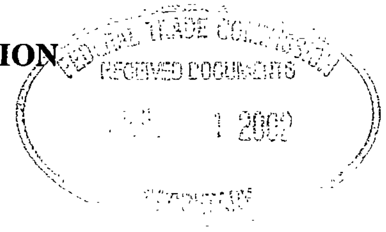
UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION



IN THE MATTER OF	)	**Public Version**
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MSC.SOFTWARE CORPORATION,	)	Docket No. 9299
	)	
a corporation.	)	

RESPONDENT MSC.SOFTWARE CORPORATION'S PRE-TRIAL BRIEF AND PROPOSED CONCLUSIONS OF LAW

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SUMMARY OF ARGUMENT

This is not a § 13(b) proceeding, and Complaint Counsel is not seeking to preliminarily enjoin the CSA and UAI acquisitions.[1] Rather, this is a Clayton Act § 7 adjudicatory proceeding, and after a two year investigation, Complaint Counsel effectively is seeking to permanently ***dissolve*** MSC.[2] Given that, Complaint Counsel cannot seek refuge in the lesser standards of § 13(b) and proclaim no "extensive market analysis" is required.[3] Complaint Counsel must prove its case, not simply rely on anecdotes that suggest competitive issues are ***possible***.[4]

But anecdotes are all Complaint Counsel has. Complaint Counsel's case is built primarily around speculations and colloquy in some of MSC's "acquisition related documents" and – as will be shown at trial – misrepresenting them, quoting them out of context and, ignoring substantial and credible direct evidence to the contrary. Snippets from these "acquisition related documents" are then interleafed with other out of context snippets from isolated, unrelated and, in many cases, outdated third party documents and testimony. Relying on this collection of cropped

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1 Section 13(b) of the FTC Act is the statutory provision under which the Commission brings a preliminary injunction action in federal court. 15 U.S.C. § 53(b).

2 Complaint Counsel also brings the case under FTC Act § 5, but as discussed *infra*, the two statutes are read coextensively in merger contexts and for simplicity the action will be referenced as a § 7 action.

3 Complaint Counsel's Pretrial Brief ("CC Br.") at 10. Unless otherwise indicated, throughout this brief all emphases in quotations have been added. Complaint Counsel's Pre-Trial Conclusions of Law will be referred to in short form as "CC COL" and its proposed findings of fact as "CC FOF." MSC's proposed findings of fact will be referred to in short form as "MSC FOF."

4 Complaint Counsel repeatedly cite § 13(b) precedent notwithstanding that Commissioner Leary has observed that the FTC's "relaxed" "burden of proof" in § 13(b) proceedings is "semantically" no different than the Commission's "reason to believe" standard for ***bringing*** a case. That is decidedly ***not*** the stringent standard for a § 7 adjudicatory proceeding. *See infra* Section I.A.; Thomas B. Leary, "An Inside Look at the *Heinz* Case," *Antitrust Magazine* 34 (Spring 2002).

quotes, the FTC's own employee, Dr. Hilke, provides a thin "patina" of "expert testimony" – but ***no*** economic analysis.

Analysis, not anecdotes, is what is required for Complaint Counsel to meet its § 7 burden. Yet Complaint Counsel has done no analysis. *First,* Complaint Counsel fails to satisfy its burden of proving a relevant product market, a threshold and fatal flaw foreclosing any need to reach the competitive effects or relief issues.[5] *Second,* Complaint Counsel fails to provide any substantial, credible evidence of the likelihood or reasonable probability of sustained adverse effects on competition (*i.e.*, a "substantial lessening of competition") in the ***nearly three years*** since these acquisitions occurred.

Complaint Counsel's approach to market definition and competitive effects reveals the circularity of its whole case. Complaint Counsel says it is not required to prove a product market because "evidence" of "actual sustained adverse competitive effects" obviates the need. CC COL,

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[5] As the court ruled in *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172 (D.D.C. 2001), in rejecting the government's proposed, narrow product market definition (based, in part, on "rapid changes in computer capabilities and the reduced costs of both hardware and communications," *id.* at 182):

> Because the Court has found that plaintiff has ***failed to meet its burden of establishing the relevant product market***, it need ***not*** address the remaining disputed issues in the case – the probable effect of the transaction on competition, the extent of concentration in the market, and defendants' argument regarding the unreliability of plaintiff's market statistics, the likelihood of price discrimination, barriers to entry into the market, the effect of knowledgeable and sophisticated customers, and the efficiencies resulting from the transaction.

Id. at 192 n.25.

¶ 32.[6] However, in addressing "competitive effects," Complaint Counsel says it can presume the acquisitions are anti-competitive because market concentration has increased in the very product market that Complaint Counsel says it does not have to prove. CC COL, ¶¶ 35-71.

This house of presumptions cannot withstand serious legal and economic scrutiny. Indeed, given this tautological approach, Complaint Counsel is engaged in classic "pot calling the kettle black" psychological "projection" where it says:

> The showing Respondent must make to rebut the presumption that flows from a substantial increase in concentration is an evidentiary showing; Respondents cannot rebut the presumption with ***mere argument***.

CC COL, ¶ 44.[7]

Throughout its investigation and discovery in this matter, Complaint Counsel failed repeatedly to ask the right questions to elicit the necessary facts to define credible relevant markets or assess the competitive effects of the acquisitions. Illustrative of this failing, Complaint Counsel has never been able to articulate what exactly it means by an "advanced Nastran" market; as far as

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[6] Complaint Counsel asserts that "evidence of actual anti-competitive effects – such as price increases or output reductions – can obviate extensive inquiry into market definition," citing two cases that are not § 7 cases and a § 13(b) case, *FTC v. Libbey, Inc.*, No. 02-CV-60, 2002 WL 984208, at *10 (D.D.C. April 22, 2002). CC COL ¶ 32. In fact, the court in *Libbey* notes that the government must prove a relevant market, *id.* at *5, and the issue of market definition was ***not disputed*** in that case. *Id.* at *6. Instead, what the court was indicating is that once a market is defined, Complaint Counsel need not use an analysis of a change in market concentration to prove a "substantial lessening of competition," but rather can meet the § 7 standard directly. According to *Libbey*, the § 7 standard is, as cited by Complaint Counsel (CC COL ¶ 32), that anti-competitive effects are shown "where [the] Commission can show ***after*** administrative investigation (*i.e.* an adjudicatory proceeding) that there were '***actual sustained adverse effects on competition***.'"

[7] "Projection" is defined as: "*Psychol.* Naive or unconscious attribution of one's own feelings, attitudes, or desires to others." Houghton Mifflin Company, *Webster's II New College Dictionary* 884 (1995).

MSC can tell, Complaint Counsel's description of an "advanced Nastran" solver is "I know it when I see it."

From the murkiness of the shifting fog that is Complaint Counsel's case, three somewhat contradictory theories emerge. The ***first*** theory is that a market for "advanced Nastran" solvers (and an alternative broader market for "advanced linear structural finite element analysis" ("FEA") solvers) can be defined based on a "SSNIP test" under the *DOJ/FTC Horizontal Merger Guidelines* ("*Guidelines*").[8] Under that theory, a hypothetical monopolist of "advanced Nastran" solvers (or alternatively "advanced linear structural FEA" solvers) can profitably raise prices 5% to 10% across the board for a sustained period of time. Under this view, the acquisitions are a merger to monopoly in the "advanced Nastran" market (or alternatively acquisitions in a highly concentrated broader "advanced linear FEA solver" market).

The problem with this theory is that Complaint Counsel has never developed any evidence to prove it. To prove this theory, Complaint Counsel should have focused on the differences between ***marginal*** and ***inframarginal*** demand for Nastran solvers and asked what the nature of substitution was for the marginal users (and uses) of Nastran solvers.[9] The competitive

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[8] The SSNIP test refers to a "small but significant and nontransitory increase in price" by a "hypothetical monopolist" under the Merger Guidelines: "the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price." *Guidelines*, § 1.11.

[9] "Marginal" and "inframarginal" demand refers to whether particular purchasers are sensitive to price increases within a certain range of existing prices. *See, e.g., Town Sound & Custom Tops, Inc. v. Chrysler Motor Corp.*, 959 F.2d 468, 489 (3d Cir. 1992) (comparing "marginal" and "inframarginal" consumers); *In re Owens-Illinois, Inc.*, 115 F.T.C. 179, 300 (1992) (describing "infra-marginal" consumers as "consumers whose purchases would be unaffected by a small but
(continued...)

reality is that many customers would have (and have had) little difficulty switching ***part of*** their MSC.Nastran usage to other solvers. The threat of such ***partial switching*** alone is sufficient effectively to discipline MSC's pricing, as it is readily apparent to MSC and others that MSC could not profitably raise MSC.Nastran prices by 5% or 10% supracompetitively across the board (or, alternatively, a hypothetical monopolist of "advanced linear structural FEA solvers" could not raise prices by 5% to 10% supracompetitively).

By ignoring the difference between marginal and inframarginal demand, along with the heterogeneity of demand in the marketplace and the resulting product differentiation among solvers, Complaint Counsel missed the many partial overlaps that exist among FEA solvers that would induce partial switching in response to a hypothetical 5% or 10% – supracompetitive – increase in price. MSC.Nastran competes with a wide variety of solvers along many dimensions. Because of this wide ranging competition, acquiring UAI and CSA did not create any substantial market change, particularly since UAI and CSA were flailing companies that could no longer sustain even their past minimal and declining market presence – approximating and respectively, in 1999, of "advanced Nastran" revenues.

Instead of developing a factual record to support this "SSNIP" theory, Complaint Counsel instead has chosen to focus on documents and deposition testimony suggesting ***some***

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[9] (...continued)
significant and nontransitory price increase"). Hence, to the extent certain purchases would be reduced in response to a 5% to 10% price increase, these purchases would reflect the "marginal" demand for the product and the remaining purchases (that would not be reduced despite the price increase) would be the "inframarginal" demand. Some cases, instead of referring to "marginal" and "inframarginal" demand or customers, use the terms "elastic" and "inelastic." *See, e.g.*, *In re R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 158, 169 (1995) (referring to "elastic" and "inelastic" customers).

MSC.Nastran customers (and that ***some*** users and uses of MSC.Nastran within these customers) would have difficulty switching to a non-Nastran solver in response to a supracompetitive 5% to 10% price increase. In effect, Complaint Counsel is focused on ***inframarginal*** users and uses of "advanced Nastran" solvers. That is a fatally flawed approach.

It is well recognized in the case law that there are inframarginal customers in ***any*** market; that the existence of such customers does ***not*** mean the market is not competitive; and that markets should not be defined in terms of these inframarginal customers. *See FTC v. R.R. Donnelley & Sons Co.*, 1990-2 Trade Cas. ¶ 69,239, at 64,854 (D.D.C. 1990) ("Isolated segments with isolated customers do not make for a separate product market. In particular, pointing out the personal preferences of a distinct group of customers does ***not*** suffice for defining a separate product market."); *see also Town Sound & Custom Tops,* 959 F.2d at 489 ("Absent an ability to price discriminate, even a monopolist must offer a single price that responds to how much the marginal consumer would pay, not the inframarginal or even the average consumer."). As such cases recognize, it takes only a small number of customers to switch to discipline pricing under the *Guidelines* SSNIP test.[10]

Complaint Counsel says that it is not under an obligation to perform an "elaborate market analysis." CC Br. at 3. Yet, as noted, Complaint Counsel's citation of anecdotes that ***some*** engineers would have difficulty switching from MSC.Nastran does not answer the question of

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[10] *See, e.g., FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999) (switching by a small number of users sufficient to show that proposed market definition was too narrow); *United States v. Engelhard Corp.*, 126 F.3d 1302, 1306 (11th Cir. 1997) (only a few customers must switch to defeat a price increase and demonstrate the proposed market is too narrow); *In re R.R. Donnelley & Sons*, 120 F.T.C. at 169 (not all users must switch to show that price increase is unprofitable and that proposed market is too narrow).

whether sufficient partial switching would occur to discipline pricing. At this adjudicatory stage, after a two year investigation and seven months of pre-hearing discovery, the inquiry must be more rigorous. What is required is a showing whether a ***critical loss*** of revenues would occur to render a 5% to 10% across the board supracompetitive price increase ***unprofitable***.[11] Complaint Counsel undeniably bears the burden of proof in this matter and the slivers of evidence it references are no substitute for a systematic analysis of the evidence.[12]

There is one exception to the principle that one should not look at inframarginal demand when assessing market definition. This exception relates to the ***second*** Complaint Counsel theory that emerges from the fog – price discrimination. As the *Guidelines* suggest, if a firm has the ability to price discriminate against certain less price sensitive customers or groups of customers (*i.e.*, inframarginal customers), a narrower relevant market (or "submarket") can be defined in terms of price discrimination. *Guidelines*, § 1.12.

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[11] As the *Guidelines* discuss, § 0.1 n.6, competition occurs along many dimensions beyond price, including quality, service or innovation. In the FEA solver marketplace, these other dimensions are particularly important. To explore whether switching is possible on the margin, it is also necessary to look at situations where relative quality between solvers has changed 5% to 10% and to analyze the extent of switching in those situations. *See infra*, section III.C.2; *In re R.R. Donnelley*, 120 F.T.C. 36, 174 (1995) ("[S]ubstitution on the basis of price alone makes little sense in the context of competition between differentiated products.").

[12] For example, in *Tenet Health Care Corp.*, the FTC's failure to undertake a "critical loss analysis" was ***fatal*** to its case. 186 F.3d 1045. There, the defendant's expert explained that "if the merged hospital were to raise prices, enough patients would leave the merged hospital and seek care at an alternative hospital to render the price increase unprofitable." *Id.* at 1050. The court of appeals held that this "compelling and essentially unrefuted evidence that the switch to another provider by a ***small percentage*** of patients would constrain a price increase, ***shows that the FTC's proposed market is too narrow***." *Id.* at 1054.

As an initial matter, the Commission has noted that it is mindful of the "***analytical hazards*** of defining markets by reference to possible price discrimination." *In re R.R. Donnelley*, 120 F.T.C. at 159. Successful price discrimination is well recognized to be difficult to execute. As former Chairman Pitofsky has stated:

> There will almost always be classes of customers with strong preferences for [differentiated] products, but to reason from the existence of such classes to a conclusion that each is entitled to the "protection" of a separate narrow market definition ***grossly overstates*** the market power of the sellers.

Robert Pitofsky, *New Definitions of the Relevant Market and the Assault on Antitrust*, 90 Colum. L. Rev. 1805, 1816 (1990). As a result, section 1.12 of the Merger Guidelines lays out strict requirements for proving price discrimination.

Complaint Counsel has not endeavored to meet these requirements. Indeed, nowhere in its brief or proposed findings of fact did Complaint Counsel articulate any product market it was defining based on price discrimination. Likewise, neither of Complaint Counsel's experts plan to base their affirmative testimony at trial on defining a market based on price discrimination pursuant to section 1.12 of the Merger Guidelines. *See* J. Hilke Dep. Tr. at 88:2-9; 89:20-90:17, 497:20-498:1; P. Spiller Dep. Tr. at 279:5-19. This absence of expert economic testimony exhibits Complaint Counsel's disinterest in rigorously pursuing any theory of price discrimination. Complaint Counsel's price discrimination case fails for an absence of proof.

Complaint Counsel's ***third*** theory is an amalgam of the first two theories, and it appears to be Complaint Counsel's primary theory. Complaint Counsel argues that there is an

"advanced Nastran" market because users of "advanced Nastran" solvers are "locked in" and would have difficulty switching to any solver other than another "advanced Nastran" solver.[13]

Any such "lock in" theory would have to be premised on a theory of price discrimination against existing customers. Yet Complaint Counsel has put forth ***no*** evidence that MSC does (or could) price discriminate between "existing" and "new" users. Indeed, Complaint Counsel's economic expert said he has not "done any systematic review of that issue." J. Hilke Dep. Tr. at 137:16-24; 138:15-21.

Complaint Counsel's "lock in" theory also is premised on the notion that customers with inframarginal demands for MSC.Nastran could easily switch to CSA Nastran or UAI Nastran in response to a 5%-10% price increase. As will be shown at trial, the reality is that the type of switching costs on which such a price discrimination theory would be based would make it unlikely that a customer would switch to ***any*** other solver based on a 5%-10% supracompetitive price increase, including CSA Nastran or UAI Nastran. In fact, there is no competent evidence – no study, no benchmark, no scientific analysis by Complaint Counsel's technical expert – demonstrating that it is easier to switch among Nastran based solvers than between a Nastran solver and non-Nastran solvers.

In short, if the inquiry focuses only on price discrimination against inframarginal users "locked in" to MSC.Nastran, there would ***not*** be an "advanced Nastran" market, but simply a "MSC.Nastran" market. That "market" is ***unaffected*** by the acquisitions.

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[13] *See* Complaint Counsel's Amended Resps. and Objections to MSC's Second Set of Interrogs., Answer to Interrog. 1, at 10-11.

In any event, courts are extremely reluctant to define a "market" based on switching costs and "locked in" demand. *See, e.g., United States v. Engelhard Corp.*, 126 F.3d 1302, 1306 (11th Cir. 1997) (rejecting defining a product market based on switching costs and "locked in" customers). As explained in *Engelhard*, if switching costs imply each product is its own market, competition is better viewed in terms of pre-"lock in" competition. *Id.* In a world where switching costs are not an issue,

In reality, the market is far broader than even that, as MSC competes with a wide variety of other solvers, including Abaqus, Permas, LS Dyna, NE Nastran and EDS/SDRC for new usage.

Complaint Counsel's case, therefore, consists of ill-formed theories and a failure of proof. This failure of proof, however, should not mask the underlying truths that will emerge at trial about the acquisitions and the dynamic and intensifying competitiveness of the FEA solver marketplace. As Frank Perna, the CEO of MSC, has said, MSC acquired CSA and UAI not to restrict output and raise prices, but rather because Mr. Perna wanted coalesced teams of FEA programmers – that were available because of UAI's and CSA's financial distress – to grow MSC's total solution capabilities. MSC FOF ¶¶ 101-105; 126-129.

Mr. Perna recognized in 1998 when he became CEO of MSC that the marketplace is seeking Mechanical Computer Aided Engineering ("MCAE") companies that can offer a broader array of engineering tools. Mr. Perna has worked tirelessly over the last few years to manage and grow the company to meet this vision. MSC's vision also involved seeking to meet increasing

customer desires to push use of engineering analysis earlier in the Computer Aided Design ("CAD") process, something which Dr. Kenneth Versprille, an industry expert, will discuss at trial. The direct byproduct of this vision has been numerous merger-specific efficiencies resulting from the acquisitions. MSC has improved its general purpose solver product (MSC.Nastran) and better integrated MSC.Nastran with other complementary products in ways that simply would not have been possible absent the acquisitions. MSC FOF ¶¶ 33-72.

The evidence at trial also will show that the FEA solver marketplace (and the overall MCAE environment) is a dynamic one, where competitors constantly add features to increase the overlaps with the features offered by other companies. This dynamism effectively means entry and expansion are not difficult, as companies can easily add features and functionalities to their solvers to divert sales from, or avoid diversion to, competitors. Once it is realized that partial switching is sufficient to discipline pricing and that an entrant need not replicate MSC.Nastran software to compete with it at the margin, a marketplace with constant entry and expansion to deter price increases emerges.

The evidence at trial will further show that Complaint Counsel's allegations of post-acquisition price increases are a mirage, based on ignoring factors such as increased usage or changes in product mix at a customer. Indeed, MSC faces more competition today than at the time of the acquisitions. MSC FOF ¶¶ 131-354.

Finally, and perhaps most important, the evidence at trial will show that CSA and UAI were troubled firms, unable to sustain their already waning niche presences in the marketplace. MSC FOF ¶¶ 73-130. Complaint Counsel has never explained how CSA and UAI could have provided the only effective constraints on MSC when in fact they had such low and declining shares

(each less than 4 percent) within Complaint Counsel's defined "market." The reality is that CSA and UAI could not match MSC's product quality, features or service, were losing their already tiny revenue base, were having their business base invaded by PC-based solvers, and lacked the complementary software to survive as general purpose solvers in the marketplace. There must have been something else disciplining MSC, and there was: the vast array of competitive FEA solvers available to buyers with ample abilities to effectively constrain any attempt by MSC to exercise market power.

The de minimus, flailing status of CSA and UAI at the time of the acquisitions is particularly important in terms of Complaint Counsel's proposed remedies. The proposed remedies are ***punitive*** – beyond any proportion to what would be needed to ***restore*** the UAI/CSA "competition" allegedly lost. In essence, Complaint Counsel proposes the ***dissolution*** of MSC.Nastran, an unprecedented remedy in a merger case.

Complaint Counsel proposes to create a marketplace where two or three firms each offer MSC.Nastran and compete on equal terms. Instead of a market where, according to Complaint Counsel's economic expert, pre-acquisition market shares were 93% MSC, 4% CSA and 3% UAI, Complaint Counsel proposes to create a market where shares would be 50%/50% or 33%/33%/33%. Under no sensible theory of "restoring lost competition" can Complaint Counsel's remedy be viewed as anything other than punitive and out of proportion with the competitive effects of the acquisitions that are alleged (but not proven) by Complaint Counsel.

I. COMPLAINT COUNSEL BEARS THE BURDEN OF PROOF OF PRESENTING EVIDENCE SUFFICIENT TO MEET THE STRICT STATUTORY REQUIREMENTS

Complaint Counsel alleges in Count I of its Complaint that MSC's acquisitions of CSA and UAI violate Clayton Act § 7 and FTC Act § 5 and in Counts II and III that the acquisitions also constitute acts of monopolization and attempted monopolization under FTC Act § 5. Under both these statutes, Complaint Counsel bears the burden of proof of presenting evidence to meet the substantive requirements of the statutes; in other words, Complaint Counsel must come forward and prove, by a preponderance of the evidence, that the challenged acquisitions have in fact caused a "substantial lessening of competition." *See, e.g., United States v. Baker Hughes Inc.*, 908 F.2d 981, 983 (D.C. Cir. 1990) ("[T]he ultimate burden of persuasion . . . remains with the government at all times."); *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, 180 (D.D.C. 2001) ("The United States has the ultimate burden of proving a Section 7 violation by a preponderance of the evidence."). As discussed below, these substantive requirements are strict ones and Complaint Counsel has fallen far short of presenting the substantial evidence necessary to meet these standards.

A. FOR COUNT I, COMPLAINT COUNSEL MUST SHOW THERE IS A REASONABLE PROBABILITY THAT THE ACQUISITIONS WILL SUBSTANTIALLY LESSEN COMPETITION

Count I is governed by the standards laid out in section 7 of the Clayton Act, which states that a merger or acquisition may be condemned only if in "any line of commerce" there is a reasonable probability that the effect of the challenged transaction "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18; *see also Fruehauf Corp. v. FTC*, 603 F.2d 345, 351 (2d Cir. 1979) ("[T]here must be the 'reasonable probability' of a substantial impairment of competition to render a merger illegal under § 7. A 'mere possibility' will not

suffice."). To establish its case, the Commission must meet two burdens: ***first***, it must define a relevant "line of commerce" (*i.e.*, product market) and then show that the line of commerce will be adversely affected by the acquisitions and, ***second***, it must demonstrate that the combination will likely have the effect not only of lessening competition, but of "substantially" lessening competition. *See, e.g., United States v. Gillette Co.*, 828 F. Supp. 78, 80-81 (D.D.C. 1993).[14]

This burden is itself substantial. As the D.C. Circuit has noted, "Section 7 involves ***probabilities***, not certainties or possibilities." *United States v. Baker Hughes Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990) (emphasis in original). While this standard does not require certainty of adverse competitive effect, it requires more than mere conjecture or speculation. *See United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 122 (1975) ("The Clayton Act is concerned with 'probable' effects on competition, not with 'ephemeral possibilities.'") (citation omitted). Hence, under Clayton Act § 7 (and thus FTC Act § 5), Complaint Counsel must show more than just "possible" anti-competitive behavior and must allege more than that the behavior "raises legitimate antitrust concerns," but rather Complaint Counsel must show that such "anti-competitive behavior is ***likely***." *In re Owens-Illinois, Inc.* 115 F.T.C. 179, 323 (1992); *see also In re Midcon Corp.*, 112 F.T.C. 93,

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[14] With respect to Count I, although the complaint challenges the acquisitions under both Clayton Act § 7 and FTC Act § 5, the legal standards are the same. *See FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1501 n.2 (D.C. Cir. 1986) ("The challenge [to the acquisition] is also based on § 5 of the Federal Trade Commission Act . . . which, for present purposes, may be assumed to be merely repetitive of § 7 of the Clayton Act."); *In re R.R. Donnelley,* 120 F.T.C. at 150 n.32 (noting that "analytical standards for assessing legality in this context are read coextensively"). Courts have consistently applied the same standard to evaluate the legality of a merger regardless of whether the Commission was proceeding solely under § 7 or also was alleging a § 5 violation. *See, e.g., Olin Corp. v. FTC*, 986 F.2d 1295, 1296 (9th Cir. 1993); *Tenneco, Inc. v. FTC*, 689 F.2d 346, 350 (2d Cir. 1982); *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1073 (D.C. Cir. 1981); *cf. FTC v. Consol. Foods Corp.*, 380 U.S. 592, 601 (1965) (Harlan, J. concurring) (noting that burden of proof on FTC under § 5 is ***more demanding*** than under Clayton § 7).

169-70 (1989) ("'possibilities' can be a weak foundation for a prediction of 'likely,' 'substantial' competitive effects").

Significantly, this case is ***not*** governed by § 13(b) of the FTC Act, 15 U.S.C. § 53(b), the standard under which the Commission brings preliminary injunction actions to challenge a proposed merger in federal court. As the D.C. Circuit has noted, under § 13(b), the "FTC is not required to ***establish*** that the proposed merger would in fact violate section 7 of the Clayton Act." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714 (D.C. Cir. 2001) (emphasis in original). Indeed, the standard under § 13(b) is even more liberal than the traditional equity standard for injunctive relief, as courts hold that the Commission need merely show sufficient "serious questions" as to justify an administrative trial. *See id.* at 714-15.[15] Commissioner Leary has noted that § 13(b) is "semantically" no different than the Commission's own "reason to believe" standard for bringing a case. *See supra* note 4. This lightened burden on the Commission at the preliminary injunction stage is justified in part based on the heavy burden of proof that the Commission has at a trial on the merits, such as in this case.

Here, Complaint Counsel is attacking transactions which were consummated nearly three years ago. Complaint Counsel is seeking ***permanent***, mandatory relief under § 7 and seeking

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[15] At the pre-merger, preliminary injunction § 13(b) stage, the FTC's burden is met if it 'has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.'" *Id.* (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978)); *see also FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 45 (D.D.C. 1998) ("To be awarded preliminary equitable relief, the Commission need not prove that the proposed merger would in fact violate Section 7 of the Clayton Act."); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1070 (D.D.C. 1997) (under § 13(b), "the FTC is not required to prove, nor is the Court required to find, that the proposed merger would in fact violate Section 7 of the Clayton Act").

effective dissolution of MSC Nastran. Complaint Counsel must therefore prove that the acquisitions are illegal.

Despite that, Complaint Counsel's pre-trial brief and proposed conclusions of law contain frequent references to preliminary injunction opinions decided under § 13(b). For example, in its proposed conclusions of law, Complaint Counsel tries to lessen its burden of proving a relevant market by reference to the standards applied in *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000), a § 13(b) case. CC COL ¶¶ 16-17. Similarly, Complaint Counsel suggests it can rely on document snippets to define markets based on § 13(b) cases. CC COL ¶ 19. And, Complaint Counsel states that the power buyer defense "has been given little weight" by courts, relying on several § 13(b) preliminary injunction cases. CC COL ¶ 53.

This attempt to lessen its burden under the statute is completely improper. Section 13(b) is ***irrelevant*** to this case.

B. THE ALLEGATIONS OF MONOPOLIZATION AND ATTEMPTED MONOPOLIZATION ADD NOTHING TO THE CLAIM THAT THE ACQUISITIONS VIOLATED SECTION 7 OF THE CLAYTON ACT AND SECTION 5 OF THE FTC ACT

Complaint Counsel asserts, in Count II, that the challenged acquisitions constitute unlawful monopolization in violation of § 5 of the FTC Act, and in Count III, that these same transactions constitute an unlawful attempt to monopolize, again in violation of § 5. These allegations add nothing to the allegations in Count I that the acquisitions violate § 7 of the Clayton Act and § 5 of the FTC Act.

The relevant Count II and Count III allegations in the Complaint, found in ¶¶ 33-35 and 37-40, all assert that the allegedly unlawful conduct was the ***product of the challenged***

acquisitions. Similarly, in its proposed conclusions of law, Complaint Counsel bases its allegations in Count II and Count III on the "acquisitions of CSAR and UAI."[16] Indeed, Complaint Counsel's brief and proposed findings are utterly devoid of any allegation that MSC has either obtained or retained, or even attempted to obtain, monopoly power, ***other than*** through the challenged acquisitions.

The basic principles discussed above, placing the burden of proof firmly on Complaint Counsel with respect to a Clayton § 7 violation, apply equally with respect to the FTC Act § 5 claims in Count II and III. If the acquisitions are found to be unlawful under § 7 of the Clayton Act, MSC presumably would be subject to the remedies appropriate for that statute. But if, as MSC will show, the transactions are found lawful under Count I (*i.e.*, if it is found that there is not a "substantial lessening of competition" in a credible "relevant market"), then it clearly cannot be unlawful for MSC (even if it is assumed to be a "monopolist") to have acquired CSA and UAI through ***lawful*** transactions that did not substantially lessen competition.

The additional allegations in Counts II and III add nothing to Count I of the Complaint. For that reason, the rest of this brief focuses on Count I of the Complaint.

II. COMPLAINT COUNSEL'S PROPOSED MARKET DEFINITIONS ARE TOO NARROW AND ARTIFICIAL TO CONSTITUTE RELEVANT PRODUCT MARKETS UNDER THE STATUTE

Complaint Counsel proposes two relevant product markets: an "advanced Nastran" market (Complaint, ¶ 21) and a market for advanced linear structural FEA solvers (Complaint, ¶

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16 CC COL, ¶ 78.

22).[17] These proposed relevant markets are artificial and far too narrow. Because they are not appropriate relevant product markets to evaluate these acquisitions, Complaint Counsel's case must fail.[18]

A. THE DEFINITION OF THE RELEVANT PRODUCT MARKET IS AN ESSENTIAL ELEMENT OF ANY CHALLENGE TO A MERGER OR ACQUISITION

It is black letter law, repeated on countless occasions, that the definition of the relevant product (and geographic) market is an ***essential*** first step in analyzing mergers. *See, e.g., United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 618 (1974) ("Determination of the relevant product and geographic markets is 'a necessary predicate' to deciding whether a merger contravenes the Clayton Act.") (quoting *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957)). As stated in *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1051 (8th Cir. 1999) (citations omitted):

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[17] Based on its pretrial brief and its proposed findings of fact, it appears Complaint Counsel may not be serious anymore about alleging the "advanced linear structural FEA solver" market. In the brief, the topic is only mentioned obliquely and no such alternative market is directly defined. CC Br. at 24. Similarly, in its proposed findings of fact, Complaint Counsel also does not appear to have defined any alternative market and presents no HHIs for the alternative market. MSC nonetheless addresses in this brief the many problems with the alternative product market, problems that Complaint Counsel (from its silence) appears to acknowledge.

The Complaint also alleges additional markets, by asserting that "separate markets exist for the licensing or sale of the relevant product for specific industries or customer categories, in particular, the aerospace industry and the automotive industry." ¶ 23. But Complaint Counsel does not define any such markets in its brief or its proposed findings of fact. And neither of Complaint Counsel's economic experts has defined such narrow markets in expressing their opinions in this matter. *See* J. Hilke Dep. Tr. at 88:2-9; 89:20-90:17; 497:20-498:1 and P. Spiller Dep. Tr. at 279:5-19.

[18] Although the Complaint proposes alternative geographic markets of the world and the United States, ¶ 24, Complaint Counsel's pretrial brief alleges only a worldwide market. CC Br. at 22. Therefore, for purposes of this brief, MSC assumes the relevant geographic market is worldwide.

> Without a well-defined relevant market, a merger's effect on competition cannot be evaluated . . . It is thus essential that the FTC identify a ***credible*** relevant market before a preliminary injunction may properly issue.

Indeed, Complaint Counsel has recognized this point, stating at the first pre-hearing conference that the "critical issue in this case will be product market definition." *See* 11/8/01 Hrg. Tr. at 11:1-2.

In the absence of a correctly defined product market, the plaintiff ***cannot*** proceed, and its case must ***fail***. *See Tenet Health Care Corp.*, 186 F.3d at 1053 n.12 ("Of course the burden is on the government to establish the relevant market."); *United States v. Engelhard Corp.*, 126 F.3d 1302, 1305 (11th Cir. 1997) ("Establishing the relevant product market is an essential element in the Government's case."); and *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, 193 n.25 (D.D.C. 2001) ("Because the Court has found that plaintiff has failed to meet its burden of establishing the relevant product market, it need not address the remaining disputed issues in the case . . . .")

The significance of this element in any § 7 case is illustrated by the Eighth Circuit's decision in *Tenet*, a case in which the Commission sought to enjoin the merger of two hospitals. Characterizing the critical question before it to be whether the Commission had met its burden of proof with respect to market definition, the court of appeals denied the FTC's request to enjoin the proposed merger, stating that "[t]he FTC's ***failure*** to prove its relevant geographic market is ***fatal*** to its motion for injunctive relief." 186 F.3d at 1053. Thus, the court of appeals dismissed the Commission's request for an injunction without ever reaching the issue of the competitive effects of the proposed acquisition.

Here, Complaint Counsel has created two artificial markets that it has not supported with hard evidence and that do not comport either with industry perceptions or economic reality. The artificial nature of the market definition is reflected in the fact that most industry participants have never even heard of the term "advanced Nastran."

Daratech, the primary source for CAD/CAE market information, does not track any "advanced Nastran" market. And a market analyst at Merrill Lynch, which tracks the CAD/CAE industry generally, in speaking about this case and Complaint Counsel's market definition, made it clear that Complaint Counsel's market definition was ***not recognized*** anywhere in the industry to Merrill Lynch's knowledge:

> The complaint was based on an assessment of the concentration of what is referred to as "the Nastran market", which it estimated to be about $60-$70 million worldwide. The FTC made multiple allegations, including that MSC "has obtained or enhanced monopoly power in the markets for advanced versions of Nastran through the acquisitions." UAI and CSAR were described as the only other vendors of advanced versions of Nastran, but it seems to us that the FTC defined the addressable market far too narrowly by apparently not including other analysis solutions, e.g., "solvers", from, for instance, Ansys, HKS (private), or from the integrated MCAD companies, such as Dassault Systemes and the former SDRC (now part of EDS). ***In the decade or more we've been tracking this market, we've not ever before ever come across such a narrow***

definition of, or reference to, a market or application, especially given the relatively modest revenues involved.

RX 847.

As these industry comments suggest, Complaint Counsel has failed to define a relevant product market that is proper and meaningful. Absent a proper market definition, its case fails and this action must be dismissed.[19]

B. THROUGHOUT THIS CASE, COMPLAINT COUNSEL HAS FAILED TO FOCUS ON THE KEY COMPETITIVE FACTORS NECESSARY FOR ANALYZING MARKET DEFINITION

Market definition is about capturing the competitive realities of the marketplace. *See United States v. Continental Can Co.*, 378 U.S. 441, 457 (1964) ("Since the purpose of delineating a line of commerce is to provide an adequate basis for measuring the effects of a given acquisition, its contours must, as nearly as possible, conform to ***competitive reality***."). To conform to "competitive reality," as the Supreme Court has explained, a properly defined product market should consist of all "commodities reasonably interchangeable by consumers for the same purposes," *i.e.*, those with "cross-elasticity of demand." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395, 400 (1956). In *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962), the Court articulated a similar test: "The outer boundaries of a product market are determined by the

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[19] In its pretrial brief, Complaint Counsel suggests that it need not prove a relevant market. CC Br. at 9-10. But two of the cases cited are not Clayton Act § 7 cases (§ 7 explicitly requires that the substantial lessening of competition must occur within some defined "line of commerce," *i.e.*, a product market) and the only other case was a § 7 case in which the relevant product and geographic markets were not disputed. While Complaint Counsel may be realizing the problems in its proposed market definition, none of its cases support its apparent attempt – at this late date – to shirk its obligation to put forward an extensive inquiry into market definition. As the cases cited above establish, courts ***require*** Complaint Counsel to prove its relevant market or its case must fail.

reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." To prove its case Complaint Counsel therefore must show that advanced Nastran solvers and other solvers lack "reasonable interchangeability of use."[20]

Over time, courts have outlined numerous factors that must be taken into account in determining whether products are "reasonably interchangeable." These factors shaping the extent of "reasonable interchangeability" include: (1) the differences between inframarginal and marginal demand for a product; (2) the differences between homogenous and heterogenous demand for a product; (3) the difficulties in attempting to price discriminate; and (4) the difficulties in defining a market based on a notion that existing customers are "locked in" to using a certain product. Throughout its investigation, Complaint Counsel has failed to analyze properly these key competitive factors and, as a result, it is apparently intending to present a case that does not address the relevant economic facts to define a market.

1. Complaint Counsel and Its Experts Have Ignored the Difference Between the Marginal and Inframarginal Demand for a Product

In understanding cross-elasticity of demand and reasonable interchangeability, it is important to remember that it is not sufficient for the Commission to establish that ***some*** users (or that some ***uses***) within a customer may have difficulty switching from an "advanced Nastran" solver to a non-Nastran solver. That is because in any market – even a perfectly competitive market – there are always "inframarginal" purchasers, *i.e.*, purchasers that have an intense demand for the product

[20] Complaint Counsel suggests there is some meaningful difference between "reasonable interchangeability of use" and "cross-elasticity of demand" and references *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1074 (D.D.C. 1997). CC COL ¶ 9. But, in fact, nothing on the page cited suggests this distinction and the *Staples* opinion specifically uses these two terms synonymously later in the opinion. *See id.* at 1076 n.8.

and that are not sensitive to price increases within a certain range, such as the 5% to 10% price increase test for market definition under the *Guidelines*. The mere existence of such inframarginal purchasers does not mean a market is not competitive, as it is the marginal purchasers that discipline prices.[21]

As a result, the Commission must show that ***virtually all*** users (or uses) within a customer have no choice but to use an "advanced Nastran" solver to sustain its narrow market definition. *See* Jerry A. Hausman, Gregory K. Leonard & Christopher A. Vellturo, *Market Definition Under Price Discrimination*, 64 Antitrust L.J. 367, 370 (1996) ("[O]nly a relatively small number of marginal customers is required to defeat a price increase.").[22] Absent some ability to price discriminate against inframarginal buyers, the fact that inframarginal buyers are not willing to switch tells nothing about how to define the market.[23] *See Town Sound & Custom Tops, Inc. v. Chrysler Motor Corp.*, 959 F.2d 468, 489 (3[d] Cir. 1992) ("Absent an ability to price discriminate, even a monopolist must offer a single price that responds to how much the marginal consumer would pay, not the inframarginal or even the average consumer.").

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[21] Courts have often stated these basic principles: "Isolated segments with isolated customers do not make for a separate product market. In particular, pointing out the personal preferences of a distinct group of customers does ***not*** suffice for defining a separate product market." *FTC v. R.R. Donnelley*, 1990-2 Trade Cas. ¶ 69,239, at 64,854 (D.D.C. 1990).

[22] Dr. Hausman, who co-authored the article cited, was respondents' economic expert in *R.R. Donnelley*.

[23] *See also id.* at 373 ("[I]t is insufficient to argue that some inframarginal customers exist (or even that inframarginal customers constitute a majority of purchasers) and that the hypothetical monopolist could raise price for them. This assumption is based on the assumption that the hypothetical monopolist can perfectly identify the inframarginal customers. Without such an assumption one cannot decisively conclude that such a group of inframarginal customers indeed corresponds to a relevant market for antitrust analysis.").

Attempts by the government to define an overly narrow market have often been defeated on the ground that it failed to focus on the fact that a few marginal customers can discipline prices. For example, in *Tenet Health Care Corp.*, the FTC's failure to undertake a critical loss analysis (*i.e.*, an analysis of how many buyers are inframarginal versus marginal so as to determine whether a hypothetical supracompetitive price increase would be profitable) was fatal to its case. 186 F.3d 1045. There, the defendant's expert stated that "if the merged hospital were to raise prices, enough patients would leave the merged hospital and seek care at an alternative hospital to render the price increase unprofitable." *Id.* at 1050. The court of appeals held that this "compelling and essentially unrefuted evidence that the switch to another provider by a ***small percentage*** of patients would constrain a price increase, ***shows that the FTC's proposed market is too narrow.***" *Id.* at 1054.

Another instructive case is *In re R.R. Donnelley & Sons*, 120 F.T.C. 36 (1995), where Complaint Counsel challenged a merger by two firms providing printing services. Complaint Counsel (and its expert economist, Dr. Hilke, the same expert as in this case) contended that the relevant product market should be limited to "high volume publication gravure printing," in part based on the argument that for high volume production runs, gravure printing had lower costs. Rejecting this narrow market definition, the Commission concluded that the market should include offset printing because customers could, and did, switch between these processes, based on a number of variables. The Commission specifically noted that "not all volume of a print customer need be shifted to offset [printing] to undermine a gravure [printing] price increase." *Id.* at 169. Examining the alternatives that were available to these large and sophisticated buyers, it found that "a sufficient number of jobs are at this ***margin*** such that a high volume gravure price increase likely would not

be profitable." *Id.* The Commission concluded that there was no evidence that all the customers in the proposed narrow market were "inframarginal," *id.* at 175, and that Complaint Counsel (and Dr. Hilke) had erred by not taking account of the competitive alternatives and the choices that customers made in shifting between them.

Similarly, the Eleventh Circuit noted in *United States v. Engelhard Corp.*, 126 F.3d 1302, 1306 (11th Cir. 1997), that "it is possible for only a few customers who switch to alternatives to make the price increase unprofitable, thereby protecting a larger number of customers who would have acquiesced in higher . . . prices." The court of appeals stated that the government should have evaluated these possibilities by considering the size of the market in its different end-use applications, and that the failure to do so ***"undermines the Government's entire case."*** *Id.* The government made the same error in *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, 192 (D.D.C. 2001), where, although the government offered some evidence that there were some inframarginal customers that could not switch even in response to a SSNIP, the court noted that the government also had the burden of proof "to show whether this captive group is substantial enough that a hypothetical monopolist would find it profitable to impose such an increase in price." *Id.* at 192.[24]

It is precisely this burden of proof that Complaint Counsel has shirked in this case. Because only a small amount of switching is necessary to discipline a price increase, any evidence of willingness to switch strongly suggests that the market is defined too narrowly. Here, the

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[24] *Sungard* provides another important analogy to this case, since it too involved services in the computer industry. Because of the merging firms' high gross margin – it derived a relatively high profit from each additional dollar of sales – its expert testified that it "could not profitably afford to lose more than 5 percent of its customers in response to a SSNIP." *Id.* at 190 n.21.

evidence at trial will show an abundance of actual and potential partial switching between MSC Nastran and other solvers.

MSC's own documents talked about how its own sales people view MSC Nastran for Windows – which Complaint Counsel says is not in the same market as "advanced" MSC.Nastran – as a competitor for part of MSC.Nastran's historic sales base. RX 736; RX 770.

By contrast, anecdotal evidence that some users might not be willing to switch in response to a price increase tells little, as the majority of users in many markets will be inframarginal

and not willing to switch. Complaint Counsel (and its expert, Dr. Hilke) did not undertake any actual pricing studies or econometric modeling to measure the extent to which demand was inframarginal or marginal. Complaint Counsel also has not rigorously analyzed the facts from the perspective of whether a sufficient number of customers would switch to deter a price increase. Complaint Counsel instead has relied on snippets of language from E-mails and the like, with the suggestion that somehow one can extrapolate from these snippets the inference that all (or even a majority) of MSC's customers would behave in the same manner as the potential behavior of a few.[25]

That will not do. Complaint Counsel would have us believe that no "elaborate market analysis" is necessary to prove its market definition. CC Br. at 3. But, as discussed *supra*, courts and the Commission have repeatedly rejected cases brought by the government under § 7 where the agency has failed to perform a sufficiently rigorous analysis to define a relevant market. Complaint Counsel cannot establish a presumption that the acquisitions are anti-competitive based on market share statistics (as it proposes to do) without a compelling analytical basis for a competitively realistic product market.

[25] In a recent article, three current Bureau of Economics economists discuss how this has been a recurring problem with the Commission's staff's review of mergers. *See* David Scheffman, Malcolm Coate, and Louis Silva, 20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective (2002). Specifically, the three economists note how it has often been the case that "staff did not appreciate the importance of determining whether there are customers ***at the margin*** and the ***volume of business they represented***." *Id.* at 10. They also go on to note that the "Guidelines, if misapplied, could be a powerful tool that could suggest implausibly narrow markets." *Id.* at 11. Complaint Counsel's investigation in this matter suffers from the precise pitfalls described in this paper.

2. Complaint Counsel Has Failed to Take Into Account the Heterogeneity of Demand in the Differentiated Marketplace for FEA Solvers

Complaint Counsel acknowledges that "FEA solvers are differentiated software products with varying features and capabilities." Complaint, ¶ 13. Complaint Counsel, however, has seemingly never recognized that the reason for this product differentiation is that the demand for FEA solvers is very heterogenous. Different users employ solvers for different purposes and have different views about which solver is best suited for a user's analysis. This heterogeneity exists across firms, but also importantly within a firm. Different users within a company will have different preferences for solvers. Indeed, a particular engineer may demand different solvers depending on the particular simulation analysis to be run. As a result, the FEA solver marketplace now offers a range of differentiated products, as different FEA solver vendors historically sought to react to the heterogenous demand by offering different bundles of features to users, bundles that overlapped significantly, but not completely, with other FEA solvers.

As will be explained by MSC's economic expert, Dr. James Kearl,[26] this product differentiation and heterogeneity of demand is important because it suggests that a general purpose solver such as MSC.Nastran competes with a wide variety of other FEA solvers along many competitive dimensions. As a result, the issue of which solver is the next best substitute for MSC.Nastran depends on: (1) the specific customer, (2) the specific user at the customer and (3) the specific use of the solver by the user. As noted in the last section, and as Dr. Kearl will explain, it is important to focus on the marginal demands for a product to determine market definition. In the

[26] Dr. Kearl is A.O. Smoot Professor of Economics at Brigham Young University with specific expertise in both the software industry and antitrust issues.

context of demand heterogeneity, a focus on marginal demand means that, in response to a hypothetical supracompetitive price increase by MSC.Nastran, switching could occur in multiple directions to a wide variety of solvers (depending on what the next best substitute is for a particular "marginal user's marginal use" of the solver), with other solvers offering a more attractive package relative to MSC.Nastran, across a combined competitive spectrum reflecting price, quality, service, reputation, financial viability of the vendor, integration with complementary software and other factors.[27]

The dangers in Complaint Counsel's failure to take into account the product differentiation and heterogeneity of demand in the FEA solver marketplace are illustrated by a recent case involving a merger in another sector of the computer industry, *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172 (D.D.C. 2001). There, the government challenged a merger by two

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[27] Courts have consistently rejected attempts to narrow markets based only on a single factor such as price, quality or service. *See, e.g., Murrow Furniture Galleries, Inc., v. Thomasville Furniture Indus., Inc.*, 889 F.2d 524, 528 (4th Cir. 1989) (noting that attempts to define narrow markets in terms of ***differences in quality, price and reputation*** are "difficult to maintain" because "consumers are willing to make tradeoffs" on these very factors); *In re Super Premium Ice Cream Distribution Antitrust Litig.*, 691 F. Supp. 1262, 1268 (N.D. Cal. 1988) (rejecting narrow product market consisting only of super premium ice creams noting that such quality "distinctions are economically meaningless where the differences are actually a ***spectrum*** of price and quality differences") (emphasis in original), *aff'd sub nom., Haagen-Dasz Co. v. Double Rainbow Gourmet Ice Creams, Inc.*, 895 F.2d 1147 (9th Cir. 1990); *Commonwealth of Pa. v. Russell Stover Candies, Inc.* 1993-1 Trade Cas. (CCH) ¶ 70,224, at 70,091 (E.D. Pa. 1993) (although price and quality distinctions might be relevant in analyzing the effect on competition of a merger, for market definition purposes, "[w]here the antitrust plaintiff articulates product differences along a ***spectrum*** of price and quality, the product market distinctions are economically meaningless . . . and unrealistic"); *State of N.Y. v. Kraft Gen. Foods, Inc.*, 926 F. Supp. 321, 355 (S.D.N.Y. 1995) (rejecting narrow product market in highly differentiated cereal market where a wide variety of cereals competed across a ***spectrum***); *Mogul v. General Motors Corp.*, 391 F. Supp. 1305, 1313 (E.D. Pa. 1975) (***rejecting argument that Cadillacs can be their own separate product market even though there are "less expensive models of automobiles***"), *aff'd*, 527 F.2d 645 (3d Cir. 1976).

of the three major providers of computer disaster recovery services. Rejecting the plaintiff's proposed market definition as too narrow, and therefore ultimately denying the request for a preliminary injunction, the district court focused on two factors that could almost have been written instead for this case, and which support a rejection of Complaint Counsel's "advanced Nastran" market: (1) the existence of an "extremely heterogeneous group of customers, particularly in terms of their needs and their computer equipment," *id.* at 182, and (2) the "striking heterogeneity of the market, particularly as reflected by the conflicting evidence relating to customer perceptions and practices." *Id.* at 182-83. Because of this heterogeneity, the court held that the government had not shown that a hypothetical monopolist could raise prices under the SSNIP test and denied the government's request to enjoin the merger, concluding that the government had not sustained its ***burden to define a product market***, thus ending the case. *Id.* at 183.

3. Despite Some Musings by Complaint Counsel on Price Discrimination, It Has Not Put Forward Evidence Meeting the Stringent Requirements to Prove Narrower Markets Based on Price Discrimination Nor Has Dr. Hilke Proposed to Do So

In theory, it is possible that a firm could target customers with inframarginal demands and seek to profit from these customers' lessened price sensitivity by raising prices only for these inframarginal customers. In such cases, a party can argue that a relevant market can be defined in terms of a firm's ability to price discriminate against certain inframarginal customers. *See Guidelines*, § 1.12.

In its complaint, Complaint Counsel suggested that it might propose market definitions based on price discrimination. Complaint, ¶ 23. Indeed, in its answers to interrogatories, Complaint Counsel mused on whether the FEA solver marketplace is susceptible to price

discrimination and suggested price discrimination may be occurring.[28] And in its proposed findings of fact, Complaint Counsel suggests that the acquisitions facilitated price discrimination by MSC.[29]

Yet, Complaint Counsel has not presented evidence supporting defining markets based on price discrimination (or identified what those markets would be). Significantly, Dr. Hilke, Complaint Counsel's liability economic expert, did not identify any relevant markets based on price discrimination in his expert report and at his deposition stated that: (1) he does not expect to define narrower markets based on price discrimination; (2) he has not analyzed whether markets can be defined in terms of price discrimination; and (3) he will not be focusing on defining markets in those terms.[30] J. Hilke Dep. Tr. at 88:2-9; 89:20-90:17, 497:20-498:1. Similarly, Dr. Spiller, Complaint Counsel's other economic expert, is not proposing to offer any opinions on price discrimination markets nor to base his proposed remedies on such markets. P. Spiller Dep. Tr. at 279:5-19.

Notably, when specifically asked in Interrogatory 17 of MSC's Second Set of Interrogatories to identify all relevant markets based on price discrimination it was defining, Complaint Counsel responded merely with a discussion about MSC's ability to determine whether a customer was an aerospace or automotive customer, but did not identify any relevant market it was

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[28] Complaint Counsel's Amended Resps. and Objections to MSC's Second Set of Interrogs., Answers to Interrogs. 17 and 19.

[29] CC FOF at 166-69.

[30] As discussed in MSC's motion in limine to exclude testimony outside the scope of expert reports, Dr. Hilke does suggest he might define relevant markets based on price discrimination "in rebuttal." J. Hilke Dep. Tr. at 94:5-8. As discussed in MSC's motion, such an attempt to identify submarkets based on price discrimination is outside the scope of Dr. Hilke's expert report, is not proper rebuttal testimony and should thus be excluded from the case.

defining in terms of price discrimination.[31] And, finally, nowhere in its brief or proposed findings of fact does Complaint Counsel outline any such relevant market. In short, despite Complaint Counsel's musings in some of its papers, it has not undertaken the effort to define markets in terms of price discrimination.

This reluctance to define a market based on price discrimination is perhaps understandable. The *Guidelines* impose stringent requirements before a narrow market can be defined in terms of price discrimination. Under the *Guidelines*, Complaint Counsel must show a that a hypothetical monopolist "can identify and price differently" to the targeted buyers and that the hypothetical monopolist's efforts will not be undermined by arbitrage, *i.e.*, that "other buyers likely would not purchase the relevant product and resell to targeted buyers." *Guidelines*, § 1.12. These requirements have been echoed in Commission precedent, such as *In re R.R. Donnelley & Sons Co.*, 120 F.T.C. 36 (1995), where the Commission outlined the same test and said it

> may find that a profitable discriminatory price increase is possible, and therefore sufficient to define a relevant market, if three conditions are satisfied: (1) the hypothetical monopolist can identify . . . customers with sufficiently inelastic demand . . . (i.e., those who will not switch . . . in response to a five percent price increase); (2) the hypothetical monopolist can selectively and profitably increase prices to those . . . customers and (3) arbitrage . . . (resale by favored elastic customers to targeted inelastic customers) would not be sufficient to undermine the price increase.

Id. at 158; *see also* Hausman, Leonard & Vellturo, *Market Definition Under Price Discrimination*, 64 Antitrust L.J. 367, 370 (1996) ("Price discrimination is feasible only under certain conditions. The two most important conditions are: first, that the hypothetical monopolist is able to identify the

[31] Complaint Counsel's Amended Resps. and Objections to MSC's Second Set of Interrogs., Answer to Interrogatory 17.

customers to whom price can be increased, and, second, that the product in question cannot be profitably arbitraged."); Philip E. Areeda, Herbert Hovenkamp and John L. Solow, IV Antitrust Law ¶ 927e, at 121 (1999) (noting that for any product there are buyers that are willing to pay different amounts, but that price discrimination is only possible if a seller can segment and identify those buyers).

In fact, satisfying these conditions and thus being able to engage in successful price discrimination is unlikely in theory and impossible here. It is typically very difficult for any seller to distinguish marginal from inframarginal customers. And, the consequences to the seller of incorrect identification – of "guessing wrong" – are very high. One study found that "when the inframarginal customers cannot be perfectly identified, so that the hypothetical monopolist would have to make guesses as to which customers would accept a discriminatory price increase, ***only a small number of incorrect guesses would be required before the price discrimination attempt would be rendered unprofitable.***" *Id.* at 383. That study concluded that, typically, error rates of only 5-10% would doom this strategy. *See id.* at 373-75.[32]

The Commission itself has expressed skepticism of the seller's likely success in implementing a program of price discrimination. In *R.R. Donnelley*, Complaint Counsel's challenge to the merger of two firms providing both gravure and offset printing services relied on a price discrimination theory (by Dr. Hilke) for its contention that the relevant product market should be limited to "high volume publication gravure printing." Reversing the Administrative Law Judge's

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[32] "[T]he hypothetical monopolist's ability to identify customers with inelastic demand is ***a very stringent condition***. When the monopolist cannot perfectly identify customers to target, the targeting must be very accurate or the price discrimination attempt will be unprofitable." *Id.* at 375.

initial decision condemning the merger, the Commission found that the facts did not support Complaint Counsel's theory, and it expressed grave skepticism about the price discrimination theory:

> The Commission must be mindful of the ***analytical hazards of defining markets by reference to possible price discrimination***. It is an economic truism that buyers do not have homogenous preferences or demand elasticities for a given product within a relevant market, and there may often be some conceptual means of identifying classes of customers that appear to have inelastic demand for the product.

120 F.T.C. at 159 (1995). The Commission went on to observe that the "potential for this approach to swallow up the market definition principles established by the federal courts and the Commission is substantial." *Id.* The Commission then stated:

> As the Commission warned in *Midcon Corp.*, [112 F.T.C. 93 (1989)]: "In considering possible markets under [a price discrimination] theory, there is a danger of implicitly assuming the conclusion." 112 F.T.C. at 168. That risk requires ***a particular rigor*** in examining the conceptual basis for distinguishing the allegedly inelastic customers and the factual basis for the prediction that price discrimination with respect to customers is likely.

Id. (footnotes omitted).

In *R.R. Donnelley*, the Commission concluded that Dr. Hilke's testimony lacked this ***rigor***, finding that "[a]lthough complaint counsel have described, ***in theory***, a methodology for identifying a category of printing customers whose demand for gravure printing should be relatively inelastic, complaint counsel have not carried the burden of proving that the methodology allows an ***accurate identification*** of inelastic end uses and, thus, that a price increase within the identified category likely would be profitable." *Id.* at 159-60.

Here, Complaint Counsel has not attempted in this case to analyze price discrimination issues with the required ***rigor***. The reality is that FEA solvers are decided non-

candidates for any theory of price discrimination. *First*, it would be impossible for MSC profitably to identify and distinguish customers with marginal and inframarginal usage, because MSC does not have the necessary information on the nature and quantity of usage at customers to avoid "guessing wrong" in too many cases. *Second*, the nature of usage in the industry creates a particular problem of preventing arbitrage. Within each customer, there are both marginal and inframarginal uses of the solver product. MSC has no way of targeting sales to users within customers that have inframarginal uses, meaning a customer can in essence arbitrage within itself to prevent a price discrimination strategy from working.

MSC faces difficulties in price discrimination not even faced in *R.R. Donnelley*, where respondents nonetheless prevailed. In *R.R. Donnelley*, each printing job could be separately priced, and thus sellers could effectively prevent arbitrage by price discriminating against inframarginal printing jobs. As a result, the Commission concluded arbitrage was not possible. 120 F.T.C. at 158. Here by contrast, MSC does not separately price each simulation analysis run by customers and has no ability to prevent arbitrage between marginal and inframarginal simulation analyses.[33]

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[33] The *Guidelines* envision that any discussion of price discrimination should take place within the auspices of the section 1.12 requirements. In section 1.12, the *Guidelines* state that the discussion prior to § 1.12 "assumed that price discrimination . . . would not be profitable" and that a "different analysis" applies where price discrimination is profitable. It then lays out this different analysis, which consists of the stringent requirements for proving that a narrower product market can be defined in terms of price discrimination. Section 1.12 concludes by stating the agency will consider alternative relevant product markets based on price discrimination if the requirements of section 1.12 are met. In essence, the *Guidelines* state that proof of price discrimination should be channeled through the requirements of section 1.12. *See R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 155 (1995) (walking through how the SSNIP test is either applied without price discrimination under section 1.11 of the *Guidelines* or with price discrimination under section 1.12 of the *Guidelines*).
(continued...)

4. Defining an Advanced Nastran Market Based on Switching Costs Is Inconsistent with the Facts and the Case Law

From the beginning of the case, Complaint Counsel has suggested that switching costs underlie its "advanced Nastran" market definition. At the very first pre-trial hearing conference, Complaint Counsel stated that non-Nastran solvers are not a substitute for Nastran solvers because the cost of switching to a non-Nastran solver is "substantial" (11/8 Hrg Tr. at 12:3), while switching between Nastran solvers is "nearly seamless" (*id.* at 13:8) with "very small, very minor" costs (*id.* at 13:11). In its brief, Complaint Counsel repeats this language, saying there are "[r]elatively minimal switching costs." CC Br. at 16.

In its response to MSC interrogatories, Complaint Counsel outlines it contention that the advanced Nastran market is determined by relative switching costs.[34] Complaint Counsel states that the "likely reaction of buyers to a price increase (prior to the acquisitions) depends upon their willingness to switch to another solver." *Id.* at 11.[35] In terms of switching between MSC.Nastran, CSA Nastran and UAI Nastran, Complaint Counsel describes an "ease of switching." *Id.* By contrast, with respect to non-Nastran solvers, Complaint Counsel says that even "if another solver

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[33] (...continued)
Because Complaint Counsel has not proposed defining relevant product markets in terms of price discrimination under section 1.12, issues of price discrimination should ***not*** be relevant in these proceedings.

[34] Complaint Counsel's Amended Resps. and Objections to MSC's Second Set of Interrogs., Answer to Interrogatory 1, at 10-11.

[35] Complaint Counsel ignores the fact that switching to an alternative solver is not the only weapon customers have to constrain MSC's prices. Because of the low variable cost of software even minor increases in usage can incentivize MSC to lower prices and even minor reductions in usage can discipline MSC.

happened to offer some of the same features, functionalities, and capabilities as advanced versions of Nastran at the time of the acquisitions, that solver would not be in the same relevant market." *Id.* The reason, according to Complaint Counsel, is that the "difficulty, time, and cost of switching make it unlikely that buyers would switch away from an advanced Nastran in response to a hypothetical price increase prior to the acquisitions." *Id.* In other words, according to Complaint Counsel, its proposed advanced Nastran market is determined in terms of relative switching costs, with switching between "advanced Nastran" solvers viewed as easy and switching between advanced Nastran solvers and non-Nastran solvers viewed as difficult.

Complaint Counsel has it wrong. Switching between MSC.Nastran, CSA Nastran and UAI Nastran is not "easy" or "nearly seamless," as Complaint Counsel suggests, but is often quite difficult. Indeed, there are countless examples of customers having difficulty switching between MSC.Nastran, CSA Nastran and UAI Nastran. CSA itself recognized during its dealings with Ford that an abrupt switch from CSA to MSC would cause "considerable frustration" as "[u]sers do not have sufficient time to adapt their CSA/Nastran decks to MSC/Nastran." RX 2886; *see also* RX 2478.

DMAP conversion, in particular, is a problem as the MSC, CSA and UAI DMAP tools were not compatible with each other.[36]

Beyond these factual deficiencies in its argument, Complaint Counsel's assertion is – in reality – merely a variant of the "lock-in" phenomenon commented upon by the Supreme Court in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). Here, existing "advanced Nastran" users supposedly are the "locked in" customers that cannot switch to another solver. Defining a market in terms of "lock in" requires that Complaint Counsel meet the requirements posed under the case law. As the Third Circuit noted in a tying case, rejecting a claim that the market should be limited to products sold only by the franchiser, "*Kodak* does ***not*** hold that the existence of information and switching costs alone . . . renders an otherwise invalid relevant [product] market valid." *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 439 (3d Cir. 1997).

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[36] DMAP refers to "Direct Matrix Abstraction Programming." DMAP is a tool that gives a user the flexibility to obtain customized solutions and results.

Absent some suggestion that MSC is not still seeking to expand its business and sell to new customers (for which there is – and can be – no evidence), Complaint Counsel's "lock in" theory must be premised on the fact that MSC price discriminates against ***existing*** customers.[37] Complaint Counsel's economic expert, Dr. Hilke, however, admits that he had not "done any systematic review" of whether MSC can price discriminate against existing customers. *See* J. Hilke Dep. Tr. at 137:16-24; 138:15-21. In fact, there is no evidence that MSC price discriminates against existing customers. Among other things, such price discrimination would not work because, given the blurred line between "existing" usage and "new" usage at any particular customer, MSC could not prevent arbitrage within a customer, *i.e.*, a customer could discipline MSC if it tried raising prices for "locked in" usage by switching usage that was not "locked in" to another solver, and MSC has no ability to target only "locked in" usage at a particular customer.

More fundamentally, the issue is ***not*** whether ***relative*** switching costs are lower between "advanced Nastran" solvers, but whether the absolute level of switching costs between "advanced Nastran" solvers is sufficiently low that users would switch between MSC, CSA and UAI in the face of a 5%-10% price increase. If switching costs are sufficiently high between the different types of "advanced Nastran" solvers that users would not switch in reaction to a 5%-10% price increase, relative switching costs cannot form a basis to define an "advanced Nastran" market based on switching costs, because then the market would be more properly defined as ***MSC.Nastran itself*** (and the acquisitions would have had no effect on competition in a MSC.Nastran only market). The

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[37] *See* Philip Areeda and Herbert Hovenkamp, Antitrust Law ¶564b (2002) (discussing how exercising market power against "locked in" users requires either that the seller have the incentive and ability to price discriminate against existing users or that the seller is not concerned about the loss of new customers).

reality is that the types of inframarginal demand for solvers on which such a price discrimination theory could be developed would consist of demand unlikely to switch to ***any*** other solver based on a 5%-10% price increase, regardless of whether the other solver is another "advanced Nastran" solver.

Notably, in *United States v. Engelhard Corp.*, 126 F.3d 1302 (11th Cir. 1997), the Government's case consisted of arguing that a few "locked in" customers would have difficulty switching in response to a 5% or 10% price increase. Here, as in *Engelhard*, a customer with inframarginal usage that could not easily be switched to another solver, is not likely to move to any other solver in response to a 5% or 10% price increase. In these circumstances, to understand competition, it is necessary to focus on competition ***prior*** to committing certain usage to a particular solver:

> Consideration of reformulation costs and the minuscule impact of GQA [the government's claimed product market] prices on the finished products in which it is used, explain why ***current*** GQA users are reluctant to switch in the face of hypothetical price increases sometimes well in excess of 10%. ***More importantly, however, it highlights the need for evidence of pre-formulation competition*** among GQA and other industrial thickeners and suspension agents. . . . As new products of all stripes are developed and old products are reformulated, GQA must compete against other industrial thickeners and suspension agents or become obsolete.

Id. at 1306.

In short, if Complaint Counsel were somehow to prove that it is possible to price discriminate successfully against existing customers and then define markets based on switching costs, it inevitably is going to be defining company-specific product markets (such as MSC.Nastran-only markets or ANSYS-only markets) or it will have to address competition for usage

prior to any "lock in." And the competition prior to any "lock in" is far broader than an "advanced Nastran" market, as even Dr. Hilke acknowledges in his expert report.[38]

C. COMPLAINT COUNSEL AND DR. HILKE ERRONEOUSLY ARGUE THAT NARROW MARKETS EXIST BECAUSE THEY FAILED TO FOLLOW THE RIGOROUS ANALYSIS REQUIRED UNDER THE MERGER GUIDELINES AND CASE LAW

Absent any attempt to define markets based on price discrimination (which Complaint Counsel has not presented), this case calls for a straight forward application of the *Guidelines*. The *Guidelines* employ a demand-side-focused approach to market definition (often referred to as the "SSNIP test"), weighing the alternatives available to customers in the face of a hypothetical price increase.[39] As the discussion in the following sections will show, Complaint Counsel has failed to rigorously apply the Commission's own *Guidelines* to this case. As a result, it has failed to define any relevant product market and its case must fail.[40]

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[38] J. Hilke Supp. Expert Report, ¶ 175 (describing how the alternative product market that includes ANSYS and Dassault applies to users that are not current "advanced Nastran users" and do not face legacy issues).

[39] *Guidelines*, § 1.11.

[40] MSC is not necessarily endorsing here the *Guidelines* as the proper basis to define markets. In certain situations, the approach laid out in the *Guidelines* can lead to an overly narrow market definition. For example, the *Guidelines* only define markets in terms of demand side substitutability. Also, as Dr. Kearl will explain, the *Guidelines* if rigidly construed may lead to overly narrow markets in software industries. *See* J. Kearl Expert Report, at 4-9. Dr. Spiller, an expert economist for Complaint Counsel on remedies, has himself written on how in industries where suppliers have sunk costs specific to the market (such as FEA solvers), large buyers can exploit these sunk costs to achieve lower prices in ways not appreciated by the *Guidelines*. RX 823. Moreover, although the "SSNIP test" uses the construct of a 5% increase in price, both the *Guidelines* themselves and the case law generally acknowledge that a higher percentage increase in price might be appropriate for determining the relevant market. *See, e.g., Olin Corp. v. FTC*, 986 F.2d 1295, 1302 (9th Cir. 1993) and *United States v. Engelhard Corp.*, 970 F. Supp. 1463 (M.D. Ga.), *aff'd*, 126 F.3d 1302,
(continued...)

1. Complaint Counsel Cannot Even Present a Description of What It Means by an "Advanced Nastran" Solver

The first step under the Merger Guidelines is laid out as follows: "[T]he Agency will begin with each ***product*** (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a 'small but significant and nontransitory' increase in price, but the terms of sale of all other products remained constant." *Guidelines*, § 1.11. This first step requires the identification of a "product." Although the parameters of the alleged relevant product market need not be drawn as the "metes and bounds" of a parcel of real property, they nonetheless must be described with some specificity, so that one can at least know what products and services are, and are not, within the alleged relevant product market. For example, if a market is identified as "televisions," the parties can seek to identify all companies that manufacture televisions and the *Guidelines* SSNIP test can be applied to a hypothetical monopolist owning all television manufacturing companies.

Here, immediately we run into Complaint Counsel's obfuscation of the meaning of an "advanced Nastran product." In its response to MSC's initial interrogatories, Complaint Counsel described an "advanced Nastran" solver as a solver that offered "a ***high level of functionality*** and a ***wide range*** of features and at prices substantially higher than versions of Nastran that lack advanced functionality and a wide range of features."[41] When MSC in its second set of

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[40] (...continued)
1304-05 (11th Cir. 1997). That said, because Complaint Counsel cannot even prove its relevant markets under the *Guidelines*, these broader issues with the application of the *Guidelines* in this case may prove beside the point at trial.

[41] *See* Complaint Counsel's Second Revised Resps. and Objections to Respondent (continued...)

interrogatories asked Complaint Counsel to precisely define the "high level of functionality" and "wide range of features" to which it was referring, Complaint Counsel refused to be precise, stating that the meaning is "continually evolving" and that advanced Nastran solvers "contain significant enhancements to COSMIC Nastran," without precisely defining what it meant by "significant enhancements."[42]

Meanwhile, Dr. Hilke ran his own game of obfuscation. In his initial report, Dr. Hilke stated: "Advanced NASTRAN refers to versions of NASTRAN offering a full range of advanced features and higher levels of functionalities used by dedicated analysts." J. Hilke Expert Report, ¶ 7. After MSC's economic expert, Dr. Kearl, pointed out that this definition was circular (*i.e.*, defining "advanced" Nastran as a solver that has "advanced" features),[43] Dr. Hilke simply dropped this sentence from his supplemental expert report and disavowed the sentence as "inartfully" written. J. Hilke Dep. Tr. at 259-261. No substitute sentence defining the meaning of "advanced Nastran" was included in Dr. Hilke's supplemental report.

Complaint Counsel's brief and proposed findings of fact provide no more clarity. Indeed, in its brief, Complaint Counsel seems to have forsaken any attempt to describe an "advanced Nastran" market. Complaint Counsel, for example, says without any other description that

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[41] (...continued)
MSC.Software Corporation's First Set of Interrogs., at 15.

[42] *See* Complaint Counsel's Amended Resps. and Objections to MSC's Second Set of Interrogs., Answer to Interrogatory 1, at 12-13.

[43] Expert Report of James R. Kearl, at 17.

"[a]dvanced Nastran is the relevant product market" and that the "relevant product market in this matter is comprised of MSC Nastran, UAI Nastran, and CSA Nastran." CC Br. at 9.

Supposedly to provide clarity, Complaint Counsel does reference MSC contracts that define the software for purposes of the contract as an "advanced version of the United States government sponsored structural analysis program known as Nastran." CC Br. at 9. These contract references are matter of fact in nature and give no explanation of what is meant by an "advanced" version of Nastran. Dr. Hilke cites these contracts simply for the notion that MSC recognizes that its product is distinguishable from Cosmic Nastran, as all Nastrans offered in the marketplace are. J. Hilke Dep. Tr. at 241:23-242:18. Dr. Hilke acknowledges, however, that the contracts do not describe how far a Nastran solver needs to have changed from Cosmic Nastran to constitute an "advanced" Nastran solver. *Id.* Nor do the contracts identify any distinguishable relevant market consisting of "advanced Nastran" solvers. In short, the contracts provide neither additional clarity on what an "advanced" Nastran solver means nor any support for creating a relevant market for "advanced Nastran" solvers.

This lack of clarity makes it difficult to assess how Complaint Counsel determined what solvers to include in its "advanced Nastran" market (other than "I know it when I see it"). Even an arbitrary decision to begin analyzing the hypothetical monopolist test only using solver products sold by MSC, CSA and UAI still leaves ambiguity, since prior to the acquisitions MSC, CSA and UAI sold a variety of solver products. Even though there is a large degree of overlap in functionality between MSC's various Nastran products,[44] Complaint Counsel has arbitrarily classified some of

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[44] *See* Respondent MSC.Software Corporation's Response and Objections to Interrogs. (continued...)

MSC's products as "advanced" (*e.g.*, Nastran Standard and Nastran Basic), while classifying other products as "non-advanced" (*e.g.*, MSC.FEA and Nastran for Windows).

The reality is that MSC's "non-advanced" solver products such as MSC Nastran for Windows and MSC.FEA actively compete with its "advanced" solver products such as MSC.Nastran. RX 770; RX 736. Since Complaint Counsel does not seem to dispute that MSC.FEA competes with ANSYS, *see* CC FOF ¶ 278, if MSC.FEA is in the same product market as MSC.Nastran, then MSC's "advanced Nastran" products are in the same market with other non-Nastran solvers.

Complaint Counsel has also been vague on what distinguishes an "advanced Nastran" solver from a non-Nastran solver. In Complaint Counsel's Second Revised Responses and Objections to MSC's First Set of Interrogatories, Complaint Counsel finally disclosed a list of the "features and functionalities [that] are present in advanced Nastran [that] generally [are] not available in non-Nastran solvers and distinguish non-Nastran solvers from advanced Nastran solvers."[45] This list of 29 features, however, was quickly disavowed by Complaint Counsel, once it realized that: (1) no customer required all of the 29 features; (2) UAI and CSA did not satisfy all of the 29 criteria; and (3) other FEA solvers performed the vast majority of these features. As a result, Complaint Counsel walked away from articulating any list, asserting that "[a]ny extant listing of features, functionalities, and capabilities shared by two or more solvers does not determine, by itself, the

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[44] (...continued)
8,9,11,15-17, and 20-25 of Complaint Counsel's First Set of Interrogs., at 37-39.

[45] *See* Complaint Counsel's Second Revised Objections and Resps. to MSC's First Set of Interrogs., at 45.

likely reaction of buyers to a [hypothetical] price increase."[46] In Dr. Hilke's deposition, he similarly claimed that he does not "believe that the technical characteristics alone are the appropriate basis to define the product market." J. Hilke Dep. Tr. at 244:20-22.

In short, by obscuring the meaning of "advanced," Complaint Counsel has sought simply to hide these fatal defects in its market definition.

2. Complaint Counsel and Its Economic Experts Make No Attempt to Define Product Markets in Terms of the Hypothetical Monopolist Test in the Guidelines and the Case Law

Complaint Counsel states in its brief that the relevant market is "comprised" of MSC Nastran, CSA Nastran and UAI Nastran. CC Br. at 8. Setting aside the obscurity of how Complaint Counsel gets to this point, the next step under the Merger Guidelines is the SSNIP test, *i.e.*, to analyze what happens when a hypothetical monopolist of "advanced Nastran" products supracompetitively raises prices by 5% to 10% across the board.[47] In applying the "SSNIP test," a determination must be made as to whether the defendant could ***profitably*** sustain the posited increase in price. Sometimes referred to as "critical loss analysis," this inquiry asks whether the hypothesized

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[46] *See* Complaint Counsel's Objections and Resps. to MSC's Second Set of Interrogs., at 11.

[47] At times, Complaint Counsel and its experts have suggested pre-acquisition prices were above competitive levels and that existing prices at the time of acquisition may not be the proper starting point for this analysis. But the *Guidelines* state that the "Agency will use prevailing prices of the products of the merging firms and possible substitutes for such products, ***unless premerger circumstances are strongly suggestive of coordinated interaction***, in which case the Agency will use a price more reflective of the competitive price." *Guidelines*, § 1.11. Neither Complaint Counsel nor its economic experts are offering any evidence that pre-acquisition prices were above competitive levels or analyzing whether pre-merger circumstances were suggestive of coordinated interaction (let alone "strongly suggestive"). J. Hilke Dep. Tr. at 161:15-162:12; P. Spiller Dep. Tr. at 83:1-10. Absent such evidence, the *Guidelines* call for the use of existing prices in analyzing price increases under the hypothetical monopolist test.

price increase would cause the defendant a sufficient loss of sales so as to deter an increase in prices. As the *Guidelines* recognize, "[i]f the alternatives [for customers] were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase ***would not prove profitable, and the tentatively identified product group would prove to be too narrow***." *Guidelines* § 1.11.

In applying this test in the context of differentiated products, it is necessary to look at variables other than just price. *See In re R.R. Donnelley*, 120 F.T.C. 36, 174 (1995) ("[S]ubstitution on the basis of price alone makes little sense in the context of competition between differentiated products."). The *Guidelines* specifically recognize that competition occurs in dimensions other than price, including product quality, service and innovation. *Guidelines* § 0.1 n.6. In *R.R. Donnelley*, the Commission held that the ALJ erred by "inferring that this [nonprice based] substitution is not economically relevant for the purpose of evaluating the competitive effects of the transaction." 120 F.T.C. at 174. As a result, in applying the *Guidelines* test and analyzing switching evidence in this case, it is important to take into account partial switching on the margin in terms of relative changes in price, quality, service and innovation.

This inquiry is precisely what Complaint Counsel has not done in this case. As noted, throughout its Part II investigation and its subsequent discovery, Complaint Counsel has been asking questions that do not get at these key analytical issues. While the SSNIP test focuses on a critical loss of ***marginal*** users and uses, Complaint Counsel has been focusing on ***inframarginal*** users and uses. For a solver product such as MSC.Nastran, however, it will ***always*** be possible within any customer to identify particular users or uses in which it would be difficult to switch to another solver. This is a common phenomenon in ***any*** market, as there are always inframarginal users and uses –

even in perfectly competitive markets. The existence of such inframarginal users and uses hardly suggests an absence of competition nor does it form a basis to define a product market.

A perfect illustration of this principle arises in two areas focused on by Complaint Counsel throughout its case: functionality and switching costs. Complaint Counsel suggests non-Nastran solvers cannot match the overall quality of MSC Nastran and the "wide range" of features and functionalities included.[48] But the issue under the *Guidelines* is not whether MSC Nastran has features that make it the "best" product for certain simulation analyses. That is no doubt possible, just as other solvers probably are the "best" solver for certain other simulation analyses. The issue is whether MSC Nastran is used by customers for analyses for which other solvers provide a reasonably adequate replacement. On this issue, Complaint Counsel has been silent and substantial evidence shows the willingness and ability for customers to switch a significant amount of usage from MSC Nastran to other solvers. MSC FOF ¶¶ 131-354.

Similarly, with respect to switching costs, the issue under the *Guidelines* is ***not*** whether there are certain "legacy analyses" that would be difficult to switch to another solver or whether there are costs to train designers or analysts to use another solver for certain simulation analyses. There no doubt are. The issue is whether customers use MSC Nastran for certain analyses for which the switching costs would not be significant to switch to another solver. On this issue, Complaint Counsel has been silent and – again – the evidence shows the willingness and ability of customers to switch a significant amount of MSC Nastran usage to other solvers in response to a change in the relative price and quality of solvers. MSC FOF ¶¶ 131-354.

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[48] Complaint Counsel's Second Revised Resps. and Objections to Respondent MSC.Software Corporation's First Set of Interrogs., at 44-46.

3. A Proper Application of the Merger Guidelines Shows That the Relevant Market is Much Broader than Complaint Counsel's Proposed Narrow Market Definitions

Applying the *Guidelines* to Complaint Counsel's proposed market definitions establishes that Complaint Counsel has failed to meet its burden of establishing a relevant product market. Under the *Guidelines*, a market definition can only be sustained if a hypothetical monopolist can profitably raise prices supracompetitively by 5% to 10%. As a practical matter, that means that the monopolist must be able to raise prices without suffering a ***critical loss*** of business so as to make the price increase unprofitable. With an across the board price increase, the critical loss ***need not occur across the board***. In the "advanced Nastran" market, for example, MSC would not need to lose business uniformly across its customer base. Rather, MSC would merely have to lose sufficient business (whether through loss of business to other competitors or reduced purchases by customers) to create a critical loss of business.[49]

As a result, it is only necessary to show that MSC would suffer sufficient lost usage or partial switching by ***some users*** to demonstrate that "advanced Nastran" is not a properly defined "relevant market." Partial switching (or lost usage) can occur at three levels: (1) at the customer level (in the sense that a customer can make a corporate-wide decision to convert the bulk of its MSC.Nastran usage to another solver or reduce usage); (2) at the engineer level (in the sense that individual engineers or "users" within a company switch from using MSC.Nastran to another solver or reduce usage); and (3) at the use level (in the sense that switching can occur on a simulation by

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[49] The amount of critical loss necessary to defeat a price increase is tied to the gross margin earned on sales of the product. *See* J. Kearl Supp. Expert Report, at 26 n.87. The lost sales can also include sales of complementary products such as MSC Patran.

simulation level, with an engineer choosing to do more of his or her analyses on another solver, while still using MSC.Nastran).

The evidence will show that customers pay on some type of usage basis (*e.g.*, seats purchased, tokens purchased, or pricing under an unlimited use contract based on past and expected usage). Reduced usage by customers across the three levels just discussed can lead to lower MSC Nastran revenues and contribute to the "critical loss" that would discipline MSC's pricing. There is no evidence of any post-merger price increases (or systematic, sustained changes in MSC's prices) precisely because MSC recognizes the ready willingness and ability of its customer base of sophisticated buyers to switch some or all of their usage of MSC.Nastran (and other complementary MSC products) to other companies. MSC FOF ¶¶ 19-21.

This lost usage can be diverted in multiple directions to a wide variety of other FEA solvers, reflecting the many overlaps in features between MSC.Nastran and other FEA solvers. MSC FOF ¶¶ 131-354. To maintain an "advanced Nastran" market, Complaint Counsel must show that the resulting loss of usage would not constitute a "critical loss" – a burden it has not undertaken, much less proven.

If an "advanced Nastran" market is rejected under the SSNIP test, the next step is to add the next best substitute to the hypothetical monopolists' product group.[50] Here that certainly

[50] The *Guidelines* describe this expansion of the product market as follows: "If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best-substitute for the merging firm's product." *Guidelines*, § 1.11. "[T]he term 'next best substitute' refers to the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a 'small but significant and nontransitory' price increase." *Id.* n.9.

would be ANSYS.[51] Assuming that ANSYS is the next best substitute, the next step would be a hypothetical price increase for "advanced Nastran" solvers and ANSYS. At this point in the analysis, Complaint Counsel would have to account for substitutes for ANSYS in its analysis (as the price of ANSYS also rises). Hence, because ANSYS has many non-linear and linear capabilities that overlap with other solvers, Complaint Counsel has to take into account lost ANSYS sales resulting from these overlaps in performing its hypothetical monopolist test at this stage. There is no evidence that Complaint Counsel has attempted to take into account such substitutes for ANSYS, and Complaint Counsel's proposed findings put forth no such analysis on this issue.

If "advanced Nastran" solvers and ANSYS are insufficient to define a market (and Complaint Counsel has provided no evidence that it is sufficient), the next step would be to add the next closest substitute – likely Abaqus. *See* MSC FOF ¶¶ 196-230. This next step would be a hypothetical price increase for "advanced Nastran" solvers, ANSYS and Abaqus. At this point in the analysis, Complaint Counsel would have to account for substitutes for Abaqus in its analysis (as the price of Abaqus also rises). There is no evidence that Complaint Counsel has attempted to take into account such substitutes for Abaqus in this manner.

The analysis would then go on and on, through Dassault, PTC, Permas, LS Dyna and the many other solvers identified as competitors. MSC FOF ¶¶ 231-354. This hypothetical

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[51] MSC's documents show a strong emphasis on ANSYS. MSC FOF 142-145. For example, MSC's Software Development Planning team, when viewing the competitive landscape, saw competition as "fierce and relentless" and because they could not fund development efforts to counter every move of every competitor, it focused on "ANSYS as enemy number 1." RX 2103. Indeed, in 1997, MSC created the ANSYS Competitive Analysis Team to analyze and develop strategies for "our number one competitor – Ansys, Inc." RX 784. And, Dr. MacNeal, in his history of MSC, describes ANSYS as MSC's "strongest competitor." RX 117.

monopolist test methodology requires that Complaint Counsel continue its analysis until sufficient solvers have been added to the hypothetical monopolist to allow a profitable price increase. Since any plausible product group will overlap with CAD products and special purpose solvers, there is no reason to believe this analysis would stop before all FEA solvers (including in-house solvers) are included in the market. For that reason, Complaint Counsel's alternative market of "advanced linear structural FEA solvers" also is not tenable.

4. Dr. Hilke's Presents an Anecdotal, Ad Hoc Approach to Market Definition, Not the Analytical Rigor Required Under the Guidelines and the Case Law

Instead of analyzing market definition under the *Guidelines* using a SSNIP test, Dr. Hilke in his expert report simply uses an ad hoc, anecdotal approach to market definition. Dr. Hilke never performed any quantitative or statistical analysis to determine whether MSC Nastran could profitably raise prices supracompetitively by 5% or 10%. *See* J. Hilke Dep. Tr. at 56 (other than reviewing sales data, Dr. Hilke has not performed any "empirical," "statistical," or "econometric" analysis). Nor did Dr. Hilke even attempt conceptually to apply the SSNIP test to analyze the nature of likely substitution and to explain why the reduced usage of MSC.Nastran would not be sufficient to prevent a price increase.

In ¶ 33 of his supplemental report, Dr. Hilke purports to follow the *Guidelines* approach. But in ¶ 34, he abandons this approach by simply asking whether CSA Nastran and UAI Nastran were the "closest substitutes" and whether there is a "major gap" between "advanced Nastran" products and other solver products. That is ***not*** the approach of the *Guidelines*. Dr. Hilke's resulting flawed analysis shows why the *Guidelines* require more "analytical rigor."

In his supplemental expert report, Dr. Hilke posits that an "advanced Nastran" market exists based on three main rationales: (1) the inability of other solvers to provide the same functionality in technical terms as MSC, CSA and UAI Nastran (¶ 17); (2) high switching costs between MSC, CSA and UAI Nastran and other solvers (¶ 18); and (3) networking advantages between MSC, CSA and UAI Nastran (¶ 19). These broad criteria (and the anecdotes Dr. Hilke references for these rationales) do not distinguish between inframarginal and marginal demand for MSC, CSA and UAI Nastran. Hence, while other solvers might not match ***all*** the functionality of MSC.Nastran, that does not mean that they do not match a large amount of the functionality of MSC.Nastran and cannot provide significant substitutes on the margin. Similarly, while there might be some uses in which switching costs might be quite high, that does not mean that there are not ***other*** analyses that could not easily be switched to a non-Nastran solver.

And even if one were to assume any network effects (for which Dr. Hilke only offers a few isolated snippets),[52] that does not mean there is not usage that is little affected by any

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[52] Chairman Muris has written that the "fact that network effects are everywhere should give us pause about the usefulness of the concept." Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 Antitrust L.J. 693, 719 (2000). Never has Chairman Muris's caution been more applicable. Engineering software is not like a telephone network or the network effects that support Microsoft's operating system monopoly. There is no obvious basis for believing network effects are important in the MCAE marketplace and Dr. Hilke's analysis provides no reason to believe they are. Indeed, Dr. Hilke's references in his supplemental expert report supporting his theory of network effects (¶¶ 19, 147-148) consists of

, a Part II transcript from a woman who stated she was not "familiar" with the subject being discussed, a reference to testimony by MSC's Ken Blakely discussing the use of translators (which would tend to alleviate any issue of network effects),

and a reference to the Part II transcript of Mr. Morgan (the former president of UAI), who states in that transcript that he tried to locate such a (continued...)

networking advantages. In other words, even if there are meaningful networking advantages, Dr. Hilke has not shown that such advantages have any effect beyond ***inframarginal*** usage.

Even under Dr. Hilke's own anecdotal approach, his analysis cannot survive close scrutiny of the documents and testimony. Dr. Hilke argues CSA Nastran and UAI Nastran were MSC's closest substitutes (and thus in the same relevant market) based on MSC documents that reference CSA and UAI and customer benchmarks and evaluations comparing MSC.Nastran to UAI Nastran or CSA Nastran. *See* J. Hilke Dep. Tr. at 308 (arguing that "benchmarking is an important aspect" of his determination that a customer "actively considered" switching to CSA and UAI Nastran); J. Hilke Supp. Expert Report, ¶¶ 70-93 (referencing discussion of CSA and UAI in MSC documents as a basis for concluding they are in the same product market). But ***if*** the standard for establishing whether MSC.Nastran is in the same product market as a competitor is (as Dr. Hilke proposes) whether MSC discusses the competitors in its documents or customers benchmark MSC against a particular solver, the evidence is that a wide variety of solvers are in the same market as MSC.Nastran.

MSC's documents frequently discuss other solver competitors.

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[52] (...continued)
network effect, but that in the twenty years UAI did business with Chrysler, he could only find one small customer that was influenced by "trickle-down effects," *i.e.*, network effects.

In short, Dr. Hilke has nothing to support the "network effects" refuge to which he so often retreated at his deposition to evade hard questions about the lack of evidence supporting his proposed "advanced Nastran" market definition.

MSC's strategic planning documents, in particular, often list several FEA solver competitors.

Similarly, customers have benchmarked and compared MSC.Nastran to a wide variety of other solvers.

In short, even if one bases market definition on Dr. Hilke's anecdotal approach (which is ***not*** the approach of the *Guidelines* or the case law), the market is far broader than what Dr. Hilke suggests and Complaint Counsel argues.

It is precisely the purpose of the SSNIP test in the Merger Guidelines to focus on the key conceptual difference between inframarginal and marginal demand. By failing to perform a

SSNIP test (or critical loss analysis), Dr. Hilke has ignored the key conceptual analyses needed to assess market definition, and his and Complaint Counsel's "advanced Nastran" market is fatally defective. As discussed *supra*, that can – and should – end the case.

III. COMPLAINT COUNSEL HAS NOT SHOWN THAT THERE IS A REASONABLE PROBABILITY THAT THE CSA AND UAI ACQUISITIONS HAVE LED TO (OR COULD LEAD TO) ANY SUBSTANTIAL LESSENING OF COMPETITION

If Complaint Counsel proves (which it has not) the existence of either of its product markets, it will argue that it has made out a prima facie case that the "merger . . . produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963). But the case does not end there.

At that point, MSC has an opportunity to rebut the presumption. And, as the D.C. Circuit has stated, it is "a foundation of section 7 doctrine, disputed by no authority cited by the government, that evidence on a ***variety of factors*** can rebut a prima facie case." *United States v. Baker Hughes Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990). Among the factors considered by the district court, and approved by the court of appeals, in *Baker Hughes* were ease of entry into the market, the misleading nature of the statistics underlying the government's prima facie case and the sophistication of the merging firms' consumers. *Id.* at 984. The court of appeals also identified the financial weakness of the acquired firm, the prospect of efficiencies and changing market conditions as some of the other ways of rebutting the government's prima facie case. *Id.* at 985-86. This collection of factors mirrors the evidence MSC will present in this case. And once "the defendant successfully rebuts the presumption, the burden of producing additional evidence of anti-competitive

effect shifts to the government, and merges with the ***ultimate burden of persuasion, which remains with the government at all times***." *Id.* at 983.

There are multiple reasons the acquisitions are not anti-competitive. *First*, entry is timely, likely and sufficient in the markets at issue, and it is well recognized that effective entry addresses any competitive issues from an acquisition. *Second*, there are substantial merger-specific efficiencies from the transactions and these efficiencies outweigh any alleged anti-competitive effects of the transactions. *Third*, CSA and UAI were flailing firms and any assessment of future competitive conditions must take into account CSA's and UAI's steadily shrinking and already de minimus competitive presences. *Fourth*, Complaint Counsel has alleged anti-competitive effects that either do not reflect a substantial lessening of competition or have no obvious connection to the acquisitions. *Fifth*, with respect to the alternative "advanced linear structural FEA solver" market, Complaint Counsel lacks a coherent theory of unilateral effects that adds nothing to the case and its allegations that the acquisitions facilitated coordinated interaction are spurious.

A. ENTRY OR EXPANSION BY COMPETITORS WOULD BE TIMELY, LIKELY AND SUFFICIENT TO REPLACE THE WANING NICHE PRESENCE OF CSA NASTRAN AND UAI NASTRAN

It is well-recognized that ease of entry by potential competitors can significantly undercut an existing firm's market power. For example, in *Baker Hughes*, the court of appeals noted that "[i]n the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time," 908 F.2d at 987, and thus it dismissed the government's challenge to a merger despite high market concentration numbers.[53] It also has long been recognized that the

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[53] *See also United States v. Syufy Enters.*, 903 F.2d 659, 664 n.6 (9th Cir. 1990) ("[W]here entry (continued...)

presence on the fringe of the market even of potential entrants can have significant disciplining effects on firms already in the market, causing them to desist from anti-competitive behavior for fear of encouraging actual entry. *See, e.g., United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 532-33 (1973) (potential for entry can cause existing competitors to maintain competitive prices).

1. The Proper Standard to Assess Effective Entry Should Be Based on the Competitive Significance of CSA and UAI Immediately Prior to the Acquisitions

In assessing the sufficiency of entry in circumstances such as this case, the relevant inquiry is whether entry could replace the waning and niche competitive presence of CSA Nastran or UAI Nastran. In other words, an entrant need not replicate MSC.Nastran to be effective; rather, entry can be effective if an entrant offers comparable competitive pressure to CSA Nastran or UAI Nastran or fills whatever niche role in terms of customer choice was played by the two companies. Complaint Counsel's economic experts, Dr. Hilke and Dr. Spiller, agree that this is the appropriate standard to assess entry; indeed, Dr. Spiller indicated entry could be effective even if it resulted in less competitive pressure than what CSA Nastran or UAI Nastran presented. *See* J. Hilke Dep. Tr. at 528:21-529:5; P. Spiller Dep. Tr. at 318-319.

By this standard, entry or expansion would need to take place only at a de minimus scale to replace CSA Nastran and UAI Nastran. The two companies were flailing firms that would have been unable to sustain even their mininal competitive impact under their existing business strategies. MSC FOF ¶¶ 73-130. UAI Nastran specifically played a niche role of providing

[53] (...continued)
barriers are low, market share does not accurately reflect the party's market power") and *United States v. Waste Mgmt. Inc.*, 743 F.2d 976, 981-84 (2d Cir. 1984) (permitting merger, despite post-merger market share of 48.8%, because of low barriers to entry).

customized software; existing companies such as CDH, NE Nastran, Vanderplaats and others can and do offer comparable or better services for customers. MSC FOF ¶¶ 131-354. CSA Nastran offered a low price, low quality "clone" product with some features of interest to specific customers targeted by CSA;

Dr. Hilke and Dr. Spiller nonetheless assert that entry would be neither timely nor likely in Complaint Counsel's proposed product markets. J. Hilke Supp. Expert Report ¶¶ 190-217; P. Spiller Expert Report ¶¶ 37-43. There is little "evidence" for these claims.

In short, entry – in response to any effort by MSC to raise prices supracompetitively – would be timely, likely and sufficient in any market alleged by Complaint Counsel and would address any competitive issues arguably raised by the acquisitions of CSA and UAI (which respectively had sales in the "advanced Nastran" market in 1999). MSC FOF ¶1.

2. Large, Sophisticated Buyers Can Facilitate Expansion and Entry and Effectively Constrain Any Theoretical Ability MSC Might Have to Exercise Market Power

It is well recognized that the presence of strong and sophisticated buyers can have significant effects on the ability of a seller with even a large market share to charge supra-competitive prices. These so-called "power buyers" have a number of alternatives that severely constrain the pricing discretion of the seller. *See United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669, 679-80 (D. Minn. 1990) (presence of power buyers, who in face of SSNIP either would invite bids from other suppliers on fringes of market or might integrate vertically, rebutted presumption of anti-competitive effect based on high HHIs); *FTC v. Cardinal Health, Inc.*, 12 F. Supp.2d 34, 58-61 (D.D.C. 1998) (noting that presence of power buyers, including some that sponsored entry into market by defendants' rivals, while not fully rebutting government's prima facie case for purposes of a § 13(b) proceeding, was evidence that partially undermined defendants' post-merger market power).[54]

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[54] *See also FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999) ("[T]he evidence shows that large, sophisticated third-party buyers can do [sic] resist price increases, especially where consolidation results in cost savings to the merging entities."); *Baker Hughes*, 908 F.2d at 986 (district court's consideration of sophistication of consumers "was not only appropriate, but imperative") (quotations & citations omitted); *United States v. Archer-Daniels-Midland Co.*, 781 F. Supp. 1400, 1416 (S.D. Iowa 1991) ("The existence of large, powerful buyers of a product mitigates against the ability of sellers to raise prices.").

MSC's customers include classic "power buyers." MSC's annual revenues (of approximately $250 million) are dwarfed by the revenues of its customers, which include huge, sophisticated engineering knowledgeable companies like Boeing, Lockheed Martin, Honeywell, Caterpillar, General Motors, Ford and DaimlerChrysler. If MSC had attempted to charge supra-competitive prices, either before or after the challenged acquisitions, these customers had numerous alternatives that they could pursue. Indeed, the continuing evolution towards a "total solution" strategy in the industry means that these large buyers will have even more leverage over smaller companies like MSC. MSC is competing not only to sell FEA solvers, but a variety of other products as well. The large buyers can, and have, made threats to MSC to reduce purchases of ***other*** MSC products if they do not obtain favorable prices on FEA solvers or on the entire "package" of products that MSC seeks to sell to them.[55]

B. THE CSA AND UAI ACQUISITIONS HAVE LED TO SIGNIFICANT MERGER-SPECIFIC EFFICIENCIES

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Recent case law, and the Commission's own *Guidelines*,[56] recognize that assessing efficiencies is a proper part of the overall competitive effects calculus. As the Eighth Circuit has put it: "[A]lthough Tenet's efficiencies defense may have been properly rejected by the district court, the district court should nonetheless have considered evidence of enhanced efficiency in the context of the competitive effects of the merger." *Tenet Health Care Corp.*, 186 F.3d at 1054; *cf. FTC v. H.J. Heinz Co.*, 246 F.3d 708, 720 (D.C. Cir. 2001) (noting that "trend among lower courts is to recognize the [efficiencies] defense").[57]

Here, MSC will show that the mergers were pro-competitive, as they allowed MSC to use UAI's and CSA's technical and human resources to develop higher quality products and new products that would not have been possible absent the acquisitions. There are two types of merger-specific efficiencies related to enhancements in quality: (1) MSC was able to add features to its MSC.Nastran, MARC, Dytran and other products at a faster pace than what would have been possible absent the acquisitions and (2) MSC, by adding some limited CSA and UAI features to its MSC.Nastran product, was able to provide the combined features of all three products in one product

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[56] *Guidelines*, § 4.

[57] A recent Report by the Commission Staff recognizes that consideration of efficiencies is particularly appropriate in high-tech industry mergers.

> [W]hen firms resort increasingly to mergers ... to cut costs and to compete in today's global, innovation-based markets, antitrust must take special care to weed out actions that harm competition while not discouraging others that are procompetitive. For mergers, this means antitrust must give more attention to efficiencies claims than it may have previously done.

Report by the Federal Trade Commission Staff, *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace*, at 35 (May 1996).

– a clear benefit to customers. MSC also was able to achieve costs savings from eliminating overlapping overhead expenses. *See* MSC FOF ¶¶ 368-371.

Complaint Counsel suggests that the efficiencies are not merger-specific because the efficiencies hinge on the acquisition of programmers and that MSC did not need to acquire CSA and UAI to obtain programmers. CC Br. at 33. But integrated teams of trained programmers experienced in FEA issues for the aerospace and automotive industries (particularly in the midst of the Internet boom in 1999) were not easy to find.

MSC has estimated that training a programmer is costly and takes a long time – about $1 million per programmer on a present value basis. MSC FOF ¶ 371.

MSC was able to integrate the UAI and CSA "teams" into its operation to develop improved versions of MSC's programs and as part of MSC's drive to offer "total solutions" to meet its customers' evolving needs. That would not have been possible through piecemeal hirings of random programmers. MSC could not have achieved these benefits, either for its customers or itself, in ways other than through these acquisitions.[58]

It is worth noting that the *Guidelines*' concern with recognizing efficiencies stems, in part, from the fact that almost all mergers are reviewed ***before*** consummation and that there are concerns that efficiencies claims may be speculative. *See Guidelines*, § 4. Here, however, the

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[58] The *Guidelines* do not impose the strict test suggested by Complaint Counsel, as they only exclude efficiencies "unlikely to be accomplished" in the absence of the acquisitions and forbid Complaint Counsel from (as it has done) putting forth alternative theories of how they can be achieved that are in fact not "practical in the business situation." § 4.0. Indeed, Chairman Muris has written that once efficiencies are proven to be reasonably likely (as they have been here), "the government should be forced to demonstrate that such efficiencies would likely be achieved in a similar time frame and at a similar cost absent the merger." Timothy J. Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, 7 Geo. Mason L. Rev. 729, 732-33 (1999).

evidence can be reviewed based on almost ***three years of experience*** and the evidence will show that the efficiencies are real. Indeed, Complaint Counsel faces a Hobson's choice – on the facts. In order to argue for its punitive relief, Complaint Counsel will talk about all the improvements made to MSC.Nastran since the acquisitions. But these very same facts make it clear that the effects of the acquisitions have been procompetitive.

C. A PROPER MERGER REVIEW MUST TAKE ACCOUNT OF CSA'S AND UAI'S RAPIDLY ERODING VIABILITY

Any assessment of the competitive effects of the UAI and CSA acquisitions must take into account the limited role the two firms played in the marketplace and their increasingly troubled financial and business prospects at the time of the acquisitions. Under Complaint Counsel's own account, UAI and CSA were de minimus players in the years prior to their acquisitions, each with a declining market share of less than 4 percent of Complaint Counsel's already narrowly defined "advanced Nastran" market. CSA and UAI offered only episodic competition to MSC prior to the acquisitions. Furthermore, the two companies were atrophying technologically given the onslaught of demand for more integrated product offerings on multiple platforms. There is no likelihood that they could have sustained their even limited historic competitive presence in the dynamically changing marketplace for MCAE products, a fact both companies' CEOs recognized. MSC FOF ¶¶ 73-130.

Complaint Counsel has never reconciled the many conflicting facts it claims about competition between MSC, CSA and UAI. Complaint Counsel acknowledges that CSA and UAI had very low market shares and also argues that CSA and UAI were undercutting MSC on prices. *See, e.g.,* CC FOF, ¶¶ 67, 69, 83. If CSA and UAI were undercutting MSC on prices and yet had

very low shares, that suggests there must have been a ***substantial difference in quality*** between MSC.Nastran and CSA or UAI Nastran. This substantial difference in quality, in turn, is inconsistent with Complaint Counsel's belief that UAI Nastran and CSA Nastran were MSC's "closest substitutes" and that the products were sufficiently close in quality to define their own market.

The reality is that neither UAI nor CSA offered the full range of products and services necessary to meet customer demand; in fact, in contrast to MSC and several other solver companies, UAI and CSA provided very little technical support and customer service to their customers. In an environment moving increasingly to a "total solution" approach, these deficiencies were becoming increasingly more terminal from a competitive perspective. Because of their limited revenues and assets, they were unable to adapt to the competitive environment, and customers were increasingly reluctant to rely on UAI and CSA for their long-term needs. MSC FOF ¶¶ 86-94; 119-130.

As struggling firms, UAI and CSA occupied positions similar to the acquired company, Reserve Coal, in *United States v. Gen. Dynamics Corp.,* 415 U.S. 486, 506-08 (1974). There, the Supreme Court held that the district court properly concluded that because of the acquired firm's depleted and committed coal resources, it was not likely to be an effective post-merger competitor, and therefore the merger was unlikely to have a substantial adverse effect on competition. As here, in *General Dynamics* the government had argued that the acquired company was "healthy," and that the defendant had not shown that it was the only available acquiring company. The Court acknowledged that these two requirements would have been important if the defendant were invoking the "failing company doctrine." But, the Court recognized that the

defendant was instead arguing (as does MSC) that the acquired firm's post-merger weakness "went to the heart of the Government's statistical prima facie case." *Id.* at 508.[59]

Here too, the reality of the bleak economic future facing UAI and CSA is significant, because it also overcomes any presumption that arguably arises from the supposed increase in market share and concentration as a result of these acquisitions. *See also Brown Shoe Co. v. United States*, 370 U.S. 294, 346 (1962) (identifying, as a "mitigating factor[ ]" in a merger challenge, "the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position"); *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 275-76 (7th Cir. 1981) (acquired firm's deteriorating market position and management difficulties prior to acquisition rebutted prima facie case); *United States v. Int'l Harvester Co.*, 564 F.2d 769, 774 (7th Cir. 1977) (finding that "even if [the acquired company] remained in the market, it did not have sufficient resources to compete effectively," thus rebutting the government's prima facie case).

D. COMPLAINT COUNSEL'S ALLEGATIONS OF POST-ACQUISITION ANTI-COMPETITIVE EFFECTS CANNOT WITHSTAND SCRUTINY

Complaint Counsel has outlined a laundry list of ways in which it believes MSC has exercised market power gained through the acquisitions. This list is a perfect example of the vagueness and ad hoc nature of Complaint Counsel's arguments in this matter.[60]

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[59] The Supreme Court therefore held that "[t]he failing-company defense is simply inapposite to this finding and the failure of the [defendants] to meet the prerequisites of that doctrine did ***not*** detract from the validity of the [district] court's analysis." *Id.*

[60] *See* Complaint Counsel's Second Revised Resps. and Objections to Respondent MSC.Software Corporation's First Set of Interrogs., at 68-69.

It is striking that, while Complaint Counsel has not been shy about alleging that MSC has exercised market power after the acquisitions, it has not come forward with any study or empirical analysis showing MSC's prices have in fact risen after the acquisitions. In his report, Dr. Hilke does put forward various anecdotal stories of customers supposedly paying higher prices after the acquisitions. But, as will be shown at trial, when each of these stories are analyzed in detail, the evidence shows that there was no post-acquisition price increase, but rather the customer decided to buy more MSC.Nastran, changed its product mix, changed the type of contract, or some other circumstance arose ***unrelated*** to the acquisitions.

Complaint Counsel also points to changes in some list prices as evidence of post-acquisition price increases. One change (increasing the maintenance rate) was implemented ***before*** the acquisitions. Another change (a 4% list price increase) was also decided upon ***before*** the acquisitions. All of these list price changes were made applicable to both "advanced Nastran" prices ***and the other products sold by MSC.*** It is odd that Complaint Counsel believes that a list price increase that applies equally to products outside the relevant market reflects market power obtained because of the acquisitions. (In fact, MSC had not raised list prices in years and Mr. Perna decided upon taking control that MSC should obtain some adjustment for years of cost of living increases.)

It also is odd that Complaint Counsel believes ***list*** price changes are significant when it is arguing that licenses are based on individually negotiated prices that deviate from list prices. CC FOF ¶ 395. Even Complaint Counsel's expert, Dr. Spiller, agrees that Complaint Counsel cannot say that prices increased based on changes in list prices and that it would have to "look at the transaction prices." P. Spiller Dep. Tr. at 312:4-9.

Complaint Counsel also alleges that MSC has eliminated paid-up pricing and unlimited use licenses because of the acquisitions. Neither claim is true as MSC still offers annual lease pricing and unlimited use contracts.

There is no connection between the change to a paid-up model and the acquisitions and, indeed, paid-up pricing is much more the norm in the software industry than MSC's prior pricing model. In fact, customers have been offered very attractive packages to switch to paid-up pricing and, if anything, a paid-up pricing model will enhance competition, as MSC will now have to compete with its installed base, meaning it will have a greater incentive to innovate. J. Kearl Dep. Tr. at 216:9-217:4 (discussing how "one of the characteristics of paid up contracts is that you have an installed base that competes against new product[s]").

With respect to unlimited use licenses, numerous prominent customers such

continue to have unlimited use licenses. MSC, in general, prices its software based on a customer's usage. With an unlimited use license, the pricing is a reflection of the parties' expectations of the likely use under the contract. Often, past usage is a proxy for future usage, but in individual situations it has turned out to be a poor predictor. In these cases, MSC has grown frustrated with the uncertainties involved in unlimited use pricing. MSC has in certain situations, therefore, required a customer to pay a higher price to reflect this uncertainty or switch to a different pricing model. Complaint Counsel, in essence, has taken these situations and declared that MSC has adopted a policy of eliminating unlimited use licenses. Not only is that not true, but

any issues surrounding the complex nature of pricing under unlimited use licenses has no connection with the acquisitions.

Complaint Counsel also suggests the acquisitions have harmed competition by reducing customer choice, specifically eliminating the choice of CSA Nastran and UAI Nastran for customers that preferred those products. Assuming for the moment that some customers did prefer the particular combination of lower price and lower quality offered by CSA Nastran's and UAI Nastran's solvers (and that those firms would have maintained their historic business strategy), the issue is whether eliminating this choice substantially harms competition.

Any such supposed loss of choice – for a handful of customers – would have to be weighed against the improvements in overall quality of MSC Nastran for the ***vast majority*** of customers that occurred because of the acquisitions. Notably, Complaint Counsel's expert, Dr. Spiller, specifically acknowledges this point. P. Spiller Dep. Tr. at 315:17-316:5 (agreeing that any "competitive effect on a subset" would have to be contrasted to the "efficiency gain throughout"). Moreover, the type of niche role played by CSA Nastran and UAI Nastran is precisely the type of market presence that can be replaced by entry and repositioning by current players, as the examples

MSC FOF ¶¶ 185-195; 253-289; 308-312. Complaint Counsel has not met its burden of showing that this type of minimal loss of customer choice constitutes a "substantial lessening of competition" under the statute.

Finally, Complaint Counsel argues that the acquisitions will have adverse effects on new feature innovation. CC FOF ¶¶ 401-407. Complaint Counsel, however, has presented no evidence that such an "innovation market" could be comprised solely of MSC, CSA and UAI. UAI generally (and CSA specifically at Ford) did offer to create new features and customize Nastran for

customers seeking a particular feature or features. MSC FOF ¶¶ 108-118. But a vast number of other firms compete in offering to provide new features for customers.

Any such "innovation market" would have to include competition from all the major non-Nastran solvers, which will all offer to add customized features to suit the needs of a particular customer or customers. For example, Permas has recently been adding durability analysis features tailored to suit the needs of automotive customers. MSC FOF ¶¶ 253-260. This competition would also include third party vendors

This competition would also include a customer's decision to create a particular customized feature itself, either by creating its own in-house code or using a program such as DMAP (that comes with MSC.Nastran) or ADPL (ANSYS's programming language) to write its own particular customized solver applications.

In short, in terms of competion to offer innovative customized solutions for customers, CSA, UAI and MSC competed with a wide variety of other firms. None of Complaint Counsel's rationales for creating an "advanced Nastran" market (*e.g.*, functionality differences or switching costs) can explain why an "innovation market" would solely be comprised of MSC, CSA and UAI.

E. COMPLAINT COUNSEL HAS NOT PROVEN ANY THEORY OF ANTI-COMPETITIVE EFFECTS IN THE BROADER ALTERNATIVE "ADVANCED LINEAR STRUCTURAL FEA SOLVER" MARKET

The Complaint argues that the acquisitions "substantially increased" concentration in the broader alternative product market for "advanced linear structural FEA solvers." Complaint, ¶ 26. Dr. Hilke estimates that the HHI in this market will increase from 4413 to 4747 because of the

acquisitions. J. Hilke Supp. Expert Report, ¶ 186. As noted earlier, however, tabulating HHIs is only the first step of the analysis. Indeed, as the D.C. Circuit states in *Baker Hughes,* a court cannot simply rely on a "tyranny of the numbers" approach to dispose of merger challenges:

> The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. ***The Herfindahl-Hirschman Index cannot guarantee litigation victories***.

United States v. Baker Hughes, Inc., 908 F.2d. 981, 992 (D.C. Cir. 1990). Other courts have expressed a similar skepticism of relying simply on HHI statistics.[61] Indeed, additional evidence often will demonstrate – as is true here – that the requisite injury to competition is absent even in the face of allegedly high numbers.

As just discussed above, there are a variety of factors – *e.g.,* entry, efficiencies, UAI's and CSA's troubled financial situation – that rebut any presumption from HHIs that the acquisitions would be anti-competitive in Complaint Counsel's broader alternative market. Beyond these factors, Complaint Counsel lacks a coherent theory of anti-competitive effects in its broader alternative market.

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[61] *See, e.g., Gen. Dynamics,* 415 U.S. at 498 ("caution[ing] that statistics concerning market share and concentration, while of great significance, were not conclusive indicators of anti-competitive effects"); *Brown Shoe,* 370 U.S. at 322 n.38 ("Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market – its structure, history and probable future – can provide the appropriate setting for judging the probable anti-competitive effect of the merger.").

1. There is No Plausible Theory of Unilateral Effects That Adds Anything to Complaint Counsel's Theory in the Advanced Nastran Market

Courts and the *Guidelines* apply unilateral effects theories only where the products of the merging parties are the "first and second choices" of a significant number of consumers. *See Guidelines*, § 2.21;[62] *see also State of N.Y. v. Kraft Gen. Foods,* 926 F. Supp. 321, 365 (S.D.N.Y. 1995) (citing § 2.21 and rejecting argument that the merging parties' products were "first and second choices" for a "significant" number of purchasers). Complaint Counsel's "advanced Nastran" market is premised on CSA Nastran and UAI Nastran being the closest substitutes for MSC Nastran. If there is no "advanced Nastran" market, CSA Nastran and UAI Nastran would not be the "second choice" for a "significant" number of purchasers. In short, if there is no "advanced Nastran" market, a unilateral effects theory in a broader alternative market will add nothing to Complaint Counsel's case.

2. Complaint Counsel's Claims That the Acquisitions Enhanced the Possibility of Coordinated Interaction Are Spurious

With respect to coordinated interaction, Complaint Counsel has offered no coherent theory why the challenged transactions led to any ***change*** in the market that would have had ***any*** effect on ***enhancing*** market participants' ability to coordinate pricing behavior in a post-merger environment. Indeed, Dr. Hilke acknowledged at his deposition that he was simply relying on the reduction of the number of competitors and had not done any other analysis of these issues.[63]

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[62] The Guidelines state: "Substantial unilateral price elevation in a market for differentiated products requires that there be a significant share of sales in the market accounted for by customers who regard the products of the merging firms as their first and second choices." *Guidelines*, § 2.21.

[63] J. Hilke Dep. Tr. at 557:8-558:25. Dr. Hilke does state MSC's alliance relationship with (continued...)

This type of reliance on rote counting of the number and size of competitors is just the type of numerology rejected in the case law. "To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7." *Baker Hughes,* 908 F.2d at 992. Indeed, the law requires a more thorough analysis. As the Supreme Court has stated: "[O]nly a further examination of the particular market – its structure, history and probable future – can provide the appropriate setting for judging the probable anti-competitive effects of the merger." *Gen. Dynamics*, 415 U.S. at 498 (citation omitted).

Here, the *Guidelines* themselves and the case law identify a number of factors to be considered in determining whether the "structure, history and probable future" of the post-merger market conditions are more conducive to coordinated interaction. It is well recognized, for example, that coordination is difficult with differentiated products. The Commission, for example, has recognized that homogeneity makes tacit collusion easier and product heterogeneity makes it more difficult to coordinate. *See Guidelines*, § 2.11 ("[R]eaching terms of coordination may be limited or impeded by product heterogeneity. . ."). Here, it is not disputed that FEA solvers are differentiated products. *See* Complaint, ¶ 13 ("FEA solvers are differentiated software products with varying features and capabilities.").

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[63] (...continued)
Dassault was a factor in his thinking, *id.*, but the MSC-Dassault relationship is not connected to the CSA and UAI acquisitions and thus cannot account for a ***change*** in the ability to achieve coordinated interaction ***because of*** the acquisitions. Dr. Spiller, Complaint Counsel's other economic expert, is not offering any testimony on coordinated interaction. P. Spiller Dep. Tr. at 10:11-14.

It is also well recognized that coordination is difficult without transparency in pricing, *i.e.*, an ability to view competitor pricing to ensure competitors are not deviating from any tacit collusion. The Commission, for example, recognizes that availability of competitor pricing information can be crucial to ensuring the viability of tacit collusion. *See Guidelines* § 2.12 ("[I]f key information about specific transactions or individual price or output levels is available routinely to competitors, it may be difficult for a firm to deviate secretly."). Here, it is clear that there is little price transparency. Prices are set with private bidding based on discounts off of list prices. Only sketchy information is available about rivals' bids to MSC and its competitors. In this setting, it would be very difficult to monitor and punish deviations by competitors from any hypothetical tacit coordination.

Similarly, the Commission and court precedent recognize that coordinated interaction is difficult in the face of power buyers, as the existence of large volume contracts creates an incentive to deviate from any tacit collusion scheme. This view is reflected in the *Guidelines*. *See Guidelines,* § 2.12 ("Where large buyers likely would engage in long term contracting, so that the sales covered by such contracts can be large relative to the total output of a firm in the market, firms may have the incentive to deviate," and therefore collusion is unlikely). The case law also recognizes the importance of large buyers: "The concentration of the buying side of a market does inhibit collusion." *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1391 (7th Cir. 1986).[64] Here,

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[64] *See also Baker Hughes*, 908 F.2d at 986 (buyers who "closely examine available options and typically insist on receiving multiple, confidential bids" show a "sophistication ... likely to promote competition even in a highly concentrated market"); *United States v. Archer-Daniels-Midland Co.*, 781 F. Supp. 1400, 1416 (S.D. Iowa 1991) ("[T]he existence of large, powerful buyers of a product mitigates against the ability of sellers to raise prices"); *FTC v. R.R. Donnelly & Sons Co.*, 1990-2 (continued...)

MSC's customers are primarily large, sophisticated power buyers in the aerospace and automotive industries, like Boeing, Honeywell, Lockheed, General Motors, Ford, and Chrysler, all of whom exercise significant, continuing leverage over MSC.

In sum, a whole host of factors point to the difficulty of coordinated interaction in the "advanced linear structural FEA solver" market. Complaint Counsel has not provided any analysis how the acquisition makes coordinated interaction more likely in light of these factors. Indeed, as already noted, Dr. Hilke acknowledges he is simply relying on a simple count of competitors and HHI statistics and that he has not undertaken a serious analysis of these issues. That is not enough.

IV. COMPLAINT COUNSEL'S CASE RESTS ON THE LEGALLY IRRELEVANT CLAIM THAT THE ACQUISITIONS WERE INTENDED TO PREVENT OTHER COMPANIES FROM ACQUIRING CSA AND UAI

Complaint Counsel alleges the acquisitions of UAI and CSA violated Clayton Act § 7 and FTC Act § 5 by "preventing other suppliers of engineering software from acquiring UAI and CSA and increasing competition." Complaint, ¶ 29c; *see also* CC Br. at 26. In essence, the argument is that the acquisitions are unlawful because, in their absence, some other company might have acquired CSA and UAI and, arguably, such alternative acquisitions would have enhanced competition. This argument suggests a standard for assessing acquisitions under Clayton Act § 7 that is contrary to precedent, contrary to the statute and completely illogical.

In effect, under Complaint Counsel's approach, any acquisition is illegal if there is an alternative buyer of the assets that might have increased competition. As a practical matter, this

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[64] (...continued)
Trade Cas. (CCH) ¶ 69,239, at 64,855 (D.D.C. 1990) ("Well-established precedent and the United States Department of Justice Merger Guidelines recognize that the sophistication and bargaining power of buyers play a significant role in assessing the effects of a proposed transaction.").

approach to mergers would impose great burdens on courts, by requiring them to determine whether there was some other prospective purchaser whose acquisition of the target company would have less anti-competitive, or more pro-competitive, results on the market.

This requirement is also illogical, since it is highly likely that after those searches, the court could find ***some*** other company that satisfied that standard. The court's inquiry would effectively turn into a search for the single, "best" company to make the acquisition. The natural consequence of Complaint Counsel's approach is that the vast majority of mergers would turn out to be unlawful – including those that were pro-competitive or merely benign.

Complaint Counsel's approach also is inconsistent with the language of the Clayton Act, which asks whether there is a reasonable probability of a "substantial ***lessening*** of competition," and ***not*** whether the acquisition forecloses the possibility of an ***increase*** in competition. Therefore, it is hardly surprising that there is ***absolutely no precedent*** for Complaint Counsel's approach. MSC's evidence demonstrates that these acquisitions were not anti-competitive, and indeed had various pro-competitive effects. That is all that is necessary to show that these acquisitions were lawful. There is simply no basis for inquiring whether some hypothetical acquisition might have been more pro-competitive.[65]

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[65] As noted above, MSC is ***not*** seeking to invoke the "failing company doctrine," under which MSC would have the burden of satisfying the standard of *United States v. Greater Buffalo Press, Inc.,* 402 U.S. 549, 555-56 (1971) and *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 136-39 (1969). Those cases would require an inquiry into the existence of alternative purchasers for the acquired firms. By contrast, inquiries as to "alternative purchasers" are inapplicable when the issue is merely the competitive effect of the acquisition. *See United States v. Int'l Harvester Co.*, 564 F2d 769, 779 (7th Cir. 1977) (rejecting contention that, after defendant rebutted government's prima facie case by showing, inter alia, acquired company's weakened financial condition, defendant must show that it "was the only available acquiring company")(citation omitted).

Finally, Complaint Counsel's premise for its argument is factually groundless. There is no basis for assuming that other companies were on the verge of acquiring CSA or UAI. In the years preceding MSC's acquisition of those two firms, several of its competitors ***considered*** acquiring one or the other of these flailing firms, but they ***rejected*** those acquisitions as financially and technologically undesirable. MSC FOF ¶¶ 101-106. Complaint Counsel can point to no white knight "waiting in the wings" to save CSA or UAI as independent competitors.

V. COMPLAINT COUNSEL RELIES GREATLY ON CERTAIN COMPETITOR AND CUSTOMER TESTIMONY THAT SHOULD BE GIVEN LITTLE WEIGHT

The courts (and the Commission) are rightly skeptical of competitor testimony opposing a merger. Although not a formal "party" to this proceeding, MSC's number one competitor, ANSYS, has been working closely with Complaint Counsel to help it win the case and impose a draconian remedy, thereby effectively raising its rival's costs. MSC FOF ¶¶ 177-184. ANSYS' active participation in this case on behalf of Complaint Counsel leads to a strong inference that the acquisitions are, in fact, pro-competitive. *See* Fullerton, *How Can I Stop That Merger? The Role of Third Parties in Agency Merger Reviews*, Antitrust 37 (Spring 1995) (noting that competitor's complaints often indicate that merger will lead to increased competition and lower prices, and suggesting that this is evidence that merger should be approved). Indeed, in *Hospital Corp. of Am. v. FTC*, a case in which the Commission prevailed, Judge Posner noted that the "most telling point" for the defendants was that the "complaint came from a competitor." 807 F.2d 1381, 1391-92 (7th Cir. 1986).

It is for precisely this reason that the Supreme Court has held twice, first in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977) and again in *Cargill, Inc. v. Monfort of*

Colorado, Inc., 479 U.S. 104 (1986), that a company does ***not*** have antitrust standing to challenge a merger undertaken by one or two of its competitors. In those cases, the Court recognized that the plaintiffs' real grievance was that the mergers would result in ***enhanced*** competition. Therefore, it held that the antitrust laws cannot be invoked by a plaintiff seeking to be shielded from competition.[66] But while ANSYS would not have standing to challenge the CSA and UAI acquisitions, it has been able to use Complaint Counsel to do its bidding.

Unlike competitor testimony, customer testimony does not typically raise the same concerns. But it is possible for customers to use the litigation process to their own advantage. It is no secret that sellers and buyers of any product or service are in an adversarial relationship, respectively seeking the highest and lowest price for that product or service that will be the result of a negotiation between the parties.

Testimony from such customers opposing the acquisitions should be given little weight.

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[66] Indeed, the Commission recognized these same concerns. Filing a joint brief in *Cargill* as amicus curiae with the Department of Justice, the Commission stated: "Competitors' challenges to acquisitions should be viewed with great skepticism.... [C]ompetitors have a substantial incentive to challenge acquisitions that will make their rivals more efficient, make their industry more competitive, and reduce the prices they can charge their customers." Joint Brief Supporting Petitioners, at 10.

VI. EVIDENCE FROM THE TIME PERIOD SUBSEQUENT TO THE CHALLENGED ACQUISITIONS, SHOWING THAT THE ASSERTED ANTI-COMPETITIVE EFFECTS DID NOT IN FACT OCCUR, IS BOTH ADMISSIBLE AND PROBATIVE

Complaint Counsel's expert, Dr. Hilke, simultaneously asserts that the ***absence*** of any evidence of actual anti-competitive effect should be ignored (arguing that permitting the introduction of such evidence allegedly would give the acquiring firm the incentive to "hide or postpone" its anti-competitive behavior), while at the same time asserting that ***affirmative*** evidence of anti-competitive effects can be used to "reinforce" any pre-acquisition evidence of the substantial likelihood of reduced competition. J. Hilke Supp. Expert Report ¶ 30. Dr. Hilke's "heads we win, tails you lose" approach to the use of post-acquisition evidence is inappropriate both legally and factually.

As a matter of law, courts have frequently approved the defendants' proffer of post-merger evidence to show that the acquisitions did not in fact adversely affect competition. *See, e.g.*, *Gen. Dynamics*, 415 U.S. at 504 & n.13 ("[P]ostacquisition evidence tending to diminish the probability or impact of anti-competitive effects might be considered in a § 7 case") (citing *FTC v. Consol. Foods Corp.*, 380 U.S. 592, 598 (1965)); *Lektro-Vend Corp. v. Vendo Corp.*, 660 F.2d 255, 276 (7th Cir. 1981) ("Post-acquisition evidence is admissible since the probability of anti-competitive effects is ***judged at the time of trial***.");[67] *Int'l Harvester Co.*, 564 F.2d at 778, 780 (noting testimony at trial about "intensification in competition since [challenged] acquisition," and concluding that

[67] "[P]ost-acquisition evidence favorable to a defendant can be an ***important indicator*** of the probability of anti-competitive effects where the evidence is such that it could not reflect deliberate manipulation by the merged companies temporarily to avoid anti-competitive activity, and could not reasonably be construed as representing less active market competition than would otherwise have occurred without the questioned acquisition." *Id.* at 276.

district court "did not overemphasize post-acquisition evidence"); *United States v. Falstaff Brewing Corp.*, 383 F. Supp. 1020, 1025 (D.R.I. 1974) ("It is well settled that post acquisition evidence in a case such as this may properly be considered in determining whether the probable effect of said merger will be a substantial lessening of competition. . . ").[68]

Significantly, in *R.R. Donnelley*, the most recent Commission challenge to a consummated merger, the Commission relied on post-merger evidence in rejecting Complaint Counsel's market definition. For example, in analyzing switching patterns, the Commission relied upon post-acquisition switching testimony by buyers. 120 F.T.C. at 172-74. In so doing, the Commission stated: "Current substitution provides the strongest evidence that marginal substitution is likely to occur in response to a supracompetitive price increase." *Id.* at 172. Indeed, in reaching its conclusion that unilateral effects were not possible, the Commission specifically referenced post-acquisition evidence:

> Following Donnelley's acquisition of Meredith/Burda, several customers have shifted substantial quantities of business from the merged firm to other gravure printers (as well as to offset printers); and many buyers have replaced one of the merging firms by qualifying other gravure printers to bid on and supply their high volume publication printing services. The merged firm's competitors have actively sought to expand their sales to high volume publication customers, with observable success. Under these circumstances,

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[68] Complaint Counsel relies on *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1383 (7th Cir. 1986) significantly for its claim that post-acquisition evidence should be disregarded. CC Br. at 27. But in that case, subsequent to the acquisition, the merging party acceded to the loss of control of one of the contracts it acquired. Judge Posner simply ruled that the court need not take into account such post-acquisition changes in the assets acquired in assessing the original transactions. Notably, immediately after a passage quoted by Complaint Counsel, Judge Posner states that the quote should be compared ("Cf.") to *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 276 (7th Cir. 1981), which is cited above, and involved the court ***accepting*** post-acquisition evidence.

> unilateral anti-competitive effects through the loss of localized competition are unlikely.

Id. at 199. Hence, Dr. Hilke's (and Complaint Counsel's) belief that MSC cannot use post-acquisition evidence has no basis in the law.

Complaint Counsel's whole premise for excluding MSC's proffer of post-acquisition evidence is that MSC somehow is acting strategically to hide evidence of its ability to exercise market power. At the same time, Complaint Counsel has identified a laundry list of post-acquisition acts that, according to Complaint Counsel, ***MSC has undertaken to exercise market power obtained from the acquisitions!*** Complaint Counsel cannot treat this case as a shell game, where it says over here that MSC is acting anti-competitively post-acquisition (and that evidence should count) and then says over there that post-acquisition evidence should be ignored because MSC is avoiding exercising its ability to undertake anti-competitive acts.

There also is no basis for Dr. Hilke's suggestion that MSC is trying to "game" the process. There is no evidence either that MSC forestalled making ordinary changes to its prices or otherwise "pulled its punches" subsequent to the challenged acquisitions. Nor has Complaint Counsel pointed to any directives from MSC's management to the firm's marketing and sales personnel that they should act differently in light of possible challenges to the acquisitions by the government.

Complaint Counsel also argues in its brief that post-acquisition evidence of competition from non-Nastran solvers should be ignored because it reflects a "cellophane fallacy." CC Br. at 21-22. Complaint Counsel's argument – again – is circular. Any possibility of a "cellophane trap" ***assumes*** MSC is a monopolist that has already fully exploited its monopoly power

by raising prices post-acquisition. This, of course, is precisely what Complaint Counsel is attempting (but has failed) to prove. In fact, Complaint Counsel has not proven the existence of any market that MSC monopolized and, as MSC will show at trial, prices have ***not*** risen post-acquisition at all – let alone supra-competitively.

Notably, Complaint Counsel's economic expert, Dr. Hilke, states that the aggregate demand for "advanced Nastran" solvers is relatively ***inelastic*** at today's prices and that MSC has ***not*** exploited the monopoly power (he alleges exists) to raise prices. J. Hilke Dep. Tr. at 175:3-25. Since, as Complaint Counsel's brief concedes, the "cellophane fallacy" only arises if an alleged monopolist has raised prices such that demand has become "highly elastic," CC Br. at 21, Dr. Hilke's belief that aggregate demand is ***inelastic*** at existing prices means that the "cellophane fallacy" is no bar to the examination of post-acquisition evidence of the competitiveness of non-Nastran solvers.

Complaint Counsel's motive for seeking to preclude post-acquisition evidence it does not like is obvious. Essentially, its entire case consists of snippets from MSC documents written ***prior to the acquisitions*** where various MSC employees (often speaking outside their area of expertise) opine on whether the acquisition ***might*** have certain effects.

It is almost invariably the case in any antitrust proceeding that defendants' files will produce "colorful" documents. The case law, however, makes it clear that "colorful" documents are no substitute for an exploration of actual effects. *See A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.,* 881 F.2d 1396, 1402 (7th Cir. 1989) (arguing that while "[l]awyers rummage through business records seeking to discover tidbits that will sound impressive," such evidence can be "misleading" and is no substitute for the "real economic questions" involved in antitrust litigation). As the

Supreme Court declared in *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993) (citation omitted): "[N]ot every act done with intent to produce an unlawful result constitutes an attempt.... [I]ntent is necessary, but alone not sufficient, to establish ... dangerous probability of success."

Although these acquisitions took place years ago, Complaint Counsel nonetheless would rather talk about a few pre-acquisition documents discussing what ***might happen***, than explore the ***actual effects*** of the acquisitions. Even though Complaint Counsel believes that MSC has acted to exploit market power it obtained because of the acquisitions, the post-acquisition record shows ***no*** increase in prices, ***no*** reduction in output, ***improved quality*** of MSC's products and ***increasing competitive pressure*** on MSC. It is therefore understandable that Complaint Counsel would prefer to talk about pre-acquisition document snippets rather than post-acquisition evidence of actual effects.

But section 7 of the Clayton Act makes unlawful only those acquisitions where there is a reasonable probability of an ***actual*** adverse effect on competition, *i.e.*, "substantially lessening competition." At best, Complaint Counsel's pre-acquisition document snippets are evidence of a ***possibility*** for harm. But what matters is ***not*** evidence of aspiration or intent, it is whether the acquisitions will "substantially lessen" actual competitive conditions, and this requires proof of the "reasonable probability" of the ***actuality*** of harm. And, where, as here, the merger is challenged nearly three years after its consummation, evidence of the defendant's pre-acquisition beliefs or intent is far less significant, because this Court now has substantial evidence that MSC neither raised its prices nor had the ability to raise prices.

This is a case where there is actual and probative evidence that adverse effects on competition ***did not*** occur. The trial will provide an opportunity to draw meaningful conclusions

from concrete facts, rather than having to speculate about future behavior, and MSC should not be prevented from doing so based on Complaint Counsel's (and its experts') shell game logic.

VII. THE REMEDIES PROPOSED BY COMPLAINT COUNSEL ARE EXCESSIVE, PUNITIVE AND UNAUTHORIZED BY STATUTE

Even if there were a finding that MSC's acquisitions of CSA and UAI were illegal – a conclusion that MSC obviously vigorously contests – the remedies that Complaint Counsel seeks are grossly excessive, punitive and unauthorized by statute. The Notice of Contemplated Relief in the Complaint seeks an "order to create and ***divest*** up to two viable on-going businesses each engaged in the licensing or sale of an advanced version of Nastran." Complaint, p. 8 (emphasis added). In essence, the Notice contemplates creating up to two more competitive independent entities offering MSC.Nastran, along with the transfer of intellectual property, employees, customer lists and various other assets. *Id.* The Notice also envisions rescinding existing contractual relationships such that the two new businesses along with MSC.Nastran would in essence compete as three equal firms in the marketplace.[69]

Although described as a ***divestiture***, this mandated sharing of MSC's "crown jewel," either with existing competitors or with one or two newly formed entities, would effectively result in nothing less than the ***dissolution*** or break-up of the core portion of MSC's business into three smaller entities. In contrast, true "divestiture" would mean the spin-off of the acquired entities, UAI and CSA, perhaps with some allied injunctive provisions to allow them to restore their prior status.

While dissolution ***may*** be an acceptable remedy for a violation of § 2 of the Sherman

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[69] In their expert reports, Dr. Spiller and Dr. Hilke couch this proposal in terms of licensing MSC.Nastran and related intellectual property to one or two licensees, but their remedy proposals essentially mirror the Notice.

Act outside the context of an acquisition – and, as discussed below, its use even in that setting is frequently rejected – the language of the statute itself, interpretive case law and consideration of relevant policies all make clear that dissolution, or its equivalent (here, the break-up of MSC's principal product line) is ***never*** an acceptable remedy for violation of § 7 of the Clayton Act. Professor Areeda's antitrust treatise highlights the inappropriateness of dissolution as a remedy in merger cases:

> [F]ederal antitrust has not commonly used dissolution [as opposed to divestiture] as a remedy in simple merger cases, ***and it would certainly be an excessive penalty for an unlawful acquisition and nothing more***. Rather, dissolution has generally been reserved for § 2 cases breaking large firms up into several component parts whose pieces do not reflect simple acquisitions that the firm had made in the recent past.

Areeda, Hovenkamp, Solow, Antitrust Law, vol. IVA, ¶ 990c2, at 103 (1998) (footnotes omitted).

The goal of all antitrust remedies, including for violations of Clayton § 7, is to deny the defendant the benefit of its alleged unlawful conduct. It is not to "pile on," or to use the occasion of the remedy to refashion the market situation in ways unrelated to the unlawful activity. Thus, if the acquisitions of UAI and CSA are found unlawful, then the remedy should "undo" the effects of those acquisitions – ***and no more***. Prior to these transactions, MSC already was the predominant solver in the "advanced Nastran" market; these two acquisitions at best could only be said to have marginally enhanced that position. Here, however, Complaint Counsel's proposed remedy would dramatically alter the market structure and create a far more competitive market than existed in 1999.[70]

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[70] The Complaint seeks a number of additional and ancillary forms of relief, including (continued...)

The statutory authority for the Commission to obtain relief, after making a determination that the merger or acquisition violates § 7, is found in § 11 of the Clayton Act. That statute provides that the Commission may issue an "order requiring [the respondent] to cease and desist from such violations, and ***divest*** itself of the stock, or other share capital, or assets, held ... contrary to the provisions of [§7]." 15 U.S.C. § 21(b).

An examination of this language reveals that although it specifically refers to ***divestiture***, it makes no mention of ***dissolution***. Indeed, when passage of the Clayton Act was being debated in 1914, an amendment was passed by the Senate, but was then rejected by the House, providing for dissolution as a remedy in the event that a merger were found unlawful.[71] It follows that the remedy sought here by Complaint Counsel is simply beyond the statutory scope of the Commission's power.

The Supreme Court has made it clear that the appropriate relief in a Clayton § 7 action, after a finding of a violation, is a remedy that will ***restore*** the market to the level of competition that prevailed before the challenged acquisitions and that presumably would have continued to prevail had those acquisitions not occurred. *See, e.g., Ford Motor Co. v. United States*, 405 U.S. 562, 573 n.8 (1972) ("[T]he relief must be directed to that which is 'necessary and appropriate in the public interest to ***eliminate the effects of the acquisition*** offensive to the statute'

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[70] (...continued)
facilitating the movement of MSC's employees to the newly-created entities, providing MSC's customer list and account information to those newly formed companies, and allowing the termination of contracts between MSC and its customers. These provisions reinforce the conclusion that the goal of the proposed remedy is not the "restoration" of the prior competitive situation, but the creation of a vastly different and ***far more competitive*** market than existed in 1999.

[71] *See* Areeda, Hovenkamp, Solow, Antitrust Law, vol. IVA, ¶ 990c2, at 104 & n.18 (1998).

... or which will 'cure the ill effects of the illegal conduct, and assure the public freedom from its continuance'")(citation omitted) and *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129, 138 (1967) (proper goal of decree was to establish a company in the "same or comparable competitive position" as it occupied prior to the illegal merger).

It is improper to use the remedy to ***punish*** the acquiring firm. *See United States v. E.I. du Pont & Co.*, 366 U.S. 316, 326 (1957) ("Courts are not authorized in civil proceedings to punish antitrust violators, and ***relief must not be punitive***."). Furthermore, the remedy is not designed to create a new, enhanced level of competition, going beyond what prevailed prior to the acquisition or which would have prevailed had it not occurred. *See id.* (noting the goal of courts must be the selection of a remedy that will "redress the violations" and "restore competition").[72]

Proposed remedies that go beyond these limits have been struck down. In *Reynolds Metal Co. v. FTC*, 309 F.2d 223 (D.C. Cir. 1962), the Commission had successfully challenged the acquisition by an aluminum manufacturer of Arrow, a small company which converted aluminum foil into decorative foil for the floral industry. Prior to the merger, Arrow had operated out of leased space; after the merger, Reynolds had constructed a new plant for its new subsidiary and purchased equipment to put into that facility. The Commission's proposed order would have required the divestiture not only of Arrow itself, but also of the new plant and related assets.

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[72] Although they seek far more drastic remedies, both of Complaint Counsel's experts recognize these limiting principles. *See* J. Hilke Supp. Expert Report ¶ 27 ("In fashioning a remedy, the objective should be to restore the competition lost due to the acquisitions."); R. Spiller Expert Report ¶ 5 ("As an economist, I see the purpose of merger remedies not as ways to punish anti-competitive behavior, or to compensate consumers for the monopoly overcharge, but as ways to restore lost competition in the most cost-effective possible way.") (footnotes omitted).

Asserting that the proper goal for relief was to restore competition by denying the defendant the benefits of the unlawful acquisition, the court of appeals rejected the Commission's sought-after remedy as excessive and over-broad. Recognizing that "[d]ivestiture is an extremely harsh remedy, " *id.* at 231, the court said that it "should be decreed as to property obtained by such an [after-the-merger] acquisition only when necessary to the ***restoration of the competitive situation altered by the acquisition***." *Id.*[73]

Complaint Counsel's proposed remedy, however, does not follow these well-understood principles. Under any view, the two acquired firms were insignificant, flailing companies, with depleted financial resources and with even more troubled prospects, each accounting for less than 4 percent of the alleged "market." Application of the accepted rule for § 7 remedies would result in a ***restoration***, or ***re-creation***, of ***that*** market situation (which might

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[73] The Commission itself has recognized that, in crafting the appropriate remedy, there are limits on divestiture. For example, in *In re Jim Walter Corp.*, 90 F.T.C. 671 (1977), the respondent, a leading manufacturer of building and construction materials, had acquired Philip Carey, a major manufacturer of asphalt and tar roofing products. As part of its challenge to the merger, Complaint Counsel sought not only divestiture of the target company, but also an order requiring divestiture to Philip Carey of a plant which was under construction by Jim Walter at the time of the acquisition. Although the Commission upheld the basic divestiture order as the most appropriate remedy after a finding of a § 7 violation, it rejected the latter proposed remedy as unnecessary, noting "that the appropriate remedy for a Section 7 violation is to 'restore competition to the state of health it might have enjoyed but for the acquisition,'" *id.* at 763, and concluding that there was "***no compelling basis***" for that additional step. *Id.* at 766.

Similarly, in *In re Ekco Prods. Co.*, 65 F.T.C. 1163 (1964), *aff'd and enforced,* 347 F.2d 745 (7th Cir. 1965), the Commission had also held the acquisition unlawful and ordered divestiture. Complaint Counsel sought divestiture of the acquired company's assets, not only in the industry causing anti-competitive effects, but also of the acquired assets in a related industry, "on the ground of [those two industries] intimate and historical relationship." *Id.* at 1227 n.2. Rejecting this expanded sought-for relief, the Commission concluded that it was not necessary to achieve "the overriding purpose" of enabling the acquired firm to be "restored as a going concern and effective competitor." *Id.*

include some ancillary remedies to assure that the successors to UAI and CSA have the same prospects for success they had in 1999). But, Complaint Counsel's proposed remedy results in the creation of two or three entities of the ***same*** market strength, in the "advanced Nastran" market, as MSC had pre-acquisition – an obviously far different, and far ***more competitive***, situation than prevailed in 1999.

Like Arrow in the *Reynolds Metal* case, UAI and CSA were also small and troubled firms. Just as the Seventh Circuit held that forced divestiture of after-acquisition enhancements was beyond the scope of a merger decree, so too are assets like MSC.Nastran – which was in no way acquired or developed as part of the challenged mergers – clearly not the proper subject for divestiture. Instead, the proposed remedy would impose grossly disproportionate penalties on MSC for making acquisitions that, at best, only marginally increased its market share.

Courts sometimes approve of dissolution in Sherman § 2 cases outside the context of an acquisition. Since the proper antitrust remedy is one designed to undo the harm to competition that flowed from the defendant's illegal conduct, dissolution of the entire firm, or breaking it up into various components, may in a § 2 context, unlike a Clayton Act § 7 context, be the best method of ***restoring*** the competition that would have existed absent the unlawful monopolization.

However, courts frequently find that dissolution is ***inappropriate even for*** Sherman § 2 violations.[74] For instance, in *United States v. Microsoft Corp.,* 253 F.3d 34 (D.C. Cir. 2001),

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[74] Commissioner Orson Swindle has noted that "[m]any high-tech markets are characterized by decreasing prices, increasing output, and robust innovation – certainly characteristics that yield tremendous benefits to consumers. To avoid 'killing the goose that lays the golden eggs' ... remedies should be very carefully calibrated to address demonstrated consumer harm...." *See* Swindle, *A Common Sense Approach to High Tech* (Nov. 4, 1999) (found at (continued...)

Judge Jackson had ordered that the defendant be split up into an "operating systems business" company and an "applications business" company. In remanding for reconsideration of this remedy, the court of appeals expressed serious skepticism about this drastic relief. Just as a remedy of forced licensing of the MSC.Nastran code bears no relationship to any harm caused by the acquisitions of UAI and CSA, the *Microsoft* court specifically required a showing of a "sufficient causal connection" between the anti-competitive conduct and the defendant's dominant monopoly position, *id.* at 106, and therefore it insisted that the remedy "should be tailored to fit the wrong creating the occasion for the remedy." *Id.* at 107.[75]

Evidently recognizing the novelty of its proposal, Complaint Counsel attempts to justify its proposed remedy through misleading precedent references. First, Complaint Counsel cites numerous merger cases where the case was resolved with a ***negotiated settlement***. It does so often in a misleading manner, such as its reference to *FTC v. Hearst Trust* in ¶ 89 of its proposed conclusions of law, where it suggests the remedy was a result of a court order, rather than a negotiated settlement. It should go without saying that negotiated settlements provide no precedent for a Commission order in this proceeding.

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[74] (...continued)
www.ftc.gov/speeches/swindle/sandiego.htm)

[75] The court of appeals also noted that divestiture of the acquired assets (what the court also called dissolution of entities "formed by mergers and acquisitions") is most commonly used when the defendant is the product of acquisitions or mergers, rather than of internal growth. *Id.* at 105. The court specifically states that "[c]omplete divestiture is particularly important where asset or stock *acquisitions* violate the antitrust laws." *Id.* (citing *Ford Motor Co.*, 405 U.S. at 573) (emphasis in original). While it is true that the challenge here is to MSC's acquisitions of UAI and CSA, the particular assets which Complaint Counsel seeks to have "divested" to one or two newly-created companies – the Nastran codes and other intellectual property belonging to MSC – are the result of internal development and growth, and are unrelated to these acquisitions.

Even where it does reference a remedy resulting from actual litigation, Complaint Counsel presents a misleading picture. In *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129 (1967), for example, a case cited by Complaint Counsel (CC COL ¶ 83), the Supreme Court held that "a plan of divestiture of the kind we envisaged must establish a New Company in the ***same or comparable competitive position*** that Pacific Northwest was in when the illegal merger obliterated it." *Id.* at 138 (emphasis added). Similarly misleading is Complaint Counsel's reference (CC COL ¶ 84) to *Crown Zellerbach Corp.*, 54 F.T.C. 769 (1957), where in the very sentence immediately after the one quoted by Complaint Counsel, the Commission qualified its order, stating: "However, it is ***not believed*** that the order should necessarily require the divestiture of all such assets added to the property by the respondent if the divestment may be otherwise accomplished ... [to achieve the result that the condition of the acquired mill will be] ***substantially as it existed at or around the time of the acquisition***." *Id.* at 807.

Complaint Counsel also misleadingly states (CC COL ¶ 85) that in *In re Automatic Data Processing, Inc.*, 124 F.T.C. 456 (1997), "the Commission ordered ADP to provide a paid-up, nonexclusive, royalty-free license . . . ." In fact, there was ***no such decree***, since that case was terminated by a ***consent order***. *Id.* at 467.

And, contrary to Complaint Counsel's characterization, *In re Diamond Alkali*, 72 F.T.C. 700 (1967), has nothing to do with "fashion[ing] a remedy when key assets have become outdated." CC COL, ¶87. Instead, after the challenged merger, the acquiring firm had closed down its only two cement plants, and the only plant it retained was the one it acquired. The Commission posed the question as what the remedy should be "where the acquiring firm has divested itself of the preacquisition assets corresponding to the particular assets whose acquisition gave the merger its

anti-competitive character." 72 F.T.C. at 740. Faced with only two choices – permitting the post-merger status quo to remain undisturbed, or forcing divestiture so that the respondent would at least be a potential competitor – the Commission chose the latter alternative. *Id.* at 747. That hardly is analogous to the current case, where here MSC has not divested the UAI or CSA codes and, given that UAI and CSA did not have the wherewithal to keep investing in their codes, the UAI and CSA codes today provide comparable functionality to what they would have absent the acquisitions. In short, none of Complaint Counsel's cases support the unheard of remedy of breaking up a company's core business as the price for making two trivial acquisitions.

Complaint Counsel's proposed remedy is ***punitive*** and goes far beyond what is necessary to restore lost competition. Prior to the acquisitions, CSA and UAI were troubled companies with inferior "Nastran products." At most, a lawful remedy would divest CSA and UAI along with adding whatever increase in quality of those products would reasonably have occurred in the absence of the acquisitions. MSC FOF ¶¶ 623-645.

VIII. CONCLUSION

The Complaint should be dismissed.

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CERTIFICATE OF SERVICE

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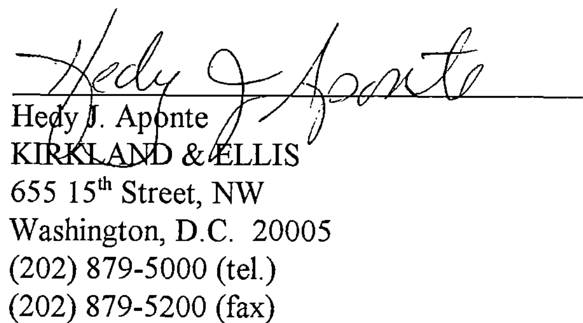

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