producer, G.E., much more effectively than either  
15 firm could do separately.

16 A second case, interestingly the same vintage,  
17 1979, was the Ford/Mazda merger. This was a case where  
18 Ford bought a 35 percent interest in the Japanese company  
19 that makes Mazda. Working with us on that merger were  
20 Don Turner and Oliver Williamson.

21 The reason for that merger was that Ford was moving  
22 toward front wheel drive cars, had very little experience  
23 making those cars, and it was acquiring the transaxle for  
24 those vehicles from Mazda. And it was very concerned  
25 about the possibility of opportunistic behavior on

1 Mazda's part. So they wanted an equity stake in Mazda to  
2 protect themselves from that opportunistic behavior.

3 In addition, that was an era when the Japanese  
4 car manufacturers had more modern management techniques  
5 than the U.S. companies, and Ford believed, and I think  
6 correctly, that the only way the Japanese manufacturers  
7 would share that knowledge with them is if they were  
8 going to benefit from sharing that knowledge because of  
9 this equity relationship. Again, these are not things  
10 that are easy to quantify, but they illustrate the  
11 importance of synergies from combining complementary  
12 assets.

13 Fast forwarding to the late 1990s, a merger  
14 that was reviewed by the Justice Department under Joel  
15 Klein and was approved was the merger of the Fox and ABC  
16 affiliates in Columbus, Ohio. This was a four to three  
17 merger. The Justice Department had never before allowed  
18 a four to three merger in the television industry. Why  
19 did they allow this merger? Well, one of the principal  
20 reasons was that we were able to persuade them that it  
21 would provide an incentive to the companies to do more  
22 complementary programming. Rather than having two  
23 Survivor type shows going head to head, competing for the  
24 same audience, which is what they would do as long as  
25 they were independent, if they were commonly owned, they

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

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

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

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

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

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

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

25 Let me move on quickly, because I have a

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

9 The second issue is how much weight should be  
10 given to fixed-cost savings. And here the text that I  
11 begin with is footnote 37 to the Merger Guidelines, which  
12 provides that while savings in marginal costs will  
13 receive the greatest weight, the agencies will also,  
14 quote, "consider the effects of cognizable efficiencies  
15 that have no short-term direct effect on prices in the  
16 relevant market," such as fixed cost savings.  
17 Again, the way that footnote is written, and that entire  
18 section of the Guidelines, suffers from this problem of  
19 the old smoke stack industry paradigm and sort of a  
20 static price theory model. As soon as you move away from  
21 that model to a more dynamic view of competitive forces,  
22 you recognize that in fact cost savings and other  
23 efficiencies that do not reduce marginal costs  
24 nevertheless are likely to benefit consumers not just in  
25 the long term but even in the medium and short term.

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1                   A good book, I think, on this subject is  
2 William Baumol's book, The Free Market Innovation  
3 Machine. And based on the arguments in that book, I've  
4 tried to extend this argument in an article that's going  
5 to be published shortly in the Antitrust Bulletin  
6 entitled "What is Competition? A Comparison of U.S. and  
7 European Perspectives." And what that all shows  
8 basically building on the intuitions of Joseph Schumpeter  
9 is that in most new economy industries, competitive  
10 behavior is driven primarily by innovation, not by cost.  
11 And where that's the case, firms need to incur basically  
12 recurring R&D expenditures. They need to invest in  
13 improving and innovating in order to remain competitive.  
14 That creates what Baumol calls a "Red Queen Game" in  
15 which the firm needs to run as fast as it can just to  
16 stand still.

17                   In these markets, not surprisingly, you find  
18 very high price/cost margins, and that's because the  
19 firms are investing heavily, and they need to be able to  
20 charge prices above marginal costs in order to recoup  
21 that investment, in order to justify it.

22                   Nevertheless, these are industries in which innovation  
23 is rapid, and in fact price is often falling over time,  
24 even as price cost margins remain high. Baumol suggests,  
25 perhaps not surprisingly, since he created it along with

1 Bobby Willig, that the model, the economic model that  
2 should be used for evaluating competition in these  
3 industries is not the traditional price theory model, but  
4 rather the contestability model. Because what he argues  
5 basically is that what determines price in these  
6 industries is the level at which prices will attract new  
7 entry, and firms, even though they charge prices that are  
8 above marginal costs, nevertheless do not have any market  
9 power because their prices are constrained by the threat  
10 of entry, and because they are earning only a minimal  
11 return on capital, i.e., on their investment.

12 In these industries, obviously, efficiencies  
13 that help to reduce the cost of R&D and other recurring  
14 common costs will help to drive down price over time and  
15 lead to greater innovation and improved products, i.e.,  
16 dynamic efficiencies, and those need to be taken into  
17 account.

18 Finally, and I apologize for rushing, but there  
19 is a lot to cover here, and I want to make sure to save  
20 time for the discussion, to what extent can a lessening  
21 of competition in one market be justified by efficiencies  
22 in other markets?

23 Joe, I think, referred to the fact that back in  
24 1982, everyone was skeptical as to whether the  
25 hypothetical monopolist approach to market definition

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

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

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

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

4 As we move to increasingly narrow market  
5 definitions, it becomes more and more important that the  
6 agencies take into account out-of-market efficiencies.  
7 Andrew Dick and I have written an article that appeared  
8 this past year in the Antitrust Law Journal and we  
9 describe a particular merger case that was reviewed by  
10 the FTC while Bob was there, which I think is a perfect  
11 illustration of how important this is. That was a merger  
12 involving two natural gas gathering and processing  
13 systems in West Texas, right next door to George Bush's  
14 hometown of Midland. That was an area in which  
15 production -- the fields were very mature. Production  
16 was declining. The processing plants were running at  
17 less than 50 percent of capacity, as a result of which  
18 unit costs were rising sharply. There were very few  
19 wells in this area that were close enough to both  
20 gathering systems to benefit from competition between  
21 them. The remaining customers were gathering systems or  
22 processing plants in these two counties. So this was in  
23 one sense a merger-to- monopoly. And yet, when the FTC  
24 staff understood that there were literally only a handful  
25 of wells, maybe a dozen or so, that benefitted from the

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

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

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

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

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

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

18 Thank you.

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

25 Chairman Pitofsky was also around, of course,



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6 I agree with that decision. I think the  
7 plaintiff has a responsibility to show clearly by  
8 convincing evidence that there will be an anticompetitive  
9 effect in a timely manner. But I think the same thing  
10 for defenses. I don't think that one should be allowed  
11 to come in and say, well, judge, I don't know about  
12 efficiencies right now. Actually, prices are going to go  
13 up now. That's what makes the merger illegal. But down  
14 the road, oh, then everybody's going to really be in  
15 great shape. A little too speculative for me.

16 Ilene talked about hierarchy of efficiencies  
17 and clearly said that, you know, maybe there are  
18 differences, but you shouldn't disregard certain  
19 efficiencies entirely. I would disregard certain  
20 efficiencies entirely. Let me say, the best work on this  
21 by far is about 70 or 80 pages in Areeda, in which goes  
22 through efficiency by efficiency by efficiency and talks  
23 about whether or not they should be taken into account to  
24 the extent that they reverse the result in an otherwise  
25 illegal merger.

1           Reduce unit cost is the clearest case. The  
2 Guidelines picked it up. The writers have picked it up.  
3 Generally speaking, you can prove it. You can know the  
4 reduced unit costs are there. The Guidelines talked  
5 about R&D efficiencies. I remember that as being quite a  
6 quarrel, because I don't think Areeda thought so highly  
7 of that. But I think R&D is so important to the welfare  
8 of the country, the economy and consumers, that R&D  
9 efficiencies should be cognizable.

10           But then these other efficiencies are more or  
11 less savaged by Areeda. Managerial efficiencies,  
12 promotional efficiencies, capital cost efficiencies.  
13 Let's just take managerial efficiencies. The company is  
14 being run poorly, and you should do something about it.  
15 Well, there are two possibilities. You can merge with a  
16 company that's being run well, or you can fire the bad  
17 manager, and like George Steinbrenner in New York, you  
18 can hire a better third baseman. You can pay the money  
19 to bring in a first rate leader or a consultant to a  
20 second rate leader, that sort of thing.

21           It seems to me that managerial efficiencies are  
22 vague, hard to measure. How do you measure what a really  
23 good CEO, president, sales manager brings to a company?  
24 What questions do you ask about that? Hard to define  
25 what a managerial efficiency is. And the tradeoff

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1       between managerial efficiencies and anticompetitive  
2       effect is going to be hard to manage.  If the prices go  
3       up, what are you saying?  But this manager eventually  
4       will bring the prices down?  Well then we're back to  
5       speculative and eventuality, which British Oxygen said we  
6       ought not do.

7               And finally, there's a less restrictive  
8       alternative.  I don't think there's a shortage of capable  
9       managers in this country.  And I don't think the only way  
10      to get a capable manager is to merge with your competitor  
11      or your customer or your supplier, something like that.

12             Let's see.  Merger-to-monopoly justified by  
13      efficiency.  I guess I've already said.  It's not our  
14      statute.  It's not our Guidelines.  It's speculative.  I  
15      understand that a company that expands internally can  
16      point to its own superior skill, foresight and industry.  
17      But this isn't expansion.  These are mergers.  And the  
18      question is whether or not you would allow a merger-to-  
19      monopoly and say, but, judge, we're so efficient.  And  
20      we'll lower costs.

21             First of all, why would a monopolist do that?  
22      If you're a monopolist and a profit maximizer, it seems  
23      to me you wouldn't lower costs if there are high barriers  
24      to entry.  If the Baumol theory is you're running hard to  
25      stay in place, the agencies should take that into

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

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

6 (Laughter.)

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

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

16 Heinz sold out. They exited the market.

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



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

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

9 Chairman Muris told me that there have been  
10 several instances. It's hard sometimes to make public  
11 prosecutorial discretion decisions. But we have allowed  
12 three to two mergers. He is allowing -- his Commission  
13 is allowing three to two mergers, and efficiencies are  
14 the turning point. Efficiencies are the decisive factor.

15 Staples. It's been so long I forgot.

16 (Laughter.)

17 But there was clear evidence that prices went  
18 up in markets characterized by fewer superstores, and as  
19 to the efficiencies -- don't hold me to any numbers.  
20 This is very general. But my recollection is that the  
21 board of the company was told when they were thinking  
22 about a merger that the efficiencies would be X, 5X.  
23 Then when they knew they were merging, the board was told  
24 25X. And then when they went to court, they said 75X.  
25 That hurt. That hurt in terms of trying the case.

1                   And the other issue is much more complicated,  
2                   and that is whether or not purchasing efficiencies, that  
3                   is to say, you're bigger so you get better discounts from  
4                   the seller, ought to be taken into account, or is that  
5                   just transferring money from one businessperson's pocket  
6                   to another?

7                   I grant that that is a very complicated  
8                   question.

9                   Let me sum up by simply saying this. I think  
10                  American antitrust is better off by the introduction of  
11                  an efficiency defense. I was thinking last night of all  
12                  the people who said you put that efficiency defense in  
13                  our Guidelines and you will destroy the ability of the  
14                  government to enforce the antitrust laws, because people  
15                  will come in with phony efficiencies and you won't know  
16                  they're phony. It will delay the matters. Cases will go  
17                  on forever. It hasn't worked out that way. It hasn't  
18                  worked out that way at all.

19                 Incidentally, there was a comment that courts  
20                 almost never say it's illegal, but because of the  
21                 efficiencies, I'll make it -- I'll call it legal. I  
22                 believe the reason for that is the agency doesn't bring  
23                 cases that are barely illegal but with substantial  
24                 efficiencies. And therefore, the courts haven't had a  
25                 shot at this, and I'm not sure they're going to get a

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

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

12 Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

1 to a Significant Impediment to Effective Competition. So  
2 that's the tool that we will work with in the coming  
3 months -- in the coming years.

4 I must say, by the way, that the new test that  
5 we have, SIEC, still singles out the notion of a dominant  
6 position as a primary example of a merger that is leading  
7 to a significant impediment to effective competition.

8 So, well, so far for the background on this new  
9 test. Let's turn to the role of efficiencies in the EC  
10 merger control system. If we look at the past or even  
11 the current situation, if you like, with the dominance  
12 test, I think it's fair to say that efficiencies have not  
13 received much emphasis in the past.

14 That is quite clear. It's probably outside the  
15 scope of this workshop to really expand on this, and the  
16 reasons why and so on. I think that development in  
17 thinking that we have gone through in the European Union  
18 quite closely resembles, I think, the development that  
19 you have seen here in the United States over the course  
20 of the years where efficiencies were first viewed with  
21 quite a bit of skepticism, of course, whether they could  
22 overturn conclusions as to the anticompetitive or pro-  
23 competitive effect of a merger. So starting from there  
24 to having a more open attitude to efficiency  
25 considerations.

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

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

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

20                  (Slide.)

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

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

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

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

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



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

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

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

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

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

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

10                  As I said, the Guidelines were adopted a few  
11 weeks ago, 30 January, and, well, if there is any  
12 characterization, I guess, of the approach to  
13 efficiencies in these Guidelines, I would say it's open  
14 but cautious. Open. I think Ilene referred a little bit  
15 to that. It's open in the sense that it's, you know, it  
16 invites any substantiated efficiency claim. So the  
17 Guidelines recognize that in whatever form, efficiencies  
18 may make the new entity more competitive. So there is no  
19 bias in that sense.

20                  On the other hand, of course, Guidelines must  
21 give some guidance, so I will come to that in the next  
22 slide. But the opening statement is open, so to speak.  
23 At the same time, the approach is cautious. I think  
24 that's also kind of natural. It's cautious in the  
25 conditions or the circumstances under which the

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

14 Thank you.

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

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

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

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

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

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

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

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

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

11 MR. PITOFSKY: Can I ask?

12 MS. COLEMAN: Sure.

13 MR. PITOFSKY: Joe, you're right. I think that  
14 your spreadsheet approach and the integration approach is  
15 very challenging and it makes a lot of sense. But what's  
16 your answer to my question? Would you go to the other  
17 side of the equation and say to the plaintiff, even if  
18 the anticompetitive effects aren't immediate, if the  
19 anticompetitive effects occurred down the road sometime,  
20 that's good enough? Or would you stick with British  
21 Oxygen which says that's not good enough?

22 MR. SIMONS: My interpretation of British  
23 Oxygen would be that the anticompetitive effect there was  
24 speculative. In other words, very, very unlikely and  
25 into the future. If what you're talking about is



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

10 MR. PITOFISKY: On both sides?

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

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

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

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

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

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

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

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

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

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

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

9 MR. PITOFSKY: Good point.

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

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

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

1 focus on that.

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

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

14 So that's the problem with the system. That's  
15 the process, and if you made the process less ad hoc and  
16 provided more guidance to staff -- this is actually how  
17 we're going to weigh things. This is how you, you know,  
18 we have to think about the fact that none of these things  
19 are certain, and don't send up a memo each time where  
20 this is absolutely the market definition; that there  
21 isn't any doubt about it, and it's just as good as the  
22 one last week we sent up, et cetera. If we have more  
23 rigor, reasonable rigor in the process, we'd get better  
24 decision making.

25 MS. COLEMAN: Vincent, did you want to?

1 MR. VEROUDEN: Yes. Just to react on Bill's  
2 comment, of course. Well, I'm not here in a position to  
3 really say a lot about the GE/Honeywell case. It's also  
4 pending in front of the court. But, certainly, the issue  
5 was broader than whether, you know, the efficiencies  
6 would allow the new entity to lower price and then as a  
7 result of the efficiencies, the ultimate result would be  
8 a negative one with the other firms exiting.

9 I think if one could say one thing, the focus  
10 of the investigation was whether the new entity would  
11 have both the ability and the incentive to kind of embark  
12 upon the strategy to marginalize in some way or the other  
13 the rivals in the markets concerned. So it's a bit  
14 broader than just giving it the label "efficiency  
15 offense." That's the only thing I want to say at this  
16 stage. And let's just leave the debate for what the CFI  
17 is going to tell. Thank you.

18 MS. COLEMAN: Another question that was brought  
19 up by some of what Chairman Pitofsky said and by Joe's  
20 analysis, is the time horizon over which we are looking  
21 at, both effects and efficiencies and the net effect of  
22 the merger and what the panel thinks about what type of  
23 time horizon should we be looking for. You know, is it  
24 two years, which some parts of the Guidelines sort of  
25 suggest? Should it be longer? Should it be different

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

25                  They may reduce the number of rivals. But as

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

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

22 MR. PITOFSKY: Yes. A couple of reactions. On  
23 the last point, absolutely right. If there are no or  
24 little barriers to entry, there's no market power, and  
25 therefore you don't have to worry about anticompetitive

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

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

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

17 (Laughter.)

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

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

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

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

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

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

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

1 way.

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

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

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

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

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

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

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

16           So this makes it more complex than even just  
17 who has the burden of proof in front of the agencies.  
18 It's also a timing issue and a difficulty issue.

19           One other thing. Both the Guidelines, and the  
20 agencies are always saying, well, the parties are in  
21 better control of the documents and the evidence to  
22 support it. That's not always the case. Sometimes --  
23 you have subpoena power. You can find out what other  
24 deals in the industry, what other third parties have  
25 achieved in the way of efficiencies that we don't have

1 access to.

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

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

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

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

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

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

11 MR. ABBOTT: Sure.

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

22 And suppose you had a situation in which, okay,  
23 the staff thought that was the type of model that was  
24 applicable, and the parties came in and showed, yes,  
25 here's the marginal cost reduction that's going to take



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

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

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

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

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

1 it comes from some sort of analysis or explanation, but  
2 what it is, is a goal that some manager has to meet. At  
3 least that's what it better be, or we shouldn't pay  
4 attention to it.

5 And as Ilene said from Sarbanes-Oxley, if you  
6 say it to the Street, you are going to be accountable.  
7 So one of the management tools is saying we understand  
8 this much about the other company. This is your target.  
9 Go achieve it. They're not going to get down into  
10 micromanagement of how you do it. So whether cost  
11 consolidations are a savings or not, you shouldn't expect  
12 to see a lot of detailed analysis of them. Now, when you  
13 get to the more sophisticated stuff, which I agree might  
14 be much more important, I think you have to be able --  
15 you know, it's reasonable for the agencies to require  
16 more. And that may be difficult to prove.

17 But I do think that a very important source of  
18 evidence is to ask, you know, show me where you've done  
19 this before. Have you done something like this before?  
20 Have you done some other deal before? Or show me what  
21 you did in a similar circumstance. I think that's very  
22 important evidence. I think it's credible to anyone  
23 including most decision makers. It hopefully the  
24 situation should be analogous. And if we did more of  
25 that, we had some of that at the FTC, if we did more of

1           that, I think the agencies would understand the way  
2           businesspeople make decisions and how they make things  
3           happen and why they may work and why they don't.

4                       MR. ABBOTT: Well, thank you, Dave. Anyone  
5           have any additional insights to add on that topic?

6                       (No response.)

7                       Well, if not, we're close on the noon hour, and  
8           believe it or not -- yes?

9                       MR. KOLASKY: Just one quick thing. I want to  
10          come back to the title of this panel and really emphasize  
11          this point about integrating efficiencies into the  
12          analysis. And this goes back to one of Bob's comments in  
13          response to some of the criticism of Heinz/Beech-Nut, and  
14          it's a very important point.

15          And that is, you know, Bob said that Beech-Nut and Heinz  
16          were competing like crazy. And that's true. They were  
17          competing like crazy in order to get on the shelves of  
18          supermarkets. And as a result of that, what they were  
19          doing is bidding up their distribution cost. So  
20          actually, that competition wasn't benefitting consumers.  
21          That was competition that was raising their costs  
22          relative to the incumbent dominant firm, Gerber.

23                       And what that points up is the importance that  
24          as you think about these issues, you think about  
25          efficiencies, you also think very clearly about what you

1 mean by competition.

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

4 (Laughter.)

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

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

25 MR. PITOFSKY: I respectfully dissent.

1 (Laughter.)

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

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

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

15 (Applause.)

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

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**AFTERNOON SESSION**

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

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

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

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

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

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

7 (Laughter.)

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

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

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

1 evaluation of mergers.

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

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

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

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

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



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

8 (Laughter.)

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

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

1 Antitrust Division in charge of our EAG shop.

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

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

17 Bobby likewise served as the economics Deputy  
18 at the Division from 1989 to '91, and he too is the  
19 author of numerous articles and has been a participant on  
20 numerous policy task forces.

21 So suffice it to say, you've got a terrifically  
22 qualified panel. The format that I think we'll follow is  
23 for me to pose a number of questions and try to excite  
24 some comment from the panelists and maybe even provoke  
25 some exchange among the panelists.

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

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

16                  VOICE: Reverse order.

17                  MR. PATE: Reverse order.

18                  (Laughter.)

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

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

1 and unfair. But never mind.

2 (Laughter.)

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

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

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

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

24 There is so much analytic R&D that it's of  
25 exceptionally great importance that the parties share

1 their work with the staff and the agency and vice versa,  
2 that the agency share with outsiders exactly what their  
3 own work is producing, how it's evolving, so that there  
4 can be a meeting of the minds in terms of the most  
5 reliable set of methods to use.

6 The other thing I want to throw out, and I  
7 won't say much about it to take the time now, but I would  
8 love to see in the coming years more organized capability  
9 in the community for handling R&D or innovation issues  
10 and some appendage to the Guidelines that I think I hear  
11 you're going to show us about 3:30 today, you promised.

12 (Laughter.)

13 The new R&D innovation markets Guidelines. How  
14 should we really handle those concerns? How should we  
15 also blend in the possibility of efficiencies in  
16 innovation markets, more efficient R&D perhaps as a  
17 result of the deal, and how can that all be blended  
18 together in the sense of Guidelines for handling those  
19 issues?

20 MR. PATE: Okay. Thanks. Dan?

21 MR. RUBINFELD: I agree with most of what Bobby  
22 said, so I can't start a fight just yet, so I'd like to  
23 start on a different subject.

24 One of the things I know the agencies debate a  
25 lot internally in merger cases is whether they should use

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

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

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

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

25 And I think that with the '92 Guidelines and

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

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

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

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

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

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

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



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

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

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

18                  And on Jim's comment about the trend away from  
19                  structural analysis, I would certainly agree that that is  
20                  a trend, but I would question whether it has had as  
21                  widespread an impact as I think we all would hope. And I  
22                  certainly would identify as one of the, at least my top  
23                  10 favorite faux pas, the agency, which will go unnamed,  
24                  briefed to the court that an HHI of 510 should  
25                  presumptively entitle it to relief.

1                   And with that, I'll pass.

2                   MR. PATE:   Okay.   Dale?

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

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

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

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

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

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

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

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

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

4 (Laughter.)

5 MR. PATE: Dennis?

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

12 In the United States, I don't know if it would  
13 make that big a difference, but certainly in other  
14 countries it will. And the United States is being used  
15 as a prototype for antitrust laws around the world. And  
16 it's a big question, especially in small countries that  
17 rely on international trade.

18 And it goes even beyond antitrust. The  
19 question is whether an antitrust authority should be the  
20 protector of property rights for consumers. Do consumers  
21 have a property right in competition? I think that's a  
22 good question. It goes to the efficiency of government  
23 and perhaps corruption. And thinking on that question  
24 would be helpful.

25 More specifically related to the United States,

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

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

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

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

1 the incentives for technological change.

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

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

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

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

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

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

20 So I think it's very dangerous. I think it's a  
21 helpful way of interpreting demand econometric  
22 estimation. It can be a dangerous way of predicting  
23 what's going to happen. And I don't mean to state by  
24 that that it's not useful. But there is a trend in  
25 academia for the use of what's called structural -- and

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

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

15             MR. PATE: Okay. Jonathan?

16             MR. BAKER: Well, there's been so much going on  
17      here in this conversation that I don't know where to  
18      start, and I certainly am not going to try and comment on  
19      every little piece that we've talked about.

20             So I'll start out by observing that I think the  
21      most interesting change, or greatest change in merger  
22      enforcement since '92 Guidelines has been the revival of  
23      coordinated effects analysis, which was very healthy, but  
24      that the problem with it is that some people seem to take  
25      the view this is an excuse for not paying attention to



1 unilateral effects.

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

13 But Greg Werden and Luke Froeb and others have  
14 responded appropriately by working to improve the tools  
15 and develop ways of testing their robustness to potential  
16 problems. And a healthy debate about methods of analysis  
17 is not a reason for skepticism about the theory.

18 So if you ask where in the Guidelines would I  
19 want to tinker, perhaps it's that 35 percent market share  
20 safe harbor for unilateral effects when it applies -- to  
21 the extent it applies -- to the loss of localized  
22 competition.

23 There's a dispute as to whether the words  
24 actually do apply there, although it certainly was the  
25 intention of Jim Rill, as I understand it, to do so. But

1 the problem is that unilateral effects having nothing to  
2 do really with market share. So when you have this 35  
3 percent safe harbor, you risk failing to challenge  
4 potentially anticompetitive mergers, but you also put  
5 pressure on the agencies to be defining narrow markets in  
6 unilateral cases because of how they have to prove the  
7 case with the 35 percent safe harbor, which could be  
8 troublesome as quantitative effects becomes revitalized,  
9 and you're looking at how the agencies define markets for  
10 unilateral effects purposes.

11 But I agree with those on the panel who have  
12 said that simulation models are a good avenue to pursue  
13 in trying to do better at understanding mergers.  
14 Particularly, I think they've been useful in unilateral  
15 effects areas. That's really where they've been applied  
16 most successfully to date.

17 Because at a minimum, and I'm just saying  
18 something a different way than Dennis said -- simulation  
19 models can provide a useful metric for understanding what  
20 the demand elasticities mean.

21 Now if you want to go farther and start  
22 thinking about how seriously do we take the predicted  
23 prices, some of the cautions that Dennis and Bobby raised  
24 I think are appropriate. To be convincing, we need to  
25 recognize that most simulation results depend on a host

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

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

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

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

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

21 (Laughter.)

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

23 VOICE: Was your prayer rewarded?

24 (Laughter.)

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

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

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

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

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

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

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

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

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

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

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

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

19 MR. PATE: Okay. Good. A lot of themes. I'd  
20 like to follow up. It seemed that simulation analysis  
21 maybe was the most frequently mentioned topic, so why  
22 don't we stick with that for a while and let me invite  
23 anyone who has a follow-up, having heard the other  
24 comments. Bobby?

25 MR. WILLIG: Thank you. Two kinds of reactions

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

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

13 But the very, very important point, and if I  
14 was in the mood to slam the table, I would on this, is  
15 that every assumption, every one of that long list that  
16 matters for the simulation is one that in less formal  
17 analysis is being made in a less aware and even more  
18 arbitrary way.

19 There's no shortcut around those assumptions.  
20 There's only whether you're using a framework that brings  
21 it clearly to mind what it is that we need to assume.  
22 It's a horrifying thought that implicitly, even in the  
23 world's greatest Guidelines, all of those assumptions are  
24 in essence being made in part based on convention, in  
25 part based on experience, but those very same areas that

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

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

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

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



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

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

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

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

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

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

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

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

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

1 efficiencies.

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

10 MR. PATE: Dale?

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

20 And I think if you ask yourself the question,  
21 what do you do with it today? Okay, and does it really  
22 have any impact at the margin in prosecutorial decision  
23 making? I think the answer to that question is largely  
24 no.

25 You can think of several things you could do

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

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

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

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

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

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

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

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

24 MR. PATE: Dan?

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

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

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

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

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

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

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

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

23 But, the science has still got a long way to  
24 go.

25 A couple of other quick points. First, I want

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

9 And I would never want to testify myself about  
10 a simulation unless I was convinced I had seen enough of  
11 the record to make me believe this was something to rely  
12 on. I have seen a number of studies which don't do that,  
13 and I wouldn't believe them just like everybody wouldn't  
14 believe them.

15 And finally, I guess I wanted to point out that  
16 we are in the process, and I think properly so of trying  
17 to do a evaluation of the effectiveness of simulation  
18 studies, and there were folks who have suggested, and we  
19 assume the agencies are doing that now, that we ought to  
20 go back and kind of look at some prior mergers and see  
21 how well these techniques have worked in the past. I  
22 think that's excellent work. We ought to think  
23 creatively about how to do that.

24 But I do want to give a warning ahead of time,  
25 because I see a possible problem down the road. When



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

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

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

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

1 same time.

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

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

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

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

2 That's good.

3 (Laughter.)

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

14 The court mainly relied really on the documents  
15 about it, although there was extensive econometric  
16 analysis confirming what the documents had said, that was  
17 important in the agency decision making at the very  
18 least. It endorsed the Merger Guidelines approach to  
19 entry and efficiencies. So all of that was in play at  
20 the time to some extent at least, and this court came  
21 through in a way that got everyone's attention to confirm  
22 these various initiatives of the agencies about empirical  
23 work, unilateral effects, the entry and efficiency  
24 sections of the Guidelines.

25 And it gave the FTC credibility at the time in

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

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

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

17 I think that that was a very --

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

20 MR. LOFTIS: The delta, yes. I think that was  
21 a decidedly unhelpful move, Bill.

22 MR. PATE: Jim?

23 MR. RILL: I'll go good and bad, but they'll be  
24 different cases.

25 (Laughter.)

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

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

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

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

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

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

4 MR. PATE: Bill?

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

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

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

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

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

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

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

11 It also put the burden then in that particular  
12 case on the defendant to go forward with evidence in  
13 rebuttal, and in that case, it happened to do with entry.  
14 But it was only the burden of going forward. Baker-  
15 Hughes makes absolutely clear that the burden of  
16 persuasion on the question of whether or not there's an  
17 anticompetitive effect on the deal always rests with the  
18 plaintiff. And I think that that is one of the most  
19 important things that's come out, you know, in modern  
20 merger law, which I'll start with like 1974.

21 I think that a lot of the debates that we have  
22 generally, I think a lot of the discussions on the panels  
23 that have been up here over the last couple of days, if  
24 we in effect join the issue much better on who bears the  
25 burden of proof, and in particular, that the plaintiff

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

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

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

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

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

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



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

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

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

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

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

9           But right away Microsoft offered to divest the  
10 Money code to some other major software house. And so it  
11 wasn't an overlap of code or of market share anymore.  
12 What was left to the case was a very, very strong overlap  
13 in what I like to call, and I think the government used  
14 these words, platforms for competitive advantage in the  
15 relevant market for personal financial software.

16           Intuit -- Quicken -- had a huge installed base  
17 of happy users. Microsoft had all the advantages that  
18 one understands Microsoft to have in any area of software  
19 dealing with the desktop, and the Department judged that  
20 these were the two most important platforms for  
21 competitive advantage in the relevant market. They  
22 should not be allowed to combine because of the market  
23 power that it would create. No concentration measure.  
24 No counting of beans, how many lines of code had been  
25 sold to whomever; just a direct assessment of competitive

1 advantage.

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

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

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

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

23 (Laughter.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

15 Sorry, Dale.

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

19 (Laughter.)

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

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

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

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

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

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



1 and the non-challenge of the tire merger.

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

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

12 (Laughter.)

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

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

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

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

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

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

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

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

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

4 MR. PATE: Jim Loftis?

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

13 (Laughter.)

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

16 MR. PATE: Okay. Dale?

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

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

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

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

1 request.

2 That was the first time we ever heard from them  
3 what the theories they were testing. Of course, we're  
4 sitting back doing everything we possibly can to cook up  
5 what are the theories they could possibly be testing,  
6 coming up with all sorts of theories, and tossing in  
7 arguments about, you know, you can't be testing this  
8 theory, because here are the five reasons why it's wrong.

9 I think what really needs to be done on both  
10 agencies' part is that the transparency in the course of  
11 the investigation needs to be improved substantially. I  
12 think there's an obligation, and let me just real quick  
13 on this -- it's an obligation that goes both ways. And  
14 it's in the following sense. The senior officials in the  
15 agency should be instructing the staff, they need to be  
16 more transparent with the parties from the beginning on  
17 the theories of anticompetitive harm they're testing.  
18 That's one way.

19 The way that it goes back is, the senior  
20 officials should tell the parties, do not come in here  
21 and tell me what the staff was, in fact, telling you as  
22 their sort of working hypothesis of anticompetitive harm  
23 early in the investigation. I don't want to hear it, all  
24 right. The only one I want to hear is the one that's  
25 being addressed at the end of the investigation. And I

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

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

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

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

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

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

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

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

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

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

24 (Laughter.)

25 MR. PATE: Other comments on transparency?

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

2 MR. BAER: I think it is marginally better in  
3 terms of that individual case process, and even the  
4 people who tended to be very closed off are at least  
5 trying, I think, to be a little more open. But it still  
6 is a widely varying experience one has in terms of the  
7 quality and the detail and the timing, as Dale says.

8 But I want to go back to the first kind of  
9 transparency. The information that the agency put out in  
10 December, the information that the FTC put out last week  
11 or the week before, is extraordinarily helpful in terms  
12 of counseling. You can now take a look at these grids  
13 and provide clients some sense of what the odds are, that  
14 if you properly define the market and your market shares  
15 are X or Y, based on the FTC data. You review the  
16 documents, and if they suggest a view of the market  
17 that's different than the one you need to win, that  
18 that's going to hurt you, and if you really have some  
19 doubts about whether the customers are going to line up  
20 and support this deal, you can help people make more  
21 informed front-end decisions about whether or not to go  
22 forward. And I think that's helpful to us in advising  
23 businesses on where to go.

24 To go just real quickly to your question about  
25 merger Guidelines, it sounds like -- whether they need to



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

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

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

21 But I do think trying to get the numbers closer  
22 to where enforcement posture really is, is probably a net  
23 benefit and not a hard thing to do.

24 MR. PATE: Jonathan?

25 MR. BAKER: I have an observation on this in

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

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

15 Revising the Guidelines is a big deal. It's  
16 hard. It's hard on the agencies. You've got to be  
17 really careful about how you say everything, and I don't  
18 object to good government improvements, but if you  
19 actually look back at the history of Guidelines  
20 revisions, it's largely not been good government  
21 improvements as the motive for revising. If you're  
22 revising it for another reason anyway, you'll make your  
23 tweaks of various things like the HHI standards.

24 But the 1982 Guidelines, what those were all about  
25 was how do we take into account what the new kind of

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

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

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

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

16 The 1992 Guidelines essentially -- and Jim's  
17 not going to like this -- but essentially took into  
18 account the reworking of industrial organization of  
19 microeconomics around game theory and oligopoly theory  
20 and took what insights we could get from that and  
21 imported those into the Guidelines, along with a host of  
22 other good government improvements along the way.

23 The 1997 revisions were prompted by, in  
24 significant part, by the hearings that the FTC did about  
25 high tech and global competition and the efficiencies

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

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

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

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

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

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

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

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

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

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

3 MR. PATE: You mean the FTC data?

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

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

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

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

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

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

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

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

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

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

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

22           (Laughter.)

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

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



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

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

11 (Laughter.)

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

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

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

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

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

5 But going back to the Guidelines, having been  
6 involved a bit in the joint venture Guidelines and having  
7 watched the 1997 efficiency improvements close hand, I  
8 actually don't think it's a good investment to try to  
9 actually write new Guidelines. I think they are great  
10 structure for thinking about mergers.

11 But if I were going to change the Guidelines or  
12 at least change some of the ways I thought about mergers,  
13 here are a couple of quick thoughts that run through my  
14 mind. One is -- with apologies to Bobby and Jim -- I  
15 don't see any value of the 35 percent unilateral effects  
16 harbor. I think if you're over 35 percent, the two firms  
17 that are closest competitors are over 35 percent, you're  
18 going to generate significant anticompetitive effects in  
19 almost any merger simulation anyway. And the 35 percent  
20 number creates weird incentives for parties.

21 Secondly, I agree generally about the point  
22 about the delta, but the states are not always on top of  
23 the common law as we are here in Washington. I cite as  
24 an example, with prejudice because I was involved, the  
25 Kraft General Foods case brought by the State of New York

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

3 (Laughter.)

4 And it just seemed weird to me because at the  
5 same time I could point to 10 mergers with deltas of 500  
6 which were going through the agencies very easily, and it  
7 was like a strange world.

8 And finally -- this is really a separate point.  
9 If I were sort of thinking about new areas other than  
10 dynamic efficiencies and innovation, I would think a new  
11 area to think about, you know, not really writing  
12 Guidelines, but developing themes, is the area of  
13 corporate governance. We're seeing more and more deals  
14 that involve partial equity acquisitions, other kinds of  
15 complex forms of governance relations.

16 The staff in the agencies are trained as  
17 attorneys or economists. Most of the internal folks and  
18 most of the economists in this business don't know a lot  
19 about the economics of corporate governance. There's a  
20 huge literature on that that's relevant, and I know the  
21 agencies, at least since I was there -- both agencies  
22 have been thinking hard about it, and I really think it's  
23 an important area to do more work in.

24 If I were advising hiring more staff, I'd say  
25 think about hiring some finance professors or some

1 lawyers who do corporate law and get them involved in  
2 this. Because right now we have some very simple rules  
3 that we use to think about governance, and I think the  
4 rules are almost always wrong.

5 MR. PATE: Bobby, last word before a short  
6 break.

7 MR. WILLING: Thank you. On numerical portions  
8 of the Guidelines, it strikes me as healthy to have a  
9 boundary to the safe harbor of 1,000, but the de facto  
10 boundary be 1,200. I mean, it's nice to have a little  
11 leeway there. And I think if in some attempt at  
12 excessive transparency the explicit boundary were raised  
13 to 1,200, the expectation would be naturally that the de  
14 factor boundary would move up to 1,400 inappropriately.

15 So I think in that respect, the numbers that  
16 have been published lately really are consistent with the  
17 published Guidelines.

18 On transparency, and we can come back to this  
19 after the break because this may be worth talking about  
20 with counsel, the boundary to transparency that I and my  
21 colleagues have repeatedly run into with the economists  
22 with respect to data handling, econometrics and  
23 simulation, has been the litigation needs of the agency.  
24 It's the big bugaboo. It's the big bear which the  
25 lawyers are always using as their hammer to alleviate

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

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

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

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

19 (A brief recess was taken.)

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

24 (Laughter.)

25 And I guess the better question might be: would

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

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

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

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

1 antitrust changes in the long run.

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

6 (Laughter.)

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

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

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

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

21 (Laughter.)

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

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

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

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

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



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

8 Now just one last quick thing. On what  
9 Jonathan said, I think something very interesting has  
10 happened at the agencies. I think the cases dichotomize.  
11 I think there are some cases where the economists are  
12 very interested, particularly front office economists are  
13 very interested, and you see basically a lot of economic  
14 content in the investigation. But I cannot tell you how  
15 many investigations I've had in the last five years where  
16 there has been essentially no real economic content in  
17 the investigation.

18 And what's really happened is the lawyers have  
19 internalized the basic economic paradigms that have been  
20 developed, and now they think they no longer need the  
21 economists to assist them. And, you know, you will find  
22 economists, quite frankly, who aren't necessarily  
23 interested in pushing themselves onto the legal staffs to  
24 get really involved, and they just sort of go along for  
25 the ride, and you never see them, at least from the

1 outside, making any contribution in the case.

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

5 MR. PATE: Other comments? Dan?

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

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

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

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

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

7 MR. PATE: Jim Rill?

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

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

1 litigation processing, but also for processing all up the  
2 line.

3 That doesn't mean dumb down. That means put  
4 down into practical terms and realistic terms based on  
5 empirical evidence rather than perhaps dancing around non  
6 empirically-based fanciful simulation theories. And I'm  
7 not talking about anyone in this room, of course.

8 MR. PATE: Dennis?

9 MR. CARLTON: I guess I have two comments. The  
10 short answer to your question, should economists take  
11 over is obviously no, because economists believe in  
12 comparative advantage. And even though economists may be  
13 able to articulate theories of anticompetitive harm and  
14 analyze evidence, they're not very good at process  
15 necessarily.

16 We are not trained to go through a process that  
17 respects certain rights and certain expectations. And  
18 that's why I think the lawyers will always remain  
19 involved, and since it's ultimately the court that is the  
20 final threat, I think the lawyers will continue to play a  
21 large role.

22 What that suggests, though, is a great  
23 responsibility on the part of the agencies, because they  
24 are typically much more sophisticated because they have  
25 more economic expertise than a court. And, therefore, I

1 find that the sophistication of the arguments you can use  
2 before government agencies is much greater than you can  
3 expect to use in a courtroom because the level of  
4 understanding is so much greater.

5 And that means the great responsibility is when  
6 if you're thinking forward, even if you can win a case  
7 and you know you could win because the court's not going  
8 to understand the sophisticated theory, you have to, and  
9 obviously you do, exercise your discretion that you're  
10 not going to bring a case just because you can win it if  
11 the sophisticated theory that your economists sign off on  
12 exonerates the transaction.

13 So I think that's why the lawyers will always  
14 be involved in the process, because it ultimately ends or  
15 could end in court, but that does mean there's this  
16 heightened responsibility.

17 Now on the transparency issue, I am not sure I  
18 agree -- well, I don't agree with what Dale said in that  
19 when I'm an expert in a case, I like to know not just the  
20 good points in the case but the bad points. I think that  
21 makes me an effective expert. In fact, I'm not sure how  
22 I can be an expert unless I'm aware of all aspects of the  
23 case.

24 So I actually think the best training for an  
25 expert who's going to be in a case is not to be shielded

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

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

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

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

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

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

1 through things. But, you know, there's thinking through  
2 things and there's thinking through things. If I've got  
3 a strategic economist who has gone down a lot of blind  
4 alleys with me, and we've figured out what works and what  
5 doesn't work, you can sort of narrow the path, if you  
6 will, in a perfectly legitimate way for the testifying  
7 economist so that they just go down a much more efficient  
8 path, if you will.

9 And it's not that you've hidden anything from  
10 them, but you don't also go say, well, let me tell you  
11 about the 15 theories that we worked out that we decided  
12 we're not going to run in this case. Those theories  
13 shouldn't be part of the case. We're not running them.  
14 You know, there's no reason to confuse people with them.

15 So, I like the economists to have lots of  
16 knowledge about the case but, if you will, be very  
17 efficient in the path they go down.

18 MR. PATE: Okay. Let's move to the data  
19 release that the agencies made before this workshop got  
20 underway, and I'd like to turn to the panel and ask were  
21 there any surprising conclusions that you thought you  
22 were able to draw from the data? More generally, did the  
23 data release tell you anything about enforcement that you  
24 think would be useful to share on the panel? Bill, go  
25 ahead.

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

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

17                   But I think Dennis or someone mentioned this  
18 earlier, the results which suggested that at certain HHI  
19 levels and increases in concentration, that if customers  
20 provide serious, credible complaints, that your chances  
21 of being challenged are about 100 percent, was really  
22 quite remarkable. And it would be interesting to have a  
23 better feel for what the standard of credible customer  
24 complaint was.

25                   But the fact of the matter is, I think the



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

8 MR. PATE: Jon?

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

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

13 (Laughter.)

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

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

23 (Interruption to the proceedings.)

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

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

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

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

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

16 (Laughter.)

17 MR. WILLIG: Was it?

18 (Laughter.)

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

25 MR. PATE: Fair enough.

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

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

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

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

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

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

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

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

19 MR. PATE: Jim Loftis?

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

23 (Laughter.)

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

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

5 MR. PATE: Other comments on the data?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

22           MR. RUBINFELD: Right.

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



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

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

7 MR. PATE: Dale?

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

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

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

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

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

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

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

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

1 just in order to sort of explore those issues.

2 (Laughter.)

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

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

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

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

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

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

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

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

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

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

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

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

1 at the threshold to go very far with this.

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

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

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

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

1 therapy.

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

12 I mean, at the end of the day, the concept  
13 analytically has some value, I think. And as long as it  
14 isn't applied in a way that is overbroad, I don't see  
15 much to debate. But I may be in a minority.

16 MR. PATE: Dale?

17 MR. COLLINS: I agree with Bill. And I think  
18 that a lot of the debate on, if you will, innovation  
19 markets, starts off with the wrong foot by the use of the  
20 term "markets" because most of the discussion really  
21 isn't about markets. It's really about whether or not  
22 you can locate an anticompetitive effect along an R&D  
23 dimension.

24 Is the R&D going to be slowed down as a result  
25 of this transaction? Or if you're using it on the

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

5 I think the first thing that I would suggest on  
6 this whole question of innovation is that the agency sort  
7 of adopt an internal rule that says we're not going to  
8 talk about innovation markets if there's any other way to  
9 talk about the problem. And that'll solve like 90  
10 percent of the difficulties right there.

11 (Laughter.)

12 MR. COLLINS: And that doesn't say that you  
13 don't talk about innovation, because innovation could be  
14 a perfectly legitimate dimension on which to assess the  
15 competitiveness of a transaction. You just don't use the  
16 term "market", you know, to talk about it. I think this  
17 whole thing, and Dennis has already mentioned this --  
18 sort of started off in some ways on the wrong foot with  
19 the ZF case. If I remember the complaint in ZF, what  
20 they did was they defined both innovation market and then  
21 they applied what amounted to a Herfindahl. They  
22 incorporated a Herfindahl allegation in order to presume  
23 an anticompetitive effect in this innovation market based  
24 on, if you will, the market shares.

25 And as I said, I think that that really got



1 things off on the wrong foot. And if you read the  
2 complaint, it was completely unnecessary to do. There  
3 were other allegations in the complaint that could have  
4 gotten you to the same result without any trouble at all.

5 MR. PATE: Bobby?

6 MR. WILLIG: What they presumed in part was  
7 that a base of market share in the tangible product is an  
8 important impetus to doing R&D. And so the theory was if  
9 you put the two major producers of the tangible product  
10 together in the merger, then you're putting together the  
11 two lead players in R&D space, leaving R&D with less  
12 competition and therefore less force for moving the  
13 frontier.

14 The trouble with that is that in economics and  
15 common sense, and I think business experience, it's true  
16 there may be a relationship to market position and  
17 impetus to R&D, but that means that if you put together  
18 two players and they become bigger, they've now got a  
19 bigger base of motivation to invest in improvements.

20 And it's the old Schumpeterian effect which has  
21 been a very real effect studied by economists that the  
22 bigger players with more clout in the marketplace  
23 actually have more incentive to do R&D as long as they've  
24 got some spur, and that spur can come from competing  
25 purveyors of R&D, or a competing product manufacturers.

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

3 MR. PATE: Dennis?

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

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

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

1 market, necessarily holds true.

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

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

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

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

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

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

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

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

1 the evidence.

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

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

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

12 MR. PATE: Jon?

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

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

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

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

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

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

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

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

10          MR. PATE: Sure.

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

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

1 consequences of those practices.

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

10 (No response.)

11 MR. PATE: No.

12 (Laughter.)

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

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

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



1 myself.

2 (Laughter.)

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

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

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

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

1 he was responding?

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

5 MR. PATE: Sure.

6 MR. WILLIG: Just to lay it out a little bit  
7 more, we frequently encounter the idea that among merger  
8 efficiencies is the ability to buy more effectively,  
9 i.e., cheaper. And of course that sounds a lot like  
10 monopsony at the same time. How could a theory of  
11 anticompetitive effect be indistinguishable from a theory  
12 of efficiencies is really a challenge. And I think  
13 there's a very simple answer in economics. I wonder if  
14 Marius agrees from his earlier work.

15 But for me, it has to do with output, as usual.  
16 But it's not downstream output, it's upstream output.  
17 It's output in the market where the monopsony power is  
18 said to be of concern.

19 So if the better clout from the merger on the  
20 efficiency side enables more effective procurement, that  
21 should also increase the output of the upstream supply.  
22 But if it's an abuse of market power to get the lower  
23 price upstream, that will be associated with fewer  
24 purchases or less quality purchases of the upstream  
25 supply.

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

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

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

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

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

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

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

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

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

17 VOICE: Law school.

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

19 (Laughter.)

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

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

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

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

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

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

1 produce some output.

2 MR. PATE: Dan?

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

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

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

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

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

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

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

25 MR. WILLIG: For me, what buyer power is all

1 about in a merger analysis is it's an important part of  
2 the structure of the output market to understand, and  
3 part of our obligation to do good analysis under the  
4 Guidelines generally is to work through the consequences  
5 for the way the firms are competing, and the remaining  
6 competitors in the market in view of the nature of  
7 demand, which include the big buyers.

8 So, for example, it may be tougher to imagine a  
9 coordinated effects theory if there's big buyers who are  
10 in control of their own procurement.

11 MR. CARLTON: I think the big buyer can protect  
12 himself, by vertical integration, for example, or by his  
13 bargaining power to sign a contract for supply. The  
14 question is, how do the other buyers protect themselves?  
15 And that then raises the question, is it one price for  
16 the product or differential prices? And that seems to me  
17 very important. I think that's taken into account when  
18 the agencies look at things.

19 But as a general matter, I think heterogeneous  
20 pricing in products and also whether it's services or a  
21 durable good, are important considerations and have very  
22 large impacts on competition.

23 MR. PATE: Dale?

24 MR. COLLINS: I think that in answer to Dan's  
25 question, I've always thought that buyer power can play a

1           role in the defense of a transaction, but what's critical  
2           and I think what so many defense lawyers fail to do is  
3           explain the mechanism by which the buyer power is being  
4           exercised.

5                        They just say there are big buyers out there.  
6           You know, that by itself, quite frankly, should get you  
7           nowhere on the defense side. You need an explicit -- you  
8           need to be explicit about the mechanism by which the  
9           buyer, in the context of the industry and that particular  
10          buyer's attributes, is actually going to be able to  
11          effect a price change, if you will, in order to protect  
12          itself.

13                       And I think Dennis is absolutely right. When  
14          you get into all the characteristics, you know, the  
15          nature of the products, whether or not there's price  
16          discrimination, there's going be a huge problem in these  
17          buyer power defenses.

18                       MR. PATE: Let me try to get some comments on  
19          coordinated effects. A couple of years ago Charles James  
20          suggested that perhaps unilateral effects had driven out  
21          coordinated effects, and that outside of stylized  
22          maverick stories, coordinated effects wasn't getting  
23          enough attention.

24                       Jonathan, I was interested by your comment  
25          leading off that coordinated effects has been so



1 reinvigorated that you think it's driving out unilateral  
2 effects. So let me just use that to solicit comments on  
3 where we are in terms of use of coordinated effects  
4 theories in merger analysis and where should the agencies  
5 be, and where should they say they are for the benefit of  
6 outside parties. Do you want the first shot?

7 MR. BAKER: Sure. I think what the agencies  
8 have been doing the last few years in coordinated effects  
9 has been very healthy and very interesting. And what's  
10 been clarified are a couple things. One is that there  
11 are two different questions that you have to ask. One  
12 is, how do the firms in the industry solve their cartel  
13 problems, reaching consensus, deterring deviation, by  
14 detecting and policing cheating? And then how does the  
15 merger matter? And that the factors in the merger  
16 Guidelines aren't just some sort of checklist. They're  
17 part of the way that integrated analysis that have to be  
18 directed towards whether and how the firms solve their  
19 cartel problems.

20 And there's a lot of empirical evidence that  
21 could bear on that. And there are interesting papers  
22 coming out of both agencies, or people who worked in  
23 them, with lots of little empirical tests that might be  
24 relevant to understanding specific coordinated  
25 interaction stories. They all have to be tied to the

1 story.

2 If you think the way coordination works is on  
3 price, then issues about transparency might be important.  
4 If you think it's a customer allocation, then it's a  
5 transparency of customers, not the transparency of prices  
6 that matters. But with that kind of a caveat, the  
7 agencies have been very thoughtful and moving the ball  
8 forward on doing empirics in the coordinated interaction  
9 area.

10 And then in analyzing whether and how the  
11 merger matters, I think that's what mavericks are all  
12 about; that there's always a constraint on coordination.  
13 Coordination -- you would generally expect if it exists  
14 to be imperfect and incomplete. In that kind of a  
15 setting, the issue is, well, why is it imperfect and  
16 incomplete? What firm doesn't want to go along or can't  
17 be, of course, can't be paid off with side payments or  
18 punished more vigorously to force it to go along, and  
19 then how does that constraint get changed by merger?

20 And I would incorporate a presumption that if  
21 the merger involved a maverick, it would be harmful. And  
22 if it didn't involve a maverick, then you need to analyze  
23 how the merger affects the constraint, the mavericks.  
24 And so that's how I think the agencies are evolving  
25 towards understanding these coordinated effects cases,

1 and it's healthy.

2 MR. PATE: Jim Rill?

3 MR. RILL: Yes. I was with you up until the  
4 presumption on the maverick. But, no, I think the agency  
5 enforcement procedure and the Guidelines really are quite  
6 good on coordinated effects.

7 When we developed them in the 1992 Guidelines,  
8 there was some sort of criticism that there was a large  
9 number of criteria and a large number of considerations,  
10 a large number of elements that were thrown into the pot  
11 to identify situations where coordinated effect might be  
12 the basis for a challenge to the merger.

13 I know the ABA was somewhat upset: What are  
14 you doing? You've given us a stew. You haven't told us  
15 what the principal ingredients are. I think we did the  
16 right thing, partly for the reason that Jonathan  
17 suggested, that cases are so fact-specific, and in many  
18 instances, so directionally pointed as to a particular  
19 focus of analysis to say, well, the real issue here is  
20 going to be heterogeneity. Well, in many instances, it's  
21 not. The real issue may be conditions of the downstream  
22 market.

23 So it has to be weighed on a case basis. And I  
24 think the agencies have done quite a good job on that.  
25 And I would not recommend, as some questions have

1 suggested, I would not recommend something to assign  
2 priorities to the elements of the competitive effects  
3 section of the Guidelines.

4 Presumption of illegality based on maverick, I  
5 have trouble sometimes identifying the difference between  
6 a maverick and a thoroughbred. And not being that good  
7 of an equestrian, I'd have to say that to create such a  
8 presumption, I think, would do considerably more harm  
9 than good across the board, because the maverick may not  
10 be so much of a maverick.

11 There may be a lot of considerations that makes  
12 him or her not a maverick, but based on other factors  
13 that make a somewhat difference from the basis of product  
14 and the basis of cost, from the basis of position, from  
15 the basis of influence in the market, that I think risks  
16 severe damage by creating that -- well, how about  
17 moderate damage, from establishing that kind of a  
18 presumption.

19 MR. PATE: Dennis?

20 MR. CARLTON: One concern I've always had with  
21 the quote, "maverick" theory is anytime you introduce new  
22 terminology, it sounds like it's a new theory. And what  
23 I've always preferred is to think of the maverick theory  
24 not as, you know, this new word "maverick," but rather  
25 the following. That the economic circumstances of a

1 particular company are such that they have the incentive  
2 to be particularly competitive.

3 And I want to distinguish that from they have  
4 some CEO who's off on a power trip and he's going to  
5 affect price for his ego or some other idiosyncratic  
6 reason. I don't think you want the identity of the  
7 person running a company to be an issue in a merger case.  
8 I think you want it to be the economic characteristics of  
9 the company. Otherwise, you're going to run into the  
10 problem that companies are going to have an incentive not  
11 to be a maverick because they know that will hurt them  
12 under the Guidelines. To have an innovative CEO who is  
13 doing innovative things, if that's going to hurt them,  
14 they won't have that type of CEO.

15 So I've always disliked the word "maverick"  
16 because it suggests someone's off, he's kind of like a  
17 wild man. And I don't like that. A wild horse. I don't  
18 like that. I don't think it should be wild at all. I  
19 think it's quite disciplined, quite predictable based on  
20 the economic situation that the firm faces. Otherwise, I  
21 think you're going to get into all sorts of puzzling  
22 policy conundrums that, should it be an antitrust offense  
23 if, you know, they fire Mr. X and hire Mr. Y? I mean, I  
24 just don't think you want to go in that direction.

25 MR. PATE: Jim?

1                   MR. LOFTIS: I would agree certainly with the  
2 proposition that the agencies have gotten it about right  
3 in what they're doing in practice and that the stew or  
4 the checklist or whatever we wish to call it of the  
5 coordinated effects section of the Guidelines has not  
6 proved to be the gigantic problem that folks thought it  
7 to be.

8                   But it is interesting that to see how the  
9 factors that are identified in the Guidelines under the  
10 coordinated effects section, to see how they are playing  
11 out in a slightly different arena. I would recommend  
12 that you take a look at the recent case law in private  
13 treble damage actions, largely on summary judgment, and  
14 just subtract out of that Sherman Act equation the  
15 consideration of agreement, and look at what they say  
16 about exchanging competitor price lists, trade  
17 associations. Every factor that is in the coordinated  
18 effects section of the Guidelines has been dealt with  
19 more than once by the courts to evaluate its significance  
20 in a specific industry.

21                   And it's not entirely unlike what the agencies  
22 are doing in the merger setting.

23                   MR. WILLIG: I thought where you were going,  
24 Jim, was that -- and this is my experience -- that the  
25 agencies are quite expert and responsible in sewing

1 together a complete story of coordinated effects, which  
2 takes into account both the plus factors and the minus  
3 factors and tries to sew them together to see if there is  
4 a coherent story of how the merger will make coordination  
5 more likely or worse for consumers.

6 But then in contrast, the courts are far less  
7 expert, and they look at the checklist of factors, and  
8 they treat it as a checklist instead of as a guideline  
9 for how to tell a story or see if there is a valid story.

10 MR. LOFTIS: Well, let's flip that around. I  
11 think you could also make the observation that if there  
12 is a weakness in the agency merger analysis of  
13 coordinated effects, it is a reluctance to conclude that  
14 there will not be coordinated effects from a lack of  
15 transparency, for example.

16 Take any significant factor that's necessary  
17 for that cartel to be effective. You have red flags that  
18 say maybe it's going to be effective. But if you  
19 subtract, if you can prove that there's no transparency,  
20 and, therefore, it's not going to be effective, I think  
21 there's a reluctance in the agencies to walk away for  
22 that single reason from a coordinated effects theory,  
23 which you don't see in the courts.

24 MR. PATE: Okay. Well, there are any number of  
25 other questions we could go into. The time has about

1 expired. What I think I'd like to do is go through and  
2 give each of the panelists an opportunity for a parting  
3 shot, one brief comment they'd like to leave us with as  
4 part of these proceedings and I  
5 guess to follow on our alphabetical theme, maybe I'll  
6 start in the middle and try to work out and give Jim  
7 Loftis --

8 (Laughter.)

9 MR. PATE: And, see, my name begins with "P" so  
10 it's always been my desire to run it this way. Jim  
11 Loftis, why don't you start?

12 MR. LOFTIS: All right. I just would observe  
13 that Guidelines are so very hard to write that will work.  
14 And what we have has gone through such a healthy process.  
15 I would not suggest additional Guidelines or revising the  
16 Guidelines, but I would suggest that resources be devoted  
17 to understand better what the circumstances of innovation  
18 are, both in the sense of improvement and in the sense of  
19 superseding technologies.

20 MR. PATE: Dale Collins?

21 MR. COLLINS: Yeah, I agree with Jim. I don't  
22 think the Guidelines should be rewritten. However, I do  
23 think that through speeches and discussions of  
24 enforcement decisions and the like, what should happen is  
25 that, in large part, the Guidelines should collapse, if



1           you will, into Section II.

2                         And as a particular example of that, I think  
3           that the current structure of the Guidelines which I  
4           think Baxter may have started, of isolating efficiencies  
5           as a defense and suggesting that they are an affirmative  
6           defense as opposed to a negative defense that should be  
7           properly considered in Section II and not considered at  
8           all as an affirmative defense, the Guidelines, you know,  
9           the talk should be move it into Section II. Don't  
10          consider it separately.

11                        MR. PATE:   Okay.   Jim Rill?

12                        MR. RILL:   Very little to add to what's been  
13          said by Jim and Dale.   I think the Guidelines should not  
14          be revised at this time.   I think the Guidelines are  
15          serving a very valid purpose in a progressive way.   I  
16          would only advocate more transparency in the direction  
17          the agencies are taking now.   I think the current release  
18          of the DOJ and FTC and the current FTC study is  
19          absolutely superb, and I think greater efforts to  
20          identify the rationale for cases not brought and basis  
21          for consent judgments would be very, very salutary.

22                        MR. PATE:   Dennis?

23                        MR. CARLTON:  Well, I echo everyone's  
24          sentiments that I think the Guidelines are pretty good as  
25          they stand.   They're broad enough to incorporate a

1 variety of new approaches without having to rewrite the  
2 Guidelines. I agree with Jim that more research on R&D  
3 and dynamic efficiency is important.

4 In terms of the way the Guidelines are actually  
5 implemented, and as you develop techniques or improve  
6 techniques such as merger simulation or whatever, I think  
7 it's very important to do retrospective studies to see  
8 what has worked and what has not worked. And in doing  
9 that, it's very important not just to compare the mergers  
10 that you're blocking but also to see what happens to the  
11 ones you've let go, to see whether your techniques are  
12 able to distinguish between mergers that lead to price  
13 increases and those that don't.

14 So I think retrospective studies are extremely  
15 valuable for allowing us to assess where current practice  
16 should go.

17 MR. PATE: Dan?

18 MR. RUBINFELD: We've done a lot, the agencies  
19 and some of the folks out there, in developing empirical  
20 techniques and applying them to help us better understand  
21 how to distinguish mergers that are pro-competitive from  
22 those that are not. And we need to keep doing more of  
23 that, particularly actually in the area of coordinated  
24 effects, which we're doing now, and that involves both  
25 developing new techniques whenever possible, making data

1 public so that people can evaluate it, as well as doing  
2 retrospective work.

3 And we should try to avoid trying to get too  
4 simple rules of thumb that we think are going to apply  
5 across the board to many industries, because it's just  
6 not going to be the case.

7 MR. PATE: Jonathan?

8 MR. BAKER: I think Jim Rill's 1992 Guidelines  
9 have been remarkably successful, and that they still are  
10 what people on the inside and the outside rely on  
11 routinely in understanding how to think about mergers.  
12 And there's no real big reason to do much with them in  
13 changing them.

14 If there's going to be a next round of  
15 revisions, I think it's when we understand innovation  
16 better than perhaps we do now and how to think about  
17 mergers and innovation, but I'm not sure whether we've  
18 gotten to that point yet.

19 So on the whole, I agree with everything that  
20 everyone has said so far.

21 MR. PATE: Bobby Willig?

22 MR. WILLIG: Thank you. I think the Guidelines  
23 are actually terrific.

24 (Laughter.)

25 MR. WILLIG: I would love to see the agency

1 leadership send the message down the line on the lawyer  
2 side to try to allow yet more transparency and mutual  
3 interactivity among the economists, even in situations  
4 where there may be some prospect of litigation. I don't  
5 know if that's appropriate. But if it is, that message  
6 really needs to be sent down the line.

7 On simulation, I think it would be great to  
8 have an even more open process among the agencies'  
9 economists and outside economists who I think, in our  
10 case, would be delighted to see outsiders involved, not  
11 in a case context, but pushing the technological envelope  
12 and trying to share thoughts and coming to a better  
13 standardized set of techniques that everybody understands  
14 and gives some degree of approval to, not in a Guidelines  
15 setting, but in the sense of mutual R&D.

16 And when it comes to technology issues and  
17 mergers, I actually believe that even though we don't  
18 know all that we would like to know as academics, we know  
19 enough that if we put our heads together to try to write  
20 some sort of a draft R&D merger enforcement Guidelines,  
21 which will be an appendage to the convention Guidelines,  
22 not a replacement of them, we might actually make some  
23 progress. We might know enough now to be able to get  
24 some progress in that respect. It's worth thinking about  
25 and trying.

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1 MR. PATE: Bill, the last word.

2 MR. BAER: It's unusual. I'll be brief. And  
3 that is, it's actually very rare to get the last word  
4 over Bobby Willig.

5 MR. WILLIG: I'm privileged.

6 MR. BAER: Not yet, apparently. The agencies  
7 under the current administration have done a great job on  
8 transparency in the broad sense. The points we made  
9 earlier about working to improve disclosure in pending  
10 cases, I think, remains an important one.

11 The points I made earlier which -- on process --  
12 - which didn't get discussed but don't necessarily need  
13 it, about making sure we're paying attention to the  
14 process, making the merger review process as efficient as  
15 possible, I think remain an area where there's  
16 opportunity for the agencies to improve.

17 MR. PATE: Okay. Well, it's really been a  
18 privilege, by virtue of my position, to be able to share  
19 the podium with such a distinguished panel of antitrust  
20 thinkers. I want to thank you for the time you spent  
21 today. I want to thank all of you in the audience for  
22 being here and those on the conference line as well.

23 (Laughter.)

24 MR. PATE: With that, again, thank you, even  
25 more particularly to the staffs of both the Trade

1 Commission and the Division who have done so much work to  
2 put this conference together.

3 With that, we are adjourned.

4 (Applause.)

5 (Whereupon, at 4:37 p.m., the conference  
6 adjourned.)

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1 DOCKET/FILE NUMBER:  P019503

2 CASE TITLE:  MERGER WORKSHOP

3 HEARING DATE:  FEBRUARY 19, 2004

4

5 I HEREBY CERTIFY that the transcript contained  
6 herein is a full and accurate transcript of the notes  
7 taken by me at the hearing on the above cause before the  
8 FEDERAL TRADE COMMISSION to the best of my knowledge and  
9 belief.

10

11 DATED:

12

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14 RITA HEMPHILL, C. V. R.

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17 **C E R T I F I C A T I O N O F P R O O F R E A D E R**

18 I HEREBY CERTIFY that I proofread the transcript for  
19 accuracy in spelling, hyphenation, punctuation and  
20 format.

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23 SARA J. VANCE

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