ROUNDTABLE DISCUSSION

Revisions to the Horizontal Merger Guidelines

Introduction

BY LARRY FULLERTON

On September 22, 2009, the Department of Justice and the Federal Trade Commission announced plans to solicit public comment and host joint workshops to explore the possibility of updating the Horizontal Merger Guidelines. The Guidelines date from 1992, and while they have been regarded as very successful, they have also been criticized increasingly as out of date.

This review was thus widely anticipated; indeed, the Antitrust Modernization Commission recommended that the agencies revisit the Guidelines. At the same time, this may represent one of the most important policy initiatives announced so far in the new Obama Administration.

What should we expect from this exercise? The stated goals are to determine whether the Guidelines accurately reflect current practice at the agencies and whether they adequately take into account recent developments in legal and economic thinking. From the materials released by the agencies in connection with their announcement, it may also be inferred that the agencies seek merely to clarify the Guidelines where needed.

From the articulation of these goals, one might conclude that the changes to the Guidelines will be comparatively modest. Indeed, FTC Chairman Jon Leibowitz has been quoted in the press as saying that any changes will be more "evolutionary" in nature. In addition, the inherent challenge faced by the agencies in considering revisions to the Guidelines—to develop an adequate consensus to support any given changes—suggests that changes will be limited.

But there are a number of signs that the revisions may be more significant. For one thing, the questions released by the agencies to guide public comment suggest that the agencies contemplate adding several new topics to the Guidelines, such as the use of direct effects evidence, the role of power buyers, acquisitions of minority interests, and merger remedies. And they suggest possible changes to the Guidelines framework itself—whether to retain the current step-by-step approach to merger analysis, for example, or whether to emphasize, as the Commentary to the Horizontal Merger Guidelines does, that the analysis of likely effects is an "integrated" one in which the ordering of the elements of the analysis is not itself significant.

In addition, as observed by Debbie Feinstein, the Moderator of the Roundtable Discussion that follows, this review of the Guidelines takes place in the context of a change in administrations, amidst criticism that the previous administration was too lax in merger enforcement, and after the agencies lost some important merger challenges in court.

Given this context, will there be a temptation to update the Guidelines with an eye toward expanding merger enforcement in the future? Toward increasing the chances for litigation successes? What are the purposes of the Guidelines, after all? To what extent are they intended to anticipate future directions for the law, and to what extent are they intended merely to "codify" established practice?

More broadly, what areas of the Guidelines deserve attention? And should the Guidelines be expanded to include examples of hypothetical or actual past mergers, or to include discussions of analytic methods, such as "critical loss" analysis, or the "upward pricing pressure" test recently developed by Professors Joe Farrell and Carl Shapiro—now the chief economists at the FTC and the Antitrust Division, respectively?

The panelists addressing these issues in the following pages come from the top tier of antitrust analysts, with decades of public and private sector experience.

And in the discussion, there was a surprising degree of agreement. One consistent theme was that the Guidelines should not stray far, if at all, from their initial purpose—to describe the analytic framework used by the agencies in reviewing horizontal mergers. For our panelists, this means the agencies should generally avoid including examples in the Guidelines, and avoid discussing or even listing particular analytic tools.

This also means that the agencies should avoid allocating burdens as between the merging parties and the agencies, and avoid articulating presumptions of harm. In the parlance adopted by our panelists, it is better to focus the Guidelines on identifying the "right questions" to ask, as opposed to suggesting—and perhaps thereby unintentionally circumscribing—the best ways to answer those questions.

A second theme was that the agencies should not abandon the presentation of merger analysis as a step-by-step process, even if merger practitioners and the agencies themselves may sometimes skip steps, or take them out of order. The discipline of a stepwise approach is useful, according to our panelists, and it facilitates the building of safe harbors into particular steps in the analysis.

That said, our panelists did recommend a number of interesting topics for review, such as the basic distinctions between coordinated and unilateral effects analysis, and committed and uncommitted entry. And where the Guidelines depart from current agency practice, they sometimes took the unexpected approach of recommending that the agencies conform their practice better to the Guidelines. I am sure our readers will enjoy and benefit tremendously from this provocative and informative discussion. ■

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ROUNDTABLE DISCUSSION

Merger Guidelines Revisited?

Moderator

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Panelists

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DEBBIE FEINSTEIN: For some time, the new administration officials have been talking about the need to revise the Merger Guidelines. At the ABA Section of Antitrust Law 2009 Spring Meeting, Carl Shapiro, the new chief economist at the Antitrust Division, was talking about the need for revisions to the Guidelines even before Christine Varney was confirmed as Assistant Attorney General.

The Merger Guidelines were last revised in 1992. At that point, a Republican administration undertook the review, after a time widely criticized for the government's lack of antitrust enforcement. This time, it will be a Democratic administration undertaking the review, also amidst criticism that the previous administration did not enforce the merger laws sufficiently and after the antitrust authorities had lost several merger challenges in court.

The FTC and DOJ just recently have come out with a plan to obtain public comment on a variety of issues questioning whether or not the Merger Guidelines should be updated.[1] They also plan to hold joint public workshops to get input on whether the Guidelines should be revised and if so, how.

The questions the FTC and DOJ raise are too numerous to discuss in the Roundtable we have today. But I'm hoping that this august panel can help provide views on some of the more key issues. We have with us Dennis Carlton, previously the chief economist at the Antitrust Division; Paul Denis, one of the principal drafters of the 1992 Merger Guidelines; Mark Whitener, Senior Counsel for Competition Law at General Electric, who will offer the client perspective; and Christine Meyer, an economist who has represented companies with mergers in such diverse industries as hospitals and movie theaters.

I'd like to start by asking: what should be the purpose of the Guidelines? Have they served that purpose? Are they there simply to guide outside counsel and their clients as to what the agency's intent is as to enforcement intentions? Are they a roadmap to how the courts should view merger enforcement? And do they actually help guide staff in their reviews?

Paul, why don't we start with you since I know you were intimately involved in the 1992 revisions to the Merger Guidelines and I'm sure you thought about this issue extensively at the time.

PAUL DENIS: At a minimum, the Guidelines ought to inform the bar as to how the agencies are going to analyze mergers. In the past, I believe the Guidelines did in fact serve that purpose. But due to the widening gap between the Guidelines and actual agency practice today, the Guidelines are no longer effective in meeting that fundamental purpose. In my mind, this fact alone is sufficient to warrant the revision process that the FTC and DOJ are undertaking.

The Guidelines ought to do a lot more than just inform the bar as to how the agencies will analyze transactions. If the Guidelines are to provide truly meaningful guidance to the bar, the Guidelines necessarily must also define how the staff is going to conduct merger reviews. Facts are integral to merger analysis. But facts can't be collected—much less analyzed—in a vacuum. There needs to be some sort of a framework in which to analyze them. If the agencies are going to just muck around in the facts, we are going to have a very inefficient process. Anybody analyzing a deal needs a framework. The Guidelines ought to provide that framework and literally become the outline the staff uses to organize information necessary to support their recommendations.

If the Guidelines can do these two things—inform the bar and guide the staff's investigations—then they can also guide the courts. If they're good enough for us, they're certainly good enough for the courts. I think the notion that only the agencies and the bar are smart enough to handle these issues is very dangerous conceit, and probably has contributed to some of the difficulties the agencies have had in court. If you signal distrust to the court, much less come right out and say that you don't think the courts can do it right, the courts aren't going to trust you. You have to rely on the courts to get it right.

And at this point, the Guidelines are so ubiquitous—Chairman Leibowitz referred to them as one of the most cited documents in modern antitrust[2]—the courts do rely on them. The agencies might as well concede that the courts are going to rely on them and draft them accordingly.

FEINSTEIN: Dennis, you were most recently in government. What are your thoughts on this issue?

DENNIS CARLTON: The Horizontal Guidelines have served a very valuable purpose by making horizontal merger analysis much more sensible than it was prior to the 1980s.

There is much less disagreement about horizontal merger policy than there is about vertical antitrust policy, so some vertical guidelines would be especially welcome. Nevertheless, despite the lack of widespread disagreement about horizontal merger policy, it is desirable, though not critical, to improve the Horizontal Guidelines, making sure that they are up to date and relevant.

The Guidelines are meant to be an important first step in an analysis, but they are just a first step. That means they are not, nor do I think they can be, a detailed explanation of how every case could be handled. They're just a guide for practitioners and for courts.

One important purpose of the Guidelines is to create some safe harbors so as to constrain government decision making in a way that is sensible and predictable. Another important purpose is to educate the courts on how to think about merger analysis.

Because the Guidelines are just a first step in any analysis, they cannot be a recipe book for the types of fact-based studies of competitive effects that are often done after one has applied the Guidelines to define a market and calculate market shares. The Guidelines cannot be a detailed description of how the facts in each case will be analyzed because the appropriate analysis will vary depending on the very different circumstances of each case. A commentary like that of a few years ago, describing examples of analyses that have been used in the past, could be useful.[3]

There is a difference between what the government agencies can do and what the courts can do. The government agencies have staffs of Ph.D. economists. The courts don't. Therefore, the sophistication of the analysis presented in court versus at the agencies might well be different. Despite this difference, the Guidelines and any associated commentary can serve a useful purpose for both courts and government agencies by specifying what are the right questions to ask, how might one answer those questions, and what are some safe harbors.

My sense is that the Guidelines are pretty good, and although I think they can be improved, I wouldn't want to change them too much, because I think they have served a valuable purpose.

MARK WHITENER: I think the current Guidelines have been the most successful at describing the agencies' overall analytical framework. And they've done that in a way that generally makes sense economically. In that respect, I think the Guidelines have stood up pretty well over time. And they've also traveled well. They have been very useful, for example, in explaining merger analysis to new enforcement regimes abroad.

On the other hand, I don't think the current Guidelines have been a particularly good roadmap to what the agencies actually do in individual investigations in some respects, particularly in terms of the analysis of coordinated and unilateral effects. Part of this, I think, is due to some problems with the Guidelines themselves. I'm thinking in particular of the presumptions that are said to apply to coordinated and unilateral effects analysis.

When the Guidelines depart from simply laying out the analytical framework and identifying the questions that are relevant to the analysis, and instead delve into HHI or share-based presumptions, I think those aspects of the Guidelines have not stood up particularly well. The HHI presumptions in the coordinated effects section have never described what the agencies actually do in practice. The 35 percent test and other aspects of the unilateral effects section never reflected a strong consensus in the antitrust community. And so those aspects of the current Guidelines have largely been ignored.

The point of the Merger Guidelines should be to provide the analytical framework that underlies the agencies' merger enforcement policy. Beyond that, I think it's important for the agencies to be guided by a sense of humility.

As we move into discussing where the Guidelines are going to go from here, my hope is that the agencies will have some measured objectives: look at places where the Guidelines framework could be updated or improved, either to better reflect consensus views on the proper analysis or to better explain how the agencies do their work. But otherwise I would hope the agencies will resist the temptation to use the Guidelines to advance any particular economic, legal, or policy agenda.

CHRISTINE MEYER: As a general matter, as the antitrust community begins to think about revisions to the Guidelines, we have to consider the effect that the Guidelines have had on the behavior of the various relevant actors, including the agencies, the merging parties, antitrust counsel, and economists. To the extent that the structure of the Guidelines and interpretation of the Guidelines have led to inefficiencies, distortions, or costly behavior by either the merging parties or by the antitrust agencies, that suggests we ought to consider revision.

So, what could those inefficiencies or distortions entail? An extreme example of a distortion would be if the Guidelines were to lead to incorrect outcomes of merger investigations. However, I think a more common inefficiency is one in which the specific, step-by-step approach of the Guidelines leads to analysis that is really not at the heart of the relevant competitive issues in a particular case. And so, I think it makes sense to revise the Guidelines to lay out the key antitrust questions, much in the spirit of what Dennis was saying.

I don't think that it would improve efficiency to add detail regarding analytical methods into the Guidelines. There are other ways for the agencies to convey to practitioners which analytical tools they have used or find most helpful. Including those specifics in the Guidelines is likely to lead to inefficiencies as firms and counsel, economists, and the agencies feel the need to jump through the various hoops that are in the Guidelines, even when those are perhaps not the best hoops to answer particular questions at hand.

FEINSTEIN: Dennis, from your perspective having recently been at the DOJ, are there ways in which the Guidelines aren't reflecting what the agencies actually do, or other ways in which they don't provide appropriate guidance as to how merger enforcement ought to be conducted?

CARLTON: I have two reactions. First, as I mentioned, the Guidelines with their emphasis on market definition are only a crude first step in any analysis. The analysis of the likely competitive effects of a merger is usually much more sophisticated than simply calculating market shares and instead relies heavily on an economic analysis of the facts. That doesn't mean you should skip the process of defining a market to calculate market shares, but that process is just a start. You then do a much more detailed analysis, if you can, of the relevant facts—for example, the relationship of pricing to entry, or the relationship of pricing to concentration, or you could perform a merger simulation. So the tools of economic analysis that are used to analyze a merger are much more detailed and sophisticated than market definition and market shares.

There is definitely not a blind adherence to mechanically apply the HHI cutoffs in the Guidelines. The typical analysis at the agencies is much more sophisticated. The recent Commentary on the Guidelines, published by the agencies,[4] makes this point clear.

Second, despite my praise for the Guidelines, there are several areas where they can be improved or where they have been unhelpful. The distinction between coordinated effects and unilateral effects is very unclear. The Guidelines make it seem like there is one economic theory for coordinated economic interaction and another for unilateral effects, and that's just not so.

Another area of the Guidelines that has not proven to be that useful is the one involving the distinction between committed and uncommitted entry. This is not to say that there is no distinction, just that the distinction has not been useful in practice. I would drop it since it can lead to confusion.

A third area for improvement involves geographic markets. The way geographic markets have been defined in the Guidelines has been confusing, especially when you define them when there is no price discrimination. The reason is that, according to the Guidelines, you are drawing circles around locations (suppliers) rather than what would appear more natural—drawing circles around individuals, the customers. Now it turns out that there is an equivalence between those two approaches under certain conditions, but I think it's just confusing to draw circles around locations rather than around customers.

The final area where I would urge some revision involves efficiencies. There's a difference between fixed cost and marginal cost savings under the current approach. When there are fixed cost efficiencies, some argue you should not pay attention to those in merger analysis because they do not benefit consumers. That is not correct in a dynamic industry. In such a case, dynamic competition will over time benefit consumers, and in any event, such fixed cost efficiencies are desirable because they save society's resources.

DENIS: Dennis alluded to the Commentary on the Horizontal Merger Guidelines that the agencies issued three years ago.[5] At that time, it was quite clear that actual agency practice deviated markedly from the Guidelines.

I wrote in ANTITRUST Magazine about this just after the Commentary came out,[6] and I don't think my views have changed appreciably since then. The agencies significantly deemphasized the importance of market concentration in practice, although not always in litigation, but increased the emphasis on competitive effects analysis. They have attempted to avoid defining markets when doing so was getting in their way of making a case. When they have defined markets, they have generally relied quite heavily on price discrimination analysis, although you would not have predicted that from reading the Guidelines. And they have largely read out of the Guidelines almost every aspect of dynamic response, whether you call it uncommitted entry, repositioning, or committed entry. So there's a big gap, I think, between what the agencies are doing and what is on paper in the Guidelines.

WHITENER: I agree with just about everything that's been said. And I would go back to the HHI presumptions in the coordinated effects section. There was no real empirical basis for them when they were created, and they never described the agencies' actual practice. Even the analytical framework of the coordinated effects section that describes factors conducive to coordinated interaction, while I think analytically sound, has not been particularly relevant in practice in coordinated effects cases.

As for unilateral effects, I'm sure we're going to talk about that more today, but I think that section is probably going to be blown up and the agencies will largely start over. And that may be a good thing. But it depends on where they end up.

And I completely agree with Paul that while the current Guidelines emphasize the role of dynamic responses, such as competitive repositioning, expansion, and entry, those factors in practice have been downplayed by the agencies, inexplicably in some instances.

I'm not too concerned with some of the other issues that the agencies are thinking of addressing. I think it will be an easy drafting fix to address the sequence of the analysis, or how to look at geographic markets in terms of customer and supplier locations. I do think the current Guidelines' discussion of uncommitted entry is helpful in some types of cases. The FTC has applied this analysis, internally at least, in some cases where, for example, there is swing capacity, such as in the chemical industry.

Efficiencies analysis should not be overlooked, and I hope the agencies follow up on the indications that they are interested in looking at fixed costs more closely. In many technology-driven industries with high costs of research and development, for example, it makes no sense to focus solely or even mainly on variable costs in examining merger efficiencies.

On the whole, the agencies don't seem interested in spending a lot of time on refining the efficiencies analysis, and I'm not sure there's a whole lot that can be said at this point beyond addressing some specific issues like fixed costs. I think it's really important that the Guidelines reflect consensus, and I'm not sure that there is a strong consensus today on exactly how you factor efficiencies into the ultimate effects analysis.

FEINSTEIN: The Guidelines right now are fairly focused on sort of a general and theoretical approach to merger review. Rich Feinstein, the new Bureau Director, has said that the Guidelines will be practical. And yet what's missing from the Guidelines are examples of the kinds of economic analysis used.

You don't see the term critical loss in the Guidelines anywhere. Certainly the Farrell and Shapiro upward pricing pressure (UPP) test[7] has been discussed extensively, and one wonders whether that will be mentioned explicitly in the Guidelines. And, as Dennis said, there are a variety of factual experiments you can do. But he counsels against giving any examples of that.

Two questions: One, do people agree that those types of examples shouldn't be in the Guidelines? And if not, how can we be sure those outside the agencies are learning what the agencies are in fact doing?

MEYER: It is interesting that you used critical loss as a motivating example in your question, because I think that's a good case study about the evolution of economic ideas and their practical implementation.

As a theoretical matter, critical loss analysis makes a lot of sense as a tool to implement the hypothetical monopolist test. It literally traces through the effect of a specified price increase and asks whether the loss in sales is so large that it offsets the gain in profit margin on the retained sales. Because the concept seems simple and straightforward, it also appears simple and straightforward to implement.

And so one might think that if we're looking to add some simple useful tools to the Guidelines that would assist business people, counsel, and courts to understand the government's review process, it might appear to be a good addition. However, my experience with critical loss as a practical tool is that it doesn't always live up to those expectations.

The first piece of the analysis, namely the critical loss element, appears to be pretty simple and formulaic, but even this piece can get bogged down in discussions of appropriate incremental margin. Once the analysis turns to the question of measuring the actual loss from a hypothetical price increase—in other words, measuring elasticities of various candidate products and product groupings—the analysis gets quickly mired down in discussions of estimation techniques and what role, if any, premerger margins have in providing a check on the estimated elasticity.

The debate regarding the practical usefulness and feasibility of really conducting a critical loss analysis and exactly how to do so rages on, even as the test continues to be used in litigated and non-litigated mergers. And so I come back to the theme that I started with, which is how to use the revision of the Guidelines to increase the efficiency of the antitrust review process.

I think the potential cost of including specific tests like critical loss is that these tests would then become ends unto themselves. And the benefit of adding them is limited. I think there are other ways to increase transparency of the process and increase information flows about which techniques are considered useful in various circumstances. For example, the agencies can issue merger retrospectives or economists can write papers about how certain cases were analyzed. There are ways, other than inclusion in the Guidelines, of spreading knowledge about specific antitrust tools while not having them be a hurdle—and possibly an inefficient hurdle—that merging firms and the agencies have to jump through.

I think the same applies to the new UPP test that Farrell and Shapiro have written about. It is not just a new alternative to critical loss, but rather an alternative to the whole concept of market definition and using market shares as screens. I would not be surprised if it followed a similar pattern to critical loss. The UPP test is certainly based in solid economics and makes a lot of sense. But its usefulness in the longer run will be determined by its usefulness, not just in theory, but practically speaking, as an element in the analysis of competition and market power.

WHITENER: Well, to be practical I think Guidelines need to serve their constituencies—agency and party lawyers, economists, business people, and the courts. Lawyers are usually the ultimate decision makers in the agencies and certainly in court. So the Guidelines need to continue to be comprehensible to the reasonably economics-savvy antitrust lawyer. I think the current Guidelines do a pretty good job of that, and it's important that any revisions do the same.

Again, I think it's important not to use the Guidelines to advance a particular agenda or a favorite mode of analysis. If there's an approach to economic analysis that can be factored into the analytical framework in a comprehensible way, and—this is critical—if it is the product of a deep and broad consensus about whether and when that approach is appropriate, then by all means the Guidelines are a place to do that.

I also think the Guidelines could do a better job of moving beyond the economic framework and describing to some extent the kinds of facts that the agencies find to be relevant in their analysis. I don't mean that the Guidelines should become an evidentiary cookbook. But it does seem to me that experienced practitioners have a sense of what kinds of information the agencies are typically relying upon in a lot of investigations, but much of this is not reflected in the Guidelines.

If it's done right, is there a place in the Guidelines for some discussion of how the agencies look at factors such as input from customers, or input from competitors, or certain types of company documents, or evidence of prior collusion in the industry? These are factors that actually influence the agencies' analysis and sometimes determine the outcome. So I think it's a fair question to ask whether and how those kinds of factors could be discussed in a useful way in the Merger Guidelines.

Finally, I'm wary of including illustrative examples in the Guidelines, whether of hypothetical or real deals. This is a question the agencies asked in their invitation for public comments.[8] It's easy to fall into some traps if you use hypotheticals to illustrate analytical points. You can either draft examples that are too cautious and become somewhat regulatory in their impact, or that are very fact specific so that they don't generalize to other situations, or that don't make clear which facts were critical in the analysis.

DENIS: I think the objective of the Guidelines revision process should be to come up with a document that's durable. The current Guidelines have lasted longer than probably any of us expected, and that has conferred significant benefits on the agencies and the bar in terms of consistency and a greater meeting of the minds in terms of how to do most merger analysis. As you go into more detail on the examples and specific models, you are going to make it far more difficult to come up with a durable document. That is one reason I would counsel against going into much in the way of examples or specific models.

The other reason, and Christine alluded to this earlier, is that you run a significant risk that those examples become ends unto themselves and become limiting of the document. We thought about this and debated it at great length in the 1992 revisions. Some examples did creep into the document as the drafting evolved. But generally we stayed away from examples, in part to avoid the limiting factor and, in part, to ensure this document would remain more durable.

CARLTON: The Antitrust Modernization Commission, a bipartisan Congressionally created commission, made several recommendations regarding the Merger Guidelines.[9] It would be useful for the agencies to look at those recommendations. The Antitrust Modernization Commission thought the Guidelines were very useful, and therefore, it follows that any revision that's a major departure would be unhelpful.

The Guidelines have served us well by providing a reasonably consistent and durable framework for merger analysis. The reason they've served us well is because they have focused attention not so much on how to answer questions but on identifying the relevant questions.

One focus of the Guidelines has been: is price going to go up? One way to address that question is through market definition. We know that's really crude, but it's a place to start. I get worried if we spend so much time focusing on market definition in the Guidelines that we're going to ignore what is the bulk of the work that the agencies do in a merger investigation, which is try to answer the question of whether price will go up using whatever techniques and data are appropriate.

I also think it's unwise for the Guidelines to list the very many different techniques that might or might not be appropriate. I think it's best for the Guidelines to say something like "in answering the question of whether price will go up, we are going to consider a wide range of techniques as we have done over the past decade."

A commentary or closing statements by an agency can be helpful to illustrate the range of analyses that may be appropriate. I'm very reluctant to put anything in the Guidelines that are specific examples of techniques, because that will suggest other techniques may not be valuable or will be deemphasized.

To the extent the Guidelines present thresholds based on HHI levels, I hope such guides will be grounded in some empirical studies. If it is based on empirical work, and especially if it's empirical work that's appeared in the economic literature, it would be very useful to know, because researchers keep doing studies and may come to different conclusions. One of the problems with the Guidelines is that some of the numbers just come out of thin air. I always have wondered what is the empirical basis for several of them. Without knowing the basis, it is unclear how much confidence one should have in them.

Finally, regarding critical loss, it would be very unwise to use that term in the Guidelines. If you want to put it in some commentary, that's okay. There is no new economic concept in critical loss. Perhaps it's a useful way of rephrasing the question of under what circumstances price will rise. But to suggest that there is any new analytic thinking underlying critical loss is wrong. I have seen enormous confusion on the agency side and on the private sector side as to what critical loss means. Introducing new terms into the Guidelines when they really don't represent a new analytic tool gives the illusion that it is a new analytic technique. It is precisely that illusion that has created a lot of confusion as to what critical loss means.

FEINSTEIN: By the way, Dennis, I completely agree.

Dennis, I'll turn to you to start off the next topic as well. The basic structure of the Guidelines is a relatively step-by-step approach starting with market definition. Should the existing step-by-step structure be entirely revamped, or are there ways to incorporate the notion of looking holistically at competitive effects into the basic structure?

I was recently reviewing some of the speeches that were given when the 1992 Guidelines were announced. One of the things they highlighted was that the agencies had moved the entry section after the competitive effects section because they determined that only after knowing what competition was lost could they ascertain whether entry was timely, likely, and sufficient to counteract any competitive concerns.

So is the step-by-step approach still right? Is there a more holistic way of doing it or is it best to have some combination of both?

CARLTON: The Guidelines do start with market definition and give some discipline as to how markets should be defined. Although market definition is often just the first step in an analysis, it can be a useful one. For example, if you define a market and then calculate market shares, there would be some cases where you could dismiss the possibility of anticompetitive harm from a merger immediately. It is very valuable to firms to have some confidence that if they fall in a safe harbor that their case will be handled expeditiously and there won't be any surprises. So, at least in those instances, a step-by-step approach starting with market definition is very valuable.

But in most merger investigations, you don't usually spend most of your time arguing about whether something is in or out of a market, or at least I haven't. You instead analyze whether changes in the existing levels of concentration are going to have an effect on price or competition more generally. You typically use techniques in addition to market definition to try to figure out what the price effect is going to be. You usually don't really rely on market share analysis all that much. It is only the first step.

The courts might rely on market share analysis more than the agencies. But it still is the case that any merger analysis is much more about using the facts and economic techniques to answer the question of whether price will go up.

What can you use from the history of the industry to help answer the question, will price go up? That is the way the agencies do look at it. They of course are aware of the Guidelines and do define markets and try to be otherwise consistent with the Guidelines. But the agencies are fundamentally using economic analysis to answer the question: will price go up or, more generally, will competition be reduced post-merger? And market definition is just one of the many methods they use.

DENIS: I remain convinced that the step-by-step approach is both necessary and desirable. Also, I don't see how the Guidelines can keep anyone from doing what Debbie was referring to as a "holistic analysis."

I start with Section 7 of the Clayton Act which references not any lessening of competition but "substantially" to lessen competition. If there is a substantiality requirement, you need some dimension over which to measure it. The statute actually tells us that we should measure substantiality over a line of commerce and a section of the country—in other words, a relevant market. It would seem if we're going to answer the ultimate question we need to know what that market is.

Another way of looking at it is to think of the factors that come into play in competitive effects analysis. Most people would agree that excess capacity is a relevant factor in both coordinated effects analysis and unilateral effects analysis where firms are differentiated by their capacities. If so, excess capacity has to be measured. Relative to what, is it excess? I think the answer is that excess capacity is measured relative to current demand conditions in a properly defined market. It follows that you really need to define the market in order to understand what capacity is excess relative to that market.

This is particularly important in price discrimination markets, where you are carving out of a large production set, a small volume directed at certain customers you believe might be targeted with non-competitive pricing. Price discrimination markets, by definition, make excess to the market all production devoted to customers other than the putative target group. The larger is this excess capacity, the more difficult it is to demonstrate adverse competitive effects.

So the market definition is really critical there. Entry is the same way. If you are to deter or counteract a competitive effect of concern, you have to know what that competitive effect of concern is.

On efficiencies, we're all wrestling with where efficiencies come into the analysis because rarely do the agencies actually make it a meaningful part of the analysis. But whether you're looking at efficiencies embedded in the competitive effects analysis, or you're trying to do a Williamsonian tradeoff, you need to understand what the competitive effect is. If you're talking about, in effect, moving out the supply curve, how far must it move?

On failing firm, it is essentially the same point. If we are going to have a less anticompetitive purchaser requirement as an element of the failing firm defense, we need to understand how anticompetitive the subject purchaser is, which requires that we've done all the prior analysis of market definition competitive effects, entry, and efficiencies.

So there is a logic to doing the steps. In practice those of us who do a lot of it may skip over steps, making assumptions about their resolution perhaps in the alternative. But I think we do need the discipline of the step-by-step approach because these issues are interrelated.

WHITENER: I think it may be easy to forget how important the Guidelines' step-by-step approach has been in shaping how we think about mergers. By now, the approach is sort of embedded in the antitrust DNA. But we shouldn't take it for granted. Even if the sequence isn't followed literally in most or even very many cases, it has been an extremely powerful tool that we should largely retain.

I would also be very careful to avoid moving the Guidelines in the direction of taking a "holistic" approach or starting and ending the inquiry with the ultimate issue of competitive effects. In practice we can often skip over steps in the analysis and focus very quickly on the key issue in a particular deal. But if the Guidelines start to move straight to the question of ultimate competitive effects, then the risk is that we end up with a less rigorous, less transparent, and more subjective analysis.

Again, I go back to how well the Guidelines explain the essence of merger analysis to people who don't deal with these issues every day, whether they are business people in this country or new enforcers abroad. Asking how well the Guidelines communicate with these constituencies is an important check on whether the Guidelines really guide.

FEINSTEIN: Let's now turn to some of the specific areas in the Guidelines. First, does the current Guidelines' approach to analyzing unilateral effects work? Is it understandable? Can it be put into practice? Is it right as a matter of economic theory? Does the 35 percent market share presumption make sense, and has that become much more than a presumption?

I've heard one senior DOJ economic official say publicly that he had never seen an actual case of repositioning in all his years at the Department of Justice. Has repositioning in essence been written out of the Guidelines?

CARLTON: As I mentioned earlier, the Guidelines fail to distinguish clearly between unilateral and coordinated effects. The Guidelines suggest that there is one theory for unilateral and another for coordinated effects. That is just not so. In terms of economic theory, they both rely on identical economic theory, which is non-cooperative game theory.

The way unilateral effects have often been implemented is as part of a merger simulation, using a static model of differentiated products with an assumption of Bertrand competition. There's no reason in theory why you can't expand a model like that to be dynamic over time. And if it is dynamic, then it looks much like what the Guidelines would call coordinated effects, where one firm interacts with another over time. Distinguishing between coordinated and unilateral analysis on the basis of whether a model is dynamic or static seems like a peculiar use of terminology. Further, one cannot distinguish between unilateral and coordinated analysis based on whether products are differentiated because both analyses allow for product differentiation.

The discussion of unilateral effects in the Guidelines suggests keeping the prices of all other firms constant in doing the analysis. This is somewhat of a detail. It is of course harder to find an anticompetitive effect if one ignores the fact that other firms may respond to a price increase by their own price increases, but there is no need to ignore the behavior of other firms. Therefore, distinguishing between coordinated and unilateral on the basis that in the latter, but not the former, the prices of rivals are being held constant seems artificial, if not peculiar. At most, one could say that a finding of anticompetitive effect under the assumption that rivals don't raise price would suggest a finding of such an effect in a more realistic model where rivals' prices respond positively.

There is however a relevant distinction that could be made based on whether the competitive structure—what we might call the competitive game—will change after a merger. This change could happen if, for example, post-merger information flows between firms became more transparent so as to change the competitive game. Note that this is different from simply changing the number of firms that are playing any specific competitive game. One could define coordinated effects to refer to this change in the game post-merger, but that is not how it is currently defined.

You often see unilateral effects being used when, in order to find an antitrust harm, the market definition would require such a narrow market definition that the people who are prosecuting the case feel uncomfortable with it. They therefore prefer to use a broad market definition and to rely on unilateral effects. When used in this way, the unilateral effects theory undercuts the way markets are supposed to be defined according to the Guidelines.

As far as the 35 percent figure goes, the Guidelines are useful for creating safe harbors. But when you create a safe harbor, it would be valuable to know on what evidence it is based. Otherwise, it is unclear how much confidence one should have in its reliability.

DENIS: Even a Ph.D. economist proceeds at his peril trying to argue economic theory with Dennis. Since I'm not a Ph.D. economist, I'm not going to try to argue theory with him. But I will offer a couple of thoughts from a historical perspective.

I think of the unilateral effects section of the Guidelines as providing sort of a simplified case in which to think about competitive effects, substantially simplified relative to coordinated effects models which are much more robust. I agree with Dennis that, in practice, some of what the agency is doing under the guise of unilateral effects analysis is, in fact, coordinated effects analysis without all the analytical rigor associated with that analysis. So that is a concern.

On the issue of the 35 percent presumption, the answer is that the 35 percent number comes from the old "leading firm proviso" in the 1982 and 1984 Guidelines. So if Bill Baxter were still alive, we could ask him where 35 percent came from, but for now the answer is that it came from Bill Baxter, and I'm not familiar with any empirical basis for it.

The unilateral effects section of the Guidelines does not create a safe harbor below 35 percent combined share. Certainly, some hoped that the 35 percent threshold would become a safe harbor (and there is a strong argument that it should), but it was not drafted that way and has not operated that way in practice.

Having the presumption in the unilateral effects section does run somewhat contrary to the Guidelines' professed desire to be burden neutral. I think the Guidelines drafters on this next revision would be well advised to drop the presumption because there is no empirical basis for it and it is inconsistent with the approach they're trying to take which is to lay out the right questions, as Dennis put it so well.

The other thing to keep in mind about this presumption is that it only applies in a highly stylized situation, which I've never seen in the real world. I don't know anybody who's ever seen it. The only time the presumption literally applies is when preferences are essentially random and substitution is proportional to share. But in the differentiated products markets where this presumption comes into play, substitution doesn't work that way. Consumers have preferences among products and those preferences dictate substitution patterns.

So the 35 percent threshold is just a benchmark to guide us, albeit one that's very difficult to apply. But calling it a presumption I think is far too strong in practice.

One other point I can't help but make is that we do have to keep in mind what a presumption is as a legal matter. I think our understanding of the meaning of a presumption has become muddled over time. Justice Thomas, then Judge Thomas, spelled it out pretty clearly in *Baker Hughes*.[10] But what has been forgotten by many is that presumptions are merely evidentiary tools. They're not of substantive significance. There's no substantive significance in the analysis that combined share is 35 percent, or that market concentration is over 1800, or that the delta is over 100. As an evidentiary matter, we may shift the burden of coming forward once there is evidence of certain structural indicators. But it doesn't change the fact that the overall burden of persuasion remains with the plaintiff. So if we focus on what a presumption really means as a legal matter, we realize that spending a lot of time debating about whether a presumption should be in or out of the Guidelines probably isn't worth the effort.

FEINSTEIN: Christine, the FTC and DOJ ask whether the unilateral effects section should be expanded with respect to a number of topics. Which of these need the most further explanation and what are your views as to what direction the Guidelines should take on these issues?

MEYER: There are several areas that could be expanded. One is a reference to bidding markets. This is really all but left out of the current Guidelines. For example, in calculating market shares using the best indicator of a firm's future competitive significance, there are a lot of different measures that are mentioned in the Guidelines, but in terms of sales, there is no distinction made between current sales and follow-on sales or between total annual sales versus sales that come from new contracts that are awarded during the year.

In markets characterized by relatively large contract awards, market shares based on total annual sales are more likely to reflect the identity of a few winners of large contracts during the previous year, rather than the competitive significance of various players. Instead, it is necessary to look at who is bidding for which types of contracts and which players are entering with second lowest bids.

Bidding data can allow for a rich and robust kind of analysis, but I wouldn't recommend putting specifics about the analysis in the Guidelines. Rather, the relevant questions to ask in bid or auction markets—and how those questions might differ slightly from the questions in other types of markets—should be included.

The 35 percent rule that you mentioned shows up in a discussion of capacity shares and in a discussion of closeness of the products of merging firms with differentiated products. Indeed, in terms of closeness of competition, the 35 percent share number is invoked when shares are a good measure of each firm's appeal to each customer. So, in other words, it's invoked when there is nothing else about the products that makes them any closer as substitutes than is already reflected in shares.

It seems to me that really this is where a lot of the work in differentiated product mergers just gets started. The real analysis gets at the question of which products are closer competitors, and that is an area in which share is perhaps least indicative of the competitive significance of each party. So I think that is another place where revisiting at least the wording and the emphasis in the Guidelines could really help the practitioner.

WHITENER: It seems clear that unilateral effects is the centerpiece of the agencies' Guidelines project, and I think the agencies have an opportunity to turn one of the weakest aspects of the Guidelines into something coherent and relevant. But there are a couple of issues that are important to talk about. One is the role of presumptions. The other is the role of dynamic market responses to mergers, which in unilateral effects cases is often a question of competitor repositioning—a key issue that has already come up in our discussion today.

The use of presumptions needs to be very carefully considered. A virtue of the current Guidelines is that they tend to be a fairly neutral analytical statement. As I said earlier, where they delve into presumptions, it is precisely those aspects of the current Guidelines that have been the least durable or successful and that are the most likely to be abandoned in the current project. But the question is, what are they going to be replaced with?

This leads to my other main concern about where the agencies could go on unilateral effects, which relates to dynamic competitive responses to mergers, or more specifically to the question of competitor repositioning. Dennis's comments earlier about the relationship between coordinated and unilateral effects theories helped crystallize an issue I have with where the agencies may be going on unilateral effects.

Coordinated effects cases have been relatively rare for a variety of reasons including, I think, a basic discomfort with predicting anticompetitive effects when there are several rivals remaining in the market and we're not confident that they're going to follow a price increase or engage in coordinated behavior in a way that will lead to higher prices. It is often noted that there simply isn't much empirical evidence to support any given correlation between concentration and price. As a result, the HHI presumptions used in the current Guidelines were necessarily arbitrary, and they never gained any real traction.

And yet on the unilateral effects side, there seems to be a willingness by the proponents of some approaches, such as Farrell and Shapiro's UPP model, to presume—once they have identified some apparent diversion ratios, which are based on historical or static bidding data, or even imputed from market shares—that diversion is going to be durable. Put another way, the assumption seems to be that competitors will not reposition, and the burden seems to shift to the merging parties to show that they will.

This has implications for both of my concerns: the role of presumptions in Merger Guidelines and repositioning. If we replace one set of dubious presumptions—the HHI thresholds and the 35 percent test in unilateral effects—with another, equally dubious set of presumptions, we have not advanced the ball. I'll refer again to the UPP model, because its proponents are now the chief economists at the agencies and are key players in the Guidelines project, so the UPP approach seems likely to play some role in the final product.

And as I understand the UPP test, you could apply it to a merger between two suppliers of differentiated products where there are five or six other competitors, with all the firms having similar shares and with no evidence of any particular closeness between the merging firms. That is, diversion is assumed to be proportional to the firms' shares.

If you imagine variable margins that are fairly typical in any differentiated products market, and you apply the 10 percent "standard deduction" that the UPP proponents have suggested could be used to account for efficiencies, you end up with a presumption that the deal raises unilateral effects concerns. However, if we were to apply the current Guidelines' HHI thresholds to that merger in a homogeneous product setting, not even those overly aggressive and largely ignored thresholds would suggest a problem with the deal. Yet as I understand the UPP model, it would create some level of presumption against that transaction.

Of course the presumption is rebuttable. Depending on how it is described, it may or may not be very strong. But we have to ask whether there is a good basis in economics or policy to create such a presumption in the first place—or one that is any better than the basis that was offered for the HHI thresholds that many now deride.

Then we need to ask, how do you rebut those presumptions? And here I come back to repositioning. There is a curious sort of skepticism about repositioning among some people at the agencies, when in reality, if you look at what actually happens in industries where firms and products are differentiated, firms are constantly repositioning.

Repositioning has many dimensions, whether it's a product modification or the addition of new features, or targeting a new customer set, or a new form of distribution. Many unilateral effects cases arise in industries where product cycles are measured in months rather than in years, and where more minor modifications occur constantly. There just does not seem to be any basis for presuming that firms in such industries will depart from what they have already had to do in order to compete—continually adjust to competitive conditions, whether the change is a competitor adding a feature to its product, or two competitors merging.

So I think the Guidelines need to be largely burden neutral, and avoid presumptions that are unfounded. And they need to take account of the fact that firms typically have an incentive to react competitively to changes in their marketplaces, so that the analysis of likely reactions to a merger is fact-based and dynamic. In a unilateral effects case, repositioning is something that should not be an afterthought in the analysis, but should be recognized as one of the key reasons why most mergers among producers of differentiated goods do not in fact lead to anticompetitive effects.

DENIS: Can I make two points on this? First, the comment that Debbie recounted about repositioning is baffling to me because there are so many markets that operate as Mark was describing, where repositioning not only happens, it may actually be the primary competitive dynamic among firms. In consumer packaged goods, for example, there is constant repositioning, often through brand extension. So, empirically, the notion that repositioning is not happening is simply wrong. Repositioning ought to remain in the Guidelines and ought to be part of the analysis.

On unilateral effects, there's a real irony when you consider the impact and the perception of the unilateral effects section in the Guidelines. In terms of impact, the advent of systematic unilateral effects analysis was perhaps the most influential of the changes in the Guidelines between 1984 and 1992.

Prior to the 1992 Guidelines, most government enforcement actions were based on coordinated effects theories. Very rarely were they based on unilateral effects theories. Subsequent to the 1992 Guidelines, there has been a sea change and it's now very rare to see a case that is based solely on coordinated effects analysis. So unilateral effects analysis has had a huge effect on how we think about mergers and how we analyze them.

But in terms of perception, the unilateral effects section of the Guidelines is perhaps the most criticized and most frequently described as unhelpful and difficult to apply. So clearly there needs to be a lot of work done on this section of the Guidelines. One thing that may help is to think about a further breakdown in this section from what we have today. In the current Guidelines we have a breakdown between markets in which firms are distinguished primarily by their products and markets in which firms are distinguished primarily by their capacities. Perhaps we should be thinking about a further breakdown based on the nature of the competitive interaction among firms. This is where we could bring in, say, a subsection related to markets where firms compete through bidding or auction type situations as contrasted, say, to consumer packaged goods where firms might compete primarily through repositioning and various non-price dimensions. That, I think, is an area worth exploring as the Guidelines revision process moves forward.

CARLTON: I would agree with Paul that the unilateral effects section has had an enormous impact. If you ask why, it's because the unilateral effects analysis requires one to focus directly on the subsequent pricing incentives post-merger. But the language in the Guidelines relies too heavily on the notion that there's a next best substitute and that there aren't other important substitutes. You really want to focus on all of the substitutes and constraints.

I find that the theory of unilateral effects is often an end run around being forced to use a narrow market definition. It may well be that we should define a market narrowly and we should say that explicitly and not be embarrassed by it. One contribution a revision could make is to say that it is not illogical to define a narrow market if when firm A and firm B merge they can raise price by 5 percent holding all other prices constant. That is exactly what the unilateral section is asking. Will price go up by 5 percent? And if it can, that implies that there's a very narrow market.

I know there has been some criticism by courts of narrow market definitions. But that is because there's not been a full appreciation as to what question the Guidelines are asking in order to define a market. If the question about a price increase can be answered positively—yes, price will go up by 5 percent, holding constant the prices of other firms—then it does imply that it's a narrow market according to the Guidelines.

Paul is right that the unilateral effects theory has led to a better understanding of what's going on. But my criticism of it is that it is not consistent with the market definition in the Guidelines, and it also incorrectly suggests that there's a different underlying theory between coordinated and unilateral effects.

FEINSTEIN: I want to turn to coordinated interaction now. The current Guidelines have a pretty good checklist of factors to use in assessing coordinated effects. Is this sufficient? And what do you make of the fact that the FTC/DOJ question list contains no questions on coordinated effects analysis?

WHITENER: My sense is that the coordinated effects section of the Guidelines is in pretty good shape analytically, but as I said earlier, the analytics haven't really been followed in practice. I think that the agencies tend to look for specific types of evidence, like prior collusion or strong oligopoly behavior in the market, but they may not always fully explain how these factors help demonstrate that the merger at hand will make successful coordination more likely. And as I said earlier, I think there could be a role for the Guidelines to talk about those factors a bit more, without becoming an evidentiary cookbook.

The HHI thresholds clearly need to be looked at. It seems to me this is an area where some safe harbors still make sense, below which there really isn't any basis for concern, but with little or no presumption of anticompetitive effects at any given HHI levels—just the need for further inquiry, applying the rest of the coordinated effects analysis.

It also seems to me that in reality the process of framing up a potential coordinated case has less to do with HHI numbers than with counting noses. Antitrust practitioners usually don't talk about HHIs. We ask, is this a four to three deal? Is this a three to two deal? I'm not suggesting that we resort to counting noses in the Guidelines. But if the Guidelines were to explain what really happens in merger analysis, I think what really happens is the agencies focus on who are the credible competitors for particular customers' business, and, critically, whether the merger reduces or eliminates competitive constraints in a way that is likely to materially affect competition and price. I'm not saying that this is easy or necessarily the best approach, simply that it has little to do with HHIs. If there are a number of other credible competitors, we don't really care what the HHIs are. We just care whether there are competitors who will constrain the merged firm's pricing.

CARLTON: The issue of repositioning is a difficult one, not because it doesn't happen. It certainly happens. But I've not seen a lot of successful empirical models of repositioning. That means that repositioning is hard to analyze. This suggests that examining prior instances of repositioning in the industry might be the best way to deal with that issue.

As far as the failure of the FTC/DOJ questions to talk a lot about coordinated effects, it is perfectly understandable because the Guidelines already do a pretty good job describing the economic forces at work in a dynamic oligopoly model. The hard question in both this and the unilateral effects analysis is how to use the available facts to build an economic model that will predict what will happen post-merger.

DENIS: Just picking up on Dennis's point, we understand well how to analyze conditions conducive to coordination. What I don't think we understand well is how mergers affect the ability of firms to coordinate or to better coordinate. How does the merger change the game for the remaining firms? There doesn't seem to be any credible story beyond absorption of a maverick. That's an area where I think we could use greater insight or admit to the limits of coordinated effects analysis.

FEINSTEIN: Are there flaws with the current market definition approach in the Guidelines? Does changing from a 5 percent to a 10 percent SSNIP test really make any difference, given that it is rare to have such precise evidence on the question? Would elimination of the "next best substitutes" and "smallest market" principle end up changing the ultimate analysis in many cases? And should there be more discussion of price discrimination, whether in the context of market definition, competitive effects, or both?

MEYER: The SSNIP test is something that again makes sense in concept. And it provides a level of rigor to the relevant market analysis. But, if the debate moves to a 10 percent SSNIP test instead of a 5 percent SSNIP test, then I think we are talking about a level of precision that is not attainable in practice, at least for most cases. So I think the real question the Guidelines should address is this: what are we really trying to do with this test? In other words, what's the real goal of the analysis?

One of the difficulties in implementing the SSNIP test is how to identify the next-best substitute. This step poses some analytical difficulties that are not clear from a reading of the Guidelines themselves. A literal reading of the SSNIP test indicates that you add one product at a time to the hypothetical market until the SSNIP test is satisfied. In reality, the SSNIP test is often implemented as product groupings, often, but not necessarily, ones that are mentioned by the firm or an industry trade group.

Even with this simplification, it is not always clear what the next-best substitute is and what should be used to make that determination. The Guidelines talk generally about adding in products with the greatest value of diversion of demand from the product whose price has increased under the test. But how do you measure that? Do you measure that as a percentage of lost sales like a diversion ratio? Do you measure cross-price elasticity—that is, the percentage change in demand of one product as a result of a one-percent change in price of the other?

So, in reality, the SSNIP test involves some analytics but also some common sense, tested against the documents produced in the ordinary course of business. It seems to me that the Guidelines should either recognize that explicitly or, at a minimum, not provide the illusion of a level of precision that is not always attainable in practice.

DENIS: In market definition I think the most important thing for the agencies to address in greater detail is the role of price discrimination. In practice, price discrimination analysis has become the dominant mode of market definition analysis.

If you read the Guidelines you wouldn't guess that to be the case. I don't think there's anything wrong about the way the Guidelines explain price discrimination analysis. But it probably should be given a more prominent position in the Guidelines, particularly in its treatment of geographic markets since very rarely in practice does geographic market definition analysis not follow price discrimination methodology.

CARLTON: I would agree with Paul about the need to pay more attention to price discrimination markets. If you have a price discrimination market, you start focusing on the buyer and then you ask who can serve the buyer. That is a perfectly sensible way of approaching the problem and, as Paul said, it is consistent with how the Guidelines deal with the issue.

But as Paul said, based on the Guidelines, one might get a false impression for whether a price discrimination or non-price discrimination market is more likely to be relevant. Especially in regard to geographic markets, I agree with Paul. Price discrimination markets are often a more sensible and more intuitive way to define a market.

As far as the alternatives to the next-best substitute principle and the smallest market principle in defining markets, my own view is—and I've written a paper on this[11]—that those principles are arbitrary. However, without those principles you don't have a tight way of defining markets. You can come up with many different market definitions. So I always thought that using those principles was a reasonable way to proceed. However, if you get a very different economic conclusion about market power by adopting different principles, it casts doubt on the whole exercise of using market definition.

As far as whether it makes a difference whether you use a 5 percent test or a 10 percent test to define markets, I think that begs the fundamental question, which is: what is the harm to society, i.e., the deadweight loss, imposed by allowing a particular merger? That question is well-posed in that it emphasizes that what you're concerned about is the size of the harm where the size depends on both the likely post-merger price elevation, as well as the volume affected. Whether it should be a 5 percent increase or 10 percent increase that you're worried about is a funny question because the harm depends also on the volume affected.

In terms of whether you use a 5 percent or 10 percent price increase to ask customers questions about likely substitutes, I don't think that matters much. What really matters is after you've gotten the answer to these questions, how do you use the answers to estimate the likely result of a merger on price.

So, my sense is how they implement the Guidelines' questions—5 percent or 10 percent test, next-best substitute, not next-best substitute, smallest market principle, not smallest market principle—all those strike me as really technical details. If they matter a lot in terms of the economic conclusions reached, it would cast doubt on the whole exercise of using market definition as a useful tool.

WHITENER: I think the really interesting aspect of the current Guidelines' market definition approach, including the SSNIP test, is that it turns out to be fairly practical. It actually can be and repeatedly is implemented in investigations, at least in a rough way.

When the Merger Guidelines are explained to new enforcers abroad, they sometimes ask, "How am I ever going to get data on substitution? Doesn't this require me to know demand elasticity? How am I going to figure that out?"

Yet the U.S. agencies routinely do something in almost every deal that turns out to be very practical. They talk to customers, and they ask them a series of questions that basically walk through the Guidelines approach. Who are your current suppliers? Who else could supply you, either at current prices or if there were a small but significant price increase? In practice, these interviews may not produce robust data that an economist could run through an econometric model, but they produce practical answers that the agencies use to come to a pretty good understanding of the marketplace and use to resolve many investigations.

I would be concerned if the direction of the Guidelines project were to move toward an approach that largely eliminated the focus on market definition, whether we are talking about the UPP approach or some other methodology that seeks to identify anticompetitive effects without going through the rigor of the market definition exercise.

And it doesn't seem to me likely that the agencies would get better practical answers to the key questions, especially early in an investigation, if they were to replace SSNIP test questions with an attempt to run a UPP-type analysis based on diversion ratios and margins. It seems to me that the analytical approach used in the current Guidelines turns out to be pretty useful in most cases, and I think it's important to keep it.

FEINSTEIN: Let's turn for a minute to entry. I find the entry section to be one in which staff's interpretation bears little relation to what the 1992 revisions intended, based on what was said at the time. The "likely" prong is often turned into "already showing evidence of entering."

Is there a problem with the Guidelines, is it with the application, or neither? And how useful in practice is the distinction between uncommitted and committed entry?

WHITENER: I think the focus has become less on entry conditions and the presence or absence of impediments that would prevent firms from entering if the incentive to do so arose. Instead, I think there's been a pretty significant burden shifting in practice, requiring the parties to show actual or incipient entry by specific firms.

This may not be the most troubling aspect of agency practice for me, because I don't know that new, "greenfield" entry is going to be the "get out of jail free card" for most deals. Sometimes ease of entry will be an important factor. But often in practice, even if you did the entry analysis perfectly, you still might conclude that new entry will not prevent or counteract the effect that you're concerned with.

But I'll come back to my theme of repositioning. It is not Chicago School pie in the sky to say that where producers of differentiated goods are already in the market and possess all the capabilities needed to compete, it's proper for merger analysis to acknowledge that unless you can show an impediment to their doing so, those competitors will adjust—reposition—when some competitive stimulus, such as a merger, creates an incentive to do so. So in unilateral effects analysis, I think repositioning generally needs to be given much more credence than is sometimes the case.

I would say a word again in favor of the uncommitted entry analysis in the current Guidelines. Analytically, it is fine. And even though it's not relevant to 99 percent of deals, I think in some industries, where there is "swing" capacity it's a useful little piece of the analysis, so I'm not sure it needs to be abandoned.

DENIS: I share your concern with how the agencies are viewing committed entry. But I think the problem goes back to the 1980s, when there was a great fear that entry arguments were going to swallow merger analysis completely.

After *Waste Management* and *Calmar* [12] there may have been some basis for that concern. But I think time has proven that concern to be misplaced. Entry arguments have not swallowed merger analysis. So we should probably stop being so skeptical of entry arguments.

The distinction between committed and uncommitted, I think, is an important one because if entry is going to play the role of the trump card, it ought to be committed entry. It should be something where firms have made long-lived investments in order to be in the marketplace. That's not to say that uncommitted entry is irrelevant. It should be considered. As we discussed earlier, it is an economic reality that cannot be ignored. But I think it is best considered where it is in the current Guidelines, in the identification of market participants.

CARLTON: The distinction between uncommitted and committed entry could be a useful one. But my experience is that it hasn't been used a lot. If you think about it, there is really a continuum between committed and uncommitted entry. Even someone who is producing a closely related product might have to make some investment in marketing and other things to get into the market. Because of that, I'm not positive how useful the analytic distinction between committed and uncommitted has turned out to be.

As far as the importance of understanding entry, Paul is right that people were worried in the 1980s that it was too easy to argue, "Oh, entry can occur if price goes up so there cannot be any competitive problem." What I have found in many antitrust policy discussions is a surprising lack of reliance on the economic literature of entry that has developed over the last twenty years with its heavily empirical content. That literature shows that entry isn't as easy as we once thought and that the type of entry turns out to be key.

As you might expect, experienced firms in related businesses have a much greater effect when they enter an industry, as compared with greenfield entry. Greenfield entry of a new firm tends to produce a firm that does not have a big competitive effect and has a high probability of failure. So in any revision of the entry section of the Guidelines, there should be at least some discussion of this economic literature. There's also been a lot of work done about how previous thinking overemphasized the constraining effect of new entry, even at the theoretical level. My recent paper explains this new thinking in detail.[13]

Entry can be a powerful constraint on competition. But before I would accept that argument in a particular industry—if I were still at the Department of Justice—I would require some evidence explaining why I should give empirical credence to the constraining effect of possible entry in the industry under analysis. Otherwise, it's too easy to say entry will prevent price from going up. Therefore, the agencies should properly demand evidence before they accept the argument that entry is a significant constraint on post-merger pricing. Otherwise, as Paul suggested, it would eviscerate merger analysis.

MEYER: I would reiterate what has been said. I can understand—and indeed I have experienced myself—a certain frustration that, in developing an entry analysis, it is usually necessary to show either that someone is on the cusp of entry or that someone has entered in the past. But how do you best show that entry is going to occur in this particular industry with these particular market facts?

Obviously, a discussion about economic theories of entry and about profitable situations inducing the entry is useful. But in order to answer the question of what is relevant in a particular industry, one of the places we always look is in the past. And so I don't think it's wrong to look at past industry experience to gauge who the players are that might actually enter.

FEINSTEIN: My last question will be on efficiencies. Dennis, I'll start with you. In their request for public comments, the agencies stated that they do not plan to alter the fundamental approach to efficiencies.[14] To many of us on the outside, this means that efficiencies are essentially irrelevant. If the transaction raises no competitive concerns, you never have to talk about efficiencies. If the agency finds anticompetitive effects, the efficiencies never trump those. In light of that, is there any point in changing the Guidelines or does anyone disagree with the premise that efficiencies are of little significance?

CARLTON: I would disagree with the premise. The agencies do look at efficiencies. Especially when they do a merger simulation model, the agencies take efficiencies in marginal costs into account. It's also the case that efficiencies can arise in a merger when there are vertical aspects to the transaction that enable the firm post-merger to eliminate double marginalization. These are efficiencies that both the FTC and the DOJ would take into account without much argument.

What is a bit more controversial and unclear is how the agencies will treat a fixed cost efficiency. The Antitrust Modernization Commission recommended they pay more attention to fixed cost efficiencies, especially in industries that are innovation-driven and dynamically changing.[15] In those industries, the fixed costs are the variable costs in the future when the firm decides whether to reinvest in R&D.

So my own sense is, especially in industries that are changing rapidly where R&D is important, the failure to take account of fixed cost efficiencies would be a mistake and that whether you believe in a total surplus concept or just a consumer surplus concept, I don't think it matters all that much in the long run because the competitive process plays itself out in the long run. Fixed cost efficiencies will eventually benefit consumers through better products and lower prices.

MEYER: It seems to me that this is a case in which the Guidelines, together with agency practice, lead to distortions away from optimal behavior on the part of the antitrust agencies and the merging parties.

The Guidelines explicitly recognize that efficiencies are often a critical reason that firms merge. And I think that, conceptually, that is generally understood among antitrust practitioners. Yet, because of the way that efficiencies are treated under the Guidelines, in many instances, it doesn't make economic sense for the merging parties to spend the time and money up front to develop a very comprehensive efficiencies story. And, likewise, the agencies don't appear to consider efficiencies to the same degree they do market shares, closeness of competition, potential competition, and so on. This has the potential to distort the outcome of merger investigations if both sides have less of an incentive to develop and understand the procompetitive rather than anticompetitive considerations of the deal.

I think that it is worth considering how to move at least some portion of the efficiencies analysis to an earlier point in the Guidelines and to integrate it with the rest of the analysis to encourage all parties to think hard about those efficiencies right from the beginning.

WHITENER: Debbie, I basically agree with your premise, although I think the conventional wisdom is still correct that you're much better off going into the agencies with a procompetitive rationale for your deal. So to that extent, any efficiency or synergy based rationale is still important to have.

I do think it is valid to focus on the level of proof that the agencies require in order to have cost reductions really taken into account in the analysis. How do you get credit for efficiencies if you don't come in with a robust efficiency study which, as Christine said, is often not cost effective since the agencies are assumed to discount such studies? And it strikes me as somewhat ironic that there is often a greater willingness in the agencies to be confident about predicting future anticompetitive effects than to accept the party's prediction of cost savings.

The last point I'd make comes back to the issue of fixed costs. That's the one area where the agencies have indicated that they are interested in looking more closely at efficiencies. And I think this is critical. Many industries, especially those that potentially fit the profile for a unilateral effects case, are technology driven, dynamic industries with substantial investments in R&D. All of that implies high fixed costs. Many deals in such industries are more about fixed cost savings and technology synergies than about variable cost reductions. So it seems to me that a focus purely or primarily on variable cost savings, especially in the kinds of deals that are more likely to raise unilateral issues, is something the agencies are properly going to reexamine.

DENIS: Unfortunately, efficiencies are of limited significance in merger analysis. In suggesting otherwise, the Guidelines do not reflect current agency practice. That should be fixed, but the necessary fix may be as much an issue of practice as an issue of Guidelines standards.

Another point that is very important in efficiencies analysis is to match the temporal dimension of the efficiencies analysis to the temporal dimension of the competitive effects analysis. Mark alluded to this earlier in his comments. Particularly in transactions where either innovation markets are being alleged or there are issues of near-term economic distress that might be putting the competitive effect of concern well out into the future, the efficiencies analysis should also be allowed to run out into the future. I know there is a concern that the further out we go in time, the more speculative the efficiency analysis becomes. I would simply note that the competitive effects analysis suffers from this same flaw to the same degree. I don't see that as a reason to give up on the efficiency analysis, and I hope the agencies can find a way to match the temporal dimensions of all parts of the Guidelines' analysis.

FEINSTEIN: This has been a terrific discussion. Thank you for your thoughtful views. There seems to be consensus that the Guidelines need revision, but that it should be done carefully and with an eye to their long-term use. I hope the agencies will bear some of these thoughts in mind when undertaking the revisions. I know we will all look forward to the continued dialogue on this subject. ■

1 Press Release, U.S. Dep't of Justice & Fed. Trade Comm'n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), *available at* http://www.ftc.gov/opa/2009/09/mgr.shtm.

2 Jon Leibowitz, Chairman, Fed. Trade Comm'n, Introduction of Philip Lowe and Announcement of Joint FTC/DOJ Project to Modernize the Horizontal Merger Guidelines, Remarks Prepared for the Third Annual Georgetown Law Global Antitrust Enforcement Symposium (Sept. 22, 2009), *available at* http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf.

3 U.S. Dep't of Justice & Federal Trade Comm'n, Commentary on the Horizontal Merger Guidelines (2006), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

4 *Id.*

5 *Id.*

6 Paul Denis, *The Give and Take of the Commentary on the Horizontal Merger Guidelines*, ANTITRUST, Summer 2006, at 51.

7 Joseph Farrell & Carl Shapiro, Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition (Dec. 9, 2008), *available at* http://ssrn.com/abstract=1313782.

8 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines: Questions for Public Comment (2009), *available at* http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf.

9 ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS (2007), *available at* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

10 United States v. Baker Hughes Inc., 908 F.2d. 981 (D.C. Cir. 1990).

11 Dennis W. Carlton, *Market Definition: Use and Abuse*, 3 COMPETITION POL'Y INT'L 3 (2007).

12 United States v. Waste Mgmt., 743 F.2d 976 (2d Cir. 1984); United States v. Calmar, Inc., 612 F. Supp. 1298 (D.N.J. 1985).

13 Dennis W. Carlton, *Barriers to Entry*, *in* 1 ISSUES IN COMPETITION LAW AND POLICY 601 (ABA Section of Antitrust Law ed., 2008).

14 Questions for Public Comment, *supra* note 8.

15 ANTITRUST MODERNIZATION COMM'N, *supra* note 9, at 49.