

## Horizontal Merger Analysis Grows Up: A Review of Chapter 5 of Richard Posner's *Antitrust Law* (2d ed. 2001)

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Richard Posner is a central figure in the generation of brilliant lawyers and economists who created the Chicago school of antitrust.<sup>1</sup> Since the first edition of Posner's *Antitrust Law* was published in 1976, most of the field has been transformed, in many respects along the very lines he proposed, and at times with a helpful decision from now—Judge Posner pushing that movement along.<sup>2</sup> But horizontal merger law, while revolutionized by the Chicago school's signature economic approach, has not changed in the precise manner Posner advocated a quarter century ago. Now, with the publication of the second edition of *Antitrust Law*,<sup>3</sup> Posner finds himself in the position of a parent dispensing fatherly advice to an adult child who has assimilated the lessons of her upbringing but also has developed distinctive views of her own.<sup>4</sup>

On the whole, Posner greatly approves of his offspring. He welcomes the way that antitrust has discarded the “social objection to concentration”—the conception of antitrust law as protecting small business—underlying the Supreme Court's 1966 decision in *Von's Grocery* (128).<sup>5</sup> He endorses the Justice Department's 1982 Merger Guidelines and their subsequent revisions: these “represent the triumph of the economic approach; and the courts have fallen into line with them quite readily” (132). Posner singles out the 1997 *Staples* decision for applause, calling it “the most recent example of the increased economic sophistication with which the antimerger law is being applied” (157).<sup>6</sup> As Judge Posner recognizes, economics has become the essence of antitrust, horizontal

merger analysis included, in significant part because he advocated that outcome decades ago.

But in reviewing the last quarter century of antitrust merger law, Posner does not claim more than “modest vindication” of his earlier views (132). Indeed, in important respects, the courts and federal enforcement agencies have found a better path for horizontal merger analysis than the one Judge Posner advocated in 1975 and, with minor modifications, continues to defend today.

### Factors Beyond Market Concentration

In the updated edition of his book, Judge Posner recollects his previous call for a greater role for market concentration and a narrower look at factors facilitating or frustrating collusion than has evolved in the courts and federal enforcement agencies. His original position can best be understood as a preference for bright line rules over unstructured standards in this doctrinal area, not an argument questioning the central role of economics in antitrust today. Yet, as Posner recognizes, the courts and agencies today are more willing than he was “to peek behind market share and examine the range of factors . . . besides concentration that may predispose a market to or against the forms of collusion that are difficult to detect, including tacit collusion” (133).

The courts and agencies have found a better role for factors beyond market concentration in horizontal merger analysis than was suggested by Judge Posner's original view. Economic theory and the empirical evidence both suggest that price rises as market con-

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centration increases, but they equally suggest the importance of other industry-specific and market-specific factors beyond concentration in determining price and the competitive effects of mergers. Moreover, the empirical research does not reliably identify any particular concentration level common across industries at which price increases begin. Although Posner does not question his original position in the updated edition of his book, he no longer wishes to debate the point. “For the time being,” he now writes, “the history of merger doctrine is at an end” (132).

Having lost the battle against truncating the economic analysis of factors that might influence whether a merger is likely harm to competition, Posner now recognizes that he must fight again to preserve a bright line rule against consideration of efficiencies. The modern trend in the lower courts is to recognize efficiencies as a defense, although efficiencies have never been the primary reason for the failure of a government challenge to a horizontal merger in court. *Heinz* would have been a counter-example, but the district court was overruled on appeal by a panel unwilling to accept the efficiencies credited below.<sup>7</sup> Efficiencies played only a supporting role in government losses in *Butterworth* and *Long Island Jewish Medical Center*.<sup>8</sup>

Posner argues against the efficiency defense mainly on the grounds that cost savings are hard to assess in prospect (“a matter of speculation flavored by hope” (133)), particularly relative to what would have occurred in the merger’s absence. He also contends that it is a practical impossibility to determine whether the benefits of merger-related efficiencies would outweigh the harm to competition from the transaction, regardless of whether the goal is merely to determine price effects or, more broadly, an effort to identify the full social efficiency costs. These complex economic questions, he writes, are better left to the discretion of the federal enforcement agencies, with their

more flexible procedures and greater staff resources. Although the lower courts are now willing to consider an efficiency defense, “they have been understandably, and I think correctly, reluctant to accept the defense in actual cases” (136).

Posner offers a serious argument. But here, as elsewhere in horizontal merger law, the courts may continue to go their own way. It is hard to see why predictions about the cost savings from merger are inherently more speculative and difficult to prove than the predictions of competitive harm. Posner concedes as much when he notes how little we still know “about the effect of marginal increases in concentration under different market conditions” (133). If the merging firms can show that their combination will reduce marginal costs by 15 percent leading to a reduction in quality-adjusted prices by the same amount (as defendants claimed in *Heinz*), why shouldn’t that information be considered in evaluating whether the transaction would likely harm competition? Posner would presumably answer that occasional errors in the application of bright line rules are more than compensated for by the reduction in administrative costs and benefits of clear guidance, and, perhaps also, that he would accept judicial consideration of an efficiency defense in an unusual case where the efficiency evidence is strong and compelling. But the same considerations could have been offered in the mid-1980s, in opposition to what the lower courts then did in accepting a wide-ranging merger defense based on ease of entry<sup>9</sup>—a defense Posner does not discuss in detail but to which he appears to have much more sympathy. Moreover, Posner’s recommendation would place antitrust in the awkward position of allowing proof of efficiencies to count in analyzing joint ventures among rivals,<sup>10</sup> but not to count in defense of a challenged horizontal merger—a setting in which the extent of integration, and concomitant efficiencies, are on average likely to be greater.

### Unilateral Competitive Effects

In revising his antitrust book, Judge Posner updated his 1976 discussion selectively, and chose not to grapple, for example, with what Professor Herbert Hovenkamp has termed “[t]he most significant post-Chicago development in the field of horizontal mergers,” the rise of unilateral theories of anticompetitive effect.<sup>11</sup> For Posner, horizontal merger law is concerned exclusively with the possibility that greater concentration “facilitates collusion, explicit or tacit, among the firms in the market by reducing the costs of collusion and of detecting cheating,” (124) the theory the current Merger Guidelines term coordinated competitive effects. But, as economists have long known and the Merger Guidelines have recognized since 1992, mergers among sellers in differentiated-product industries can also lead to higher prices through the loss of localized competition, even if the other firms in the market do not change their behavior. This theory became highly influential at the antitrust enforcement agencies with the development of econometric methods of quantifying the magnitude of the possible anticompetitive effects,<sup>12</sup> and with the availability of point-of-sale scanner data from supermarkets.

Posner’s neglect of unilateral competitive effects analysis is apparent in his discussion of the FTC’s successful challenge to the Staples-Office Depot merger, one of only two court decisions handed down since the first edition of the book to which he devotes significant textual discussion. *Staples* involved an FTC challenge to a proposed merger of two of the three leading office supply superstore chains, Staples and Office Depot. The district court judge treated the case primarily as a question of market definition. The court defined a submarket consisting of the sale of consumable office supplies through superstores within a broader product market involving all retail sales of such products, relying on the *Brown Shoe* practical indicia as legal authority to do so.<sup>13</sup> Within this market, the merger would have reduced the number of sellers from three to two in some metropolitan

areas, and from two to one in others.

The most important evidence in the case involved pricing, as Judge Posner observes with approval. The FTC showed that Staples charged significantly higher prices, on the order of 7 percent or more, in geographic markets where it had no office superstore competition than in markets where it competed with Office Depot or a third office superstore chain. Posner finds compelling the FTC’s systematic (econometric) analysis of pricing data in reaching this conclusion (as do I)<sup>14</sup>; in contrast, the district court judge relied mainly on evidence from party documents to the same effect.

Judge Posner likes this evidence for the right reason: it is direct evidence that the merger would harm competition. He explains that “the courts and the enforcement agencies bother with market definition only because they cannot make a direct assessment of the likely effect of a merger on price” (158). However, he does not take the next step, debated in recent commentary, to consider whether market definition can or should be dispensed with entirely under such circumstances.<sup>15</sup>

Judge Posner also does not address the *Staples* court’s use of *Brown Shoe* to define a submarket. Elsewhere in the chapter he terms submarkets “unsound” (152) if they fail to include close substitutes. The district court’s submarket definition in *Staples* does not make that mistake, however, as Posner implicitly recognizes by describing what the *Staples* court did as defining a market (rather than a submarket). Posner does not consider the possibility that the submarket label could serve a useful purpose in that case (although one not mentioned by the district court judge): as an expositional tool for highlighting the potential loss of localized competition within a broader market.

This issue of how antitrust law should address unilateral competitive effects of merger within the framework of market definition and market shares goes beyond *Staples*. There are two alternatives, assuming that market definition is actually necessary (notwithstanding the

debate mentioned above). First, if the loss of head-to-head competition among merger partners would permit the firms to raise price regardless of the response by other sellers in the market, the competitive concern can be described as a unilateral competitive effect within a broad market. This frame allows the court to consider the competitive significance of all possible influences on post-merger competition, however distant, but does so at the risk of appearing to minimize a potentially serious competitive problem by reducing measured market concentration. Second, the transaction equally could be described as a merger to near monopoly within a narrow submarket, as is arguably suggested by *Staples*.<sup>16</sup> This alternative frame heightens concentration levels, and may therefore make the case more attractive in court—at least if the submarket definition can be simply stated with practical appeal, and not appear to reflect result-driven gerrymandering. Given the prominence of unilateral competitive effects analysis in merger reviews at the federal enforcement agencies during the past decade, it is disappointing that Judge Posner, in updating his book, chose not to share his views on this interpretation of *Staples* or on the role of unilateral competitive effects analysis generally.

### Empirical Evidence

Judge Posner commendably encourages reliance on empirical evidence like the pricing data in *Staples*. But he highlights two specific econometric techniques for evaluating aspects of mergers without taking on criticisms that have encouraged empirically-oriented economists to prefer alternative approaches. First, Posner writes approvingly of defining markets based on high positive price correlations, a methodology that would include products in the same market if their prices tend to rise and fall simultaneously. This approach is suspect as a market definition tool, and not just for the reason Posner points out: that it is prey to the *Cellophane* fallacy when market power has already been exercised. More fundamentally, high price correla-

tions can be poor indicators of demand substitution, the economic force at issue in market definition. After all, closely correlated price movements may merely represent the result of similar forces, such as common changes in input costs or demand, affecting price in different markets.

Second, Posner writes approvingly of the use of stock market evidence to determine whether a merger harms competition on balance, accounting for the efficiencies. The theory is simple: If the stock market price of rival firms rises upon the announcement of the merger (or falls when the investment community learns that antitrust enforcers have launched an investigation), then Posner would infer that the transaction is likely to harm competition; if the stock market price of rival firms falls on the merger announcement (or rises in response to information about increased enforcer concern), he would infer that the transaction is likely to promote competition. Posner correctly notes that a study along these lines was relied upon by the FTC's economic expert in *Staples*, although the main focus of the Commission's other economic expert, an econometrician, was on the previously-mentioned studies relating price to variations in market structure.

Posner does not, however, address three basic problems with relying on the stock market "event study" methodology to decide merger cases, which go beyond technical implementation difficulties (such as determining when the merger news gets out or controlling for other events affecting share prices). First, the key inference—interpreting lower stock market prices for rival shares to suggest that the merger creates efficiencies rather than anticompetitive harm—is correct on its own terms only if the anticompetitive theory involves collusive rather than exclusionary effects. After all, a merger that harms competition by excluding rivals would also lower the price of rival shares. Second, it is inappropriate for antitrust enforcers to delegate their decisions to the stock market. Wall Street analysts often do not take a sophis-

ticated approach to competition analysis, and even when they do, they rarely know what the antitrust agencies can find out about the industry. Only the enforcement agency staff can subpoena and read the marketing documents of all the firms.

Third, there is a fundamental difficulty with a government policy of drawing inferences about the competitive effects of particular mergers from the stock market response to their announcement—once Wall Street learns that this information matters in agency decision-making. When investors forecast the likely financial consequences of a merger proposal, they must consider not only the competitive effects of the deal but also the likelihood that the transaction will be challenged by antitrust enforcers. If investors believe that the merger would likely harm competition by facilitating tacit collusion, for example, they should bid up the stock market price of rival shares. But if the resulting

increase in the stock market price would make a successful government challenge to the deal likely, investors would not choose to increase the stock price after all. Under such circumstances, it is far from clear what, if anything, the antitrust agencies could reliably infer by analyzing the stock market response to merger announcements.

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Judge Posner concludes his discussion of horizontal merger analysis in the voice of a proud parent. With *Staples*, he writes, “[e]conomic analysis of mergers had come of age” (158). Posner is surely entitled to look upon contemporary horizontal merger analysis with satisfaction, a quarter-century after his work helped revolutionize the field. Antitrust law may no longer reflexively follow his advice, but Judge Posner as much as anyone should be allowed to take a front row seat at antitrust’s graduation. ●

<sup>1</sup>In academic writings published during the 1960s and 1970s, including the essays collected in the first edition of *Antitrust Law*, Posner, along with Robert Bork, Aaron Director, Frank Easterbrook, George Stigler and others, laid the intellectual groundwork for a broad transformation of antitrust doctrine in the courts.

<sup>2</sup>*E.g.*, *Hospital Corp. of America v. FTC*, 807 F.2d 1381 (7th Cir. 1986 (Posner, J.) (upholding FTC injunction against an acquisition reducing the number of hospitals competing in Chattanooga from eleven to seven, and the number of major firms to four).

<sup>3</sup>RICHARD A. POSNER, *ANTITRUST LAW* (2d ed. 2001). Page references to this edition are set forth in the text in parentheses.

<sup>4</sup>See generally Jonathan B. Baker, *A Preface to Post-Chicago Antitrust*, in *POST-CHICAGO DEVELOPMENTS IN ANTITRUST ANALYSIS* (Roger van den Bergh, Roberto Pardolesi & Antonio Cucinotta eds., forthcoming 2002) (describing role of the Chicago school in antitrust history and evaluating prospects for further doctrinal change).

<sup>5</sup>*United States v. Von’s Grocery Co.*, 384 U.S. 270 (1966).

<sup>6</sup>*FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997). I was Director of the FTC’s Bureau of Economics during this litigation.

<sup>7</sup>*FTC v. H.J. Heinz Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000), *rev’d*, 246 F.3d 708, 720 (D.C. Cir. 2001). I testified on behalf of the merging firms as an expert economic witness in this case.

<sup>8</sup>*FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996), *aff’d*, 121 F.3d 708 (6th Cir. 1997); *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121 (E.D.N.Y. 1997).

<sup>9</sup>*E.g.*, *United States v. Waste Management, Inc.*, 743 F.2d 976 (2d Cir. 1984).

<sup>10</sup>See, *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).

<sup>11</sup>Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2 *COLUM. BUS. L. REV.* 257, 332 (2001).

<sup>12</sup>This literature begins, I should disclose, with the articles I wrote with Timothy F. Bresnahan during the mid-1980s on estimating residual demand functions. Jonathan B. Baker & Timothy F. Bresnahan, *Estimating the Residual Demand Curve Facing a Single Firm*, 6 *INT’L J. INDUS. ORG.* 283 (1988); Jonathan B. Baker & Timothy F. Bresnahan, *The Gains from Merger or Collusion in Product Differentiated Industries*, 33 *J. INDUS. ECON.* 427 (1985).

<sup>13</sup>*Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

<sup>14</sup>See generally Jonathan B. Baker, *Econometric Analysis in FTC v. Staples*, 18 *J. PUB. POLICY & MKTG.* 11 (1999) (discussing FTC’s econometric analysis of pricing data).

<sup>15</sup>*E.g.*, James F. Rill, *Practicing What They Preach: One Lawyer’s View of Econometric Models in Differentiated Product Mergers*, 5 *GEO. MASON L. REV.* 393, 400 (1997) (criticizing economists who suggest that market definition and analysis of market structure can be dispensed with in the analysis of certain differentiated products mergers).

<sup>16</sup>There is no logical contradiction between this alternative and the previous one. The existence of a broad market does not preclude the possibility that a more narrow market, also properly defined according to the substitution criteria of the case law and Merger Guidelines, is nested within it.

## Antitrust 2001–02: The Year of the Baseball Bat

### Stephen Calkins

The past year should go down in antitrust lore as the year of the baseball bat, as commentators continue to reference the *Microsoft* court's memorable analogy, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (per curiam). To be sure, 2001 may not rank with the year that we learned that the "sole consistency" in merger litigation is that "the Government always wins," *United States v. Von's Grocery Co.*, 384 U.S. 270, 301 (1966) (Stewart, J., dissenting), or that "the rule of reason can sometimes be applied in the twinkling of an eye," *NCAA v. Board of Regents*, 468 U.S. 85, 109 n.39 (1984) (quoting Phillip Areeda), let alone the year that we learned that antitrust truly is to protect "competition, not competitors," *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)). The D.C. Circuit's vivid analogy promises to be an enduring image, nonetheless. Indeed, in reviewing the cases of the year, one can consider cases in which courts have been (1) protecting the plate by fouling off pitches, preventing core merits issues from being addressed; and (2) being forced, finally, to take a cut at core merits issues, putting the ball in play. One can also (3) take a brief look at what the future is likely to hold, as even Yankees fans are forced occasionally to do.

### Courts Fouling Off Pitches

Most antitrust litigation is about issues that might seem to be on the substantive periphery, on the edges of the antitrust plate, if you will. The statutes suggest that the principal questions are

whether an agreement restrains trade, or whether a firm is a monopoly, or whether some method of competition is unfair. In fact, however, the courts vigorously resist addressing (or letting juries address) these issues. This year was no exception, as courts took tough positions on standing, on letting a jury consider whether or not an agreement existed at all, and in determining whether conduct was exempt from the antitrust laws altogether.

**Standing.** Any defendant failing to claim the absence of antitrust injury risks committing malpractice. The applicable case law is in disarray, with the only consistency being that defendants almost always win. All too often one gets the impression that a court, confident that a defendant deserves to win but unsure of why, simply concludes that antitrust injury is missing.

Noteworthy recent cases include:

*RSA Media, Inc. v. AK Media Group, Inc.*, 260 F.3d 10 (1st Cir. 2001). Defendant AK Media Group prevailed in this billboard war, winning summary judgment even though it enjoyed a 92 per cent share of a market into which restrictive zoning made entry virtually impossible. Apparently seeking to discourage entry, AK Media told landlords that if they switched to another billboard firm, AK Media would (1) tear down the existing billboard, and (2) retain the permit for a billboard at that site, such that neither the landlord nor any billboard company would be able to erect a replacement billboard. The court of appeals ruled that even if this were exclusionary, RSA Media lacked antitrust standing. "RSA was not excluded from the market for outdoor billboards because of AK's threats; it

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**Ed. Note:** Professor Calkins presented a review of the past year's antitrust law developments at the ABA Section of Antitrust Law Annual Meeting (Aug. 8, 2001). We asked Professor Calkins to turn his speech into an article for The Antitrust Source.

This article also contains references to several important developments that occurred after the presentation.

was excluded because of the Massachusetts regulatory scheme that prevents new billboards from being built.” *Id.* at 15. The court thus viewed the dispute as turning on the state-controlled inability to erect a billboard, rather than AK Media’s refusal to allow a license to be transferred.

*Indeck Energy Services, Inc. v. Consumers Energy Co.*, 250 F.3d 972 (6th Cir. 2000) (per curiam), cert. denied, 121 S. Ct. 2623 (2001).<sup>1</sup> Consumers Energy won dismissal of an antitrust challenge by a frustrated new entrant into the Michigan energy market, with the district court ruling that Consumers’ actions were highly regulated and thus protected by the state action exemption. *Id.* at 975. The district court also ruled almost in passing that dismissal was justified under the Sixth Circuit’s aggressive application of the antitrust injury doctrine, and this was the sole ground on which the Sixth Circuit affirmed. *Id.* at 975–77. Although the opinion is not entirely clear, it could be read to suggest that when a dominant firm offers a major customer a favorable price in exchange for an exclusive contract, that customer is the only firm with standing to allege an antitrust violation.

*Watkins & Son Pet Supplies v. The Iams Co.*, 254 F.3d 607 (6th Cir. 2001). Watkins, a distributor, complained without success when it was terminated by a manufacturer that wanted to grant a rival an exclusive territory and a 2 percent price discount (in exchange for a promise that the favored distributor would carry no rival brand). The court rather cryptically wrote that antitrust standing is lacking “because the injury to Watkins flows from the termination; the antitrust violation was not a necessary predicate of the injury.” *Id.* at 616.

*Pool Water Products v. Olin Corp.*, 258 F.3d 1024 (9th Cir. 2001). The Ninth Circuit affirmed dismissal of a claim that mergers and predatory practices harmed a competitor of defendant Olin Corp. “It is not enough . . . to show that defendants violated the law and that the plaintiffs suffered a causally related injury.” *Id.* at 1036.

Losses caused by a defendant’s non-predatory prices are irrelevant, and the court was unimpressed with evidence that the plaintiff’s market share fell from 60 to 35 percent. *Id.* at 1035–36. “A decrease in one competitor’s market share . . . affects competitors, not competition. Shifting [plaintiff’s] sales to [defendant] and other competitors in the market does not directly affect consumers and therefore does not result in antitrust injury.” *Id.* at 1036. The court declared that “reduced profits from lower prices and decreased market share is not the type of harm Section 4 was meant to protect against.” *Id.*

There were exceptions, of which the most noteworthy was *Andrx Pharmaceuticals, Inc. v. Biovail Corp. International*, 256 F.3d 799 (D.C. Cir. 2001), which allowed an excluded competitor to challenge a patent-related agreement that allegedly “neither enhanced competition nor benefitted consumers.” *Id.* at 813. (The court also ruled that even if consumers could assert an antitrust claim, an illegally-excluded competitor can seek redress for its own, distinct injury.) *Id.* at 816–17. The D.C. Circuit thus reversed the district court’s conclusion that antitrust injury had been absent—which serves as a reminder that the outcomes of these cases are not easy to predict.

**Proof of Agreement.** Although the great antitrust issues revolve around the reasonableness of various restraints, the appraisal of questionable practices, and the measurement of market power, in recent years defendants have had singular success winning summary judgment decisions that kept the issue of agreement from a jury. See, e.g., *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan*, 203 F.3d 1028 (8th Cir.), cert. denied, 531 U.S. 815 (2000); *7-Up Bottling Co. v. Archer Daniels Midland Co. (In re Citric Acid Litigation)*, 191 F.3d 1090 (9th Cir. 1999), cert. denied, 529 U.S. 1037 (2000); *Merck-Medco Managed Care, LLC v. Rite Aid Corp.*, 201 F.3d (4th Cir. 1999) (table decision), text available at 1999 WL 691840. (not for publica-

tion); *In re Baby Food Antitrust Litigation*, 166 F.3d 112 (3d Cir. 1999). This year saw more of the same, albeit with an exception or two.

The most significant decision was *Aguilar v. Atlantic Richfield Co.*, 24 P.3d 493 (Cal. 2001) (Mosk, J.). The seven justices unanimously and decisively acted to position California state law within the pro-defendant federal stream originating with *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). “Ambiguous evidence . . . do[es] not allow . . . a trier of fact [to find an unlawful conspiracy].” 24 P.3d at 514. According to the court, collection and dissemination of capacity, production, and pricing information is not troubling because, as suggested by the old case, *Maple Flooring Mfrs. Ass’n v. United States*, 268 U.S. 563 (1925), information is a good thing. 24 P.3d at 518–19. The use of common consultants can be explained by the need to draw on scarce expertise. *Id.* at 519. Barter-type exchange agreements have long been common and have been recognized as likely beneficial. *Id.* Interdependence? In an oligopoly such as exists here, it is inevitable. “In such a market . . . prices may move generally upward across all of the firms more or less together, rising quickly and falling slowly, and may do so interdependently but nevertheless independently.” *Id.* at 520. In short, proof of “motive, opportunity, and means to enter into an unlawful conspiracy . . . is not enough.” *Id.* No matter how much evidence a plaintiff has, if it is entirely “ambiguous”—that is, perhaps, “open to more than one interpretation,” THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4th ed. 2000)<sup>2</sup>—the California courts may prevent juries from finding the facts.

Another strong defense win was *In re High Fructose Corn Syrup Antitrust Litigation*, 156 F. Supp. 2d 1017 (C.D. Ill. 2001). To no avail, the class of high fructose corn syrup purchasers pointed to evidence, such as announcement of a pricing formula followed by adoption by industry members; trade association meetings at seemingly-suspicious times; similar or identical

prices lists, circulated in advance; intra-firm contacts; inter-defendant sales; and examples of firms refusing to cut prices to win attractive orders. The court concluded that “no single piece of evidence tends to exclude the possibility of independent action,” *id.* at 1055, and that was the end of the matter. “It is undisputed that the HFCS market is a highly concentrated market dominated by very few players, and it is well established that where a market is dominated by a few major players, parallel pricing is not uncommon and is generally insufficient to prove an antitrust conspiracy.” *Id.* at 1038. (The court ruled that the case turned on inferences because direct evidence was not found in statements such as, “‘We have an understanding within the industry not to undercut each others’ prices.’” *Id.* at 1029.)

To be sure, there were exceptions to the pattern. Most notable was *In re Disposable Contact Lens Litigation*, No. MDL 1030, 2001 WL493244 (M.D. Fla. Feb. 8, 2001), which denied summary judgment in a case alleging a horizontal agreement to eliminate discounters. The court pointed to a series of letters suggesting pressure and compliance, and, quoting some typically colorful Posnerian language, noted that “when a conspirator warns a non-complying dealer to restrain trade and the dealer ‘merely grunts but complies’ there is agreement.” *Id.* at \*7 (quoting *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7th Cir. 1987)).

The pattern nonetheless remains.

**Antitrust Exemptions.** Although there are exceptions,<sup>3</sup> the most noteworthy exemption cases this past year addressed the *Noerr-Pennington* doctrine. Two treated that doctrine expansively. *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir. 2001), *petition for cert. filed*, 170 U.S.L.W. 3317 (U.S. Oct. 19, 2001) (No. 01-656), held that a settlement between state governments and tobacco companies, and apparently the resulting consequences, was immune: “[I]f its conduct constitutes valid

petitioning, the petitioner is immune from antitrust liability whether or not the injuries are caused by the act of petitioning or are caused by government action which results from the petitioning.” *Id.* at 251. Even if tobacco companies had craftily negotiated a consent order whose various penalty clauses discouraged vigorous competition, and even if the plaintiff states had been motivated by an interest in sharing in the anticipated profits, settlement agreements were awarded as much protection as traditional petitioning.

More disconcerting was *Baltimore Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394 (4th Cir.), *cert. denied*, 121 S. Ct. 2521 (2001). Here, the only metal shredder in Baltimore attempted to block a threatened new entrant, Baltimore Scrap, by secretly financing “consumer” litigation. The district court lambasted the defendant’s conduct as “‘deceitful,’” “‘underhanded,’” and “‘morally wrong,’” *id.* at 398—but protected by *Noerr*. The court of appeals affirmed. In an explanation reminiscent of (and no more uplifting than) campaign-financing debates, the court declared: “Funding of litigation by a non-party can be petitioning to the same extent that filing a lawsuit itself is petitioning.” *Id.* at 401. The Fourth Circuit rejected the Fifth Circuit’s contrary view, espoused in *In re Burlington Northern, Inc.*, 822 F.2d 518, 531 (5th Cir. 1987), as fatally undermined by *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries*, 508 U.S. 49 (1993). *Baltimore Scrap*, 237 F.3d at 400–01.

The exception, and a case that serves to cabin *Bedell*, is *Andrx Pharmaceuticals, Inc. v. Biovail Corp. International*, 256 F.3d 799 (D.C. Cir. 2001). This rich opinion is well worth reading on several grounds, including its prospective importance in the on-going wars over the Hatch-Waxman Act and its ramifications. Relying largely on the reasoning of Judge Nancy Edmunds in a related case, *In re Cardizem CD Antitrust Litigation*, 105 F. Supp. 2d 618 (E.D. Mich. 2000), the court held that an agreement between litigants, ancillary to their litigation, is not protected

by *Noerr*. Agreeing with Judge Edmunds, the D.C. Circuit explained that “[t]he harm . . . was not the result of a court decision. ‘Rather, it is the result of purely private conduct and thus constitutes a private restraint of trade subject to liability under the antitrust laws.’” *Biovail*, 256 F.3d at 818 (quoting 105 F. Supp. 2d at 635).

### When the Ball Is Over the Plate: Courts Dealing with Core Issues

When issues are squarely presented and easy outs are not available, courts may seriously address core antitrust doctrine. The three examples of this in the past year are (a) the relationship between the per se rule and the rule of reason, (b) mergers, and (c) *Microsoft*.

**Per Se—Rule of Reason.** Anyone who thought that the Supreme Court’s disappointing opinion in *California Dental Ass’n v. FTC*, 526 U.S. 756 (1999),<sup>4</sup> had resolved the tension between the per se rule and the rule of reason will be discouraged. This remains an area in which much work is still to be done. This past year, six different institutions offered opinions that sought with limited success to clarify the law:

*A.D. Bedell Wholesale Co. v. Philip Morris Incorporated*, 263 F.3d 239 (3d Cir. 2001), *petition for cert. filed* (Oct. 19, 2001). Although it dismissed the complaint on *Noerr-Pennington* grounds, the Third Circuit found the *Bedell* complaint otherwise meritorious. It ruled that an output cartel that, without explicitly raising prices, creates a significant disincentive to increasing market share, is sufficiently likely to be illegal that a challenge to it states a cause of action. *Id.* 247–48. Noting that none of the analytical categories are separated by bright lines, the court wrote, “We need not address whether the output cartel alleged here would be illegal per se or would be illegal under a ‘rule of reason’ analysis.” *Id.* at 248 n.23. (The otherwise meritorious complaint was dismissed on *Noerr-Pennington* grounds.)

*Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979 (9th Cir. 2000) (2–1). Cheese-makers

accused of price fixing under state law with respect to their principal input, milk, defended in part by arguing that their combined purchases were obviously much too insignificant to permit them to exercise any market power or affect competition. *Id.* at 986. The argument won below and helped attract Judge Paez's vote. *See id.* at 1002–03 (Paez, J., dissenting). The majority, in an opinion by Judge Dwyer, was unpersuaded. The per se status of price fixing deflects any claimed lack of competitive effect.

*Toys "R" Us v. FTC*, 221 F.3d 928 (7th Cir. 2000) (Wood, J.). It was no defense to a charge of horizontal group boycott for ringleader Toys "R" Us to point to its 20 per cent market share. *Id.* at 937. Market power, to the extent needed, can be proven either by market share or directly from anticompetitive effects.

*Carpet Group International v. Oriental Rug Importers Association*, 227 F.3d 62 (3d Cir. 2000). A boycott by the defendant wholesalers' association of oriental rug manufacturers who sold directly was per se illegal. Proof of market power is often necessary, but not here: "[W]hen the defendants are not engaged in any significant integration of production or distribution, and the only rationale for the restraint is the elimination of additional, lower-cost, higher quality, or more innovative output from the market, this rationale 'implies the existence of market power.'" *Id.* at 74 (quoting 13 HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 2203a (1999)). The district court relied on the absence of proof of market definition or market impact. *Id.* at 75. The court of appeals reasoned, in contrast, that plaintiffs' showing "that the defendants' conduct had its intended effect of undermining the trade shows, and that its only purpose was to eliminate competition in the United States" raised "a strong inference that ORIA [the association] and its member rug importer/wholesalers possessed some degree of market power." *Id.*

*Continental Airlines, Inc. v. United Air Lines, Inc.*, 126 F. Supp. 2d 962 (E.D. Va. 2001). This fascinating case, made somewhat dated by

the events of September 11, saw plaintiff Continental Airlines win summary judgment in its challenge to defendant Dulles Airport Airline Management Council's decision to adopt defendant United Airlines's suggestion and use baggage-screening "templates" with x-ray machines. (Continental had retrofitted planes with extra luggage space and promoted itself as the carrier for serious "road warriors.") The court applied what it described as the "abbreviated rule of reason." "This third mode of analysis skips the inquiry into anticompetitive effects because those effects are manifest from the nature of the restraint; instead, the focus of the abbreviated Rule of Reason analysis is the pro-competitive justifications offered in support of the restraint . . ." *Id.* at 972–73.

The court characterized the Management Council's use of templates as an "output restriction" because it was "an agreement to provide a lower quality product . . . . It restricts output because it standardizes, and thereby eliminates open competition on, an element of the bargain between carriers and passengers." *Id.* at 975. The court also complained that "defendants' agreement restricts product and service diversity and constrains innovation competition in the market for air carriage." *Id.*

Although the novelty of the application precluded use of the per se rule, the court focused its inquiry sharply on whether the agreement promoted competition. When the defendants tried to argue that templates would improve the traveling experience, the court was unimpressed: "it cannot be accepted that the elimination of competition through product standardization . . . is procompetitive because it makes more efficient competition on other elements of airline service. . . . Put differently, to sanction an elimination of competition where it has not been shown that unfettered competition in the market has failed is flatly inconsistent with the goals of the Sherman Act . . ." *Id.* at 980–81. Much of the court's analysis—on what constitutes an output restriction, on use of the abbreviated rule of reason, and on acceptable

justifications—is potentially important, whether or not the case was decided correctly. The defendants appealed.

**Warner Communications/Polygram.** This fascinating FTC consent decree/administrative complaint (Warner Communications settled; Polygram decided to contest the complaint) challenged Warner and Polygram, which jointly produced and promoted a recording of the Three Tenors' 1998 concert, for agreeing not to advertise or discount the 1990 (Polygram) and 1994 (Warner) recordings. The Analysis to Aid Public Comment rejected any "free riding" justification because the 1998 promotion was shared, not independent. The consent decree stipulated that price and advertising restriction agreements are permissible when "reasonably related" to a lawful joint venture and "reasonably necessary to achieve its procompetitive benefits"; that firms may set prices and restrict advertising for jointly produced products; and that proper ethical codes concerning parental advisories are permitted if "reasonably tailored to such objective." *Warner Communications Inc.*, File No. 001-0231 (July 31, 2001) (proposed consent order Part III). Especially intriguing, as is discussed in the conclusion below, is the Analysis to Aid Public Comment's comfortable reliance on the *Massachusetts Board* method of analysis that had been downplayed in the Commission's *California Dental Ass'n* opinion.

**Mergers.** Merger law saw the Federal Trade Commission and two courts enjoying what amounted to an old timers' day. New subtleties could be found, of course, but much of the writing would have been familiar to an antitrust veteran.

**FTC v. Swedish Match**, 131 F. Supp. 2d 151 (D.D.C. 2000). The FTC won a preliminary injunction (and more: the parties subsequently abandoned the merger) the old fashioned way: by proving a narrow submarket in which market shares were prohibitively high. The submarket was limited to loose leaf chewing tobacco, which excluded moist snuff and other tobacco

products. Oral tobacco products were functionally interchangeable, to be sure, but the court found sufficient *Brown Shoe* factors to support a submarket. Conflicting econometric testimony served largely to cancel each other out, so the court relied heavily on documents, witness testimony, industry recognition, and distinct pricing. It was almost as though, with the FTC having posited a plausible small market, the burden shifted to the defendant to disprove it. With high market shares established, *Philadelphia Bank* permitted a strong presumption of anticompetitive effects. The court was unmoved by defendants' pointing to excess capacity and declining demand because these had long been present yet firms had enjoyed wide margins and rising prices.

**FTC v. H.J. Heinz Co.**, 246 F.3d 708 (D.C. Cir. 2000). The FTC's challenge to the merger of Heinz and Beech-Nut baby food, controversial when filed, resulted in a resounding Commission victory. The court ruled that HHI figures, by themselves, establish a prima facie case, and, where substantial direct competition would be eliminated and entry barriers are high, the FTC is entitled to a presumption of illegality. Defendants argued that any loss in wholesale competition between merging Heinz and Beech-Nut would not be felt by consumers; the court responded that cost increases will be passed through (here, from wholesalers to retailers, and, in any event, "Section 7 is, after all, concerned with probabilities, not certainties." *Id.* at 719 (citing, e.g., *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 658 (1964); *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962))).

The court was very tough on efficiencies, explaining that the high market concentration could be rebutted only by "proof of extraordinary efficiencies," 246 F.3d at 720. In part the appellate court objected to the lower court's math: the relevant reduction is in the percentage of total variable costs, and cost savings must be compared to the combined entity's total output (since presumably all prices are at risk of rising).

In part the court rigorously insisted that only “merger specific” efficiencies, which “cannot be achieved by either company alone,” count. *Id.* at 721–22. Thus, Heinz could not point to the benefit of superior Beech-Nut recipes, since the parties did not show that Heinz could not improve its recipes by alternative means. Although Beech-Nut may have an inefficient distribution system, “it can make that system more efficient without merger.” *Id.* at 721 n.19. The court found the claim that a firm needed a very substantial shelf presence in order to launch new products to be “highly speculative.” *Id.* at 723.

Finally, the court rejected the district court’s finding that “‘structural market barriers to collusion’” will prevent competitive harm. No such barrier is unique in the baby food industry, ruled the court of appeals, so it would adhere to the usual presumptions: “The combination of a concentrated market and barriers to entry is a recipe for price coordination.” *Id.* at 724. Indeed, the court adopted the cautionary language of the leading treatise: “Tacit coordination ‘is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.’” *Id.* at 725 (quoting 4 PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 901b2, at 9 (rev. ed. 1998)).

**Microsoft.** So much about *Microsoft* requires a sophisticated understanding of technology. What are appropriate terms for a settlement? What role should the court play? How should decision making be coordinated among the Justice Department, the many different states, and the European Commission? Even as this is written, developments occur almost too quickly to chronicle.<sup>5</sup> This article will discuss none of these difficult questions, or even the underlying questions of how the district court and court of

appeals should have ruled.<sup>6</sup> Instead, it will consider what *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. June 28, 2001) (per curiam), (*Microsoft III*) means for the rest of antitrust law.

For antitrust, the *Microsoft* decision was profoundly important. In a singularly controversial case in which massed government and private forces squared off, and after the trial judge unfathomably embarrassed himself and the antitrust system, a very tough, sophisticated, en banc panel that included distinguished conservatives and liberals issued a unanimous opinion. Before the opinion was issued, antitrust (or at least monopolization) enforcement as an institution had been in a perilous state. For instance, after the oral argument, a *Business Week* commentary had warned:

The law can never be crystal clear, but it’s supposed at least to be predictable. . . . Most judges should reach the same conclusions most of the time.

After listening to the D.C. Circuit savage the government’s lawyers—much as Judge Jackson trashed Microsoft’s team—it isn’t clear antitrust law meets this standard. And if it doesn’t, there may be good reason to begin rethinking its value.

Mike France, *Is Antitrust Law in Need of Remedy?*, BUSINESSWEEK online, Mar. 5, 2001, [http://www.businessweek.com/technology/content/mar2001/tc2001035\\_299.htm](http://www.businessweek.com/technology/content/mar2001/tc2001035_299.htm). The mere fact of a unanimous decision by a distinguished court that obviously worked hard to draw lines while preserving consensus goes far toward reassuring observers that we live in a nation of laws.

The court’s opinion addresses the law of attempted monopolization, tying, exclusive dealing, and monopoly maintenance, with the last being particularly important.

**Attempted Monopolization.** The court broke no new ground on attempted monopolization. It applied black letter law, and merely concluded that the district court had failed sufficiently to define a relevant market that Microsoft had attempted to monopolize or to identify significant entry barriers. 253 F.3d at 80–84. The court

was singularly unreceptive to relatively undisciplined claims of wrongdoing.

*Tying.* The court's treatment of tying was particularly elegant. See 253 F.3d at 84–97. Its most important action was its brisk dismissal of the permissive standard it had flirted with adopting in *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998) (known as *Microsoft II*). The *Microsoft II* court had interpreted a consent decree to permit any product integration with a “plausible claim” to any consumer benefit, even if the net effect was harmful. See *id.* at 950. Although that court had described its understanding as “consistent with tying law,” *id.*, *Microsoft III* squarely limited the *Microsoft II* test to that particular consent decree: the test does not govern antitrust law more generally.

The elegant part of *Microsoft III*'s tying discussion was its explication of the *Jefferson Parish* “separate demand” test for determining the existence of two products. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). In a sense, the court viewed Justice Stevens's majority opinion through the lens of Justice O'Connor's influential concurrence. Justice O'Connor treated surgery and anesthesia as a single product because there was no “coherent economic basis for treating the tying and tied products as distinct.” 466 U.S. at 39. “When the economic advantages of joint packaging are substantial the package is not appropriately viewed as two products . . . .” *Id.* at 40. In contrast, the Court held that surgery and anesthesia were separate products because “there is a sufficient demand for the purchase of anesthesiological services separate from hospital services to identify a distinct product market in which it is efficient to offer anesthesiological services separately from hospital services.” *Id.* at 21–22. (The Court looked at very practical factors such as billing records and the practice of requesting specific anesthesiologists.) The *Microsoft III* court quoted this *Jefferson Parish* “separate demand” sentence and then, by providing context and then employing the simple expedient of italicizing

the word “efficient,” interpreted the separate demand test as “a rough proxy for whether a tying arrangement may, on balance, be welfare-enhancing, and unsuited to per se condemnation.” 253 F.3d at 87.

The D.C. Circuit cautioned that one is to examine the proxy (separate demand) rather than efficiencies directly. *Id.* at 88. But by moving efficiency and net welfare effects to center stage, the court has virtually guaranteed that defendants will attempt to litigate these issues. If courts succumb to the temptation to resolve such litigation through rulings, Justice O'Connor's concurrence will have won more of the war.

*Microsoft III* is known more specifically for rejecting the per se rule in the particular case before it. Building on its efficiency-based interpretation of the “separate products” test, the court showed that “the separate-products test is a poor proxy for net efficiency from newly integrated products.” *Id.* at 92. The court explained that in a feverishly innovating and integrating industry such as that at issue, the backward-looking test of separate demand does a poor job of distinguishing beneficial from harmful new product integration.

Certainly the decision further undermines the already shaky foundation of the per se rule against tying. Although the court limited its holding to the case before it, the reasoning has much broader applicability. Tying cases often involve new integration, whether being when cars begin to include radios or cemeteries begin to include grave stones. Surely the vast majority of defendants will now insist that the rule of reason should be applied. Logic would predict that courts outside the District of Columbia will reject these pleas. Any court that would rule for a defendant under a rule of reason can rule for it under the unusual per se rule against tying; why not, therefore, take the risk-averse approach and apply Supreme Court, rather than D.C. Circuit, law? Yet simply by focusing so sharply on underlying competitive effects, the court has further weakened the per se rule against tying.

*Exclusive Dealing.* Exclusive dealing, as a separate antitrust issue, was not technically before the court. Microsoft won below, and the plaintiffs did not appeal. Nonetheless, the court importantly reestablished exclusive dealing as a viable antitrust offense. The district court had adopted a “total exclusion” test, which prevented liability unless rival firms were completely excluded from (not just seriously disadvantaged in reaching) roughly 40 percent of the market. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 52 (D.D.C. 2000), *aff’d in part, rev’d in part*, 253 F.3d 39 (D.C. Cir. 2001). The district court ruled that practices lawful under Section 1 could nonetheless be unlawful under Section 2, and the court of appeals agreed. In doing so, however, it implicitly disagreed with the lower court’s Section 1 analysis by using the dismissive phrase, “Even assuming the holding is correct . . . .,” 253 F.3d at 70, and noting that there are “various scenarios under which exclusive dealing, particularly by a dominant firm, may raise legitimate concerns about harm to competition.” *Id.* (citing Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why Aspen and Kodak Are Misguided*, 68 ANTITRUST L.J. 659 (2001)).

*Monopoly Maintenance.* The great line in the *Microsoft III* opinion is the court’s rejoinder to Microsoft’s argument that the exercise of lawfully acquired intellectual property rights cannot violate the antitrust laws. “That is no more correct than the proposition that use of one’s personal property, such as a baseball bat, cannot give rise to tort liability.” 253 F.3d at 63. The analogy may be a little unfair, but it is so telling and so effective at communicating a fundamental truth that it quickly has become a standard line in debates about the relationship between antitrust and intellectual property.

In fact, the entire monopoly maintenance discussion has the air of a professional ballplayer using a bat to swat away arguments:

- Middleware might eventually replace part of the operating system’s function? “The test of reasonable interchangeability, however,

required the district court to consider only substitutes that constrain pricing in the reasonably foreseeable future, and only products that can enter the market in a relatively short time can perform this function.” 253 F.3d at 53–54.

- Microsoft may have achieved its operating system position “through superior foresight or quality”? *Id.* at 56. “But this case is not about Microsoft’s initial acquisition of monopoly power,” and “the applications barrier to entry” is “a characteristic of the operating system market, not of Microsoft’s popularity, or . . . efficiency.” *Id.*
- Microsoft never charged the short-run profit-maximizing price? It might have charged the long-term monopoly price. *Id.* at 57.
- Microsoft did not totally exclude Netscape? But Microsoft may have excluded Netscape from the most efficient channels. *Id.* at 70–71.
- Microsoft’s exclusive dealing did not violate Section 1? It may have violated Section 2. *Id.* at 70.

Monopoly maintenance is the heart of the court’s opinion, and the court’s discussion will yield lessons for years to come. Several particularly important points are worth noting:

(a) The court’s Section 1-like burden-shifting series of analytical steps likely will become the basic format for Section 2 analysis:

- (i) The plaintiff “must demonstrate that the monopolist’s conduct indeed has the requisite anticompetitive effect.” 253 F.3d at 58–59.<sup>7</sup> If the plaintiff establishes a prima facie case, this shifts a burden (whether of proof or merely of going forward is a little unclear) to the defendant.
- (ii) If the defendant “proffer[s] a ‘pro-competitive justification’ for its conduct,” meaning a “nonpretextual claim that its conduct is indeed a form of competition on the merits . . . then the burden shifts back to the plaintiff to rebut that claim.” *Id.* at 59 (quoting *Eastman Kodak Co. v. Image Technical Servs.*,

*Inc.*, 504 U.S. 451, 483 (1992)).

- (iii) The plaintiff may meet this burden by successfully rebutting the claimed justification. If the plaintiff fails to do so, then it “must demonstrate that the anti-competitive harm of the conduct outweighs the procompetitive benefit.” 253 F.3d at 59. The court likened this balancing approach to the “rule of reason” employed to resolve disputes under Sherman Act Section 1.<sup>8</sup> *Id.*

Although subtleties remain to be worked out, the court’s structure is likely to appeal to judges seeking a comforting roadmap for decision. An unusually influential court has set out a comprehensible approach to appraising monopoly maintenance claims. No litigant can afford to ignore *Microsoft III*’s template.

- (b) The court distinguished sharply between alleged predation through pricing, which it saw as very rarely of concern, and through exclusive dealing, which it saw as more potentially problematic.
- (c) The court rigorously scrutinized justifications. When Microsoft sought to justify exclusive dealing by its desire “to keep developers focused upon its APIs,” the court translated this as saying the firm “wants to preserve its power in the operating system market. That is not an unlawful end, but neither is it a pro-competitive justification . . . .” *Id.* at 71.
- (d) Although it was demanding on many points, the court was very forgiving on causation, even referring to the “rather edentulous test for causation.” *Id.* at 79. (“Edentulous” is defined as “having no teeth; toothless.”)
- (e) On the other hand, the court snuck the *Brunswick* antitrust injury concept into a government case: “In a case brought by a private plaintiff, the plaintiff must show that its injury is ‘of the type that the statute was intended to forestall’; no less in a case brought by the Government, it must demonstrate that the monopolist’s conduct harmed competition, not just a competitor.” 253 F.3d at 59 (citations of *Brunswick* and other cases

omitted). As noted above, the *Brunswick* concept, if allowed to flourish, can have a sweeping impact.

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Perhaps the most important lesson from the court’s decision was suggested by FTC Chairman Timothy Muris’s first speech to the ABA Antitrust Section last August. He noted that “[w]e used to believe that antitrust counseling, at least for major companies, would generally deter anticompetitive conduct.” *Antitrust Enforcement at the Federal Trade Commission: In a Word—Continuity*, Prepared Remarks of FTC Chairman Timothy J. Muris Before the ABA Antitrust Section Annual Meeting 9 (Aug. 7, 2001), <http://www.ftc.gov/speeches/muris/murisaba.htm>. This has been proven wrong by two groups of cases, he said. First, the many recent cartel cases, and, second, *Microsoft*. “The strong appellate decision in *Microsoft* reconfirms that improper conduct by firms with monopoly power can give rise to substantial antitrust issues.” *Id.* at 10. The unanimous *Microsoft* decision legitimizes the concept of limited monopolization enforcement, and, more important, it reconfirms the rule of law.

## A Look to the Future

After September 11, nothing unconnected to terrorism is really front page news. Nonetheless, antitrust’s preview of coming attractions includes a series of potential major headlines within the world of antitrust if not the world at large.

The Antitrust Division and the states can stake a claim to the spotlight based on *Microsoft* alone. Beyond that, the states will be sorting out their role with the new Administration and their role in causing wrongdoers to disgorge ill-gotten gains. The Division boasts an impressive list of cases already in litigation, including the Alfred Taubman criminal trial (sentencing is currently pending for perhaps the most prominent business leader ever formally tried for felony price fixing), *United States v. Visa U.S.A. Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001) (the

split decision that is presumably about to be appealed), *United States v. AMR Corp.*, 140 F. Supp. 2d 1141 (D. Kan. 2001), *appeal docketed*, and *United States v. Dentsply International, Inc.*, 2001-1 Trade Cas. (CCH) ¶ 73,247 (D. Del. 2001) (denying summary judgment).

The Commission of the European Communities has already claimed its share of the antitrust spotlight. Its *GE/Honeywell* decision thrust “portfolio effects” into the current antitrust lexicon. That case, plus the Commission’s statement of objections concerning Microsoft, and its *IMS Health* challenge to a refusal to license a copyright (*IMS Health Inc. v. Commission*, Case T-184/01R (C.F.I. Oct. 26, 2001) (suspending Commission-ordered interim measures)), have highlighted the reality that outcomes can be different on the two sides of the Atlantic.

In looking to the future, however, the Federal Trade Commission is worthy of particular note. In part, this is because its new Chairman, Timothy Muris, has an overtly declared interest in shaping antitrust doctrine. Chairman Muris wants to influence the law through hearings, guidance, and litigation.

In part, however, the FTC is interesting because it enjoys unusual remedial power. Section 13(b) of the FTC Act has been interpreted to give the Commission sweeping equitable authority to redress wrongs. Although this authority has been developed and used principally in consumer protection cases, the Commission has now started trying it in competition cases. In *FTC v. Mylan Laboratories, Inc.*, 62 F. Supp. 2d 25 (D.D.C. 1999), *reconsideration granted in part*, 99 F. Supp. 2d 1 (D.D.C. 1999), the court reaffirmed the appropriateness of this authority, and Mylan Laboratories subsequently agreed to pay \$100 million into an escrow account to be administered by the plaintiff FTC and 50 states. See FTC Press Release (May 2, 2001) (announcing preliminary approval of settlement), available at <http://www.ftc.gov/opa/2001/05/fyi0127.htm>. Then the Commission, by a 3–2 vote, invoked its 13(b) authority against The Hearst Trust to seek dis-

gorgement of allegedly ill-gotten gains derived from the acquisition of a principal competitor. See FTC Press Release (April 4, 2001), available at <http://www.ftc.gov/opa/2001/04/hearst.htm> (former Chairman Pitofsky was part of the majority). The then-two Republican Commissioners dissented from this use of Section 13(b): “We particularly dissent from the Commission’s decision to seek disgorgement in this situation. Without expressing a view on whether that extraordinary remedy should ever be available in an antitrust case, we believe that, if a violation is proved, existing private remedies are adequate to ensure that respondents do not benefit from any possible wrongdoing and that their customers can be made whole.” *Dissenting Statement of Commissioners Orson Swindle and Thomas B. Leary*, File No. 9910323 available at <http://www.ftc.gov/os/2001/04/hearstdiswinleary.htm>. How the Commission uses its Section 13(b) authority, and how this fits in with the alternative ways the wrongdoers are forced to disgorge gains, is one of the great unsettled issues of antitrust enforcement.<sup>9</sup>

The Commission’s other unique antitrust authority is its power to adjudicate. Although many leading antitrust cases began life as an FTC administrative complaint, e.g., *FTC v. Tigor Title Insurance Co.*, 504 U.S. 621 (1992); *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411 (1990); *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986); *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948); *Fashion Originators’ Guild v. FTC*, 312 U.S. 457 (1941), so few cases are actually adjudicated that observers sometimes forget about this weapon in the Commission’s arsenal.

That may change. The sharp decrease in mergers reportable under the Hart-Scott-Rodino program guarantees that more mergers will be subject to old-fashioned, post-acquisition challenge, which, at the FTC, will be done through administrative adjudication. This is already occurring, in *Chicago Bridge & Iron Co.*, FTC Docket No. 9300 (administrative complaint announced October 25,

2001), <http://www.ftc.gov/os/2001/10/chicagobridgeadmincmp.htm>, and MSC Software Corp., Dkt. 9299 (administrative complaint announced Oct. 10, 2001, <http://www.ftc.gov/os/2001/10/msccmp.htm>). Beyond mergers, the Commission has staked out a position as an aggressive enforcer of perceived abuses of intellectual property rights, where the law is sufficiently unclear and the stakes sufficiently high that administrative litigation is inevitably occurring. (Commission activities are reviewed in *Competition and Intellectual Property Policy: The Way Ahead*, Prepared Remarks of FTC Chairman Timothy J. Muris Before the ABA Antitrust Section Fall Forum (Nov. 15, 2001), available at <http://www.ftc.gov/speeches/muris/intellectual.htm>.) The Muris Commission's interest in self-regulation and other horizontal arrangements, as well as in immunities, also seem likely to lead to the administrative court room.

Administrative adjudication offers the potential to contribute importantly to the development of antitrust doctrine. The *Chicago Bridge & Iron* complaint invokes concepts such as removing a low cost-bidder, reducing "innovation competition," increasing barriers to entry, and allowing the unilateral exercise of market power, Complaint ¶ 40; the MSC Software complaint includes a potential competition charge, Complaint ¶ 29(c). The most intriguing example, however, is provided by *Polygram Holding, Inc.*, FTC Docket No. 9298 (complaint issued July 31, 2001), <http://www.ftc.gov/os/2001/07/tenorscmp.htm>. This is the *Three Tenors* dispute discussed above, and, if litigated fully, it will give the Commission the opportunity to try again to adjudicate in the interstices between the per se rule and the rule of reason as applied to horizontal restraints. It is ironic that after the Commission issued its *California Dental* opinion walking away from the *Massachusetts Board* approach, it was then-Professor, now FTC Chairman Timothy Muris, who urged the Commission to return to the structured approach of

*Massachusetts Board*. Timothy Muris, *FTC and the Rule of Reason: In Defense of Massachusetts Board*, 66 ANTITRUST L.J. 773 (1998). Professor Muris presciently observed that whether the Commission would follow his advice "depends on the Commission leadership, particularly the Chairman and Bureau Director." *Id.* at 799. (The final irony is that now-Chairman Muris (but not his Bureau Director) is recused from participating in *Polygram Holding*.)

FTC administrative adjudication has important ramifications for the Commission's court appearances. Before administrative adjudication commences, when the Commission is seeking a preliminary injunction, the Commission enjoys a more permissive legal standard than most litigants. The court in *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001), explained this with unusual clarity, and really seemed to mean that the Commission merely had to "raise[] 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." *Id.* at 714-15 (citations omitted). Then, if the Commission adjudicates a case and finds a violation, it is entitled to very deferential review. As described by the Seventh Circuit in two cases: "'Our only function is to determine whether the Commission's analysis of the probable effects of these acquisitions . . . is so implausible, so feebly supported by the record, that it flunks even the deferential test of substantial evidence.'" *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 935 (7th Cir. 2000) (adopting *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1385 (7th Cir. 1986)). In a conspiracy case, "[t]he test states only that there must be some evidence which, if believed, would support a finding of concerted behavior." *Toys "R" Us*, 221 F.3d at 935. In an implied deception claim case, the "court's 'task' is 'to determine if the Commission's finding is supported by substantial evidence on the record as a whole.'" *Novartis Corp. v. FTC*, 223 F.3d 783, 787 (D.C. Cir. 2000) (quoting *Thompson Medical Co. v.*

FTC, 791 F.2d 189, 196 (D.C. Cir. 1986)). Although legal issues are reviewed de novo, if courts in fact accord the Commission the deference that judicial phrasings suggest it is due, the Commission will enjoy considerable leeway to use litigation for good or ill.

With all that is occurring at the FTC and the Division, and in the states and the European Union (not to mention private litigation), all of us have ample incentive to keep our eyes on the ball. ●

<sup>1</sup> I was consulted by the defendants in this case.

<sup>2</sup> Read cautiously, *Aguilar v. Atlantic Richfield Co.* actually contemplates a specialized meaning of “ambiguous evidence,” namely, “conduct’ that is ‘as consistent with permissible competition’ by independent actors ‘as with illegal conspiracy’ by colluding ones” (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986)). It is unclear whether courts successfully distinguish between this meaning and the ordinary dictionary definition of “ambiguous.”

<sup>3</sup> The past year saw some important discussions of U.S. courts’ jurisdiction over foreign parties and actions, *Den Norske Stats Oljeselskap AS v. Heere Mac VOF*, 241 F.3d 420 (5th Cir. 2001) (denying relief to foreign plaintiffs), *petition for cert. filed*, 69 U.S.L.W. 3791 (June 11, 2001) (No. 00-1842), *Carpet Group Int’l v. Oriental Rug Importers Ass’n, Inc.*, 227 F.3d 62 (3d Cir. 2000) (finding not insubstantial effect on commerce, which is sufficient), but readers interested in this topic are referred to more specialized sources of information. The year also saw some unremarkable discussions of the ever-litigated state action exemption, *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 260–65 (3d Cir. 2001) (insufficient state supervision for exemption on this ground), *petition for cert. filed*, 70 U.S.L.W. 3317 (U.S. Oct. 19, 2001) (No. 01-656); *TFWS, Inc. v. Schaeffer*, 242 F.3d 198, 208–09 (4th Cir. 2001) (state statute and regulations requiring posting and maintaining prices, and prohibiting volume discounts, violate the Sherman Act and are not immune state action).

<sup>4</sup> See Stephen Calkins, *California Dental Association: Not the Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495 (2000)

<sup>5</sup> The Revised Proposed Final Judgment and Competitive Impact Statement reflecting the stipulation into which Microsoft, the Justice Department, and nine states entered are available at 66 Fed. Reg. 59,452 (Nov. 28, 2001). Public comment is invited for sixty days.

<sup>6</sup> Were I to evaluate the underlying merits of the case, I would have to note two affiliations. I currently serve of counsel to Covington & Burling, a law firm that has represented Microsoft, including in connection with the Justice Department case. From 1995–97 I served as General Counsel to the FTC, and in that capacity had informal conversations with Justice Department officials who were evaluating Microsoft’s conduct. The views expressed herein are entirely my own, based on public information.

<sup>7</sup> The court counts this as its second point, but since the first point is merely that a monopolist’s conduct can be condemned only if it has an “anticompetitive effect,” *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001), the first two points listed are really only one.

<sup>8</sup> Although not a separate step, the court added that during the weighing of the net effect of the monopolist’s conduct, the focus is on the effect of the conduct, not the underlying intent. *Id.* at 59.

<sup>9</sup> The Commission recently entered into a proposed settlement that calls for \$19 million in disgorgement. See FTC Press Release (Dec. 14, 2001), <http://www.ftc.gov/opa/2001/12/hearst.htm>. Commissioner Leary dissented from the requirement of disgorgement; Commissioner Swindle issued a separate statement asserting that the decision to seek disgorgement was incorrect; Commissioners Anthony and Thompson issued a statement reasserting their view that disgorgement was appropriate. Chairman Muris was conspicuously silent—but cast an unqualified vote in favor of the proposed settlement. The Commission has now formally solicited comments on the use of disgorgement as a remedy for competition violations. Press Release (Dec. 20, 2001), available at <http://www.ftc.gov/opa/2001/12/disgorgefrn.htm>.

# Interview with David Scheffman, the FTC's New Director of the Bureau of Economics

## ABA Section of Antitrust Law "Brown Bag" Program

September 26, 2001



### S P E A K E R

**David Scheffman**

*Director, FTC Bureau of Economics*

### M O D E R A T O R

**Philip Nelson**

*Chair, ABA Section of Antitrust Law Economics Committee*

**Editor's Note:** *The insider's insider, David Scheffman returned to the FTC this past year to head the FTC Bureau of Economics as Director, having previously served as an economist in the Bureau from 1979–88, and in senior management positions from 1982–88, including as its chief from 1985–88.*

*Prior to rejoining the FTC in June, Dr. Scheffman was an economic and business consultant and Professor of Business Strategy and Marketing at the Owen Graduate School of Management at Vanderbilt University. He continues to teach business strategy as an adjunct professor at Vanderbilt and at the Johnson School of Management at Cornell. While a consultant, his practice included business consulting and antitrust economics consulting and serving as an expert witness in antitrust cases and other complex litigation.*

*Dr. Scheffman received his B.A. in Mathematics and Economics from the University of Minnesota and his Ph.D. in economics from M.I.T. He is the author of many articles and books in the areas of industrial organization and antitrust economics, law and economics, and marketing and business strategy.*

*Dr. Scheffman was the guest speaker in the following interview moderated by Philip Nelson, Chair of the ABA Section of Antitrust Law Economics Committee and a principal with Economists, Inc. in Washington, DC, as a "Brown Bag" session sponsored by the Antitrust Section. The "Brown Bag" program, which took place on September 26, 2001, offered Antitrust Section members an opportunity to hear comments from Dr. Scheffman, which were followed by a question and answer session led by Phil Nelson.*

*The Antitrust Source is pleased to present this edited and updated version of the transcript of that session, which also includes Dr. Scheffman's responses to additional questions posed by our Editorial Board.*

*We see the strength of economics as providing methodologies for empirical testing and for developing data, or as the Chairman said in his speech, “stubborn facts.” In my opinion, we’re not going to make recommendations for prosecutorial decisions based on economic theory as opposed to facts guided by economics and other analysis.*

**PHILIP NELSON:** Today we have the opportunity to spend some time with David Scheffman, Director of the FTC’s Bureau of Economics. David will start by making a few introductory comments. Then we will open the floor to questions.

**DAVID SCHEFFMAN:** Of course, I don’t speak for anyone at the Commission, other than myself. With the new group, we do want to communicate to the Bar, and I to the professional economists who work on matters that we’re involved in or share an interest in, to try and be as clear and transparent as possible about what we’re thinking, what we’re doing.

It’s fair to say that we have a very economics-oriented group of senior staff. We have a Chairman, Tim Muris, who can rightfully claim to be an economist. The Director of the Bureau of Competition, Joe Simons, is a very smart guy who knows a lot of economics. We have Bill Kovacic, General Counsel, who knows quite a bit of economics. Joe Simons has an economics assistant named Mark Frankena, an old classmate of mine who worked with me at the FTC. So we have a group of people who are quite comfortable thinking about things in economic terms.

Those of you who are practitioners should read Chairman Muris’s speech to the ABA at the Annual Meeting “Antitrust Enforcement at the Federal Trade Commission: In a Word—Continuity” (Aug. 7, 2001), <http://www.ftc.gov/speeches/muris/murisaba.htm> because I think you should take what he says as being a fact. That is, in my opinion, I don’t think any of us see any significant change in policy occurring. From my perspective, the way we look at things, I think, is probably to some degree different from the people who preceded us because we’re more economics-oriented, but we don’t see any need or justification for any significant change in policy.

The Pitofsky Commission was extremely well run and had high quality staff in all the bureaus

and management positions. We have a group of people who (1) all worked together before at the FTC, and (2) probably are more sympathetic to looking at things in terms of economics and are more comfortable with that. That would probably mean some differences, maybe, in how we look at certain things in some specific situations.

But as the Chairman said in his speech, we don’t see the strength of economics in theory. We see the strength of economics as providing methodologies for empirical testing and for developing data, or as the Chairman said in his speech, “stubborn facts.” In my opinion, we’re not going to make recommendations for prosecutorial decisions based on economic theory as opposed to facts guided by economics and other analysis.

I think the Bureau of Economics will have a more important role with some people in the Commission than it did before, even though for many years now it has had an important role. I was at the Commission in the 1980s and that was a very different time. I became the head antitrust economist when Tim Muris became the Director of the Bureau of Competition, and that was a very big change. That was just after Bill Baxter issued the Merger Guidelines and when antitrust policy truly fundamentally changed and, in my mind, caught up to where the case law, mainstream economics, and common sense were. Those were very different times—in a real way, the Bureau of Economics and the Bureau of Competition were at war with one another. It was an intellectual war about what antitrust law and policy should be. I think that was a useful war, but that war is over. Not surprisingly, many of us that were in the antitrust agencies in the 1980s think we “won” the war. The best evidence of that is that we are basically comfortable with general policy of the past eight years. In any event, we’re not at war anymore.

It’s nice to be back with the Commission. We work very cooperatively with the lawyers. We’re

dealing with very different matters now. Before, there was fighting between the Bureau of Competition and Bureau of Economics about whether to block a 7 to 6 merger with (from the economists' perspective) little economic evidence of potential anticompetitive effects beyond that the level and change in HHI tickled the Guidelines. Most of the matters we're dealing with now clearly raise significant potential competitive issues from an economist's perspective.

Some more specifics about what we're doing: Tim Muris brought me on to do some specific things. One of the first things we did, working with Dennis Carlton, was to convene a group of leading industrial organization economists to come in and talk about what is the most current thinking and research in *empirical* industrial organization economics, which can help us guide our decisions, and what is the sort of research in empirical industrial organization economics that would advance our ability to contribute to antitrust investigations.

That conference was, unfortunately, scheduled on September 11. We actually went forward with the conference. The conference was going to begin just before the terrible events of the day began to unfold, and all the participants were there. We had to decide, well, what are we going to do? And we talked about it seriously at the time. All of our folks were from out of town, they weren't going to go anywhere and we decided to just go ahead. The participants, the panelists, and people who wanted to stay in the audience, said we would just go ahead, despite the tragedy of the day; we were there to do something and it seemed like the best thing we could do under the circumstances. So that's what we actually did and, although under terrible circumstances, we had a very good conference.

We had a very good discussion and the participants were Dennis Carlton, Dick Schmalensee, Jerry Hausman, Ben Klein, Mike Whinston, and Janusz Ordover. Steve Salop, unfortunately, couldn't make it because of the

events of that tragic day. The idea was to get a cross-section of leading industrial organization ("I.O.") economists who had considerable experience in antitrust investigations and litigation. So we had a very good discussion of where we think I.O. is; what is the empirical basis of I.O.; what it tells us about what we should be doing and how; and what sort of things we should be doing in the future, what sort of new research exists or would be helpful.

A significant focus of the conference—maybe a third of it—was talking about another thing that was particularly on Tim's agenda when he asked me to rejoin the FTC and has been on my agenda for a long time: what do we think about these econometric analyses of scanner data and unilateral effects theories? I have long had concerns that the practice has gone faster than the science. We had considerable discussion among the economists at this panel and there was largely a general consensus. Jerry Hausman is probably the most responsible, of any single person here, for stimulating this approach to branded products merger analysis (even though we had actually done such analyses when I was at the FTC in the 1980s). It was the clear consensus of the panel that this sort of analysis should be, at most, an input into the decision process; it's not *the* answer. There was also quite a lot of discussion about potential limitations in these analyses that we need to think about, and people are beginning to think about this now. I actually wrote a paper about this long ago, but until recently no one paid much attention to it.

Let's talk about the scanner data analysis. We're doing a lot of work in the Bureau of Economics on that. We have been working with some prominent outside econometricians. We have posted a short summary of our findings on our Web Page [<http://www.ftc.gov/be/econometrics.htm>] and will have a Bureau of Economics Working Paper out in January. We've probably done more scanner data analysis than anyone, other than maybe our friends at DOJ. We're doing a lot of thinking and working on

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scanner data analysis. I hope to talk to some of you economists more about this when I visit the various economics consulting companies, to talk about what we're thinking or have you come in and tell us what you think, which we'll be doing, too.

Let me briefly summarize some of our thinking, which of course is still in progress. There are issues in the data that economists have not really addressed. I've been a marketing professor for a long time, so I actually know quite a bit about these data. I had a market research person come in July and spend a day with us talking about the Nielsen and IRI data and its pluses and minuses. We know there are some potentially significant issues about the data, but, as far as we can tell, the economics literature and economists have not really addressed issues like the potential implications of having data aggregated up to the city level. For you economists, that may lead to some problems in the specification of the model, it raises some statistical issues, and it may confound things in that it aggregates in an unfortunate way the promotional activity. The aggregation may lead to not having a good match between the promotional activity and prices. And we know from market research and even from economics research, such as Mike Katz's and Carl Shapiro's paper on coffee years ago, [Michael A. Katz & Carl Shapiro, *Consumer Shopping Behavior in the Retail Coffee Market*, in *EMPIRICAL APPROACHES TO CONSUMER PROTECTION* (1986)] that there can be very strong interactive effects between promotions and prices. That is, if you have a hot price in the supermarket and you promote at the same time, say, with an end aisle display, the expansion in sales is much bigger than if you do just one or the other. So it's very important to match the promotional activity with the prices. When you aggregate up to a city level, that matching can be problematic.

There are also issues in the inference—the statistical inference, t-statistics, confidence intervals, etc. It's actually quite complicated to estimate key statistics such as standard errors,

t-statistics, etc. This is because—I'll do some “econospeak” for the economists—we're doing linearization *approximations*. And the linearization is two or three levels removed from the core statistical estimates. We need to think some more about that. For example, we've found, in some cases, doing sampling distributions that you get some warning signs about the lack of robustness of the estimate and the potential unreliability of the estimated standard errors.

I have said for years now that there's an issue in the modeling of the statistical estimation, which is that these estimates are coming from competition at the *retail* level. The estimates are a product, only in part, of what we're really interested in, which is the competition between manufacturers, which is the level where the merger occurs. This requires some serious thought rather than just a glossing over, as has been done in the past. I have been thinking about this for many years, and wrote about it about ten years ago. A number of people are beginning to think about this. There is a Ph.D. student at Berkeley working on this, Froeb and Werden are working on this, as are we.

This wholesale/retail issue is, I think, in a way one of the most serious issues here. Since the 1992 Merger Guidelines, cases have increasingly focused on unilateral effects. It's interesting how different our investigations are from what they were when I left the FTC in 1988. In 1988 we were doing mostly coordinated interaction cases, but we didn't have many four-to-three cases. Strangely, we don't have many coordinated interaction cases anymore. (However, speaking only for myself, I suspect that we will have more). This has happened because of the powerful economic logic of unilateral effects: A diverts to B, or vice versa, or both, and A and B are merging; therefore, the price is going to go up. There is nothing wrong with that basic logic, except as to whether the conclusion is correct. What's missing here is a proper weighing of the strength of the evidence bearing on diversion, and that logic is independent of the competition in the marketplace. Of par-

ticular importance here is the wholesale/retail issue—what is the nature of competition at the manufacturer level and what is the evidence on diversion at that level related to *manufacturer* prices?

In the late '80s, because we were doing mostly coordinated interaction investigations, we generally did a very extensive investigation into what really drove competition in all its detail. However, we do less of this these days, particularly the economists—both inside and outside the agencies. That does not make sense. Think about the ready-to-eat (RTE) breakfast cereal industry. In the 1970s it could be argued that at least on price it was a pretty tight-knit oligopoly. In recent years, due to changes in the players and other changes, it appears to be a much more competitive (on price) industry. If we focused on econometric analysis of scanner data, the difference in the nature and intensity of competition *at the manufacturer level* would not really come into the analysis (except for calculated price-cost margins). In my view that doesn't make any sense.

We have to spend a lot more time, and we are now beginning to do that, investigating the actual competition between manufacturers. It appears to me that inside and outside economists cut back somewhat on such in-depth investigations of the nature and intensity of competition, in part, because it's hard. It's hard in grocery manufacturing (and a number of other industries) to get price data at the manufacturer level that is easy to use. We can't get nice data we can just stick in our computer and calculate average prices, let alone demand elasticity estimates, like we get with scanner data. On the other hand, we get prices that are actually set by the parties to the proposed merger and their competitors. So we're trying to spend more time actually looking at what drives the competition among manufacturers.

Remember, we tend to focus on price at the retail level, but grocery manufacturers compete on the quote "list" price, either the regional or national prices. But then there's all this

other stuff like promotion, discounts, shelf and display payments, etc., where the real pricing action takes place, which deserves much more looking at than we have done in the past. Recall that this was an issue in the *Baby Food* case [*FTC v. H.J. Heinz Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000), *rev'd*, 246 F.3d 708 (D.C. Cir. 2001)]. And beyond competition on price, there is competition on product and advertising, and in some cases, distribution.

One of the key things in looking at the competition in branded consumer products is that when we do this unilateral effects analysis, we're assuming that the competition is in some sense "localized." (For example, Kelloggs Corn Flakes competes significantly more directly, with, say Post Toasties than with other RTE Cereals—at the *manufacturer* level). Now that's a testable proposition—but at the *manufacturer* level. Is the competition really localized or is it really more diffused? Or is it really not localized? What we have been doing with econometrics analysis of scanner data is concluding that because our scanner data analysis says A and B have particularly strong cross-elasticity *at the retail level*, then, if the companies merge, they'll raise the price. Well, there are other relevant and important ways of looking at that. If A and B are particularly close competitors *at the manufacturer level*, if you look at the past history of the marketplace, then you should see evidence of localized competition between A and B at the manufacturer level, as opposed to some industries where you see the competition being more broadly based across all brands.

This critique of scanner data analysis and unilateral effects theories should not, again, speaking only for myself, be taken as an indication that we're more likely to view mergers between branded products favorably. That's simply not true. Rather, we need to expand and refine our analyses of competition at the manufacturer level, and, in some cases, we may actually be more interested in coordinated interaction theories than in unilateral effects. But this is not at all an indication that the policy is going to

change. A three-to-two merger like in *Baby Food* is going to be a really tough case, no matter what. For confirmation of this, see the press release and proposed consent for the recent “rum” matter [<http://www.ftc.gov/opa/2001/12/diageo.htm>; <http://www.ftc.gov/os/2001/12/index.htm>].

Let me now turn to a different topic. I have been following and participating in the use of economists in merger investigations for many years now. It appears to me that the use of economists by outside lawyers has become much more limited. I have worked on a number of matters in which we did a lot of work, but our work was never used by the lawyers in presentations to the FTC or DOJ, even though, in my opinion, our work supported some of the parties’ arguments. There appeared to be a view that the economists’ work was not important to Commission decision makers other than to say the deal was okay and to do some econometrics analyses.

I don’t know if that approach was a mistake with the past Commission but it is certainly a mistake for the current Commission. Our decisions are not going to be made by economist pronouncements, as opposed to solid empirical economic analysis. The empirical analysis, econometrics analysis of scanner data, specifically, has to be thoroughly thought out and justified as being reliable and applicable to the issue at hand—the merger of manufacturers. So I’d urge the lawyers and economists who are going to come in and see us to have a much broader *empirical and institutional* perspective and basis of facts and evidence than just what your econometric analysis indicates.

A few other points. We’re quite interested in and we are going to convene a panel of I.O. economists like we had in September—this time on coordinated interaction, sometime in the next few months. We will have a number of prominent I.O. economists come in and talk about coordinated interaction because that’s an area which I think has been much too de-emphasized as a potential concern in a merger. The

issue is what does economic theory and empirical research contribute to developing the use of coordinated interaction theories in mergers and other antitrust investigations?

As I said at the outset, we are trying to become more transparent in our views and the basis for those views. Our aim, without unduly sacrificing our litigation position, is to be even more transparent, communicating to you what, as best we can tell, our real concern is and the bases for that concern. That said, I remember that almost immediately after I left last time, I had considerable difficulty figuring out what the Commission staff was thinking on some specific matters. But if I had thought about it, I would have realized, and, being back again, I now realize, that often the problem is that we don’t really know for sure what the specific problem is. That is, we appear to have a significant potential problem, but we have difficulty nailing down market definition, or barriers, or competitive effects. For example, we may know that we have a *likely* four-to-three (e.g., market definition is not “air tight”), but we have a bunch of complicated evidence which points in different directions on competitive effects and barriers that we’re trying to figure out. In this sort of situation we have enough of a *potential* concern with the transaction that we’re not telling you to go away and consummate, but we’re not necessarily telling you clearly what our concerns are because we might not yet be sufficiently sure. We think that there might be a case here, but we’re still struggling with it. So, the fact that you don’t get a crystal clear signal doesn’t mean that we’re not being transparent.

As I said a week ago at the Antitrust Section’s FTC Committee Brown Bag program, and as I’ve told my clients on the outside, in that case, what you should do is write the closing memo for the Bureau of Competition. You’ve got to cover all the potential significant bases. We will be as transparent as we can, realizing, of course, that we may be in court with you in a few months. We’re not going to give away our litigation position, but there’s no reason for us not

*I’d urge the lawyers and economists who are going to come in and see us to have a much broader empirical and institutional perspective and basis of facts and evidence than just what your econometric analysis indicates.*

to be pretty forthcoming with our basic concerns and to have a reasonable debate about that.

I look forward to talking to you more in the future, especially the economists, to talk about what we're thinking about, what we're doing, and where things are going at the Bureau of Economics. Thank you.

**NELSON:** We will now take questions from the audience.

**AUDIENCE QUESTION:** Can you talk a little bit more about how coordinated interaction will be used to investigate a merger?

**SCHEFFMAN:** Coordinated interaction never went away entirely. Coordinated interaction is a basic situation in which the reduction in the number of players from, say, five-to-four or from four-to-three might reduce the competition sufficiently that you'd get a price increase, but that the parties to the merger could not raise price unilaterally. That has always been part of the Guidelines and of enforcement, but there has been a move towards more emphasis on the reduction in the competition between the parties to the merger causing a price increase. And that's a situation where the competition is quite localized. The two parties have enough post-merger control of price to raise price unilaterally as a result of the merger.

This is something that we're looking at, and, in my personal opinion, over time coordinated interaction may become more important. Of course, that decision is up to our clients, the Commissioners. What Chairman Muris asked of me, and I agree, is that we need to be able to deal with this. We need to understand the implications of relevant economic theory and empirical research for analyzing mergers under a coordinated interaction theory. This is something that really has not been revisited much, at least by economists at the practitioner level, for quite a while because we've been mostly all engaged in doing unilateral effects cases.

I was involved in some substantial coordinated interaction cases on the outside and did a lot of empirical work. I will be putting out a B.E. Working Paper early next year. So this is an issue which we, as economists, are charged with thinking about and getting some outside help thinking about—rethinking oligopoly theory and reviewing empirical research and what implications it has for how we should do investigations. We're going to be doing that. My advice is to look to make sure that the competition isn't broader than localized. The fact that it's broader doesn't mean that you don't have a case. For example, I didn't work on the Pennzoil/Quaker State "canned motor oil" merger, but I know quite a bit about that industry and I was quite surprised that the investigation appeared to focus on unilateral effects. From what I knew about the industry, I thought that there likely was a potential coordinated interaction issue, but I hasten to add that I did not do a thorough economic investigation of the industry. Beyond this anecdote, what it means is we should be looking at what really drives competition and how competition might be affected by a merger.

**NELSON:** As a follow-up to the question about coordinated effects, when economists model coordinated effects, they tend to use Cournot or Bertrand models. Is there an effort to determine what types of formal oligopoly models should be used? Or, is there a more general empirical effort to determine what types of information should be collected to determine whether the oligopoly is a particularly tight oligopoly, without getting into arcane issues about whether a Cournot or Bertrand model is the appropriate model to use?

**SCHEFFMAN:** Well, I think it's the latter that is likely to be more important, i.e., the empirical evidence bearing on the details of actual competition. I've done quite a bit of work on this. My forthcoming B.E. working paper will clarify what I think are some important empirical tests and what testing the relevant data would tell us

about the viability of a coordinated interaction theory in a particular case. Determining that a coordinated interaction theory is valid is probably harder than developing empirical analyses that tend to show that a coordinated interaction theory is probably not valid (if the facts are there). Economics doesn't provide much guidance. I remember we had the old Posner checklist: Is the product homogeneous? What is the frequency of transactions? Are they big, lumpy transactions or frequent? And so on. That checklist doesn't really give us much help at all. When we were doing a lot of coordinated interaction investigations in the late '80s, we'd actually advanced pretty far away from that, and looked in various ways at competition and in various empirical ways at the evidence of whether there was significant coordinated interaction and whether it would be facilitated by a particular merger. I can't tell you more than that. I think that the art did advance significantly in the agencies during the late '80s, but there was hardly any literature that came out of that experience. So we're going to have to rethink that and we're going to be talking among ourselves and with outside industrial organization economists about what are the empirical approaches we should use in deciding whether we have a viable coordinated interaction theory or not.

**ANTITRUST SOURCE:** What are you saying about the calculation of the price-cost margin or the time period over which the effects of the merger are predicted? For example, we now evaluate the merger in terms of its short-term (one or two years) effect on prices. Are you saying that such an approach is often misleading because firms may not choose the short-run profit maximizing price because of long run considerations? If so, how do you identify the potency of that long-run constraint?

**SCHEFFMAN:** I am talking about something different. Using scanner data we are estimating extremely short-run elasticities. Brand man-

agers probably do not act in their pricing decisions on such short-run elasticities. The issue is: what is the relevant elasticity (in time and other dimensions) that governs brand managers' pricing decisions?

**ANTITRUST SOURCE:** You have expressed skepticism about the role of unilateral effects in merger analysis. Would you support amending the Guidelines to eliminate the section on unilateral effects or to revise it in some manner?

**SCHEFFMAN:** I have expressed skepticism of the intensity of use of unilateral effects theories in mergers (at the expense of coordinated interaction theories) and some of the aspects of the application of unilateral effects analyses in some contexts. We hope to put out more guidance on this, beginning in the first half of next year.

**AUDIENCE QUESTION:** What is your criteria for evaluating efficiency defenses? From an evidentiary standpoint, what's a minimally acceptable efficiency defense?

**SCHEFFMAN:** The agencies spoke with some clarity in the 1997 Guidelines. Again, I cannot speak for the Commission. However, I think it is fair to say that efficiencies analysis is still evolving. One of the things we are doing is looking at what parties have actually been doing in response to the 1997 Guidelines, and how we have responded to their efficiency arguments and submissions. Our work here is at a very early stage. Of course, we've also litigated efficiencies in some cases. As a matter of economics, my opinion is that I think the approach articulated publicly by the Commission in the past is too narrow—we should be thinking more broadly as to potential sources of credible efficiencies. Chairman Muris took this position in a law review article [Timothy J. Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, 7 GEO. MASON L. REV. 729 (1999)]. My review of a lot of mergers and the literature on mergers leads me to conclude that,

*In my view the most important thing parties on the outside need to do is to explain from the beginning why their deal is taking place. What is the deal about? Is there a plausible business justification? What is the support for that business justification, and what are the potential competitive implications? And then, of course, are there explicit efficiencies with factual support?*

for example, increasing sales is probably a more important driver of mergers, on average, than reducing costs. This motivation sometimes gets somewhat disguised because of perceptions that antitrust review will look dimly on objectives that include increased market share. In any event, we have the 1997 Guidelines and one thing we are going to do of course is to analyze efficiencies as laid out in the Guidelines. Nonetheless, the Bureau of Economics and I have some ability to forward analyses and recommendations to the Commission that encompass a broader, what I what call a more sophisticated economics-based and business strategy approach to efficiencies. And we have five Commissioners who are the decision makers. In any event, supportable facts are absolutely essential for a credible efficiency argument.

But at a more general level, in my view the most important thing parties on the outside need to do is to explain from the beginning why their deal is taking place. What is the deal about? Is there a plausible business justification? What is the support for that business justification, and what are the potential competitive implications? And then, of course, are there explicit efficiencies with factual support? But remember, we're prosecutors. So our view is, what's wrong with your deal? That's our job. That makes it particularly important for you to highlight whatever is good about your deal in terms of business justification, efficiencies, potential impact on competition, etc., even though you can't necessarily quantify it in the sense of our 1997 Guidelines. This provides a different perspective that this deal might actually make good business sense and have the possibility of strengthening competition and benefiting consumers. However, I caution you to have plausible arguments that are as much as possible based in facts.

I have spent over twelve years as a business strategy MBA professor and consultant. I think I have some ability to assess the strategic merits of a proposed transaction. So, of course, I am interested in learning about the strategic moti-

uations and projected effects of a transaction. However, in my view, such general themes and arguments are not going to lead anyone to decide they're not going to sue you, if we think the deal is clearly anticompetitive. But in a situation where we're weighing a very complicated, ambiguous situation, convincing us that in a business and economic sense the deal is probably "pretty good," absent antitrust concerns, is a lot better than a vacuum where we just say, well, if we block this deal . . . so what? Of course, the Commission does not attempt to block transactions without a solid basis. I'm not saying that there's a "balancing" here. If the deal is anticompetitive, we're going to sue (although, remember again, I am not the decision maker). However, a lot of deals that we investigate are pretty complicated and, in a "close call," the strategic and economic purposes and implications of a proposed deal can make a difference.

So I'd urge everyone to think about what their deal is about and then see if it does have a plausible business purpose that perhaps also has the potential to be procompetitive. Of course, there is not much credibility from producing this from whole cloth which is not reflected in company documents. On efficiencies as analyzed under the antitrust laws, as discussed above, in the Bureau of Economics, we're trying to examine past practices to look and see what parties have done since the 1997 Guidelines and study what we've done about it. We have limited resources, but we're thinking about that.

In investigations, we're going to try and engage people in meaningful discussion if they put forward an apparently credible efficiency argument. For those companies that regularly appear at the agencies with mergers ("merger recidivists"), I'm very interested in asking them what actually happened in the merger that we investigated a couple of years ago? Why don't you tell us about it? You made these claims that these things were going to happen. Tell us what happened. Show us whether what you claimed to do actually happened or not. When I was on

the outside, I advocated that my clients do that when we had been in with another deal in the recent past. Why don't we show them what we actually did, so that we'll have credibility because we could show that we actually did what we said we would do?

My own opinion, and this is supported by both academic work and M&A consulting, is that the key to a successful merger is implementation. A past track record of actually achieving merger benefits in my opinion provides some support for merger benefits. Furthermore, I am personally interested in what specific plans you have to actually carry out what you claim you are going to do. My opinion as a business strategy professor, is that if you do not have explicit measurable goals and targets and timetables with accountability, "it" is probably not going to happen.

To sum up, we are thinking about the efficiency issue, but more in terms of understanding what parties are doing in response to the 1997 Guidelines and how to analyze efficiencies. There's no change in policy. But explicit consideration of efficiencies is still pretty new. I think what we're going to do is understand better what the '97 change meant and how it has played out. What sorts of things are we getting from the outside? How are we dealing with them? Then, we hope, maybe sometime next year, we'll be able to report what we learned.

**NELSON:** I have a follow up question on efficiencies: Let's assume that you may be able to show that the merger will lead to significant cost savings. In concentrated industries where an efficiencies defense may be particularly important, there's often a debate with the staff about whether there's significant pass-through of the efficiencies to consumers. There also may be a debate over whether the efficiencies are "merger specific." As a former marketing professor, just in terms of the "merger specificity" issue, assume that the acquiring firm thinks it has particularly strong managerial skills and expects

that it will be able to eliminate organizational slack in the acquired firm so that it can manage the acquired assets better. Some lawyers will argue that this type of efficiency is not merger-specific because anybody who's a smart entrepreneur can take out organizational slack. On the other hand, it may be that the organizational slack has been present for a decade, nobody has attempted to remove the slack, and relatively few firms are able to identify the slack and eliminate it. Is this type of cost saving a merger-specific efficiency? Should this type of efficiency be identified in presentations to the FTC?

**SCHEFFMAN:** It is my opinion that any credible efficiency that you can back up should be put forward. However, you had better be able to back it up because there is one thing worse than saying nothing and that's saying something that we find out isn't true. And then you're in a big hole rather than just being at zero. The way the agencies, the Pitofsky FTC in particular, have discussed efficiencies in public pronouncements, it appears that what you're talking about would not generally have been counted as merger-specific and it wouldn't have been "weighed" by the Pitofsky Commission, at least according to public pronouncements of senior Commission officials. (B.E. is doing some work to get a better understanding of how efficiency considerations figured in actual decisions).

As an economist, that isn't the policy I would choose. However, remember that the 1997 Guidelines don't say that you can only put forward what is summarized in the Guidelines. You can put forward whatever you want. We have a number of decision makers who weigh things: the five Commissioners, with input from BE and BC staff, and Joe Simons and myself. Different people may look at things somewhat differently. I'd say, again, there's no change in policy. You can see in Bob Pitofsky's writings that he was not "anti-efficiencies." But the policy doesn't say that you can't make whatever factually-supported case you want, to see whether you can influence any decision maker that a certain argu-

ment should be weighed. But, again, I think a situation in which we are “balancing” a merger that we are pretty sure is anticompetitive against efficiencies, in my opinion, is going to be extremely rare. However, where we think there really are substantial efficiencies, someone may conclude that because of the efficiencies and a lot of other things, the merger is probably not likely to be anticompetitive. From an economics perspective, I think it would be very rare if you have a situation where you thought this was a really efficient transaction, was going to strengthen competition, and prices were going to go up. I don’t know. I have not seen such a situation, so I don’t think that this balancing is really empirically very important. However, efficiencies can be very important because some cases are close calls and then lots of things come into play. But again, remember, I’m not a decision maker—the Commissioners are the ones who decide these matters.

**AUDIENCE QUESTION:** Can you give us your thoughts on how you evaluate fixed cost versus variable cost efficiencies?

**SCHEFFMAN:** What we will do, you can be sure, as in anything the Bureau of Economics sends up to the Commission, will begin by following the approach laid out in the Guidelines. Under *simple* economic arguments, variable cost reductions would generally be counted to be more important. However, fixed costs aren’t unimportant. It would depend on the situation. What’s the incentive of the party that is gaining the efficiencies to expand output or to reduce price. As a matter of simple economics, that’s most closely related, generally, to variable cost. However, it certainly can, in some situations, be related to fixed cost. (Through, for example, the effect of ongoing fixed cost reductions on the rate of return on incremental investments).

**AUDIENCE QUESTION:** Joe Simons said something about looking at more vertical cases and also about the issue of raising rivals’ costs. Are the

vertical cases that you’re interested in things where there’s already kind of a horizontal problem, since the vertical things typically are not problematic?

**SCHEFFMAN:** As Joe indicated, we do have some investigations that have some significant vertical issues that are part of the investigation. I think that in terms of both law and economics, a vertical case is more likely to be a good case if it has a significant horizontal component. There wasn’t a lot of so-called vertical enforcement over the last ten years. There were cases where vertical issues were important parts of the case. That was true in the 1980s, also. We just did not flag them. Again, I don’t see any significant change. We are looking at potential cases that have a vertical component that are probably good cases.

**ANTITRUST SOURCE:** Regarding evaluations of consummated mergers, does the Bureau of Economics intend to conduct any concerted review of mergers (1) generally, as to whether claimed efficiencies were achieved, and (2) as to what the overall impact mergers have had on the market structure and performance indicators? If so, would such a review be focused on specific types of mergers, e.g., hospital mergers?

**SCHEFFMAN:** We are devoting some resources to review of mergers, both as to competitive outcomes and efficiencies. We are interested in trying to assess the effects of mergers of hospitals.

**ANTITRUST SOURCE:** Under what circumstances might such a review warrant reopening a merger investigation?

**SCHEFFMAN:** That would be a decision by the lawyers.

**NELSON:** Our discussion has largely focused on issues relating to the parties that are being investigated by the FTC. However, the FTC is

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also contacted by firms that want to complain. Do most of your comments today apply to people filing complaints, or is there something additional that you think someone who is going to go in and lodge a complaint either in a monopolization case or in a merger case should know?

**SCHEFFMAN:** I've never done this on the outside, but if you're coming in as complaining competitor in a merger, you have a significant burden in that case to convince the economists that you really have something, because the usual economic presumption is if a competitor does not like the transaction it's because it's going to be pro-competitive, not anticompetitive. We've had that presumption (at least the economists) for twenty years, so you have a real burden in that case to show us that you've got some real facts. Of course that is a rebuttable presumption (after all, I did co-author "Raising Rivals' Costs").

In the past I have come into the Commission a number of times for complaining parties (but not competitors), to try and get the Commission to act on something that my client was concerned about. My opinion is that you've got to really give us something in terms of facts and, in some situations, other things. For example, in some matters it's probably a good idea to try to give us some help with the law, if it's an area of the law that's not so clear. IP issues, for example, often make for very tricky issues, given the state of the law. You should think about how you can help beyond alerting us to your concern. The way you can really help is to provide us with some of the investigation that we would normally do—the facts and legal analysis, if that's important.

**NELSON:** There are some structural characteristics of the Bureau of Economics in which I thought some people might be interested: How many economists do you have now? Is the staff going to grow or shrink? Is there going to be any sort of reallocation of staff between mergers and other efforts? For example, when we were

both at the Commission together, there was a fair amount of intervention work, such as testifying at the ITC or other places about consumers' interest. Is there going to be an increase in this type of competition advocacy work? Generally, how are the Bureau of Economics's resources going to be allocated and are they going to grow?

**SCHEFFMAN:** To begin with, we already have a really, really fine staff. They are a very solid group of economists, as some of you who have been there know. There are a number of people, probably twenty-five or so, who were in the Bureau back when I was there in the '80's, and maybe more than that, as well as some fresh, new blood—very bright young folks. We really have a very good group of people who work very well together. When I got to the Commission, the Bureau of Economics was around 200 people. Now it's 100. That's about what it was when I left in 1988. And the Commission has grown since. That's put a lot of strain on us. There are many more "hot" investigations going on at any one time now than in the 1980s. It's really interesting because there's no controversy at all anymore with the lawyers on the antitrust side whether economists are needed on antitrust investigations and litigation. That used to be what the fight was about in the '80's—what do we need you folks for? There's no fight about it now. They know they need us. And so there's really much more demand for our services than before and we're a lot busier.

However, we're a lot more efficient. In the 1980s we were still trying to figure out the Guidelines and find our way. We know a lot better what we're doing now, so we can be, and are, much more efficient. But we're actually stretched very thin. So we allocate resources so that we contribute most when economics has an important contribution. It's a difficult resource allocation problem, particularly since the Commission has a very active nonmerger enforcement program. But we're working much more closely with the lawyers.

In a way, in the 1980s, we were duplicating a lot of stuff that the lawyers were doing, collecting deposition and documentary evidence, etc. because we thought that the evidence actually showed something different than what the lawyers thought it did. We're not doing these duplicative efforts so much anymore. We don't have time. We're working much more closely with the lawyers, so we can allocate our resources better. But we have a lot of demands on our time.

There's much more burden on the outside parties than there was years ago. We have to do our job and you have to do your job. It's not so much a "mystery" like it was in the 1980s, where no one knew what we were doing because we were "making it up" (increasing our understanding of the Guidelines and how to do economics-based merger investigations) as we went along. We are much more settled in our approach to merger investigations than we were then.

But you've got to do your part. That's why I'm going to meet with the parties as early as possible, trying to clarify our needs for information and for analyses and to identify our issues. We've got very limited resources. In the 1980s, the Bureau of Economics in a lot of ways was doing the work for the outsiders because the outsiders didn't know what to do. We weren't trying to make the case for the outsiders. Rather, we were trying to develop the evidence because the economics suggested that the parties, if they knew what they were doing and had good economists, would do it. We don't have the resources to do this anymore. Often these days we are going to ask you—have your economists or business people develop these data and analyses and get it to us soon enough that we can check it thoroughly and think it through.

So there's much more burden on the outside parties, and that's why it's much more important that we be transparent and say, "This is what we're interested in. What have you got on this?" Because we have scarce resources.

**NELSON:** There sometimes is a feeling in FTC investigations that the FTC staff and the outside parties are "ships passing in the night." For example, lawyers periodically said, "Gee, the FTC economist who attended the meeting may not have understood our point. You should give him a call and sort through the issue with him to make sure he understood the argument and factual support." At times, there have been restrictions on conversations that an FTC economist can have with outside parties—either outside economists working on the matter or outside lawyers. Are those restrictions still in place or is the FTC more open? Can outside economists and FTC economists just pick up the phone and talk?

**SCHEFFMAN:** No, I think we'd be very careful of picking up the phone and talking to outside parties. We have to clear that with our lawyers. I've been a litigation economist—an expert witness—for a long time. I understand that we don't want to have stuff pop up where economists speak to economists like economists do outside a litigation environment. We have to be careful how we do it, but I do think that after touching the legal bases, that we can be more transparent and share data and have more discussion, subject to protecting our legal prerogatives.

**NELSON:** How should outsiders go about identifying what arguments the FTC has in mind?

**SCHEFFMAN:** One obvious issue is that we know a lot of things that you don't know. We talked to your customers, and your business people very often don't know what your customers and your competitors are saying. But, I think the biggest problem with "outsiders" not understanding what we are grappling with is "groupthink." At some point, back early on, if you did a good job, you identified the potential issues. Then you focus your attention on trying to make those issues "disappear." In my experience, the outside parties often lose sight of the likelihood

that there are genuine issues that they do not really have conclusive answers for, sometimes because people talked themselves into believing that they had an issue nailed, but did not, sometimes when further work might have actually nailed it. And we fairly often end up being concerned about something that probably was on your list of potential problem areas early on, but somehow got crossed off *your* list and you can't, anymore, even entertain the idea that that would be an issue. I always use my role as an economist, either inside or outside the agency, (and outside that wasn't always very popular with the lawyer's client), to be a devil's advocate and say maybe they're thinking about this and what do we have to say about this? People don't like to hear that when you get far into the investigation. Put differently, I think that a real problem in advocacy is getting locked into your own view and not realizing we're not stupid. We're actually, on average, very good at what we do. But we don't know some stuff you know and we do know a lot of stuff you don't know. And we have a larger perspective for you to try and think about—what we might be thinking about and why.

**NELSON:** Another thing that has varied over the years has been the extent to which staff economists are involved in informal interviews and depositions. At various times, there have been at least rumors that there is sort of a gag order on the economists that limits their ability to just step up and ask any questions that are on their minds. Under FTC rules, as I understand them, economists can cross-examine even in a formal deposition and before an ALJ. Are economists always free to ask anything they want, or do they typically have to ask their questions through an attorney?

**SCHEFFMAN:** Depositions require a lot of skill. Most of our lawyers do not want to have the economist ask the questions. I can't argue with that. I do argue if our lawyers don't want to somehow get the information that we think is

important. But they run the deposition. We don't even let our new lawyers do depositions. They have to be here awhile and be trained. In any event, I don't think this issue is of much importance.

**NELSON:** What I thought was a major change in FTC policy under the Pitofsky/Baer regime was a change in what it took to settle merger cases. It became harder to close the merger before finding a buyer for assets that had to be divested—there was more pressure to find an up-front buyer. Is there any thinking that the FTC's policies with respect to fixing mergers might change or is it likely that you will follow the policies of your predecessors?

**SCHEFFMAN:** Well, again, I cannot speak for the Commission. I think Joe Simons said something about merger remedies at the FTC Committee Brownbag last week. In my opinion, an up-front buyer has some plusses and minuses. The main plus is that you can evaluate the buyer from the beginning and determine whether you can effect a suitable fix. On the other hand, the up-front buyer situation often limits information we want to have about potential alternatives, the "true" requirements of the up-front buyer to be fully competitive, etc. So again, in my opinion I don't think the policy is that we always want an up-front buyer, but Joe Simons will speak more clearly on that. But I do think that all of us in the current senior management think that it's taken too long in the past to resolve things. I think both Joe Simons and I don't like things to linger on. We do our work, we make decisions, and we like to get a matter resolved. We think that the Chairman has a lot of confidence in us and vice versa. But we have five decision makers we work for and we're not the ultimate decision maker. Only the Commissioners can determine the ultimate resolution, and this can sometimes get complicated. ●

## Paper Trail: Working Papers and Recent Scholarship

*This department tracks current working papers or recently published articles on issues of interest to antitrust practitioners and enforcers. In this issue, we offer for your consideration three recent papers and one not-so-recent article. The paper by Paul Pautler dovetails nicely with the David Scheffman interview published in this issue. Pautler is one of Scheffman's deputies at the FTC, and the paper may be at least suggestive of what the Bureau of Economics thinks of recent empirical research in Industrial Organization. Patrick Greenlee and Alexander Raskovich have a surprising answer to those who think that a financial interest by a downstream firm in an input supplier can reduce the degree of double marginalization. Patrick Bolton, Joseph Brodley, and Michael Riordan—all distinguished antitrust scholars—evaluate predatory pricing case law in light of modern research. And in a not-so-recent article, Gregory Werden and Luke Froeb reach some unsettling conclusions about the practical role of entry in antitrust analysis. While not covered here, the editors also encourage readers to review the article by Roy Epstein and Daniel Rubinfeld in the forthcoming issue of the Antitrust Law Journal, Vol. 69, Issue 3 (2002).*

*We welcome readers' suggestions of papers you have found to be particularly useful or insightful. Contact Editors Bill Page, [page@law.ufl.edu](mailto:page@law.ufl.edu), or John Woodbury, [jrw@crai.com](mailto:jrw@crai.com).*

—JRW

### Papers and Summaries

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**Paul A. Pautler, "Evidence on Mergers and Acquisitions," FTC Working Paper No. 243 (Sept. 25, 2001).**

This paper is a very useful compendium of merger studies conducted from the mid-1980s to the present. Pautler—who is one of David Scheffman's deputies in the FTC's Bureau of Economics—describes the primary empirical methodologies used to gauge the effects of mergers and then, with an admittedly broad brush, characterizes the results from each approach. For example, with respect to "event" methodologies using stock market returns, Pautler concludes that there are small net gains to shareholders, but the bulk of the returns are captured by rival firms. Whether this is due to an anticompetitive effect of the merger, an expectation that rivals are now also "in play" for a merger, or to an efficiencies "demonstration effect" is unresolved. It is unfortunate that

Pautler does not offer an overall conclusion about what this vast empirical literature implies for the severity of merger policy.

**Patrick Greenlee and Alexander Raskovich, "Vertical Ownership Without Control," Economic Analysis Group Discussion Paper (EAG 01-6) (July 20, 2001) [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=278088](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=278088).**

One piece of conventional wisdom is that if a firm acquires a purely passive (silent) financial interest in an upstream (input) supplier, and if the upstream market is something less than perfectly competitive, then that acquisition is pro-consumer. This is because effective price to the downstream firm—the nominal price of the input charged by the upstream supplier less the share of upstream profits due the downstream firm as a result of its passive financial interest—will be closer to the marginal cost of producing the input. The downstream firm will then increase its output above its pre-acquisition level. It is also conventional wisdom that this

statement isn't exactly true. As a result of the lower effective price for the input, the downstream firm will demand more of the input, and so the upstream firm will respond by raising the price "somewhat." Greenlee and Raskovich show that for a large class of market environments, the upstream price increase exactly offsets what the effective reduction in price would have been due to the downstream firm's financial interest. As a result, the downstream firm does not increase its output and, in these equilibria, there is no consumer benefit from the acquisition of the interest. In these cases, some control over the upstream firm might be required to realize the efficiencies from the elimination of double-marginalization. A competition policy that limits any control accompanying a financial interest (out of, e.g., vertical foreclosure concerns) may have the effect of limiting the efficiency gains from the acquisition.

**Patrick Bolton, Joseph F. Brodley, and Michael H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy,"** 88 *Georgetown L.J.* 2239 (2000).

For some time—particularly since the *Brooke Group* decision—plaintiffs' success in bringing federal predatory pricing claims has been trivial at best. The authors of this article argue that the predatory pricing pendulum has swung too far in the reluctance of the courts to pursue these matters. As a result, too many "true" predatory pricing events are unpunished. Among the sources of this disconnect is the failure of the courts to realize that further review of some of the key empirical literature on which the courts have relied did not establish that price predation is in fact a rarity. Another major disconnect is the theoretical approach taken by the courts, using an outdated theory of price predation that is static and non-strategic. Using the modern theory of predation that is both dynamic and strategic, the authors provide a framework for assessing predation claims that they believe is consistent with *Brooke*.

**Gregory J. Werden and Luke M. Froeb, "The Entry-Inducing Effects of Horizontal Mergers: An Exploratory Analysis,"** *J. Indus. Econ.* 525 (Dec. 1998).

While this article might not be "recent" by many definitions of the word, an editorial board member recently (as conventionally defined) stumbled across it. Entry considerations play a critical role in evaluating the likely competitive effects of a merger. Yet, this paper suggests that reliance on entry may be misplaced. In particular, the paper uses simulations of Bertrand competition to evaluate the efficacy of entry in constraining post-merger price increases. However, the typical Bertrand models—the type that antitrust practitioners usually roll out to evaluate unilateral effects in a differentiated product industry—evaluate the sufficiency of entry after the model is "run." Here, the authors incorporate entry explicitly into the model and find that typically, the entry opportunity created by a post-merger price increase—even with very large mergers—is in fact not sufficiently large to induce entry. These results suggest, then, that our usual reliance on entry to resolve apparent competitive problems could be misplaced. ●

# HOTLinks

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**Hot Links**, an annotated and periodically updated source list for antitrust lawyers and economists.

*[Neither The Antitrust Source nor its sponsor, the ABA Section of Antitrust Law, necessarily endorses the sites listed below or any of the content within them.]*

## General

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### From the American Bar Association:

■ <http://www.abanet.org/antitrust/>

*Contains abstracts and tables of contents for the Antitrust Law Journal and Antitrust magazine; links to antitrust-related Web sites; Membership services, committee activities and publications; meeting information and new publications order forms.*

■ <http://www.abanet.org/abapubs/>

*From the ABA, its listing of publications on antitrust and other legal disciplines.*

■ **From the US DOJ Antitrust Division:** <http://www.usdoj.gov/atr/contact/otheratr.htm>

*Not just their home page, but they actually have a comprehensive set of links to a lot of competition agencies around the globe.*

■ **From the Federal Trade Commission:** <http://www.ftc.gov/ftc/antitrust.htm>

*Links to who's who in the Bureau of Competition, their mission, public schedules, and documents.*

■ **From NAAG:** <http://www.naag.org/>

*The National Association of State Attorneys General (NAAG) for the latest on what States are doing in the antitrust arena.*

■ **From FindLaw:** <http://www.findlaw.com/01topics/01antitrust/index.html>

*A great source for finding other AT law firms, consultants, summaries of law, cases, discussion groups, and more.*

■ <http://www.antitrustcases.com/>

*More antitrust case law that allows one to search chronologically, or by legal issue or even by product.*

## General continued

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■ **From Cornell Law:** <http://www.law.cornell.edu/topics/antitrust.html>

*Links to the statutes that bind us and the latest decisions that guide us . . . as well as information on antitrust generally. Includes links to federal and state enforcement and decisions as well.*

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■ **From Ripon College:** <http://www.ripon.edu/faculty/bowenj/antitrust/INTRO.htm>

*Excerpts from the Supreme Court's debates on antitrust cases up to about 1993.*

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## Antitrust Policy

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■ <http://www.antitrust.org/>

*A pretty broad range of editors, including economists and lawyers in government, private practice, and academia. Interesting articles. More economics, and news.*

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■ **From the American Antitrust Institute:** <http://www.antitrustinstitute.org/>

*Information on the latest antitrust issues, links to cases, people in antitrust.*

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## International Antitrust

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■ **From the United Nations:** <http://www.unctad.org/en/subsites/cpolicy/index.htm>

*Thorough set of links to international competition authorities.*

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### From the EU:

■ <http://europa.eu.int/comm/competition/antitrust/oj/>

■ [http://europa.eu.int/comm/competition/index\\_en.html](http://europa.eu.int/comm/competition/index_en.html)

*A calendar of events of interest to competition lawyers from the EU.*

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■ **From the OECD:** <http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-home-71-3-no-no-no,FF.html>

*The leaders of the world's major competition authorities provide a source of policy analysis and advice to governments.*

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■ **From the IBA:** <http://www.ibanet.org/general/CommHome.asp?section=SBL&Committee=SBL-C>

*From the International Bar Association: their Antitrust and Competition site, complete with international links*

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■ <http://www.clubi.ie/competition/comprframesite/WorldsBiggestAntiTrustSitesList.html>

*From Competition Online, a site with links to a variety of national competition agencies*

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## The Politics of Antitrust

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■ <http://thomas.loc.gov/home/thomas.html>

*This is a great site for general information about the legislative process, pending legislation, and links to committees.*

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■ <http://www.senate.gov/~judiciary/>

*The Senate Committee on the Judiciary's Web site. These are the Senators and staffers who are responsible for writing and passing antitrust legislation.*

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■ <http://www.house.gov/judiciary>

*The House Committee on the Judiciary's site. These are the representatives and staff working on antitrust laws on the House side.*