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This article considers the circumstances in which a court, faced with a challenge to a decision taken by a primary decision-maker, accords a “margin of appreciation” to that decision-maker by limiting the intensity of its review. It compares the concept of the margin of appreciation as applied by the Community Courts in the application of Article 81 with that of the domestic courts in the United Kingdom when they are dealing with challenges based on directly effective Community rights or alleged breaches of the European Convention on Human Rights. The article examines how discussion of the existence and scope of the margin is influenced by the reviewing court’s perception of its role in administrative challenges more generally and whether the position of a specialist tribunal established to hear a particular kind of case is different from the position of a generalist court.

*The author is a Chairman of the Competition Appeal Tribunal (“CAT”) in London. The views expressed in this article are entirely personal, do not necessarily reflect the views of my colleagues and do not indicate how the Tribunal is likely to decide any cases whether currently pending or arising in the future. I would like to thank David Bailey, référendaire at the CAT, for his help with the preparation of this article.

I. Introduction

In this article the term “margin of appreciation” refers to the practice of courts when reviewing a particular decision to acknowledge that they should exercise restraint when considering whether to substitute their own assessment of the merits of the decision. In such cases the reviewing court will not overturn the original decision simply because it would have decided the matter a different way. Rather the court recognizes that the decision-maker’s assessment should be overturned only if there is something manifestly wrong with it.

RATHER THE COURT RECOGNIZES THAT THE DECISION-MAKER’S ASSESSMENT SHOULD BE OVERTURNED ONLY IF THERE IS SOMETHING MANIFESTLY WRONG WITH IT.

II. Community Law

The concept—or at least the use of the term “margin of appreciation”—has a much longer pedigree in Community law than it has in English domestic law. Indeed, the idea with which we are so familiar now in the application of certain aspects of the competition rules was expressly incorporated in Article 33(1) of the expired European Coal and Steel Community Treaty 1951. That article provided that the Court may not review the conclusions of the European Commission (“Commission”), drawn from economic facts and circumstances, except “where the [Commission] is alleged to have abused its powers or to have clearly misinterpreted the provisions of the Treaty or of a rule of law relating to its application.”

The idea in Community law of conferring a margin of appreciation is not limited to the application of the competition rules. For example, in *Germany v Commission*¹ Germany challenged a Commission decision which found that Germany’s national allocation plan for greenhouse gases failed to comply with the relevant Directive. The Court of First Instance recognized that it was dealing with a double margin—first, the margin that the Commission must accord to the Member State when the State decides how to implement a directive and secondly, the margin that the Court must accord to the Commission’s review of that Member State’s implementation in so far as the review entails complex economic and ecological assessments. In its own review of the Commission’s assessments, the Court of First Instance stated that it “cannot take the place of the Commission” but must confine itself to verifying that the measure in question is not vitiated by a manifest error or a misuse of powers; that the competent authority did not clearly exceed the bounds of its discretion; and that procedural guarantees have been fully observed.

Any consideration of the powers of review of the Court of First Instance in competition matters must start with the source of its power to review: Article 230 EC. Article 230 provides that the legality of Commission acts can be chal-

lenged “on grounds of lack of competence, infringement of an essential procedural requirement, infringement of this Treaty or of any rule of law relating to its application, or misuse of powers.” On its face this is a limited form of review as compared with the “unlimited jurisdiction” which is referred to in Article 229 with regard to the imposition of penalties. But within this single test set out in Article 230, both the Court of First Instance and the Court of Justice have adopted a flexible approach to the scope of review for the different grounds of challenge. The existence of a margin of appreciation for the decision-maker is not uniform across all the different grounds of appeal. There has been no margin conferred when the Court is considering an alleged error of law in the construction of a Community instrument. Indeed, the Community Courts are enjoined by Article 220 EC to ensure that in the interpretation and application of the Treaty, the law is observed. No matter how complex the drafting of the instrument or how arcane and technical the subject matter, the Court will always get to grips with purely legal questions. Thus, in its recent judgment in *British Aggregates Association*,² the Court of Justice held that the Court of First Instance had been wrong to accord the Commission a margin of appreciation on the question of whether a particular State measure was an aid for the purposes of Article 87 EC. Since State aid is a legal concept and must be interpreted on the basis of objective factors, the Community Courts must carry out a comprehensive review. There was no justification for the Court giving a broad discretion to the Commission on this issue.

The Court of First Instance also examines the factual findings made by the Commission with great diligence. In his often quoted Opinion in *Commission v Tetra Laval*,³ Advocate General Tizzano said that

“With regard to the findings of fact, the review is clearly more intense, in that the issue is to verify objectively and materially the accuracy of certain facts and the correctness of the conclusions drawn in order to establish whether certain known facts make it possible to prove the existence of other facts to be ascertained.”⁴

This reflects both the purpose for which the Court of First Instance was established, namely to strengthen the Community’s system of judicial review of such complex assessments,⁵ and its role as the human rights compliant tribunal for reviewing cases which may involve the imposition of substantial penalties.⁶

The Court of First Instance has itself drawn a distinction between its close scrutiny of errors of law and of fact and its more constrained scrutiny of matters of complex economic appraisal. There are a number of areas where the European

Courts have acknowledged that a margin of appreciation is appropriate; the discussion in this article will focus on the use of the concept in the application of Article 81. It is also commonly referred to in reviewing the exercise of the Commission's discretion in rejecting complaints⁷ and in the application of the EC Merger Regulation.⁸

The reference in the context of the application of Article 81 EC to limits on the scope of review of matters involving "complex economic assessment" goes back to the early case law of the European Court of Justice in *Consten and Grundig*⁹ where the Court held that judicial review of these complex matters "take[s] account of their nature by confining itself to an examination of the relevance of the facts and of the legal consequences which the Commission deduces therefrom." A more recent description of the test can be found in *Shaw v Commission* where the Court of First Instance stated that:

“[r]eview by the Community judicature of the complex economic appraisals made by the Commission when it exercises the discretion conferred on it by Article [81](3) of the Treaty, with regard to each of the four conditions laid down in that provision, must be limited to verifying whether the rules on procedure and on the giving of reasons have been complied with, whether the facts have been accurately stated, and whether there has been any manifest error of assessment or a misuse of powers.”¹⁰

Although the test is conventionally thought of as relevant to the application of Article 81(3) rather than Article 81(1), in fact the same formula referring to the need for a "manifest error of assessment" has been invoked in relation to both stages of the application of Article 81. This, perhaps, reflects the move towards a more economics-based application of Article 81(1), with the courts acknowledging that the same margin should be accorded to the Commission in relation to the application of the prohibition in the first place, before any consideration of Article 81(3). Thus in *Remia*¹¹ (one of the early cases pointing towards a more economics-based approach) the Court of Justice was reviewing a Commission decision which had declared that a vendor's 10 year non-compete covenant fell within the prohibition of Article 81(1) only after the end of the first four years. The Commission then refused to apply the exemption in Article 81(3) to the final six years of the covenant. Advocate General Lenz addressed the question "whether it is possible for the prohibition in Article [81](1) not to be applied to agreements in restraint of competition which in theory fall within its scope without adopting the exemption procedure under Article [81](3)." Having concluded that this was possible he considered that such "non-application" of Article 81(1) must be governed by criteria similar to those contained in Article 81(3):

“If this is right and the principles regarding exemption from the prohibition of restrictive agreements may be applied to this case by analogy, a further consequence will follow regarding the scope for judicial review of the Commission’s decision. . . . The Court of Justice has recognised that Article [81](3) necessarily implies complex economic assessments of economic matters. Similarly, where such assessments are made in the case of prohibitions of competition agreed in connection with transfers of undertakings, the judicial review must take that fact into account and therefore confine itself to determining the correctness of the facts on which the assessments are based and the applicability to those facts of the relevant legal principles.”

The Court followed the Advocate General’s conclusions and expressly applied the “manifest error” terminology to the Article 81(1) stage of its review as well as referring to “the discretion which the Commission enjoys” in the application of the exemption. As regards Article 81(1) the Court stated:

“Although as a general rule, the Court undertakes a comprehensive review of the question whether or not the conditions for the application of Article [81](1) are met, it is clear that in determining the permissible duration of a non-competition clause incorporated in an agreement for the transfer of an undertaking, the Commission has to appraise complex economic matters. The Court must therefore limit its review of such an appraisal to verifying whether the relevant procedural rules have been complied with, whether the statement of the reasons for the decision is adequate, whether the facts have been accurately stated and whether there has been any manifest error of appraisal or a misuse of powers.”¹²

The same approach has been adopted more recently when the Court of First Instance has considered the application of both Article 81(1) and 81(3). In *Van den Bergh Foods*¹³ the Court referred to the manifest error of assessment test when considering a challenge to the Commission’s findings as to the degree of foreclosure in the market for impulse ice cream (paragraph 80) and to the same test when considering the challenge to the Commission’s refusal of exemption under Article 81(3) (see paragraph 135). In that case the Court dismissed the challenge as unfounded in both respects. Similarly, in *GlaxoSmithKline Services*¹⁴ the Court of First Instance again referred to the *Remia* formulation of limited review both in its preliminary observations on the application of Article 81(1) (see paragraph

57 of the judgment) as well as in the part of its judgment dealing with Article 81(3) (see paragraph 241). However, in neither context in the *GlaxoSmithKline Services* case did this prevent the Court from making substantial inroads into the Commission's decision. Although it was not contested either that the relevant clause existed and was enforced, or that its purpose was to restrict parallel imports, the Court after reciting the "manifest error of assessment" formula nonetheless overturned the Commission's decision that the clause fell within Article 81(1) by reason of its object alone, and then devoted 80 paragraphs to annulling the Commission's refusal to grant exemption under Article 81(3).

In these cases concerning the application of Article 81(1) and (3) there is no detailed discussion by the Court as to *why* a margin of discretion should be accorded by the Court of First Instance to the Commission in respect of these particular aspects of its review jurisdiction. The attitude of the Community Courts is illustrated by the Opinion of Advocate General Reischl in *Metro (No 1)*¹⁵ where he states that an assessment of a selective distribution system involves difficult economic judgments and that the balancing of the advantages flowing from the system against the restriction of competition calls for complex assessments. "This *necessarily* means" according to the Advocate General "that the Commission has a margin of discretion in this respect and this means at the same time that there is *a corresponding restriction* on judicial review" (emphasis added). But complexity is not generally considered, in itself, a reason for the courts to shrink from getting into the detail of a case. There are many instances where the Courts are willing to immerse themselves in complex matters. Nor can the margin of discretion simply be a recognition of the fact that it is possible for reasonable people to differ on the conclusions to be drawn from an economic analysis. After all, the law is no less an inexact science than economics. It is possible for reasonable lawyers to differ on the proper interpretation of a particular statutory provision but that is not considered a reason for the Courts to refrain from substituting their own interpretation. In relation to the law, though, because of the precedent-setting characteristic of case law and the importance attached to the consistent application of the law across courts sitting within the same jurisdiction, the importance of establishing the one "true" meaning of a provision will always trump respect for the original decision-maker's conclusion.

IN RELATION TO THE LAW, THOUGH, BECAUSE OF THE PRECEDENT-SETTING CHARACTERISTIC OF CASE LAW AND THE IMPORTANCE ATTACHED TO THE CONSISTENT APPLICATION OF THE LAW ACROSS COURTS SITTING WITHIN THE SAME JURISDICTION, THE IMPORTANCE OF ESTABLISHING THE ONE "TRUE" MEANING OF A PROVISION WILL ALWAYS TRUMP RESPECT FOR THE ORIGINAL DECISION-MAKER'S CONCLUSION.

The key here appears to be the fact that the complexity relates to the application of principles of economics (rather than purely of law) and these are pecu-

liarily within the expertise of the Commission rather than the Court. The second element appears to be that where there is a balance to be struck between the advantages and disadvantages of an agreement, (whether in the context of applying Article 81(1) or 81(3)), the decision-maker is entitled to a margin of discretion when it carries out that balance.

III. Domestic Law

The modern principles governing judicial review of executive decisions in England grew out of the prerogative writs which the court could issue at the suit of the Crown when the Crown brought an action against the executive on behalf of an individual citizen.¹⁶ Although national arrangements for hearing challenges to administrative action differ across the Member States, all national courts within the EU have had to accommodate within their legal systems the direct effect of Community law. Those which, like the United Kingdom, have incorporated the European Convention on Human Rights into their domestic law enabling citizens to enforce those rights through their domestic courts will also have had to grapple with how traditional tests for assessing executive decisions need to be adapted to ensure that Convention rights are fully protected.

The expression “margin of appreciation” arrived relatively late in English domestic jurisprudence but the idea behind it has been at the core of the development of judicial review. The discussion has been conducted against a legal background marked by two important features. The first feature is the existence of two well recognized but traditionally very different standards of review. The contrast is thus between “an appeal on the merits” in which the reviewing court examines the matter afresh, hearing evidence and forming its own view and “an application of the principles of judicial review.” This distinction is firmly embedded, and the language used in the lengthy and continuing debate among English judges and jurists over how far review of decisions challenged on Community law or human rights grounds has moved towards a “merits” review is a product of this dichotomy.

The second feature is that the courts’ review of the decisions of public bodies in English law is moving from a position of traditional reluctance to intervene in areas of policy to a position of greater intensity of scrutiny. In Community law, as we have seen, the courts could be said to have adopted the concept as a self-denying ordinance, given that there is nothing within Article 230 which requires the application of a less intense degree of scrutiny in respect of some aspects of the Commission’s decisions but not others. The margin of appreciation conferred by the Community courts on the Commission is thus set against the “default position” of a more intensive degree of scrutiny. By contrast, the “default position” in review of administrative decisions in English law is one in which a much greater degree of deference has generally been shown to the decision-maker.

IV. “Traditional” Judicial Review

There are three generally recognized grounds of challenge in judicial review under English law—excess of power, irrationality, and procedural irregularity. More recently a fourth has been added: in *E v Home Office*¹⁷ the Court of Appeal held that mistake of fact giving rise to unfairness is a separate head of challenge in judicial review proceedings. As with Community law, the courts’ scrutiny of legal issues generally allows no margin of discretion to the decision-maker in relation to any aspect of legal interpretation that the decision-maker is called on to undertake.¹⁸ In some rare instances, a margin of appreciation has been extended to a decision-maker if the factors relevant to the proper interpretation of a statutory term are considered peculiarly within that decision-maker’s expertise. This is illustrated by the decision in *R v Monopolies and Mergers Commission, ex p South Yorkshire Transport*.¹⁹ The jurisdiction of the former Monopolies and Mergers Commission over mergers was limited to cases where the area affected by the merger constituted “a substantial part of the United Kingdom.” Although the interpretation of the phrase therefore set the bounds of the MMC’s jurisdiction, the House of Lords held that because the criterion of substantiality was so imprecise and included not only geographical extent but population and economic activities, the court was only entitled to interfere if the MMC’s decision could not be regarded as rational.

In the main, however, the debate over margins of appreciation has taken place in the review by the courts of the executive’s exercise of discretionary powers—although the debate predates considerably the introduction of that phrase in English case law. In the English jurisprudence the issue for discussion is not when the courts should hold back from a full, rigorous appraisal of the merits of the decision but rather in what narrow circumstances can the courts intervene in the decision-making of the executive at all. The early cases set the bar high. The classic exposition is that of Lord Greene MR in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation*²⁰ and the test, commonly referred to as “the *Wednesbury* test,” is usually expressed in terms that the courts intervene only if the decision is so unreasonable that no reasonable decision-maker could have made it. Sometimes this has been expressed in more extravagant terms. Indeed, in *Wednesbury* itself, Lord Greene MR stated that the decision needed to be “something so absurd that no sensible person could ever dream that it lay within the powers of the authority.” Lord Diplock has described the task facing some-

THERE ARE THREE GENERALLY RECOGNIZED GROUNDS OF CHALLENGE IN JUDICIAL REVIEW UNDER ENGLISH LAW—EXCESS OF POWER, IRRATIONALITY, AND PROCEDURAL IRREGULARITY. MORE RECENTLY A FOURTH HAS BEEN ADDED: IN *E V HOME OFFICE* THE COURT OF APPEAL HELD THAT MISTAKE OF FACT GIVING RISE TO UNFAIRNESS IS A SEPARATE HEAD OF CHALLENGE IN JUDICIAL REVIEW PROCEEDINGS.

one challenging the exercise of a discretionary power as needing to establish that the decision was “so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it.”²¹

RECENT CASES HAVE EXPRESSED THE TEST IN MORE MEASURED TERMS—AN OFTEN CITED FORMULATION IS THAT OF THE DECISION “BEING UNREASONABLE IN THE SENSE THAT IT IS BEYOND THE RANGE OF RESPONSES OPEN TO A REASONABLE DECISION-MAKER.”

Recent cases have expressed the test in more measured terms—an often cited formulation is that of the decision “being unreasonable in the sense that it is beyond the range of responses open to a reasonable decision-maker.”²² A recent application of the classic test can be seen in the judgment of Beatson J in *R (Centro) v Sec of State for Transport*.²³ There a challenge was

brought against a decision by the defendant Government department concerning the method of calculating the reimbursement of transport providers who provide concessionary fares for elderly and disabled people. Beatson J stated:

“If this ground of the challenge is analysed as based on irrationality the claimant has to overcome a high threshold. This is because the issues for decision concerned the application of complex economic concepts in particular the elasticities applied to price increases to be used as part of the calculation of the reimbursement rate paid to transport operators providing travel concessions. It is clear that, when considering decisions of this nature in the context of judicial review, the court is particularly cautious and reluctant to intervene.”

It is this test that has had to be adapted to deal first with the direct effect of Community law and more recently with the domestic incorporation of the European Convention on Human Rights (“Convention”). In the development of judicial review concerning alleged breaches of directly effective Community rights, there has been considerable discussion of the shift from “traditional” judicial review which leaves a substantial margin of appreciation to the decision-maker to a more intensive review where the court cannot avoid substituting its own decision. A description of what is needed was set out in the judgment of Laws J in *R v MAFF ex parte First City Trading Limited*.²⁴ That case concerned a challenge to a national instrument, the Beef Stocks Transfer Scheme, on the grounds that it infringed the fundamental Community principle of equality of treatment. The judge held that the Community principle did not apply in this purely domestic context. But he went on to consider whether, if the principle

had applied, the scheme was objectively justified. The Government relied on a passage from *Roquette Frères*²⁵ which adopted the “manifest error” test. The Government argued that this was in reality “a test closely akin to *Wednesbury*.” Laws J rejected this. He recognized that there must remain a difference between the approach of the court in arriving at a judicial decision on the question whether a measure is objectively justified and that of the primary decision-maker himself: the court’s task is to decide whether the measure in fact adopted lies within the proper legal limits of the decision-maker’s powers.

Laws J then went on to explain the difference between *Wednesbury* and what he called “European review”:

“The difference between *Wednesbury* and European review is that in the former case the legal limits lie further back. I think there are two factors. First, the limits of domestic review are not, as the law presently stands, constrained by the doctrine of proportionality. Secondly, . . . the European rule requires the decision-maker to provide a fully reasoned case. It is not enough merely to set out the problem, and assert that within his discretion the Minister chose this or that solution constrained only by the requirement that his decision must have been one which a reasonable Minister might make. Rather the Court will test the solution arrived at, and pass it only if substantial factual considerations are put forward in its justification: considerations which are relevant, reasonable, and proportionate to the aim in view. But as I understand the jurisprudence, the Court is not concerned to agree or disagree with the decision: that would be to travel beyond the boundaries of proper judicial authority, and usurp the primary decision-maker’s function. Thus *Wednesbury* and European review are different models—one looser, one tighter—of the same juridical concept which is the imposition of compulsory standards on decision-makers so as to secure the repudiation of arbitrary power.”

Referring to Laws J’s judgment as repaying close study, the Court of Appeal in *Eastside Cheese*²⁶ also stressed two aspects in particular: first, the difference between ordinary judicial review and the test to be applied when the challenge concerns the proportionality of the decision; and second, the need to respect the choice made by the responsible decision-maker after consultation with his expert advisers. The Court in *Eastside Cheese* introduced the idea that the width of the margin of appreciation is a flexible concept:

“(…) there seems to be no good reason in principle or authority for two sharply different tests. The margin of appreciation for a decision-maker (which includes, in this context, a national legislature) may be broad or narrow. The margin is broadest when the national court is concerned with primary legislation enacted by its own legislature in an area where a general policy of the Community must be given effect in the particular economic and social circumstances of the member state in question. The margin narrows gradually rather than abruptly with changes in the character of the decision-maker and the scope of what has to be decided (not, as the secretary of state submits, only with the latter).”

Inevitably the question arose as to how far the principle of proportionality, originally regarded as relevant only in Community law cases, should be regarded as part of the *Wednesbury* test in a purely domestic context. In *Alconbury*²⁷ Lord Slynn noted that the difference between that principle and the *Wednesbury* test was not as great as was sometimes supposed because of the margin of appreciation the Community Courts accord to the Commission in making economic assessments. It should be recognized as part of English administrative law: “Trying to keep the *Wednesbury* principle and proportionality in separate compartments seems to me to be unnecessary and confusing.” However, he cautioned that this does not mean that judicial review amounts to a complete rehearing on the merits of the decision unless Parliament has authorized this in a particular area.

This idea of some flexibility in applying the judicial review standard was described more recently in *Mabanaft Ltd.*²⁸ There Beatson J. referred to the margin left to the decision-maker in that case as being “at the broader end of the spectrum.” Carnworth LJ also adopted the idea of a spectrum of intensity of review in *IBA Health*²⁹ where he said that at one end of the spectrum a “low intensity of review” is applied to cases involving issues of political judgment or matters of national economic policy while more intense review is applied at the other end of the spectrum for decisions alleged to infringe fundamental rights. The idea of a spectrum thus suggests a more nuanced approach.

In the human rights sphere, the margin of appreciation conferred on the Contracting States by the Convention was described by the Strasbourg court in *Fretté v France*.³⁰ In that case the application challenged the ban in France on homosexuals being considered as potential adoptive parents. Having found that there was no common practice among the Contracting States as to whether to apply such a ban, the Court held that the States enjoy a certain margin of appreciation in assessing whether and to what extent differences in otherwise similar situations justify a different treatment in law. The scope of the margin will vary, the Court said, according to the circumstances, the subject matter, and its back-

ground. It is therefore natural that national authorities, who have a duty in a democratic society to consider the interests of society as a whole, should enjoy a wide margin of appreciation when they are asked to make rulings on such matters. Because of their “direct and continuous contact with the vital forces of their countries” such authorities are in principle better placed than an international court to evaluate local needs and conditions.

The way in which this affects the role of the domestic courts was described by Lord Hope in *ex p Kebilene*³¹ who stated that when national courts are considering Convention issues arising within their own countries “the Convention should be seen as an expression of fundamental principles rather than as a set of mere rules.” Further, the questions which the courts will have to decide in the application of these principles will involve questions of balance between competing interests and issues of proportionality:

“In this area difficult choices may have to be made by the executive or the legislature between the rights of the individual and the needs of society. In some circumstances it will be appropriate for the courts to recognise that there is an area of judgment within which the judiciary will defer, on democratic grounds, to the considered opinion of the elected body or person whose act or decision is said to be incompatible with the Convention. . . . It will be easier for such an area of judgment to be recognised where the Convention itself requires a balance to be struck, much less so where the right is stated in terms which are unqualified. It will be easier for it to be recognised where the issues involve questions of social or economic policy, much less so where the rights are of high constitutional importance or are of a kind where the courts are especially well placed to assess the need for protection.”

There have been two aspects of this adaptation which vary in the extent to which they depart—or at least in which they acknowledge that they are departing—from the traditional judicial review test. The first aspect expresses the idea that although the test being applied is still the same “within the range of reasonable responses” test, it is applied more intensely because of what is at stake for the person affected by the decision. Thus in *R (Ross) v West Sussex Primary Care Trust*³² the judge expressed the test in the following terms: “the more substantial the interference with human rights, the more the court will require by way of justification before it is satisfied that the decision is reasonable; the Courts must subject [the decision-maker’s] decision to anxious scrutiny because the Claimant’s life is at stake.”

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But recent decisions have acknowledged that the courts' approach to the judicial review of decisions challenged directly on human rights grounds must go beyond even this "anxious scrutiny." An often cited exposition of the test is found in the speech of Lord Steyn in *ex p Daly*.³³ He noted that there is an overlap between the traditional grounds of review and the approach of proportionality such that most cases would be decided in the same way whichever approach is adopted. But, he went on, the intensity of review is "somewhat greater" under the proportionality approach. The doctrine of proportionality may require the reviewing court to assess the balance which the decision-maker has struck, not merely whether it is within the range of rational or reasonable decisions. Further, the proportionality test may go further than the traditional grounds of review inasmuch as the test may require attention to be directed to the relative weight accorded to interests and considerations. Lord Steyn acknowledged that the differences in approach between the traditional grounds of review and the proportionality approach may sometimes yield different results.

In that case the House of Lords still emphasized the distinction between the proportionality test and "a shift to the merits"—Lord Steyn stressed that the respective roles of judges and administrators are fundamentally distinct and will remain so and that "In law context is everything." This has been maintained even in a case (such as *R v Governors of Denbigh High School*³⁴) where the courts have stressed that in the human rights context, the court is not concerned with the *process* by which the decision-maker arrived at the impugned decision but with whether or not the decision was right. But perhaps the high point of this adaptation of the judicial review test has come in the context of the courts' review of decisions in relation to compulsorily-detained people under mental health legislation. The Court of Appeal in *R (Wilkinson) v Broadmoor*³⁵ held that, when judicial reviewing a decision to treat a detained mentally ill hospital patient without his consent, the court should conduct a "full merits review" as to whether the proposed treatment infringed his human rights, and, to that end, he was entitled to require the attendance of witnesses to give evidence and to be cross-examined. That case has been treated as authority for the proposition that a court, albeit exercising a judicial review function, does so not on a *Wednesbury* basis, but by deciding the matter for itself on the merits after a full consideration of the evidence, whether oral or in writing.³⁶

V. A Margin of Appreciation in Proceedings before Specialist Tribunals

The move in domestic law away from the idea of two different tests, one for “traditional” judicial review and one for “European” or “human rights” review, to the idea of the margin of appreciation involving a spectrum of different intensities of review is to be welcomed. It is particularly useful when considering the jurisdiction of specialist tribunals set up to hear appeals from the decisions of a single kind of decision-maker. For such tribunals, the legislation establishing them will usually specify the nature of the appeal and may provide for different kinds of appeal for different kinds of decisions. For example, the Competition Appeal Tribunal is required in appeals against decisions under the domestic competition regime which mirrors Articles 81 and 82 EC to “determine the appeal on the merits by reference to the grounds of the appeal set out in the notice of appeal.”³⁷ But in considering appeals from decisions relating to merger control, the Tribunal is enjoined to “apply the same principles as would be applied by a court on an application for judicial review.” A similar dichotomy is found in the jurisdiction of the recently created Charity Tribunal which is required, when considering appeals from certain decisions of the Charity Commission, to “consider afresh” the decision appealed against but which must apply judicial review principles in challenges to other Charity Commission decisions.³⁸

THE MOVE IN DOMESTIC LAW AWAY FROM THE IDEA OF TWO DIFFERENT TESTS, ONE FOR “TRADITIONAL” JUDICIAL REVIEW AND ONE FOR “EUROPEAN” OR “HUMAN RIGHTS” REVIEW, TO THE IDEA OF THE MARGIN OF APPRECIATION INVOLVING A SPECTRUM OF DIFFERENT INTENSITIES OF REVIEW IS TO BE WELCOMED.

Two questions arise from the idea of a margin of appreciation in this context. The first is whether the width of the margin accorded by the tribunal to the decision-maker is, or should be, different because of the specialist expertise of the tribunal. The second is whether there is scope for the tribunal to confer on the original decision-maker a margin of appreciation even in those appeals where the legislation specifies that the appeal is on the merits.

As regards the first question, the Competition Appeal Tribunal has considered this issue in the context of its merger jurisdiction in which, as noted above, it is required to apply the principles that would be applied by a court on an application for judicial review. In *British Sky Broadcasting*³⁹ the appellant argued that since Parliament had chosen to allocate the power of review to the Tribunal, a specialist body, as opposed to a generalist court, Parliament must be taken to have intended that a higher intensity of review would follow from that choice. The Tribunal rejected this argument and described the difference that having a specialist tribunal should make. The Tribunal recognized that it is a specialist body to which Parliament has entrusted applications to review decisions of the

competition regulators in the context of the complex statutory merger regime. Such cases often concern consideration of concepts and issues which the Tribunal is also required to grapple with on a day-to-day basis in its other jurisdictions. That is why the Tribunal's composition is required by statute to contain competition expertise, and its members are selected for their relevant knowledge and experience. In its consideration of the cases which come before it the Tribunal enjoys a degree of familiarity with the statutory regime, the relevant case-law, and some of the legal and economic concepts which arise. This familiarity, as well as the relevant expertise at its disposal, "may render the Tribunal a more demanding and/or less deferential tribunal than might otherwise be the case where a court is called upon to review the decision of a specialist regulator." But the Tribunal went on:

"(...) in our view none of this means that the Tribunal is applying judicial review principles in a different way or is exercising a higher intensity of review than would be the case if the matter were before the Administrative Court. If [the appellant's] submission amounts to no more than that the Tribunal should use its specialist expertise wherever possible when assessing the validity of findings and the lawfulness of decisions in the context of section 120 reviews, then such submission can hardly be disputed. However this would not in our view be applying the principles of judicial review in a different way from the Administrative Court. If his submission amounts to more than this then it seems to us that it is not supported by the authorities to which he has drawn our attention, and is inconsistent with [*Office of Fair Trading v IBA Health Limited* [2004] EWCA Civ 142] and with subsection 120(4) itself."

The decision in *British Sky Broadcasting* was undoubtedly correct as a matter of statutory interpretation and was necessarily in line with the authorities, particularly the Court of Appeal's judgment *IBA Health* there cited. The legislator in directing a tribunal to apply the same principles as a generalist court does not intend the tribunal, however specialist, to take advantage of its expertise by moving closer to a merits review. But if the generalist courts are moving towards considering the margin of appreciation inherent in the judicial review process as more of a spectrum—depending on the character of the decision-maker and the scope of what has to be decided—there is perhaps room, as the Tribunal acknowledged, for a specialist tribunal to be "more demanding and/or less deferential" in its application of those same principles. Indeed in *IBA Health*,⁴⁰ although Carnwath LJ held that the statutory provision was a clear indication that, notwithstanding the Tribunal's specialized composition, the review was

limited to the ordinary principles applied by the Administrative Court, he went on to say that the Tribunal's "instinctive wish for a more flexible approach than *Wednesbury* would have found more solid support in the textbook discussions of the subject, which emphasise the flexibility of the legal concept of 'reasonableness' dependent on the statutory context."

Two further strands support such a conclusion. The first takes us back to a consideration of why a margin of appreciation arises in the first place. We saw earlier how, in Community competition law cases, the Court of First Instance limits the intensity of its review in areas where the Commission has carried out a complex economic assessment. There are also domestic cases in the competition law sphere where the same reason has been given by a generalist court for not interfering with the decision-maker's conclusions. In two recent cases involving the Rail Regulator, the courts stressed the specialist knowledge of the regulator and the availability to it of expert advice. In *London and Continental Stations*⁴¹ Moses J. (as he then was), stated that in considering the various challenges to the regulator's directions, the court must "bear in mind that he was reaching his conclusions in a field in which he was both expert and experienced. He was advised by experts." The imbalance in access to expert knowledge and experience of necessity meant that the reviewing role of the courts is modest.⁴² Moses J. referred to the earlier case of *Winsor v Bloom*⁴³ where the Court of Appeal acknowledged the role of the rail regulator as the guardian of the public interest and stated that "he is better placed than a court to make an overall assessment of what is in the interest of the rail network." It is an open question whether such considerations are still relevant where the appeal goes to a statutory tribunal which is set up specifically to review the regulator.

The second strand can be drawn from the cases which consider how the margin of appreciation conferred by the Human Rights Convention is translated into the domestic sphere by national courts. A straightforward illustration can be seen in *Belfast City Council v Miss Behavin' Limited*⁴⁴ where the House of Lords considered the application of Article 10 ECHR and Article 1 Protocol 1 to the refusal by a local Council in Northern Ireland to license a sex shop in a particular locality. Lord Hoffmann said that this is an area of social control in which the Strasbourg court has always accorded a wide margin of appreciation to Contracting States and that in terms of the domestic constitution this "translates into the broad power of judgment entrusted to local authorities by the legislature." But the relationship can be more complex. Lord Hoffmann's stance in *Miss Behavin'* can be contrasted with his speech in another recent Northern Irish case *In re P and others (AP)*⁴⁵ where the House of Lords was considering a legislative prohibition on adoption by unmarried couples. The question was whether it was within the margin of appreciation of the Northern Irish Government to apply such an outright ban. The case was striking because there was substantial evidence before the court that the Government had consulted widely on the draft legislation and that 95 percent of respondents to the consultation were opposed

to the proposal to extend adoption to unmarried couples. Lord Hoffmann acknowledged that “where questions of social policy admit of more than one rational choice, the courts will ordinarily regard that choice as being a matter for Parliament.” But he held that the margin conferred by the Court in Strasbourg on the Contracting States does not necessarily translate in the domestic sphere to a margin of appreciation conferred *by the judiciary on the domestic legislature*:

“In such a case, it [is] for the court in the United Kingdom . . . to apply the division between the decision-making powers of courts and Parliament in the way which appears appropriate for the United Kingdom. The margin of appreciation is there for division between the three branches of government according to our principles of the separation of powers. There is no principle by which it is automatically appropriated by the legislative branch.”

Baroness Hale agreed with Lord Hoffmann that an element of flexibility in the Strasbourg Court’s application of the Convention does not mean that the national courts must give the legislature the benefit of that flexibility. Where a matter lies within the Contracting State’s margin of appreciation, it is up to that State to form its own judgment, and the courts were, in this case, in as good a position to form that judgment as the Northern Ireland legislature.

The difference in approach in the two cases is perhaps a reflection of the courts’ assessment of the legitimacy of their own assessment of the proportionality of the measure under challenge. In *Miss Behavin’* the margin of appreciation

is extended to the local authority because the court respects “the judgments made by those who are in much closer touch with the people and the places involved than the court could ever be.”⁴⁶ But where, as in *In re P*, the court considers that it is just as able as the legislature to decide what “appears to be appropriate” within that margin in the United Kingdom, it need not shrink from doing so.

FINALLY AS TO THE SECOND QUESTION WHETHER THERE IS SCOPE FOR A MARGIN OF APPRECIATION WHEN AN APPEAL AGAINST THE EXERCISE OF A DISCRETION IS ON THE MERITS, THE ANSWER IN THE COMMUNITY CONTEXT IS A CLEAR “YES.”

Finally as to the second question whether there is scope for a margin of appreciation when an appeal against the exercise of a discretion is on the merits, the answer in the Community context is a clear “yes.” As we have seen, the conferring of a margin of appreciation in challenges to the Commission’s application of Article 81 occurs in the context of a test which, in other respects including errors of fact, is treated as a full merits review. Even in relation to the review of fines, where the

Courts' jurisdiction is unlimited, the Court of First Instance will allow a margin of appreciation on the part of the Commission.⁴⁷ The margin of discretion therefore does not arise because the nature of the appeal is regarded as something less than an appeal on the merits. It arises because of the nature of the decision under review.

In domestic law, if one could move away from the “judicial review” and “appeal on the merits” tags, one could argue that the case law concerning EC law and human rights challenges are also examples of what is, in effect, a merits appeal in which a margin of appreciation is conferred on the decision-maker. The court recognizes that, while the traditional *Wednesbury* test is inadequate because the court must come closer to deciding whether the decision is right or wrong, there is also to some extent an area of discretion within which the decision-maker's conclusions should not be disturbed. Cases such as *Eastside Cheese* which focus on the nature of the decision and the decision-maker encourage this flexibility.

This situation arose in sharp focus in the recent decision of the Competition Appeal Tribunal in *T-Mobile (UK) Limited (Sequencing)*.⁴⁸ The mobile phone operators challenged the Office of Communication (“OFCOM”)’s decision to carry out an auction of new bands of radio spectrum before it had decided whether it was going to require operators to hand back bandwidth that the operators already used. The question, which was tried as a preliminary issue, was whether this challenge fell within the jurisdiction of the CAT, in which case it would be heard as an appeal “on the merits” or whether the operators could only challenge the decision by way of judicial review. A subsidiary question was what difference, if any, there would be between the intensity of review in each case. Both sides accepted that judicial review was a “flexible” test but the operators relied on *ex p Daly* and *Governors of Denbigh High* to show that there was still a real difference between an appeal on the merits and judicial review—even the more intensive judicial review carried out in human rights cases. The Tribunal decided that it did not have jurisdiction, without having to decide how its approach to the appeal would differ from that of the Administrative Court. On appeal, the Court of Appeal referred to cases in which the judicial review test had been adapted to allow a full merits investigation where this was required by the Human Rights Act 1998. Jacob LJ, with whom the other members of the Court agreed, said:

“it seems to me to be evidence that whether the ‘appeal’ went to the CAT or by way of JR, the same standard for success would have to be shown. In either case it would not be enough to invite the tribunal to consider the matter afresh—as though the [decision] had never been made.”

In other words, the nature of the decision, which Jacob LJ described as “an overall value judgment based upon competing commercial considerations in the context of a public policy decision” meant that even if it was challenged in an appeal on the merits before the Tribunal, it would not be appropriate for the Tribunal simply to disregard OFCOM’s reasoning and start with a blank sheet.

The Tribunal has, in another telecoms case, indicated that despite a statutory appeal being on the merits, the regulator has a margin of appreciation as to how it tackles a particular dispute. In *T-Mobile and ors (Termination Rate Disputes)*⁴⁹ the Tribunal was considering an appeal against a dispute determination brought under section 192 of the Communications Act 2003. OFCOM argued that it would be inappropriate for the Tribunal to allow a complete opening up of the disputes’ subject matter which went beyond the confines of the matters that had been raised by the parties in the course of OFCOM’s investigations of these disputes. Moreover, the Tribunal should be “slow to interfere” where errors of appreciation are alleged as opposed to errors of fact or law. The Tribunal acknowledged this margin:

“(…) there may, in relation to any particular dispute, be a number of different approaches which OFCOM could reasonably adopt in arriving at its determination. There may well be no single “right answer” to the dispute. To that extent, the Tribunal may, whilst still conducting a merits review of the decision, be slow to overturn a decision which is arrived at by an appropriate methodology even if the dissatisfied party can suggest other ways of approaching the case which would also have been reasonable and which might have resulted in a resolution more favourable to its cause.”

VI. Concluding Remarks

In one of the leading text books on domestic judicial review principles, the editors contrast the high threshold of the traditional *Wednesbury* test with the abundant instances in the case law of courts overturning the executive’s decisions and actions at all levels. This is not, they say, because ministers and public authorities regularly take leave of their senses or act in an outrageous manner. Rather it is “because the courts in deciding cases tend to lower the threshold of unreasonableness to fit their more exacting ideas of administrative good behaviour.”⁵⁰ For competition lawyers, this brings to mind the Court of Justice’s description of the Commission’s first ground of appeal in *Tetra Laval*, namely that the Court of First Instance, “whilst claiming to apply the test of manifest error of assessment, in fact applied a different test.”⁵¹

The development of the margin of appreciation in Community case law has taken place in a coherent way within the context of the tests laid down by Article 230 and the instruments implementing Article 229. Although the precise bounds of the margin may be open to debate, the formulations used by the Courts to describe what they are doing, and the circumstances in which the margin is accorded, are reasonably consistent. The development of the concept in English domestic law has been accelerated by the courts needing to get to grips with the application of Community and human rights norms. The case law shows an increasing focus on the characteristics of the decision, of the decision-maker, and of the reviewing court as determining the scope of the margin to be accorded rather than on the traditional divisions between judicial review principles and appeals on the merits. ▼

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- 1 Case T-374/04 *Germany v Commission*, 2007 E.C.R. II-4431.
 - 2 Case C-487/06 P *British Aggregates Association v Commission*, judgment of 22 December 2008.
 - 3 Case C-12/03P *Commission v Tetra Laval*, 2005 E.C.R. I-987 at ¶186. The CFI made the same point in Case T-201/01 *General Electric v Commission* 2005 E.C.R. II-5575, ¶62.
 - 4 For a discussion of the difficulty of separating consideration of errors of fact from errors of appraisal, see T. Reeves & N. Dodoo, *Standards of Proof and Standards of Judicial Review in EC Merger Law*, INT'L ANTITRUST L & POL., Ch. 6, (Barry Hawk, ed., 2005).
 - 5 See the comments of AG Cosmas in Case C-344/98, *Masterfoods v Commission*, 2000 E.C.R. I-11368, at ¶ 54.
 - 6 See, e.g. Case T-348/94 *Enso Española v Commission*, 1998 E.C.R. II-1875, ¶¶55-65.
 - 7 E.g. Case T-115/99 *Système Européen Promotion SARL v Commission*, 2001 E.C.R. II-691, ¶34.
 - 8 The Tetra Laval case (*supra* note 3) has been the subject of much discussion.
 - 9 Joined Cases 56 & 58/64 *Consten and Grundig v Commission*, 1966 E.C.R. 299.
 - 10 Case T-131/99 *Shaw v Commission*, 2002 E.C.R. II-2023, ¶38. National courts now, of course, face this task when considering private law actions under Article 81 post Modernisation.
 - 11 Case 42/84 *Remia v Commission*, 1985 E.C.R. 2545.
 - 12 Case 42/84 *Remia v Commission* [1985] ECR 2545. The use of the word “manifest” to describe the kind of defect which takes a decision outside the margin of appreciation is a constant factor in the test as applied in many different contexts.
 - 13 Case T-65/98 *Van den Bergh Foods v Commission*, 2003 E.C.R. II-4653.
 - 14 Case T-168/01 *GlaxoSmithKline Services v Commission*, 2006 E.C.R. II-2969. This case is on appeal to the ECJ: Joined Cases C-501/06 P etc.
 - 15 Case 26/76 *Metro v Commission (No 1)*, 1977 E.C.R. 1875 at page 1924. Note that AG Tizzano in Tetra Laval (*supra* note 3), ¶89, stated that it is the rules on the division of the powers between the

Commission and the Courts which prevents the courts from entering into the merits of the Commission's complex economic assessments.

- 16 The prerogative writs were "certiorari" issued to quash a decision, "prohibition" ordering the public body not to do something, and "mandamus" ordering the public body to take specified action. These names have now been updated to a quashing order, a prohibition order, and a mandatory order. Judicial review proceedings in the United Kingdom are still nominally brought by the Crown on the application of the individual against the public body.
- 17 *E v Home Office*, 2004 EWCA Civ 49.
- 18 See, for example, the discussion in *R (Iran) v Home Secretary*, 2005 EWCA Civ 982.
- 19 *R v Monopolies and Mergers Commission, ex p South Yorkshire Transport*, 1993 1 W.L.R. 23.
- 20 *Associated Provincial Picture Houses Ltd v Wednesbury Corporation*, 1948 1 K.B. 223.
- 21 *Council for Civil Service Unions v Minister for the Civil Service*, 1985 A.C. 408, at 410.
- 22 *R v Ministry of Defence ex p Smith* 1996 Q.B. 517.
- 23 *R (o.a.o. Centro) v Sec of State for Transport*, 2007 EWHC 2729 (Admin).
- 24 *R v MAFF ex parte First City Trading Limited*, 1997 1 C.M.L.R. 250.
- 25 *Case 138/79 Roquette Frères v Council*, 1980 E.C.R. 3333.
- 26 *R v Secretary of State for Health ex p Eastside Cheese*, 1999 EuLR 968.
- 27 *R v Secretary of State for the Environment, Transport and the Regions ex p Alconbury Developments Ltd*, 2001 UKHL 23.
- 28 *R (o.a.o. Mabanafit Ltd) v Secretary of State for Trade & Industry*, 2008 EWHC 1052 (Admin), recently upheld by the Court of Appeal, [2009] EWCA Civ 224.
- 29 *Office of Fair Trading v IBA Health Ltd*, 2004 EWCA 142.
- 30 *Fretté v France* 2002 38 E.H.R.R. 438.
- 31 *R v DPP ex p Kebilene*, 2000 2 A.C. 326.
- 32 *R (Ross) v West Sussex Primary Care Trust* judgment of the Administrative Court 10 September 2008 at ¶39.
- 33 *R v Secretary Of State for the Home Department, ex p Daly*, 2001 UKHL 26.
- 34 *R v Governors of Denbigh High School*, 2006 UKHL 15.
- 35 *R (o. a. o. Wilkinson) v Broadmoor*, 2001 EWCA 1545.
- 36 *R (o. a. o. JB) v Haddock*, 2006 EWCA Civ 961.
- 37 A similar test applies in appeals under section 192 of the Communications Act 2003: see section 195 of that Act.

- 38 See ¶¶ 1(4) and 4(4) of Schedule 1C to the Charities Act 1993 inserted by the Charities Act 2006 section 8(3).
- 39 *British Sky Broadcasting v Competition Commission*, 2008 CAT 25. An appeal against the CAT's decision is pending.
- 40 *Supra* note 30.
- 41 *R (London and Continental Stations and Property Ltd) v The Rail Regulator*, 2003 EWHC 2607 (Admin).
- 42 See also *J. Sullivan in GNE Railway v Office of Rail Regulation* 2000 EWHC 1942 (Admin) at ¶¶ 39 and 44.
- 43 *Winsor v Bloom*, 2002 EWCA Civ 955.
- 44 *Belfast City Council v Miss Behavin' Limited*, 2007 UKHL 19.
- 45 *In re P and others (AP)*, 2008 UKHL 38.
- 46 *Per* Baroness Hale at ¶37.
- 47 See e.g. *Case T-49/95 Van Megen Sports v Commission*, 1996 E.C.R. II-1799 where the Court pointed out that because fines constitute an instrument of the Commission's competition policy, the Commission "must therefore be allowed a margin of discretion when fixing their amount" (¶53).
- 48 *T-Mobile (UK) Limited and Telefónica O2 UK Limited v Office of Communications (Sequencing)* [2008] CAT 15.
- 49 *T-Mobile and ors v Office of Communications (Termination Rate Disputes)*, 2008 CAT 12. See similarly *E.ON v GEMA* a decision of the UK Competition Commission in an appeal against the energy regulatory: *Case CC02/07* 10 July 2007 at ¶5.15.
- 50 WADE & FORSYTH ADMINISTRATIVE LAW (OUP 9th ed., 364 (2004)).
- 51 *Case C-12/03P Commission v Tetra Laval*, 2005 E.C.R. I-987 at ¶19.



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Institutional Aspects of European Commission Guidance in the Area of Antitrust Law

B. M. P. Smulders

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*B.M.P. Smulders**

From an institutional law perspective, the question arises how to qualify the more than thirty existing communications, notices, and guidelines which the Commission has issued in the area of antitrust law. It is uncontested that they are not legislation adopted by the Commission on the basis of an empowerment granted by the Council of Ministers under Article 83 EC and that is the reason why the Commission itself often refers to them as “non regulatory documents.” But do the documents also produce legal effects?

*Director—Principal Legal Advisor, European Commission. The views expressed are strictly personal and do not reflect necessarily those of the institution. This article is based on a speech delivered by the author at the Jevons Institute for Competition Law & Economics in London on July 10, 2008.

I. Introduction

From an institutional law perspective, the question arises how to qualify the more than thirty existing communications, notices, and guidelines which the European Commission (“Commission”) has issued in the area of antitrust law. It is uncontested that they are not legislation adopted by the Commission on the basis of an empowerment granted by the Council of Ministers under Article 83 EC and that is the reason why the Commission itself often refers to them as “non regulatory documents.”

They may take different forms and can pursue different but—in practice—not easily distinguishable and often combined objectives, which can be summarized as follows: (i) to provide Commission guidance for undertakings on the way it intends to use its powers under substantive and procedural antitrust law; and (ii) to summarize the case law interpreting that law and the Commission’s understanding of it.¹ Practice also shows that in fulfilling the first of these roles, publication of these documents constitutes an important policy tool for the Commission.² But do the documents also produce legal effects?

II. Legal Effects of Commission Documents Giving Guidance on the Way It Intends to Use Its Powers under Antitrust Law

With regard to the legal effects of the first guidance category, which is characterized by the fact that the Commission gives guidance on the way it intends to use a given power in relation to which it enjoys a certain discretion (*cf.* its exclusive power to apply Article 81(3) EC before Council Regulation 1/2003³ entered into force), the Court of Justice ruling on appeal in *Dansk Rörindustri*⁴ dealing with Commission guidelines on its powers to impose fines sheds some light:

“In adopting such rules of conduct and announcing them by publishing them that they will henceforth apply to the cases to which they relate, the institution in question imposes a limit on the exercise of its discretion and cannot depart from those rules under pain of being found, **where appropriate**, to be in breach of the general principles of law, such as **equal treatment** and **legitimate expectations**. It cannot therefore be excluded that, on certain conditions and depending on their conduct, such rules of conduct, which are of general application may produce legal effects.” (emphasis added)

This judgment has served as an important precedent for later Court of First Instance rulings, e.g. in *Archer Daniels*:⁵

“First, the Guidelines are capable of producing legal effects. Those effects stem not from any attribute of the Guidelines as rules of law in themselves, but from their adoption and publication by the Commission.” (What follows is a literal repetition of the Court’s ruling in *Dansk Rörindustri* cited earlier, emphasis added).

The Court of Justice followed the same approach in its judgment on appeal in *JCB Service*:⁶

“It should be recalled first of all that, according to the case-law of the Court of Justice, although the Guidelines may not be regarded as rules of law which the administration is always bound to observe, they nevertheless form rules of practice from which the administration may not depart in an individual case without giving reasons that are compatible with the principle of equal treatment.” (emphasis added)

Also relevant in this context are the Court of First Instance recent findings in relation to guidelines whereby the Commission imposes limits on the use of powers it was given under a Council and Parliament Directive dealing with emission trading, a phenomenon commonly referred to as “auto limitation” in French or “Selbstbeschränkung” in German.⁷ In that case, the CFI not only based its ruling on general principles of law such as equal treatment and legitimate expectations, but also on the principle of legal certainty.

Moreover, from well-established case law in an area of law adjacent to antitrust, i.e. the rules on State aid control and in particular the rules on the compatibility of State aid with the common market, i.e. an area where the Commission enjoys far reaching discretionary powers on an exclusive basis,⁸ it can be inferred that the Court will not hesitate to annul Commission guidelines, which formally are only intended to set out the course of its conduct, but in reality create new obligations for Member States and, as a result, for the undertakings affected.⁹

Finally, reference should be made to the Court's case law concerning the Commission guidelines for determining the calculation of the lump sums or penalty payments it proposes to the Court in the context of Article 228 infringement procedures against Member States (cf. Case C-387/97 *Commission v. Greece* and C-304/02 *Commission v. France*).¹⁰ The Court held that these guidelines: "help to ensure that the Commission acts in a manner which is transparent, foreseeable and consistent with legal certainty and are designed to achieve proportionality."

Although the Court made it clear that these guidelines did not bind the Court, it considered them "a useful point of reference." Nevertheless, in his recent opinion in Case C-121/07, *Commission v. France*, Advocate General Mazak criticized the approach taken in these guidelines on a specific point for being "tout à fait disproportionnée au regard d'une affaire donnée et qu'elle devrait donc être rejetée." In its judgment, however, the Court of Justice confined itself to repeating that:

MOREOVER, FROM WELL-ESTABLISHED CASE LAW (...) IT CAN BE INFERRED THAT THE COURT WILL NOT HESITATE TO ANNUL COMMISSION GUIDELINES, WHICH FORMALLY ARE ONLY INTENDED TO SET OUT THE COURSE OF ITS CONDUCT, BUT IN REALITY CREATE NEW OBLIGATIONS FOR MEMBER STATES AND, AS A RESULT, FOR THE UNDERTAKINGS AFFECTED.

"(...) while guidelines such as those in the Commission's communications may indeed help to ensure that the Commission acts in a manner that is transparent, foreseeable and consistent with legal certainty, the fact nevertheless remains that such rules cannot bind the Court in the exercise of the power conferred on it by Article 228(2) EC."¹¹

III. Legal Effects of Commission Documents Summarizing the Case Law on Antitrust Law and the Way It's Understood

What about the legal effects of the second type of the Commission's non-regulatory documents, the so-called interpretative communications?

Interpretative communications are intended to inform Member States and undertakings about their rights and obligations under Community law, in particular in the light of new case-law. Famous examples are the Commission's 1980 Communication on the consequences of the Court's judgment in *Cassis de*

Dijon,¹² its 1993 Communication on cross border services,¹³ and its 2000 Communication on concessions.¹⁴ In the area of antitrust, mention should be made of a series of successive notices on the cooperation between the Commission and the courts of the EU Member States in applying Articles 81 and 82 EC, which were largely based on the Court's judgment in the *Delimitis* case.¹⁵ Again, in issuing such types of communications, the Commission seems not to

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be entitled to go further than giving, for reasons of transparency and legal certainty, an objective, reasonable, and systematic interpretation and/or clarification of the (case) law.

Occasionally, a Commission position expressed in an interpretative communication inspires the Court when interpreting the law.

This was the case in *Teleaustria*¹⁶ as regards the definition of the concept of "concession" which the Court derived from the Commission communication on the subject. It was an important point of law as it determined the scope of the EC public procurement directives. The same approach was followed by Advocate General Maduro's recent opinion in *ASM Brescia*.¹⁷ In its judgment in the same case, however, the Court did not refer explicitly to the Commission and that, of course, was not necessary as it has the last word on the interpretation of the law. Therefore, if, on closer examination, it appears that through an interpretative communication, the Commission in reality intends to create new law or change existing law, the communication risks annulment by the Court, as was the case in relation to the Commission's 1994 Communication on an internal market for pension funds (cf. C-57/95, *Commission v. France*).¹⁸ Advocate General Kokott in her Opinion in *British Airways v. Commission*¹⁹ made an unequivocal plea for discipline in that respect when dealing with the plaintiff's submission that the Commission envisaged a reform of its practice in relation to Article 82 EC and was planning the publication of a discussion paper for that purpose:

"In this context, it is immaterial how the Commission intends to define its competition policy with regard to Article 82 EC for the future. Any reorientation in the application of Article 82 EC can be of relevance only for future decisions of the Commission; not for the legal assessment of a decision already taken. Moreover, even if its administrative practice were to change, the Commission would still have to act within the framework prescribed for it by Article 82 EC as interpreted by the Court of Justice." (emphasis added)

IV. Commission Guidance on Its Enforcement Priorities in Applying Article 82 EC to Certain Types of Abusive Conduct: Not a Tertium Genus

One of the Commission's most recent and much awaited documents providing guidance is the communication on its enforcement priorities in applying Article 82 EC to certain types of abusive exclusionary conduct by dominant undertakings.²⁰ It is not a statement of the law and should therefore not be considered to provide guidance of the second type described above.²¹ Nor does it intend to change the law. As indicated by some authors,²² short of a change in the Treaty itself, changing the law is for the Community courts within the limits of Article 220 EC *et seq.* Moreover, Article 82 EC is not like Article 81 EC where the Commission makes significant changes on its own initiative, either by introducing new or amending existing block exemptions, for which it is properly mandated by the Council of Ministers on the basis of Article 83 EC. Instead, the communication is intended to give greater clarity and predictability as regards the general framework of analysis which the Commission employs in determining whether it should pursue cases concerning various forms of exclusionary conduct and to help undertakings better assess whether certain behavior is likely to result in intervention by the Commission under Article 82 EC.²³ It therefore provides guidance of the first type described above.

AS INDICATED BY SOME AUTHORS, SHORT OF A CHANGE IN THE TREATY ITSELF, CHANGING THE LAW IS FOR THE COMMUNITY COURTS WITHIN THE LIMITS OF ARTICLE 220 EC *ET SEQ.*

Does the guidance, at the same time, clarify how the Commission intends to use its freedom, as conditioned by the Court in its case law (e.g. its judgments in *UFEX* and *A.C. Treuhand*²⁴), to decide on the order of priority for dealing with the complaints before it and possibly to reject these complaints for “lack of Community interest” if they do not correspond to the priorities set out in the guidance? This should be possible, since paragraph 8 of the communication states that in applying these “general enforcement principles,” the Commission will take into account the specific facts and circumstances of each case and “may adapt the approach (...) to the extent that this would appear to be reasonable and appropriate in a given case.”²⁵ At any rate, cases that the Commission for whatever reason does not investigate can be dealt with, if at all, by national competition authorities, which may have their own prioritization criteria; or may be litigated before national courts which in case of doubt may, respectively, must refer the case to the Court of Justice under the terms of Article 234 EC.

V. Legal Effects of Internal Guidelines and Documents of the Commission Services

So far, only the possible legal effects of non-regulatory documents, which the Commission not only adopts but also publishes, have been considered. What about internal guidelines? According to settled case law, an action for annulment must be available in the case of all measures adopted by the institutions, whatever their nature or form, which are intended to have legal effects. However, it should also be noted that internal guidelines have effects only within the administration itself and do not give rise to rights or obligations on the part of third parties. They do not, therefore, constitute acts adversely affecting any person, against which, as such, an action for annulment can be brought under Article 230 EC. See e.g. Case C-443/97, *Spain v. Commission*²⁶ concerning internal guidelines relating to the management of structural funds indicating the general lines along which the Commission envisaged to adopt individual decisions; the legality of which could be challenged before the Court by the Member State concerned.

Such an act of the Commission reflected only the Commission's intention to follow a particular line of conduct in the exercise of the powers granted to it by a Council regulation on the coordination of structural funds. It could not therefore, according to the Court, be regarded as intended to produce legal effects. Neither the circumstances, in which the internal guidelines were adopted (i.e. consultation with a group of representatives of Member States) nor the fact that, after adoption, they were communicated to Member States, Parliament, and the

HOWEVER, IT SHOULD ALSO BE NOTED THAT INTERNAL GUIDELINES HAVE EFFECTS ONLY WITHIN THE ADMINISTRATION ITSELF AND DO NOT GIVE RISE TO RIGHTS OR OBLIGATIONS ON THE PART OF THIRD PARTIES.

Court of Auditors—all of which could be explained as a way of complying with the principle of partnership underlying the financial management of Structural Funds—altered the Court's conclusion that these were purely internal guidelines producing no external legal effects. It is, in particular, this element which may be of relevance to the way internal Commission guidelines on antitrust matters could be adopted. Indeed, the European

Competition Network ("ECN") is also very much based on the principle of partnership among competition regulators and, following the Court's reasoning, one could argue that consulting the ECN before adoption of Commission guidelines would not change their "internal" character.

More and more documents are issued by Commission services which are discussion papers that do not reflect the position of the Commission but merely seek to obtain views of interested parties. An example is the 2005 *Staff Discussion Paper* on the application of Article 82 EC.²⁷ In *Pfizer v. Council*,²⁸ a case where the question arose whether through such a document the Commission had committed itself to applying the precautionary principle in a certain way, the CFI

made it clear that, whatever its title, the document did not produce any legal effect. However, this ruling contrasts to some extent with the Court's finding in *VW-Audi Forhandlerforeningen*,²⁹ where it did attach some importance to a Commission staff brochure clarifying the scope of the Block Exemption for motor vehicle distribution agreements.

VI. Conclusions

The case law of the Court of Justice shows that whatever the nature, object, or purpose of the non-regulatory document adopted by the Commission in the area of antitrust, such as a notice on procedural issues, guidelines on the way it intends to apply certain powers, or an interpretative communication, the Commission needs to be very diligent and should be respectful of the division of powers between institutions as foreseen in the Treaty. Clearly, the Commission cannot create or change the law, whatever economists may think of its merits in terms of a given consumer welfare or harm theory. Therefore, if the Commission wishes to clarify the state of the law, it should remain faithful to the Treaty and the case law and accept that the Court has the final word about its interpretation.³⁰ However, where the Treaty confers to the Commission as a discretionary power it has some room to develop a policy on how to use that power. Nevertheless, if the Commission decides to lay down that policy in guidelines and to publish them, it should realize that general principles of law do not allow the Commission to deviate from these guidelines as they entail a self-imposed limitation on its freedom of action. However, the words “where appropriate,” used by the Court in *Dansk Rörindustri* quoted above, seem to indicate that this might be different provided the Commission is able to properly reason a deviation in a specific case, that is to say without violating in particular the principles of equal treatment and legal certainty.

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The Commission's responsibility and the inherent necessity of prudence in issuing guidelines were very eloquently described by late Advocate General Geelhoed in his opinion in *VW-Audi Forhandlerforeningen*:³¹

“The importance of the Commission's communications for policy-making and the administration of justice in the Member States has increased since responsibility for supervising the compliance with Community competition rules was transferred to the national competition authorities and the national courts under Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81

and 82 of the Treaty. Legal certainty and unity of law in the application of and compliance with those rules, and the effectiveness thereof, are ensured if the Commission provides clear guidance on the application of the components of those rules.” (emphasis added)

In that respect, reference should also be made to Article 16 of Council Regulation (EC) nr 1/2003 which codifies the main finding of the Court in *Masterfoods*.³² The ultimate rationale of this rule is to ensure that the Luxembourg Courts can effectively guarantee the uniform application of antitrust law by fully reviewing, on the basis of Article 230 EC, the legality of Commission decisions. This implies that the decisions of neither national courts nor national competition authorities can run counter to these Commission decisions. It also implies that clear and carefully formulated Commission guidance on the way it intends to use its decision making powers, though not binding national courts or national competition authorities, is also of some use to them. ▼

- 1 The Commission regularly produces and updates such documents. The most recent survey can be found at <http://ec.europa.eu/competition/antitrust/legislation/legislation.html>.
- 2 See C. BELLAMY AND G. CHILD, *EUROPEAN COMMUNITY LAW OF COMPETITION*, 6th Ed. 37 *et. seq.* (2008).
- 3 Council Regulation (EC) No 1/2003 (O.J. 2003, nr L 1).
- 4 Case C-189/02P, *Dansk Rørindustri and others / Commission*, [2005] ECR I-5425.
- 5 Case T-59/02, *Archer Daniels Midland / Commission*, [2006] ECR II-3627.
- 6 Case C-167/04P, *JCB Service/Commission*, [2006] ECR I-8935.
- 7 Case T-374/04, *Germany v. Commission*, [2007] ECR II- 4431.
- 8 See Article 87(3) EC.
- 9 Case C 310/85, *Deufil*, [1987] ECR 901.
- 10 Case C-387/97, *Commission v. Greece*, [2000] ECR I-5047 and Case C-304/02, *Commission v. France*, [2005] ECR I-6263.
- 11 Opinion delivered on June 5, 2008 and judgment of December 9, 2008, Case C-121/07, *Commission v. France*, not yet reported.
- 12 O.J. 1980, nr. C 256.
- 13 O.J. 1993, nr. C 334.
- 14 O.J. 2004, nr. C 121.

- 15 Case C-234/89, *Delimitis v. Henniger Bräu*, [1991] ECR I-935.
- 16 Case C-324/98, *Teleaustria and Telefonadress*, [2000] ECR I-10745.
- 17 Opinion delivered on April 24, 2008 in Case C-347/06, not yet reported.
- 18 Case C-57/95, *Commission v. France*, [1997] ECR I-1627. See also T-258/06, *Germany v. Commission* (pending).
- 19 Case C-95/04P, *British Airways v. Commission*, [2007] ECR I-2331.
- 20 O.J. 2009, nr C 45.
- 21 See ¶ 3 of the communication.
- 22 See R. WISH, *COMPETITION LAW*, 6TH ED. 210-211 (2008).
- 23 See ¶ 2 of the communication.
- 24 Case C-119/97P, *UFEX and others v. Commission*, [1999] ECR I-1341 and judgment of July 8, 2008 in Case T-99/04, *AC Treuhand v. Commission*, not yet reported.
- 25 See for a detailed analysis of that question, Friedrich Wenzel Bulst, *Mehr Licht—Zur Anwendung des Art. 82 EG auf Behinderungsmisbräuche*, forthcoming in RABELZ, Vol. 4 (2009).
- 26 Case C-443/97, *Spain v. Commission*, [2000] E.C.R. I-2415.
- 27 Available at <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf>.
- 28 Case T-13/99, *Pfizer Animal Health v. Council*, [2002] ECR II-3305.
- 29 Case C-125/05, *VW-Audi Forhandlerforeningen*, [2006] ECR I-7637.
- 30 Compare also Case T-170/06, *Alrosa v. Commission*, [2007] ECR II-2601, dealing with the limits of the Commission's powers under Article 9 of Regulation 1/2003 in relation to so-called commitments—appeal pending, C-441/07.
- 31 See *supra* note 29.
- 32 Case C-344/98, *Masterfood and HB*, [2000] ECR I-11369. See for an identical approach as regards the relationship between national judges and Commission decisions under the Customs Code, the ECJ's recent judgment of November 20, 2008 in Case C-375/07 *Heuschen & Schrouff Oriental Foods Trading*, not yet reported. See also the opinion of Advocate General Mengozzi delivered on 5 March 2009 in Case C-429/07, *Inspecteur van de Belastingdienst v. X BV*, not yet reported, dealing with the scope of Article 15 (3) of Regulation (EC) 1/2003 conferring the right to the Commission to submit, on its own initiative, written observations to national courts "where the coherent application of articles 81 or 82 of the Treaty so requires".



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Merger Trials: Looking for the Third Dimension

Vaughn Walker

Merger Trials: Looking for the Third Dimension

*Vaughn R. Walker**

I do not argue here that concern about judicial competence regarding complex economic evidence is without substance. Nor do I contend that mergers are best committed in the final analysis to generalist judicial officers who lack expertise in issues of industrial organization although, as will be noted, this provides some check against complete capture of merger policy for purely political purposes. Rather, accepting that in the United States we have committed important decisions about mergers to generalist judges, I argue that a judge's task in a merger case does not entail recondite analysis. Rather, the judge's task is less one of economic learning than it is of using the economic analysis to bring the evidence into sufficient focus to reach a decision.

*Chief Judge, U. S. District Court, Northern District of California. The author thanks Charlie Yu, University of San Francisco School of Law 2009, who contributed research and ideas for this paper.

I. Introduction

In antitrust cases, *per se* rules and bright line prohibitions have receded in the past several decades in favor of statistical and econometric analyses of evidence.¹ Because judges typically lack training in, and experience with, these analytical tools, the ability of judges to comprehend such evidence has been drawn into question.² At least one imminent jurist has observed that econometrics is such a difficult subject that it is unrealistic to expect most judges to comprehend it.³ The organized bar has been concerned enough about the issue to devote an important study to the problem.⁴

Of course, complexity of evidence is not confined to antitrust cases or to economic subject matter. Many other types of cases and kinds of evidence also present obstacles to lay comprehension. Merger cases, however, often involve the possible organization or reorganization of large economic enterprises. Therefore, adjudication in merger cases can have far reaching effects on consumers, communities, employees, shareholders, and other stakeholders in these enterprises. Ad hoc or random decision making in merger cases may, for that reason, impose particularly heavy social and economic costs.

Furthermore, in the United States, a merger case—whether initiated by either of the two federal competition agencies, the United States Department of Justice (“DOJ”) or the Federal Trade Commission (“FTC”), by private parties, or by state agencies—almost always seeks equitable or injunctive relief, either to stop an incipient merger or unwind a merger that has already been consummated.⁵ This invests the judge alone, usually a federal district judge,⁶ with the sole power to decide both the facts as well as the law.⁷ Hence, unlike many other types of cases involving complex evidence but in which a constitutional right to a jury trial exists, questions about competence in the merger context focus primarily on the judge.

Commentators and others have proposed several remedies to enable judges to deal with complex economic evidence. These remedies usually involve some form of judicial education or re-education in economics. The study prepared by the American Bar Association suggested that judges employ court-appointed economic experts pursuant to Federal Rules of Evidence Rule 706.⁸ Long ago, a group of distinguished judges recommended the use of special masters in antitrust cases.⁹ Allowing competing experts to cross-examine one another, the so-called “expert witness hot tub,” is another approach.¹⁰ Parties have often suggested and conducted tutorials for judges to educate them in the economic issues involved in such cases.¹¹ Yet another option is for judges to attend seminars and training pro-

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grams conducted by the Federal Judicial Center, law schools, and related institutions devoted to law and economics.¹²

All of these activities have their place and can be helpful to judges in dealing with the difficult issues that merger challenges present. But each of these remedies has distinct shortcomings. Judges historically have been reluctant to appoint court experts or special masters for a variety of reasons.¹³ Some judges see the use of court-appointed experts or special masters as an abdication of the judge's judicial responsibility. Many judges are uncertain how to go about finding an expert or master. Still others are skeptical that truly impartial experts or masters can be found; after all, expertise implies knowledge and experience, factors that seldom leave one without views on the most controversial issues in any field. Because persons truly expert in a field are likely to have an opinion bearing on the subject matter of the case, or at least have voiced views suggesting an inclination one way or the other, selection of a court-appointed expert or special master

would seem to predestine the outcome of a case and judges are loathe to create any impression of doing so.

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The "expert witness hot tub" is just a different form of cross-examination which is, after all, the stock in trade of skilled and experienced trial lawyers. I have been told by an economist who often testifies that cross-examination at

trial is far more challenging than defending one's dissertation in a PhD oral examination. Furthermore, a battle solely between experts might actually be more rather than less confusing to judges as the conversation may become an academic dialogue instead of the parry and thrust of lawyer-driven examination.

Tutorials are often interesting but, in my experience, usually not very useful. Out of fairness, judges almost always allow both sides to make tutorial presentations and these usually amount to little more than a dress rehearsal for the trial. And, in any event, whether the content of the tutorial should be deemed part of the record for purposes of appellate review is an open question that gives many judges pause.

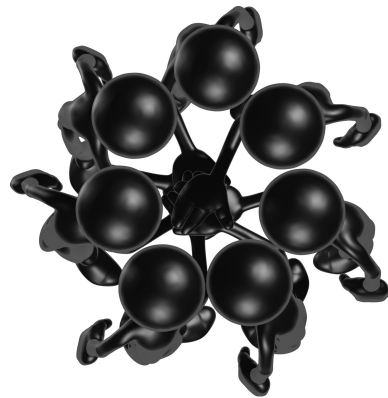
Finally, while the seminars and programs on economic issues presented by the Federal Judicial Center, universities, and private organizations are often wonderful learning experiences for the judges who attend, the connection to the issues that a judge sitting in a merger case must decide are usually so attenuated that these programs amount to a kind of liberal arts enrichment rather than a course that equips the judge to handle a specific merger case. In any event, these programs have not been without controversy which discourages many judges from attending them.¹⁴

Since 2000, I have presided over two merger cases that have proceeded through a full trial to final judgment.¹⁵ This note largely reflects that experience along with nineteen years handling all manners of federal cases. While two

datums and a couple decades of experience by one judge would not ordinarily satisfy anybody's idea of a sufficient foundation for definitive conclusions, during this period the total number of merger cases that proceeded to final judgment after a full trial or a preliminary injunction proceeding in which witnesses were called appears to be very limited.¹⁶ Only a handful of judges have had the privilege of trying one merger case all the way through; possibly none has tried more than two. Armed with this experience, I have the temerity to offer the observations and opinions herein. Moreover, for what it's worth, neither of the decisions in the two cases tried was appealed, a fact which at least two authors have posited is an indication of correctness,¹⁷ an assertion I happily accept (but would not like to have to defend).

I do not argue here that concern about judicial competence is without substance. Nor do I contend that mergers are best committed in the final analysis to generalist judicial officers who lack expertise in issues of industrial organization although, as will be noted, this provides some check against complete capture of merger policy for purely political purposes. Rather, accepting that in the United States we have committed important decisions about mergers to generalist judges, I argue that a judge's task in a merger case does not entail recondite analysis. After all, in these cases witnesses whose credentials can be subject to no reasonable question and who, by their credentials, are presumed fully and completely to understand the economic analysis, nonetheless testify in complete opposition to one another. As those indisputably expert in the subject matter reach different conclusions, it cannot be that the judge's job is to understand the economic analysis in the same way and with the same facility as those expert in the field.

Rather, the judge's task is less one of economic learning than it is of achieving a perspective emanating from the evidence. The judge weighs the evidence in a merger case by using the standards of evidence that apply in every case; this enables the judge to bring the competing economic analyses offered by the parties into focus for the decision at hand. The judge seeks to discern, from both the evidence and the economic analysis, a perspective in somewhat the same way a viewer discerns in an autostereogram two similar but distinct images so that from a two-dimensional surface there emerges a third image having depth, shape, and relief. The impression drawn from the evidence must converge with the economic analysis so as to produce that third dimension which forms the basis of a decision. Drawing from the evidence and the econom-



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AND RELIEF ...”

ic analysis together enables the judge to verify or discredit the parties' contentions and moves the judge to a decision.

II. Evidence and the Economic Analysis Must Converge

The central issue in almost every merger case, of course, is the definition of the relevant market. Typically, parties seek to delineate the boundaries of their respective positions regarding the relevant market by enlisting the testimony of economic experts. These expert witnesses, usually eminent professors of economics who specialize in the study of industrial organization, employ methodologies

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that use concepts such as demand elasticity, concentration ratios, merger simulation, critical loss analysis, and the like. The persuasiveness of testimony based on these concepts to a generalist judge is open to question. This is not so much because judges do not or cannot understand such evidence (although one would be ill-advised to presume that all judges fully grasp these analyses with all their nuances) as it is that testimony of this type is not the sort of evidence that judges are accustomed to using to make decisions. In other words, judges are

reluctant to base credibility determinations and thus findings on evidence of a kind and nature that usually is not the grist from which they mill their decisions.

Most cases that federal district judges hear and decide involve evidence that takes a narrative form. Such narratives are the accounts of witnesses, prompted of course by a friendly lawyer on direct examination, and challenged by an opposing lawyer on cross-examination. These narratives in civil cases are typically laced together with documents authored or received by the witnesses. From this, the judge weaves a scenario of events that leads to some factual finding relevant to one of the elements of the claim or defense at issue. It is evidence of this type that judges are most familiar with and, therefore, by which they are most likely to be influenced. It may seem anomalous to attempt to delineate the metes and bounds of a product or geographic market by narrative rather than quantitative measures, but to a judge this seems not anomalous at all.

Judges have many guides for determining the persuasive value of evidence. Among the most familiar are the numerous exceptions to the hearsay rule.¹⁸ These exceptions guide the evaluation of evidence in contexts other than ruling on hearsay objections. While the hearsay rule seeks to exclude out-of-court statements¹⁹ as unreliable, the underlying rationale for these hearsay exceptions is that statements made under the specific circumstances of the exceptions are reli-

able enough to be introduced as evidence. Exceptions can serve as a starting point or analogue in evaluating whether particular items of evidence in a merger case will seem credible to the generalist judge.

For example, the evidence rules presume that statements in the ancient documents are reliable because the documents have not suffered from forces generating the litigation at hand.²⁰ In much the same way, a document not prepared under a threat of possible legal review carries greater persuasive weight than one prepared under the influence of the litigation. Accordingly, documents created before the merger had even been anticipated or for purposes demonstrably different from the litigation do not suffer from the ills of manipulation which can occur after a merger or a merger challenge is on the horizon.

Judge Thomas F. Hogan tried the *Staples*²¹ case which was replete with valuable pre-merger documents that told the government's story. The key question in *Staples* was whether the government could establish that an "office supply superstore" submarket existed within the consumable office supplies market.²² At first blush, the court admitted that it seemed odd that a seller of office supplies, by virtue of its physical store configuration, did not compete with another seller of office supplies.²³ But this is exactly what the government ended up proving by selecting the right evidence on which the court felt comfortable relying.

In one set of records, the government presented Staples' internal pricing documents from 1994-1996 which compared the prices between Staples and Office Depot and OfficeMax, the other two office supply superstores.²⁴ These price comparisons showed that where there were no office supply superstores nearby, Staples charged prices more than 5 percent higher than they charged in store locations that were close to an Office Depot or OfficeMax.²⁵ This pre-merger evidence assured the judge that Staples would raise prices by 5 percent or more if it merged with Office Depot. The evidence was persuasive because it was not prepared for litigation and because it gave dimension to the FTC's economic analysis. The fact that these records were also self-incriminating further helped the government's case.

Documents created in the ordinary course of business carry more persuasive force than those that are not so prepared. Business records carry an aura of reliability because regularly creating business records and the routine involvement of the record keepers suggest a consistency which reduces the risk of mistake. Again, this is a fundamental and well-worn exception to the restriction against hearsay evidence.²⁶ Furthermore, when records are for internal as opposed to external purposes, judges take assurance that the businesses rely on these same records and maintain their accuracy to fulfill the business mission.²⁷

Two categories of records within the realm of business records are often presented to judges as economic evidence in merger cases.²⁸ The first category consists of factual records; the second consists of analytical records. Records factual

in nature tend to be relied on more heavily than records analytical in nature. Factual records include customer lists, sales and pricing information, geographic sales information, and the like. These records inform judges of the actual market conditions and how firms respond to competitive forces in the market place.

Analytical records are also useful but tend to be less persuasive as their conclusions are often evaluations and speculations of the factual record. Such records include strategy documents, business and marketing plans, and short- and long-term projections. These records tend to predict future behavior and reveal how market players assess the competitive landscape. But rather than demonstrating actual behavior, these analytical records demonstrate a player's perception of the market.

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When lawyers present pre-merger documents that are created in the ordinary course of business, such documents can carry significant persuasive force. In the *Staples*²⁹ case, the government presented a second set of compelling analytical documents which gave perspective to the economic analysis the government presented. The government offered strategic pricing documents which showed how Staples divided its geographic locations into “competitive” and “non-competitive” zones.³⁰ The competitive zones included those areas in which there was another office supply superstore, whereas non-competitive zones did not include such superstores.

Together, the pricing comparisons and the geographic strategy documents demonstrated the competitive landscape; superstores competed with one another but were less competitive with other sellers of office supplies. In addition, the documents disclosed Staples' actual behavior in the market—pricing 5 percent more in non-competitive zones than in competitive zones.

By contrast, post-merger records may distort the impression for the judge, due to added scrutiny and skepticism. This is what happened in the *Whole Foods*³¹ case, albeit on appeal, and for one particular judge. Whole Foods presented pricing comparisons which were conducted after the merger announcement. Judge Tatel³² criticized the pricing comparison as all-but-meaningless price evidence because the pricing comparison was conducted several months after Whole Foods announced its intent to acquire Wild Oats.³³ Judge Tatel specifically stated that the merger provided an incentive for Whole Foods to eliminate price differences which may have previously existed.³⁴ Here, while Whole Foods' lawyers chose the proper evidence to fit its economics, the dimension the lawyers sought to portray was not perceived by Judge Tatel. His skepticism grew out of a convention associated with the rules of evidence.³⁵

Despite the generally informative and reliable nature of pre-merger documents prepared in the ordinary course of business, documents selected by counsel or expert witnesses for litigation purposes also provoke a certain skepticism. In *United States v Oracle Corporation*,³⁶ the government's expert witness used Oracle's discount approval forms to attempt to demonstrate that Oracle competed only with PeopleSoft and SAP in the "high function" financial management services and human resource management software market and did not compete with other software developers to a significant degree.³⁷ Financial management services and human resource management software are two "pillars" of an enterprise resource planning software suite which can encompass one or many pillars. The government's expert used the discount approval forms and considered software which sold for \$500,000 or more to be high function software.³⁸ But in using the discount approval forms, the expert failed to separate financial management services and human resource management software which sold for \$500,000 or more from the entire suite which sold for \$500,000 or more.³⁹

The problem was that the entire suite contained multiple other pillars, such as customer relations management, supply chain management, or business intelligence software, thus preventing the isolation of the competitive impact of the proposed merger on financial management services and human relation management software which was the alleged product market. One example in the expert's set of examples showed bundled software which sold for \$500,000 or more, yet the human resource management software was discounted 100 percent in order to sell the supply chain management software.⁴⁰ Nonetheless, the government's expert considered the entire sale under human resource management software. The expert's selection of pre-merger documents suffered from the appearance of selection bias distorting the image the expert sought to portray.

ANOTHER INDICATOR OF RELIABILITY IS WHETHER EVIDENCE IS SELF-SERVING OR NOT. A STANDARD CONVENTION OF EVIDENCE POSITS THAT MOST PEOPLE WILL NOT MAKE A STATEMENT CONTRARY TO PECUNIARY INTEREST UNLESS TRUE OR THOUGHT TO BE TRUE.

Another indicator of reliability is whether evidence is self-serving or not. A standard convention of evidence posits that most people will not make a statement contrary to pecuniary interest unless true or thought to be true.⁴¹ Again, going back to Judge Tatel and the *Whole Foods*⁴² decision, Judge Tatel paid close attention to the statements of Whole Foods and Wild Oats when asked if both operated in the natural and organic market.⁴³ Their historical statements found in emails and commentary that they operated in a distinct market were both a statement against interest but also a prior inconsistent statement as Whole Foods later asserted that there is no separate natural and organic market.⁴⁴

Many other examples of how judges use conventional evidentiary principles to identify the evidence that they find persuasive could be cited. Suffice to say that it is evidence as measured and assessed by conventional principles for weighing

evidence that judges use to verify or discredit a party's economic analysis. An economic analysis that depends on evidence that fails to pass conventional evidentiary tests is unlikely to be persuasive, a point to which I now turn.

III. Verifying the Economic Analysis

Because it is thought that markets with certain characteristics will cause firms to behave in certain ways, the relevant market is important in a merger case. And a merger that is anticompetitive in the relevant market is thought likely to have certain competitive effects. Industrial organization economists have come to label these as “coordinated effects” and “unilateral effects.” A judge untutored in the issues of industrial organization will likely draw parallels to concepts that he or she sees in other cases. And judges are thoroughly familiar with the underlying notions. The idea of “coordinated effects” is, of course, analogous to concerted action, conspiracy, and the like; features of many other case types. Similarly, “unilateral effects” are not unique to merger or competition cases; over-reaching, oppression, and the like are not dissimilar concepts found in myriad types of cases.

How does one tell in more or less narrative fashion through non-expert witnesses that a merger is more or less likely to result in the threat of coordinated or unilateral effects? Concerted action, conspiracy, over-reaching, and oppression in other types of cases are often proved by circumstantial rather than direct evidence. Key circumstances in proving such concepts are those facts which tend to show whether or not parties had the motive and opportunity to engage in such conduct. These circumstances can be demonstrated through the histories of companies and industries.

All companies and industries have a history and background. Companies and industries don't just happen; they originate, grow, and develop. The shape and habits of companies and industries are, at least in part, owed to their pasts. In most instances, these histories are rich in narratives. All companies of any size and certainly any industry of any scope will admit a past that is replete with sagas of accomplishment, success, and failure.

In the two merger cases I have tried to judgment, relatively little time or effort was devoted by the lawyers in painting this background. In a way this was surprising because the two cases involved the newspaper and business application software industries. Both industries are peopled by colorful and interesting personalities; newspapers, in particular, have a storied past, replete with myriad narrative possibilities. The lawyers—all of whom were among the most capable members of the bar in any field—devoted little time or attention to their histories and associated array of personalities.

To be sure, these histories and personalities might have little or no obvious bearing on the issues that must be decided in a merger case, but with lawyerly imagination a connection sufficient to sustain admissibility can usually be found. Admissibility of evidence, after all, is not solely the product of applying the rules of evidence; evidence promising an interesting tale can overcome many obstacles to admission. These histories may well touch upon past coordinated activities of competitors in the industry, trade association activities, common corporate ancestries or founders, movement of executives from one company to another, connections of the companies to the same investment bankers or venture capitalists; these are all facts that can suggest or negate the circumstances that make the actual or potential means and inclination to coordinate in anticompetitive ways more or less likely.

These same narrative histories may also suggest the potential for, or lack of capability of, overreaching, hard practices, and abusive negotiation tactics with suppliers or customers that similarly suggest or negate an ability and propensity to abuse a dominant position. Again, of course, the direct nexus between such evidence and the issues in the case at hand may be objected to as inadmissible character evidence,⁴⁵ but it is evidence of this kind that judges hear in other cases and from which they craft their decisions, so it is evidence not foreign to a judicial mind.

THE LARGER POINT HERE IS THAT A GENERALIST FEDERAL DISTRICT JUDGE HEARING A MERGER CASE IS UNLIKELY TO APPROACH THE CASE WITH THE SAME EMPHASIS ON QUANTITATIVE MEASURES OF MARKET CONCENTRATION AS WOULD AN ANTITRUST AGENCY.

The larger point here is that a generalist federal district judge hearing a merger case is unlikely to approach the case with the same emphasis on quantitative measures of market concentration as would an antitrust agency. These agencies consist of individuals with a special interest or background in competition issues. Generalist federal district judges for the most part lack this kind of specialist interest. Furthermore, competition agencies generally have a staff of expert economists and lawyers who are themselves specialists in competition issues. Federal district judges are aided by law clerks who generally have come right out of law school and whose service to the judge may well be substantially shorter in tenure than the period most cases remain on the judge's docket. In no stretch of the imagination can one of these law clerks be considered a specialist in competition related issues.

The result is that the judge and the individual that the judge may look to for research and drafting assistance will view the merger case through a lens that projects a different image from that of the agency or even, perhaps, lawyers who specialize in competition law. Thus, although much of the evidence in a merger case may be the handiwork of industrial organization specialists, it will be most effective if the evidence is presented by witnesses who relate a narrative based on first-hand experience which gives dimension to the party's market contention.

Judges are accustomed to evidence that casts an impression, not evidence which establishes a scientific truth. Witnesses all swear to tell the “truth, the whole truth, and nothing but the truth,” but witnesses seldom relate the same truths.

So trial evidence, like an autostereogram, is a collection of dots in which a hidden image emerges after the viewer stares at it for some time. The image is not apparent initially, and it may take several minutes for the eyes to focus and adjust and for the image to appear. Many viewers are unable to see the image at all. Some viewers may see it differently. As in an autostereogram, while there may be a scientific truth in the evidence of a merger case, a judge may not readily see that truth and may miss it altogether unless it converges with the impression cast by evidence that is consistent with their backgrounds and qualifications not the product of economic analysis.

Let me give examples from the two merger cases that I tried to judgment. In *United States v Oracle Corporation*,⁴⁶ the government seeking to enjoin the merger of Oracle with another producer of business application software, PeopleSoft, relied almost exclusively on a series of customer witnesses⁴⁷—I’ll have more to say about such testimony presently. The government neglected, however, to paint a convincing picture that a merged company of these two producers would, by itself, be able to dominate the line of software involved in the case.⁴⁸ The government’s customer witnesses were certainly consistent, all telling the same story: A merged Oracle and PeopleSoft would be the only source of the “high function” business application software required by the customer witnesses’ enterprises or institutions.⁴⁹ A special brand of judicial skepticism is reserved for a parade of witnesses beating the same drum.

Apart from the rehearsed character and monotony of these witnesses’ testimony, the most striking feature or image the testimony conveyed was that it was at odds with the basic premise of the government’s case. That premise was that a merged Oracle and PeopleSoft would dominate the supply of high function software and be able to exert monopolist pressures on its consumers.⁵⁰

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Each of these government witnesses was sophisticated and knowledgeable in the field of information technology. The witnesses all had notable backgrounds in their field, demonstrated capabilities, and the substantial resources of the enterprises with which they were associated. These facts made the witnesses and their employers seem unlikely victims for oppression or abuse of a dominant position by a supplier in the market. The witnesses thus projected an impression that was inconsistent with the impression that the government needed to establish, namely that a merged Oracle and PeopleSoft would be able to extract monopoly profits from these customers over a period of time significant enough to warrant the costs of the merger transaction.⁵¹ Of course, skill and

experience are no guarantees against becoming the victim of oppression. Yet, by their backgrounds and qualifications, the witnesses the government relied on to tell its story projected an impression that tended to negate the fundamental showing that the government needed to make in order to carry its burden in the case. There was a disconnect between the economic analysis the government sought to relate and the storytellers it brought to court.

In the other merger case, *Reilly v Hearst Corporation*,⁵² tried to judgment, the industry was newspaper publishing and one of the parties was the Hearst Corporation. One is hard pressed to think of an industry with a more colorful past or a corporation identified with a larger figure in the public imagination. This was not entirely overlooked by the plaintiff's counsel, himself an advocate with a penchant for color. But the pertinent history here was the development and acceptance for antitrust purposes of joint operating agreements among formerly competing general circulation daily newspapers.⁵³ The issue in the case involved dissolution of such an agreement.

The problem for the plaintiff with this history was that it cut against the economic analysis that the plaintiff tried to establish, namely that separately owned and operated general circulation newspapers could survive as separate entities in the same market.⁵⁴ The long history of joint operating agreements in the newspaper industry suggested just the opposite, namely that joint operating agreements were necessary in order for editorially separate general circulation newspapers to survive in the same market.⁵⁵ Indeed, history suggested that the viability of the newspaper industry was such that a joint operating agreement simply staved off the inevitable collapse of the weaker newspaper in that agreement and that metropolitan daily general circulation newspapers were a kind of "natural" monopoly.⁵⁶ This history was replete with numerous supporting examples which defendants' witnesses repeatedly presented and emphasized.

In this case, it was defendants that capably painted the historical picture. No doubt recognizing the difficulty this history presented, plaintiff's able counsel began his case with another theme: There must be something wrong with the transaction because of the tactics employed by the defendants in attempting to consummate the transaction.⁵⁷ Plaintiff's counsel called as his first witness⁵⁸ the publisher of the Hearst newspaper, who admitted that he attempted to influence the mayor of San Francisco to support Hearst's position in the case by blandishing favorable coverage of the mayor in the Hearst newspaper.⁵⁹ Needless to say, this was explosive and entertaining testimony. It passed the admissibility test more because the testimony was interesting than relevant to the merits of the case.⁶⁰ But it did little to advance the plaintiff's fundamental theme: Two separately owned and operated newspapers were viable in the market. Plaintiff's most memorable evidence and its economic analysis failed to converge into a single impression.

There is a certain irony in this failure as subsequent developments have shown. A later purchaser of the Hearst newspaper brand, by following a different business model from that of the traditional general paid circulation newspaper, has preserved some editorial, circulation, and advertising competition in the market through a free distribution tabloid. But no serious evidence of such a plan was apparent in plaintiff's evidence in *Reilly*. Indeed, the plaintiff's evidence suggested that his willingness to produce a competing newspaper depended on certain concessions from Hearst that were entirely inconsistent with the premise that the market could support more than one general circulation daily. The evidence and the economic analysis needed to establish viability did not converge, dictating a decision against the plaintiff.

IV. Conclusion

Evidence produced by economic analysis is an essential ingredient in a merger case. But no matter how effectively compiled, no matter the imminence and credentials of the expert witness whose testimony presents such evidence, such evidence takes its place along with other evidence. Economic analysis is unlikely to prove decisive in a case in which the non-economic evidence points to an opposite result. Economic analysis is neither the most nor the least important source of evidence in a merger case. If consistent with other evidence, the economic analysis will project a convincing image for one side or the other. If not consistent, no amount of sophisticated econometrics will rescue the analyses or the witnesses who present it. No one analysis, no one item of evidence makes or breaks the case; it is the evidence and the economic analysis together from which an impression or image emerges—or does not emerge—and leads to an outcome. ▼

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- 1 The decline of *per se* rules has been ascribed to many influences: the advent of the Merger Guidelines in 1968 with their emphasis on statistical measures of competition; the publication in 1978 of Judge Bork's classic, *The Antitrust Paradox*; and the scholarship in law and economics associated initially with the University of Chicago, but now a universal feature of legal education. No doubt an intellectual revolution of this magnitude and importance has many sources; it is sufficient for present purposes simply to recognize the pervasive effect economic analysis has exerted in competition issues during the past forty years or so.
 - 2 MICHAEL R. BAYE & JOSHUA D. WRIGHT, IS ANTITRUST TOO COMPLICATED FOR GENERALIST JUDGES? THE IMPACT OF ECONOMIC COMPLEXITY & JUDICIAL TRAINING ON APPEALS (George Mason Law & Economics Research Paper No 09-07, January 27, 2009), available at <http://ssrn.com/abstract=1319888>.
 - 3 Richard A. Posner, *The Law and Economics of Expert Witnesses*, 13 J. ECON. PERSPECTIVES 91, 96 (Spring 1999).
 - 4 Economic Evidence Task Force, American Bar Association, Final Report of Economic Evidence Task Force 8-10 (2006), available at <http://www.abanet.org/antitrust/at-reports/01-c-ii.pdf>.
 - 5 See Antitrust Division, United States Department of Justice, Antitrust Division Policy Guide to Merger Remedies (2004), available at <http://www.usdoj.gov/atr/public/guidelines/205108.htm> (stating structural remedies are preferred); Bureau of Competition, Federal Trade Commission, Statement of the

- Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies (April 2, 2003), available at <http://www.ftc.gov/bc/bestpractices/bestpractices030401.shtm> (demonstrating FTC's strong preference for structural remedies).
- 6 See 15 USC §§18, 25 and 45 (granting federal district court jurisdiction in restraint of trade and unfair methods of competition cases). See also 28 USC §§1331, 1337(a) and 1345 (granting federal district court jurisdiction in federal question, commerce and antitrust cases, and cases commenced by the United States).
 - 7 Since the merger of law and equity effective in 1938, 48 Stat 1064 §2 (June 19, 1934), federal district judges serve as the finders of fact in cases seeking equitable remedies and thus decide both the law and facts.
 - 8 Economic Evidence Task Force, *supra* note 5, at 8-10.
 - 9 Leon R. Yankwich, et al, '*Short Cuts' in Long Cases*, 13 FRD 41, 80 (1951).
 - 10 Lisa C. Wood, *Experts in the Tub*, 21 ANTITRUST 95 (Summer 2007).
 - 11 Economic Evidence Task Force, *supra* note 5, at 6.
 - 12 Economic Evidence Task Force, *supra* note 5, at 6.
 - 13 See Economic Evidence Task Force, *supra* note 5, at 9; Lisa C. Wood, *Court-Appointed Independent Experts: A Litigator's Critique*, 21 ANTITRUST 91 (Spring 2007); 4 Jack B Weinstein & Margaret A Berger, Weinstein's Federal Evidence §706.02[2] (2d ed 2005) (court appointment of experts is "a rarity").
 - 14 See the Community Rights Counsel's comments on judicial junkets, available at <http://www.communityrights.org/>.
 - 15 *United States v Oracle Corporation*, 331 F Supp 2d 1098 (N D Cal 2004); *Reilly v Hearst Corporation*, 107 F Supp 2d 1192 (N D Cal 2000).
 - 16 Although the following list may not be exhaustive, it appears that in addition to *Oracle* and *Reilly*, full scale trials or preliminary injunction hearings with witnesses in federal district court merger cases since January 1, 2000 have been conducted in: *FTC v Whole Foods Market, Incorporated*, 502 F Supp 2d 1 (D DC 2007), *rev'd*, 548 F3d 1028 (DC Cir 2008); *FTC v Foster*, 2007-1 Trade Cases (CCH) ¶175,725 (D NM 2007); *FTC v Arch Coal, Incorporated*, 329 F Supp 2d 109 (D DC 2004); *Atlantic Coast Airlines Holdings, Incorporated v Mesa Air Group, Incorporated*, 295 F Supp 2d 75 (D DC 2003); *United States v UPM-Kymmene Oyj*, 2003-2 Trade Cases (CCH) ¶174,101 (N D Ill 2003); *FTC v Libbey, Incorporated*, 211 F Supp 2d 34 (D DC 2002); *United States v SunGard Data Systems, Incorporated*, 172 F Supp 2d 172 (D DC 2001); *FTC v Swedish Match*, 131 F Supp 2d 151 (D DC 2000); *United States v Franklin Electric Company, Incorporated*, 130 F Supp 2d 1025 (W D Wisc 2000); *FTC v H J Heinz Company*, 116 F Supp 2d 190 (D DC 2000), *rev'd*, 246 F3d 708 (DC Cir 2001); *California v Sutter Health System*, 84 F Supp 2d 1057 (N D Cal 2001), *amended*, 130 F Supp 2d 1109 (N D Cal 2001).
 - 17 *Baye & Wright*, *supra* note 3, at 13.
 - 18 Federal Rules of Evidence Rules 801, 803-04. Hearsay exceptions encompass hearsay exemptions in this article.
 - 19 A "statement" is: (1) an oral or written assertion or (2) nonverbal conduct of a person, if intended by the person as an assertion. Federal Rules of Evidence Rule 801(a).
 - 20 Federal Rules of Evidence Rule 803(16).

- 21 *FTC v Staples, Incorporated*, 970 F Supp 1066 (D DC 1997).
- 22 *Id.* at 1073.
- 23 *Id.* at 1075.
- 24 *Id.* at 1075-76.
- 25 *Id.*
- 26 Federal Rules of Evidence Rule 803(6).
- 27 Federal Rules of Evidence Rule 803(6).
- 28 Merger Working Group, International Competition Network, Developing Reliable Evidence in Merger Cases (2003), available at http://www.internationalcompetitionnetwork.org/media/library/conference_2nd_merida_2003/Reliable.pdf.
- 29 *FTC v Staples, Incorporated*, 970 F Supp 1066 (D DC 1997).
- 30 *Id.* at 1079-80.
- 31 *FTC v Whole Foods Markets, Incorporated*, 548 F3d 1028 (DC Cir 2008).
- 32 *Id.* at 1041. Judge Tatel concurred with Judge Brown's judgment but filed a separate opinion. *FTC v Whole Foods Market, Incorporated*, 548 F3d 1028 (DC Cir 2008) has no majority opinion.
- 33 *Id.* at 1047. *But see* Judge Kavanaugh's dissenting opinion which relied upon Whole Foods' pricing comparison. *Id.* at 1051.
- 34 *Id.* at 1047.
- 35 *FTC v Whole Foods Market, Incorporated*, 548 F3d 1028, 1047 (DC Cir 2008).
- 36 *United States v Oracle*, 331 F Supp 2d 1098 (ND Cal 2004).
- 37 *Id.* at 1145-46.
- 38 *Id.*
- 39 *Id.* at 1158-59.
- 40 *Id.*
- 41 Federal Rules of Evidence Rule 804(b)(3).
- 42 *FTC v Whole Foods Market, Incorporated*, 548 F3d 1028, 1041 (DC Cir 2008).
- 43 *Id.* at 1045.
- 44 *Id.* at 1045.
- 45 Federal Rules of Evidence Rule 404(b).

46 United States v Oracle Corporation, 331 F Supp 2d 1098, (N D Cal 2004).

47 *Id.* at 1125-33.

48 *Id.* at 1158-61.

49 *Id.* at 1125-33.

50 *Id.* at 1130-33.

51 *Id.* at 1158.

52 Reilly v Hearst Corporation, 107 F Supp 2d 1192 (N D Cal 2000).

53 *Id.* at 1200-05.

54 *Id.*

55 *Id.* at 1201.

56 *Id.*

57 *Id.* at 1206-11.

58 Calling a defendant as the first witness is almost always a good idea for plaintiffs.

59 *Id.* at 1209-11.

60 This and other evidence in the case made inexplicable the refusal of the antitrust authorities to approve dissolution of the joint operating agreement without conditions that served the political interests associated with the Clinton administration and some of its allies. Reilly v Hearst Corporation, 107 F Supp 2d 1192, 1210-11 (2000). The ability of a generalist judges to point out these facts without fear of reprimand serves as at least one virtue of committing merger decisions to such judges.



Square Pegs in Round Holes: The Interaction between Judges and Economic Evidence

Diane P. Wood

Square Pegs in Round Holes: The Interaction between Judges and Economic Evidence

*Diane P. Wood**

Competition law is not the only area in which it is essential that decision-makers understand economic evidence, but it is surely one of the most important. After all, the concept of competition itself conjures up images of rivalry for some sort of prize, and in the area of competition law, that prize is success in the market. Through the magic of microeconomic analysis, it has become well accepted that the competitive process between or among producers yields not only a winner from the producer standpoint, but more importantly yields benefits to consumers. The latter benefits, which normally take the form of lower prices, better quality, superior ancillary services, or some combination of those features, involve a transfer of wealth from the producer to the consumer, and thus would not necessarily exist in a world without competition. All of that may be relatively easy to say, but when it comes to the real world, matters quickly become more complex. The judge has no choice but to study the economic evidence that is presented by the parties and to come to a conclusion that is consistent with that evidence. This paper considers whether judges have been up to that task.

*Circuit Judge, United States Court of Appeals for the Seventh Circuit; Senior Lecturer in Law, The University of Chicago Law School.

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All of that may be relatively easy to say, but when it comes to the real world, matters quickly become more complex. How is a judge to know whether the proposed merger between General Electric and Honeywell represented a threat to competition (as the European authorities believed) or was at worst competitively neutral and possibly even competitively desirable (as the U.S. authorities believed)?¹ How can a judge say whether Microsoft should be permitted to integrate its internet browser, Internet Explorer, into its Windows operating system, or if it should be compelled to use an open architecture that permits users to choose more effectively among browsers offered by competitors?² And what wisdom does a judge bring to the question whether a proposed joint venture between General Motors and Toyota would (a) yield important competitive benefits to both companies, or (b) be tantamount to a cartel between important competitors in the market for personal automobiles?³ The short answer is that the judge has no choice but to study the economic evidence that is presented by the parties and to come to a conclusion that is consistent with that evidence. This paper considers whether judges have been up to that task.

The first question is how much economics the judge, personally, really needs to know. Put differently, if the judge sitting in a competition case of any consequence had spent his or her entire career before becoming a judge as a chemical engineer, or as a Shakespearian scholar, or as an advertising executive, is it inevitable that this judge would botch the case? This is another way of asking the question whether competition law must be the province of a specialized judiciary, or if it can be entrusted to generalist judges. Both systems exist in the world today, and so if specialization were clearly superior, it should be possible to document that proposition. No evidence of which I am aware, however, would support such a strong conclusion. To the contrary, the United States—by far the largest jurisdiction to rely on generalist judges for the adjudication of competition cases—stands up well in any comparative study. As economic learning has advanced, the federal judiciary has absorbed its lessons and applied them competently.

This may be counter-intuitive, when one considers the sophistication of the economic analysis that is often necessary in competition cases. But perhaps that

takes too narrow a view of the judge's role. A federal district court judge—who sits as the court of first instance in cases brought by the U.S. Department of Justice's Antitrust Division, as well as in cases brought by private parties and state attorneys general—has many responsibilities. Above all, the judge is

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charged with ensuring that the case goes forward in a procedurally regular manner, allowing each side the opportunity to develop the facts, to put forth legal theories, and to have their positions tested by a neutral decisionmaker. In an antitrust case, the court will almost certainly convene a number of pretrial conferences. It will establish a scheduling order for the case;

that order will address such things as the timing of mandatory disclosures under the discovery rules, the extent of discovery that will be permitted, rules for handling electronic information, agreements relating to privileged materials, and a presumptive date for the trial itself.⁴ One topic singled out for attention is expert testimony.⁵

If the case cannot be resolved during the pretrial process (which is when many antitrust cases are⁶), then, assuming that the plaintiff may be entitled to damages and that it has filed a proper request for a jury, the court will preside over a jury trial. (There is no entitlement to a jury in cases for purely equitable relief.⁷) If the parties do not want a jury, then the district judge will sit as the trier of fact.⁸ In that case, the litigants need have no fear of lay jurors being overwhelmed with economic evidence. Even if there is a jury, the court is entitled to guide the jury's consideration of the evidence by submitting specific questions for the jurors to answer, rather than simply asking for a bottom-line conclusion.⁹ Influential sources such as the *Federal Judicial Center's Manual for Complex Litigation* encourage the use of this procedure in complex trials.¹⁰ The court's ability to structure the pretrial process and its role in focusing the parties and the trier of fact on the relevant questions both help to make the evidence offered by economic experts understandable for the generalist.

Judges in American courts bear a heavy responsibility for screening any expert testimony that is proffered by the parties. With rare exceptions, experts in the United States are engaged by one party or the other, not by the court. Given the risk of both partisanship and sheer lack of scientific rigor, the court must function as a gate-keeper, letting in the worthwhile evidence and keeping out the so-called junk science.¹¹ Federal Rule of Evidence 702 gives the judge her marching orders:

“If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education,

may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.”

The Advisory Committee Notes on the 2000 Amendments to Rule 702 explain how the rule was derived from the Supreme Court’s decision in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*¹² and later decisions elaborating on *Daubert*. Rather than deciding by some kind of seat-of-the-pants system whether an economist (or for that matter, a chemical engineer, a physician, an accountant, or any other expert) is qualified to offer expert testimony and has done the necessary work on the case before the court, *Daubert* set forth a non-exclusive checklist for trial courts to use. That list includes the following considerations:

1. Whether the expert’s technique or theory can be or has been tested—that is, whether the expert’s theory can be challenged in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot reasonably be assessed for reliability;
2. Whether the technique or theory has been subjected to peer review and publication;
3. The known or potential rate of error of the technique or theory when applied;
4. The existence and maintenance of standards and controls; and
5. Whether the technique or theory has been generally accepted in the scientific community.

The *Daubert* factors were explicitly recognized as non-exclusive at the time the Court announced them. Since that time, which was more than fifteen years ago, courts have built upon the *Daubert* foundation and identified additional issues that normally should be addressed before admitting expert testimony:

6. Whether experts are proposing to testify about matters growing naturally and directly out of research they have conducted independent of the litigation, or whether they have developed their opinions expressly for purposes of testifying;
7. Whether the expert has unjustifiably extrapolated from an accepted premise to an unfounded conclusion, and, in connection with this, how much of an extrapolation is justified under the circumstances;
8. Whether the expert has adequately accounted for obvious alternative explanations;

9. Whether the expert is being as careful as he would be in his regular professional work outside his paid litigation consulting; and
10. Whether the field of expertise claimed by the expert is known to reach reliable results for the type of opinion the expert would give, or if, in contrast, it is seen to be less reliable or more fanciful (like astrology or phrenology).

Courts have become accustomed to their role as gatekeeper, and they take it very seriously. One of the more famous, and perhaps slightly chilling, examples of this diligence comes from the field of antitrust and the pen of Judge Richard A. Posner, of the Seventh Circuit Court of Appeals. The case was called *In re Brand Name Prescription Drugs Antitrust Litigation*, and the year was 1999.¹³ The district court had excluded certain testimony offering an economic analysis of the case that had been proffered by Nobel Prize-winning economist Robert Lucas. Judge Posner, reviewing that decision, had this to say:

“The plaintiff’s principal economic evidence was that brand name prescription drugs are indeed priced discriminatorily, to the detriment of the pharmacies; that discrimination requires (and thus demonstrates the existence of) market power; and that the chargeback system facilitates discrimination. The defendants spent days cross-examining the plaintiff’s principal economic witness, Professor Robert Lucas, and ultimately persuaded the district court to exclude most of his testimony under the rule of Daubert But what was objectionable about his evidence actually had nothing to do with Daubert; it was that the evidence mainly concerned a matter not in issue—that the manufacturers of brand name prescription drugs engage in price discrimination, showing that they have market power. Everyone knows this. The question is whether that market power owes anything to collusion. . . . On that, Lucas had virtually nothing to say. . . . His opinion that there is price discrimination in the prescription drug industry is one that an economist of Lucas’ distinction should have been able to reach in even less time [than the 40 hours he spent working on the case].”

Frightening words, for those who hope to win their cases by snowing the judges with the reputation of their expert economists. No one doubted that Professor Lucas would have been capable of examining evidence that might have proven or disproven collusion, and if he had done so, it is very likely that his evidence would have been admitted. The problem was that he apparently had not been asked the right questions by the plaintiffs’ lawyers, and thus the evidence he was willing to present was simply not useful for purposes of the case. Perhaps another way of put-

ting the point is just that experts must be willing and able to put in the time to analyze the particular case before them; broad generalities will not do.

Courts also have other devices, in addition to Evidence Rule 702, to help them deal with expert evidence. One of the most important of these relates to transparency among experts. (This aspect of U.S. practice does not quite reach the openness of the Australian “hot tub” system, in which the experts interrogate one another directly, but it is quite useful for both sides’ trial preparation, as well as for the court’s ability to evaluate the case.) The primary mechanism is found in one of the discovery rules, Federal Rule of Civil Procedure 26(b)(4)(A), which calls for prediscovery of all expert opinions that are expected to be presented as testimony in the case. Both sides must submit reports from their experts to the other side, and both sides are entitled to take the depositions of the opponent’s experts. The Rule requires detailed disclosures, as this excerpt illustrates:

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The report must contain:

1. A complete statement of all opinions the witness will express and the basis and reasons for them;
2. The data or other information considered by the witness in forming them;
3. Any exhibits that will be used to summarize or support them;
4. The witness’s qualifications, including a list of all publications authored in the previous 10 years;
5. A list of all other cases in which, during the previous four years, the witness testified as an expert at trial or by deposition; and
6. A statement of the compensation to be paid for the study and testimony in the case.¹⁴

Nontestifying experts—that is, the experts that the parties may wish to consult on a confidential basis in order to evaluate the strength of their own case, or any other expert that they would rather not use publicly—are subject to different rules. The work of these experts falls under the work product privilege recognized in the discovery rules, and thus disclosure can be ordered only if there are compelling reasons.¹⁵

The *FJC’s Manual for Complex Litigation, Fourth*, has an entire section devoted to the best way to handle expert economic testimony. Although it is rather long, it is worth reproducing here, as this is the source to which virtually any federal

district court judge, experienced or not in antitrust, is likely to turn if and when he or she is confronted with a significant antitrust case:

“30.2 Transactional and Economic Data, and Expert Opinions

Antitrust cases often involve the collection, assimilation, and evaluation of vast amounts of evidence regarding numerous transactions and other economic data. Some of this material may be entitled to protection as trade secrets or confidential commercial information. Effective management of such cases depends on pretrial procedures that facilitate the production and utilization of this material and its efficient presentation at trial as well as the early resolution of privilege claims. The following are among the measures that may be useful:

- Limiting scope of discovery. Early attention to the issues may make feasible reasonable limits on the scope of discovery. Limits may be fixed with reference to the transactions alleged to be the subject matter of the case, to the relevant products or services, or to geographical areas and time periods. Limits should be subject to modification if a need for broader discovery later arises. . . .
- Confidentiality orders. Protective orders may facilitate the expeditious discovery of materials entitled to protection as trade secrets or other confidential commercial information. . . . Especially if the parties are competitors, provisions may preclude or restrict disclosure by the attorneys to their clients. Particularly sensitive information, such as customer names and pricing instructions, may be masked by excision, codes, or summaries without impairing the utility of the information in the litigation.
- Summaries and computerized data. The court should encourage the parties to work out arrangements for the efficient and economical exchange of voluminous data. Where feasible, data in computerized form should be produced in computer-readable format. Identification of computerized data may lead to agreement on a single database on which all expert and other witnesses will rely in their testimony. Other voluminous data can be produced by way of summaries or tabulations—subject to appropriate verification procedures to minimize and quickly resolve disputes about accuracy—obviating extensive discovery of source documents. Counsel should produce such exhibits well in advance of trial. . . .
- Other sources. Relevant economic data may be available from government or industry sources more quickly and cheaply than through discovery from the litigants. Accordingly, consider making an early determination regarding the admissibility of such evidence under Federal Rule of Evidence 803(8), (17), and (18) [referring to various

exceptions to the rule prohibiting hearsay evidence].

- Expert opinions. Parties may plan to retain economists to study such topics as relevant markets, the concentration of economic power, pricing structures, elasticity of demand, barriers to entry, marginal costs, and the effect of the challenged practices on competition and the claimants. Early in the litigation, it is advisable to call for an identification of the subjects on which expert testimony will likely be offered, determine whether such testimony is necessary, rule at least preliminarily on the appropriate scope of expert testimony, and establish a schedule for disclosure of experts' reports, recognizing that some studies may require considerable time to prepare and review. Agreement on a common database for all experts to use is desirable, and the court can require the parties to agree on methodology and form before conducting surveys or polls. . . . Under Federal Rule of Evidence 104(a) [governing certain preliminary matters], the judge must hear and decide, before trial, objections to the admissibility of experts' opinions. If significant conflicts exist between the parties' experts on matters of theory, an expert may be appointed by the court under Federal Rule of Evidence 706. . . ."¹⁶

The last of those suggestions—a court-appointed expert—is worth a closer look. As the *Manual* indicates, the Federal Rules of Evidence expressly provide for a court-appointed expert:

“The court may appoint any expert witnesses agreed upon by the parties, and may appoint expert witnesses of its own selection. An expert witness shall not be appointed by the court unless the witness consents to act. A witness so appointed shall be informed of the witness' duties by the court in writing, a copy of which shall be filed with the clerk, or at a conference in which the parties shall have opportunity to participate. A witness so appointed shall advise the parties of the witness' findings, if any; the witness' deposition may be taken by any party; and the witness may be called to testify by the court or any party. The witness shall be subject to cross-examination by each party, including a party calling the witness.”¹⁷

This is somewhat different from the court's ability to appoint a master to assist it in processing a case, although an expert master can be useful if the court

wants someone to sift through specialized materials and help to create a record for the case.¹⁸

As the excerpt from the *Manual* indicates, it is not always necessary to delve into the economic evidence in order to resolve an antitrust case. The generalist judge should have no trouble deciding such basic issues as the court's subject-matter jurisdiction over the case, whether the complaint states a claim at all under the antitrust laws, whether the particular plaintiff before the court has standing to sue, whether the statute of limitations has run, whether the defendant (especially if it is a state entity or affiliated with a foreign government) is entitled to immunity from suit, and whether the court will be able to bring all necessary defendants before it (*i.e.* does the court have personal, or adjudicatory, jurisdiction over the defendants). It is not at all uncommon for a case to be resolved on one of these preliminary grounds, and so the district court has no need to plunge into the field of economics. Even if it does become necessary to allow the parties to begin reach-

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ing the merits, it is often possible for the court to bifurcate the case so that liability issues will be resolved first. This would allow postponement of economic evidence relating solely to damages until the time (if ever) after the plaintiffs have prevailed on liability and are ready to prove damages issues.

Procedural tools are not the only things that assist the court in managing an antitrust case. A number of substantive rules have evolved that also have the effect, taken together, of

making antitrust understandable not only to the generalist judge, but also to the generalist businessperson. The most well-known of these is the classic *per se* rule that developed in American law from the early 1940s onward. The Supreme Court consciously tried to achieve some level of clarity and simplification in antitrust rules for the set of cases in which the Court thought that competitive harm would almost always be present and justifications would almost never succeed. Interestingly, as time has gone on, the Court has progressively been narrowing the scope of the *per se* rule. While it once covered both maximum and minimum resale price maintenance, for example, it now covers neither one, thanks to the Court's decisions in *State Oil Co. v. Khan*,¹⁹ rejecting the *per se* rule against maximum resale price fixing that had been announced in *Albrecht v. The Herald Co.*²⁰ and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,²¹ overruling the 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*²² and thus abolishing the *per se* rule against minimum resale price maintenance. Perhaps this is a sign of the Court's greater confidence not only in economic learning, but also in the ability of judges to understand and apply that learning competently. Or perhaps it reflects the Court's concern that the cost of false positives (that is, findings of antitrust violations where in fact there is no harm

to competition) is higher than the mid-twentieth century Court had appreciated, and thus there is no responsible alternative to looking carefully at every case. Whatever the reason, the trend is unmistakable, and so district court judges at present are not as often able to rely on a *per se* rule to resolve an otherwise complex case.

Another common judicial device that helps the judge resolve close questions is the allocation of the burden of persuasion (as well as the lesser burden of coming forward with evidence on a point). If the evidence, including the expert evidence, is in equipoise, then the plaintiff will lose. Allocating the burden of proof in this way makes sense, if one accepts the proposition that judges will make mistakes from time to time, and thus the real task is to ensure that both the number of mistakes will be minimized, and the consequences of whatever mistakes remain will also be contained. Chief Judge Frank Easterbrook, of the Seventh Circuit Court of Appeals, wrote about this phenomenon ten years ago.²³ He began by setting forth two key concepts:

“Expressing the extent of the law’s comparative advantage over rivalry in undercutting monopoly requires the use of the social scientist’s terms “false positive” and “false negative.” If a judge wrongly condemns as monopolistic a business practice that is efficient and beneficial to consumers, that is a false positive. Consumers would be better off if the judge had decided the case the other way. If the judge wrongly excuses conduct that is harmful to consumers, that is a false negative. Litigation produces both false positives and false negatives. The more complex or unusual the conduct, the more false positives and false negatives there will be. And of course the more complex the conduct and the scarcer our knowledge of its consequences, the longer the case will take to conclude, and the more it is apt to cost along the way. All the while competitors will be trying to undercut monopolists.”²⁴

He argues that courts should refrain from condemning practices that are likely to be corrected by the market in a shorter time than the litigation process would take. Even for long-lived practices, Judge Easterbrook argues that

“courts have a comparative advantage only when false positives are few and false negatives will survive competitive pressure. Unless there is a strong reason to suspect that a monopoly or monopolistic practice can survive the attempts of other firms to undermine it, then the costs of inaction (excusing

harmful conduct) are low. Unless there is strong reason to suspect that we can identify harmful conduct accurately, then the costs of action (condemning beneficial conduct) are high.”²⁵

If the standards of proof required by the substantive law demand a compelling showing from a plaintiff before a court is authorized to intervene in a market, one need have less concern about the lack of specialization in the judiciary. Even the generalist judge should be able to evaluate expert economic testimony and understand the broad picture it is painting. Expert administrative agencies are better able to handle the sophisticated judgments that might be necessary when the matter hangs more closely in the balance (although even then, under virtually every system of competition law, the agency must show that it is more likely than not that harm will occur before it may enter an order prohibiting the conduct).

Lastly, there are areas in which the balance between the need to assure competition and the need to achieve a different public policy goal is one that is drawn by the legislature, not by courts or administrative agencies. Exemptions from the U.S. antitrust laws are not common, but they exist. At a general level, there is the exemption for activities regulated by the states, usually known by the name of the Supreme Court decision that established it, *Parker v. Brown*.²⁶ Antitrust liability is also excluded for activities associated with petitioning the government.²⁷ There is also something called the “filed rate doctrine,” under which a private party cannot recover treble damages against regulated companies based on rates that they filed with (and for which they received approval from) an administrative agency.²⁸ Finally, there are a host of special antitrust exemptions in specific industries, such as the immunity for agricultural cooperatives,²⁹ certain forms of sports broadcasting,³⁰ the business of insurance,³¹ and (notoriously) the common-law exemption for the business of baseball.³² Keeping antitrust law entirely out of an area may seem like an extreme way to handle the risk that judges might fail to assess economic evidence accurately, but one suspects that more than a concern about the economic sophistication of judges lies behind these rules.

Returning to the central concern of this paper, the last serious question to ask is how judges become educated in economics, or in any other specialty they must know in order to understand a case fully. The most important way has already been mentioned: by the parties, through the adversarial process. In addition, there is a wealth of continuing education programs available for judges. Some of these are offered by public entities such as the Federal Judicial Center and the National Center for State Courts. Others are offered by sections of the bar devoted to the judiciary, such as the American Bar Association’s Judicial Division and the Judges’ Forum within the Public and Professional Interest Division of the International

Bar Association. Finally, a number of privately sponsored seminars offer judicial education programs. Federal judges must disclose their attendance at many such seminars (for example, those offered by universities), in accordance with a policy adopted by the Judicial Conference of the United States. Assuming that the seminar organizers have made the proper disclosures on the judiciary's website, however, and that the judge properly follows through after attending the seminar, this is another potential source of education on specialized topics like economics.

In the final analysis, therefore, there is reason to be optimistic about the ability of judges to handle expert economic evidence in antitrust cases. Through devices as varied as the *Daubert* inquiries, the availability of the written expert reports filed in the case, and straightforward judicial education programs, judges can and do learn enough to glean the important messages that the experts are trying to convey. Substantive legal standards also help to reduce the risk of error. The act of ensuring that economic evidence is comprehensible to the judge comes with a great side benefit: It ensures that antitrust law itself remains comprehensible to the lay business people who must comply with it and to the public that must support it. So, even if at first blush it seems that asking judges to handle economic evidence is something like pushing a square peg into a round hole, on closer examination the fit is much better. Antitrust law depends more than ever on accurate assessments of the likely competitive effects of different practices, and the judges will be there to ensure that this takes place. ▼

THE ACT OF ENSURING THAT ECONOMIC EVIDENCE IS COMPREHENSIBLE TO THE JUDGE COMES WITH A GREAT SIDE BENEFIT: IT ENSURES THAT ANTITRUST LAW ITSELF REMAINS COMPREHENSIBLE TO THE LAY BUSINESS PEOPLE WHO MUST COMPLY WITH IT AND TO THE PUBLIC THAT MUST SUPPORT IT.

- 1 See *General Electric v. Commission*, OJ C48 25.2.2006; see also Stefan Schmitz, *The European Commission's Decision in GE/Honeywell and the Goals of Antitrust Law*, 23 U. PA. J. INT'L ECON. L. 539 (2002).
- 2 See *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).
- 3 See *General Motors Corp.*, 103 F.T.C. 374 (1984).
- 4 See Fed. R. Civ. P. 16(b)(3).
- 5 See Fed. R. Civ. P. 16(c)(2)(D).
- 6 Two recent prominent examples are *Pacific Bell Tel. Co. v. linkLine Communications, Inc.*, 07-512, 2009 WL 454286 (U.S. Feb. 25, 2009), holding on the basis of the pleadings alone that a complaint failed to present a valid antitrust claim, and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), holding that allegations of a conspiracy in violation of the antitrust laws failed on the basis of the pleadings.
- 7 The right to trial by jury in civil actions in federal courts is governed by the Seventh Amendment to the United States Constitution. It preserves that right for "suits at common law" where the value

exceeds \$20. As the Supreme Court most recently explained at length in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 707-22 (1999), this is understood to mean that the right to a jury exists only for suits that would have fallen on the “law” side of the English courts in 1791; it does not exist for proceedings in equity, such as a request for an injunction or other equitable relief. The Court has also recognized other exceptions to the constitutional right, most notably the fact that the Seventh Amendment does not apply to suits against the United States, which are all non-jury. See *Osborn v. Haley*, 549 U.S. 225, 252 (2007). Suits against foreign sovereigns, to the extent they are permitted at all by the Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1330, 1602-11, are also expressly stated to be “nonjury” actions. 28 U.S.C. § 1330(a).

- 8 See Fed. R. Civ. P. 52(a).
- 9 A verdict reached through answers to specific questions is called a “special verdict.” See Fed. R. Civ. P. 49(a). The court may ask the jury to furnish “a special written finding on each issue of fact,” by giving the jury “written questions susceptible of a categorical or other brief answer,” or through any other method that the court considers appropriate.
- 10 See Manual for Complex Litigation, Fourth, at sec. 12.451 (FJC 2004).
- 11 The leading case describing this process is *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993).
- 12 509 U.S. 579 (1993).
- 13 186 F.3d 781, 787 (7th Cir. 1999).
- 14 Fed. R. Civ. P. 26(b)(2)(B)(i).
- 15 Fed. R. Civ. P. 26(b)(3).
- 16 FJC Manual for Complex Litigation, Fourth, § 30.2, at 522-24.
- 17 Fed. R. Evid. 706(a).
- 18 See Fed. R. Civ. P. 53. The Supreme Court frequently appoints masters to assist it when it is called upon to resolve boundary disputes between two or more states (a subject matter that falls within the Court’s original jurisdiction).
- 19 522 U.S. 3 (1997).
- 20 390 U.S. 145 (1968).
- 21 127 S.Ct. 2705 (2007).
- 22 220 U.S. 373 (1911).
- 23 Frank H. Easterbrook, *Does Antitrust Have a Comparative Advantage?* 23 HARV. J. L. & PUB. POL. 5 (1999).
- 24 *Id.* at 7-8.
- 25 *Id.* at 8.
- 26 317 U.S. 341 (1943).

27 See *Eastern Railroad Presidents Conference v. Noerr Motor Freight*, 365 U.S. 127 (1961).

28 See *Keogh v. Chicago & Northwestern Railway*, 260 U.S. 156 (1922).

29 See the Capper-Volstead Act, 7 U.S.C. §§ 291-92.

30 See the Sports Broadcasting Act, 15 U.S.C. § 1291-95.

31 See the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15.

32 See, e.g., *Flood v. Kuhn*, 407 U.S. 258 (1972).



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Generating Evidence to Guide Merger Enforcement

**Orley Ashenfelter, Daniel Hosken, &
Matthew Weinberg**

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The challenge of effective merger enforcement is tremendous. U.S. anti-trust agencies must, by statute, quickly forecast the competitive effects of mergers that occur in virtually every sector of the economy to determine if mergers can proceed. Surprisingly, given the complexity of the regulators' task, there is remarkably little empirical evidence on the effects of mergers to guide regulators. This paper describes the need for retrospective analysis of past mergers in building an empirical basis for antitrust enforcement, and provides guidance on the key measurement issues researchers confront in estimating the price effects of mergers. We also describe how evidence from merger retrospectives can be used to evaluate the economic models that predict the competitive effects of mergers.

*Orley Ashenfelter is the Director of the Industrial Relations Section at Princeton University, Daniel Hosken is a Deputy Assistant Director at the U.S. Federal Trade Commission, & Matthew Weinberg is a staff economist at the U.S. Federal Trade Commission. The views expressed in this paper are those of the authors and do not necessarily represent those of the U.S. Federal Trade Commission or any individual Commissioner. We would like to thank Chris Taylor and Joseph Farrell for their comments.

I. Introduction

The Federal Trade Commission and the Department of Justice attempt to block or modify only those mergers that would reduce consumer welfare. The challenge of effective merger enforcement is tremendous. U.S. antitrust agencies must, by statute, quickly forecast the competitive effects of mergers that occur in virtually every sector of the economy to determine if mergers can proceed. Surprisingly, given the complexity of the regulators' task, there is remarkably little empirical evidence on the effects of mergers to guide regulators. This paper describes the need for retrospective analysis of past mergers in building an empirical basis for antitrust enforcement, and provides guidance on the key measurement issues researchers confront in estimating the price effects of mergers. We also describe how evidence from merger retrospectives can be used to evaluate the economic models that predict the competitive effects of mergers.

SURPRISINGLY, GIVEN THE COMPLEXITY OF THE REGULATORS' TASK, THERE IS REMARKABLY LITTLE EMPIRICAL EVIDENCE ON THE EFFECTS OF MERGERS TO GUIDE REGULATORS.

Determining the price effects of consummated mergers is difficult for several reasons. First, calculating the effect of a merger on prices necessitates estimating what prices would have been had the merger not occurred. These counterfactual prices are inherently unobservable, and assumptions that may be questionable must be made in order to identify and estimate these effects. Further, prices are often difficult to measure in available datasets. Difficulties in measuring prices can have important consequences on the results of merger retrospectives. Finally, as noted by Carlton¹ and Ashenfelter & Hosken,² it is difficult to generalize from the results of even a large number of retrospective studies because only the price effects of consummated mergers are observed. Mergers that are consummated represent a selected sample of all possible mergers, not a random sample. Fortunately, a well-designed study can overcome these three difficulties and much of this paper describes different approaches for doing so.

In addition to identifying whether past antitrust enforcement was at its proper level, retrospective analysis can also directly improve future antitrust decision making. Due to the costliness of dissolving consummated mergers, U.S. antitrust policy towards mergers is almost entirely prospective. The government must forecast how each potential merger would affect prices and, hence, consumer surplus. A large number of retrospective studies could aid government decision making by revealing which observable characteristics of mergers are associated with price increases. Further, retrospective evidence provides a useful method for evaluating economic models used to forecast the competitive effects of mergers. These methods include financial event studies, retrospective analysis from non-merger related activity, and simulations from structural oligopoly models (merger simulations). A chief benefit of these methods is that they generate explicit predictions of the competitive effects of mergers and, in the case of merger simulations, an explicit prediction of the price effect. Further,

the assumptions underlying these models are explicitly stated and can be subjected to rigorous review.

In contrast, the analysis of the evidence traditionally used in merger reviews—testimony of market participants and company documents—is inherently more subjective. Because economic models generate explicit predictions of the competitive effects of mergers, it is relatively straightforward (though resource intensive) to evaluate their performance with retrospective evidence. If these tools are proven effective, they could lead to a more efficient, objective, and accurate merger review process.

The rest of the paper is structured as follows: Section II describes the decision problems facing antitrust authorities and discusses extant retrospective evidence; Section III describes the key issues in estimating the price effects of consummated mergers; and Section IV describes the economic models used to forecast price effects. Section V concludes.

II. Antitrust Decision Making

The Clayton Act forbids mergers that may “substantially reduce competition.” The U.S. Federal Trade Commission (“FTC”) and the Antitrust Division of the U.S. Department of Justice (“DOJ”) enforce the Clayton Act, and the protocol by which they do so is given in the Hart-Scott-Rodino Act (“HSR Act”). In practice, the agencies seek to block mergers that would reduce consumer surplus, primarily as a result of higher prices. The HSR Act requires parties engaged in commerce and acquiring assets valued at more than \$65.2 million to file an intention to merge with the FTC and DOJ before coordinating their activities. The firms must then wait while the merger is allocated to one of the agencies and investigated for potential anticompetitive effects.

Because it is undesirable to delay efficient mergers, the HSR effectively forces the U.S. antitrust agencies to make decisions under strictly-legislated time constraints. The HSR Act gives the government 30 days for an initial investigation. If the merger is potentially problematic, the government issues a “second request” to the merging parties. The second request is a detailed subpoena requesting documentary evidence (including quantitative data) that is relevant to the government investigation. While the merging parties do not face any formal time deadline to comply with the second request, it is in their interests to comply quickly so as not to delay the transaction more than necessary. After all documents are submitted for the second request, the government has a final 30 days to review the case.

The 1992 FTC/DOJ *Horizontal Merger Guidelines* provide the analytic framework used in merger review. In the course of their investigation, the agencies must first define geographic and product markets, and then predict competitive

effects, efficiencies, and the likelihood of entry. The information with which the government makes these decisions is limited. Often government attorneys and economists are limited to the information contained in company documents and the testimony of merging firms' executives and other market participants. When the merging parties have high quality price, quantity, and or revenue data, it is possible to use demand estimates and oligopoly models to help define product and geographic markets and simulate the price effects of mergers.

WHEN THE MERGING PARTIES HAVE HIGH QUALITY PRICE, QUANTITY, AND OR REVENUE DATA, IT IS POSSIBLE TO USE DEMAND ESTIMATES AND OLIGOPOLY MODELS TO HELP DEFINE PRODUCT AND GEOGRAPHIC MARKETS AND SIMULATE THE PRICE EFFECTS OF MERGERS.

The sheer magnitude of the number and variety of merger filings each year demonstrates the difficulties facing antitrust enforcers. Figure 1 plots the total number of merger filings, as measured on the left vertical-axis, and the total number of second requests, as measured on the right vertical-axis. While the vast majority of mergers are consummated without modification or review; on average over the past decade, the agencies conducted major investigations of mergers (that generated a second request) 71 times a year.³ Further, over the past decade, these mergers took place in roughly 80 different industries, as defined by 3-digit NAICS codes.⁴

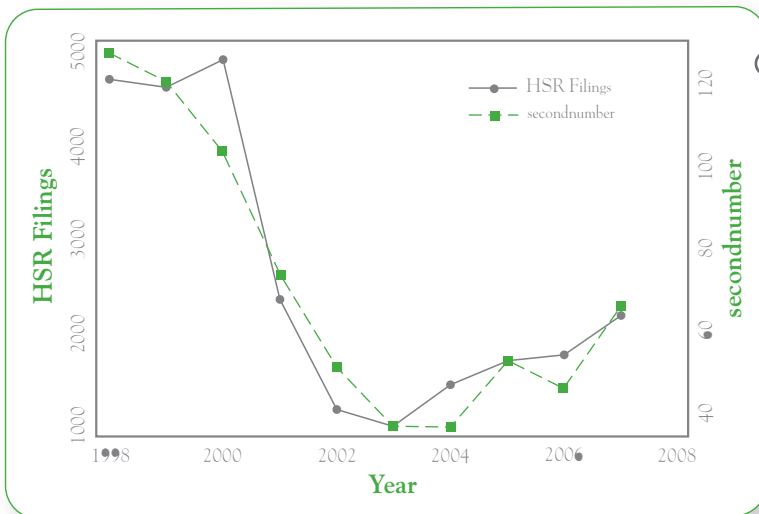


Figure 1

Hart Scott Rodino Filings and Second Requests, 1998-2007

Thus, not only do the agencies have to review a large number of mergers in a short time period, they often are forced to make decisions with only limited exposure to the industry. Industries differ dramatically in the institutional detail critical for merger analysis. Mergers take place in markets that differ in seller and buyer concentration, substitutability of different products, and barriers to entry.

Studies of the price effects of consummated mergers provide a useful aid for government decision making. Currently, there are about twenty published merger retrospectives—see Pautler,⁵ Hunter et al.,⁶ and Weinberg⁷ for recent surveys. The mergers that have been studied are not representative of consummated mergers. Instead of estimating the average price effect of a merger, most studies focus on mergers that were likely to be on the enforcement margin. For example, Ashenfelter and Hosken⁸ focus on five consumer product market mergers that took place in highly concentrated markets. Thus the results of these studies should be interpreted as measuring the effectiveness of specific (non) enforcement decisions and not as the average price effect caused by a consummated merger. In addition, most existing studies have taken place in four industries where pricing data are publicly available: airlines, banking, hospitals, and petroleum. The vast majority of merger retrospectives find evidence of price increases; at least in the short period they observe post-merger pricing. However, the number of merger studies is not large; they cover a time span of roughly 30 years; and only a handful of industries have been studied. That being said, the main implication of this research is that mergers in concentrated markets can lead to price increases. Given our limited knowledge, it is impossible to draw either broader conclusions about the effectiveness of enforcement or specific guidance as to what market characteristics are more likely to result in anticompetitive mergers.

III. Generating Evidence to Improve Decision Making

Merger retrospectives are useful for both evaluating past antitrust policy and learning what types of mergers lead to increases in consumer prices. As in all empirical analysis, for a study to yield useful results it is critical to have a sensible design and data sufficient to answer the question of interest. Below we highlight what we see as the key issues in estimating the price effects of the merger. First, and of primary importance, is developing a reasonable estimate of what the prices in an industry would have been had the merger not occurred. Second, we discuss the importance of identifying a reasonable measure of price. Finally, we discuss issues involved in identifying the time period in which we think the price effects of the merger will manifest themselves.

A. MODELING THE COUNTERFACTUAL

The goal of a merger retrospective is straightforward: Learn if prices changed as the result of a merger. A decrease in prices implies that the merger was efficient, and an increase in prices implies that the merger increased market power to the detriment of consumers (assuming no coincident increase in quality). The major issue in estimating the price effect of a merger, as with any evaluation of a change in a market using non-experimental data, is the method used to control for other confounding factors that may also have changed at the time of the event. Of spe-

cial concern in a merger setting is the effect of possible changes in demand or costs that may cause prices to change and are unrelated to the merger.

For example, suppose a merger of two large gasoline refiners operating in the U.S. Midwest was consummated on January 1, 2008. The antitrust agencies are subsequently asked by the U.S. Congress to determine if that merger adversely affected consumers. In response to this request the antitrust agencies ask their economists to measure the price effect of this merger. The antitrust economists find that the week before the merger was consummated, gasoline prices in the Midwest were roughly \$3.03 a gallon; they rose to \$4.03 six months after the merger date, and then fell to \$1.57 at the end of 2008.⁹ Would it be correct to conclude from this price pattern that directly following the merger the gasoline refiners exploited their market power causing the price to increase about \$1 a gallon; however, by the end of the year (after the firms had time to integrate their facilities) the efficiencies were so great that prices fell to nearly 50 percent when measured relative to prices just before the merger was consummated? This conclusion seems unlikely. Variability in gasoline prices is largely caused by changes in crude prices. Crude oil prices were roughly \$96 a barrel on December 31, 2007; \$140 a barrel on June 30, 2008; and \$39 a barrel on December 31, 2008.¹⁰ Thus, in this hypothetical merger retrospective relying on a simple “before and after” estimator would yield highly misleading results about the price effects of the hypothetical merger. The technique being used did not control for other factors (crude oil prices) that are important inputs into the production of gasoline. While this example is highly simplified, it illustrates why a researcher must control for factors unrelated to the merger that may affect prices. In most studies, these factors typically consist of shocks to supply and demand.

OF SPECIAL CONCERN IN A MERGER SETTING IS THE EFFECT OF POSSIBLE CHANGES IN DEMAND OR COSTS THAT MAY CAUSE PRICES TO CHANGE AND ARE UNRELATED TO THE MERGER.

In a merger retrospective, the price effect of the merger is defined as the difference between the observed price following the merger and what prices would have been “but for” the merger. The typical merger retrospective assumes that there is a reduced form pricing relationship similar to equation (1) below in the markets affected by mergers.

$$(1) \quad p_{Mt} = \alpha_{M0} + \gamma_t + \alpha_{M1} \text{Post Merger}_t + \varepsilon_{Mt}$$

These studies assume that the price in the market affected by a merger (p_{Mt}) is a function of costs and demand factors which vary over time (γ_t), and an indicator (or series of indicators) corresponding to the post-merger period (Post Merger_t). Using a reduced form pricing equation, there are two dominant identification approaches used to estimate the price effect of a merger. The first approach uses explicit controls for the cost and demand factors that affect prices independent of the merger. In these papers, the researcher explicitly specifies both the factors

that affect a product's price and the functional form; i.e., the researchers explicitly specify γ_t as a function of observed cost and demand factors.

An example of the first approach is the Chouinard and Perloff¹ study of retail and wholesale gasoline price variation. The goal of this study is to determine the relative importance of different factors that affect gasoline prices over time, including increases in market power caused by mergers. Chouinard and Perloff use monthly state level gasoline pricing data from the U.S. Energy Information Agency ("EIA") from March 1989 through June 1997. They include a large number of variables that likely determine the supply and demand of gasoline over time in different U.S. states (γ_t in equation 1 above). Specifically, Chouinard and Perloff include variables that affect the demand for gasoline (including measures of income, weather, population, automobile ownership, and population density), input prices (crude oil prices, taxes, and controls for the type of pollution requirements in a given state), supply shocks (indicator variables for the first Persian Gulf war and refinery outages), and state fixed-effects (separate indicator variables allowing for a different price level in every state). Mergers are modeled as affecting price as in equation (1), a series of indicator variables for each merger where the indicator is equal to 1 in the post-merger time period for states affected by the merger.

For this approach to generate reliable estimates of the price effects of a merger, it is critical that the variables included in the econometric model (the supply and demand variables) control for all important factors that affect prices and may be correlated with the timing of the merger. If some factor that is not included in the regression causes prices to rise (or fall) in the post-merger period, the researcher would mistakenly attribute this unobserved factor as the price effect of the merger. The validity of this approach depends on the application. There are many regional factors which are very difficult to observe (much less measure) that can have a large impact on gasoline prices. Because supply and demand for gasoline are both very inelastic, unanticipated changes in output can have large effects on consumer prices. For example, in the summer of 2000 unanticipated decreases in output in the Midwest (caused primarily by unanticipated difficulties associated with meeting tighter environmental regulations) led to large price increases in the Midwest.¹² While large shocks can be controlled for by including indicator variables in the estimating equation (as done by Chouinard and Perloff), smaller disruptions to the gasoline distribution network (pipelines, barges) can also lead to significant changes in regional prices which, while transitory, can last for weeks or even months.¹³ Thus, during the relatively short time horizon typically used to identify the price effect of a merger—one or two years—a cost shock could confound the ability to measure the price effect of a merger. The validity of this modeling approach critically depends on the ability to specify the factors that affect the prices of the products affected by the merger.

The second approach uses some form of a difference-in-difference estimator to identify the price effect of the merger and is the most common approach used in

estimating the price effects of mergers. Instead of explicitly specifying the factors that change the demand and cost of a product over time (γ_t), these studies identify a “control” group of products that face similar demand and cost conditions to those potentially affected by a merger and then determine how those products’ prices change relative to the products sold in markets affected by a merger. Specifically, assume that the conditions causing prices to change over time in the control market are identical to those of the treatment market but for the price effect caused by the merger, as in equation (2) below.

$$(2) \quad p_{Ct} = \alpha_{C0} + \gamma_t + \varepsilon_{Ct}$$

In equation (2) prices of the control product are allowed to be different than those of the product affected by the merger by a constant amount (α_{C0}); however, time-varying factors affect prices in an identical manner as for the product affected by the merger. This leads to the estimating equation (3) which is the difference of equations (1) and (2).

$$(3) \quad p_{Mt} - p_{Ct} = (\alpha_{M0} - \alpha_{C0}) + \alpha_{M1} \text{Post Merger}_{Mt} + (\varepsilon_{Mt} - \varepsilon_{Ct})$$

In equation (3) the intercept has the interpretation of being the *difference* in the pre-merger price between the product affected by the merger and the control product, and the error term is the *difference* in the error terms in the two products. Under the assumption that the factors that cause prices to change for the two products are identical ($\gamma_t^M = \gamma_t^C = \gamma_t$), this estimating equation yields the correct estimate of the price effect of the merger, α_{A1} . The difficulty of the difference-in-difference approach is in identifying a good control product (or group of products¹⁴) for the products produced by the merging firms. In an antitrust setting, for example, there is often a tension between finding products that are in different geographic markets and therefore not affected by the transaction, while truly facing similar demand and cost conditions.

Kim and Singal¹⁵ estimate the price effects corresponding to a number of airline mergers using a difference-in-difference approach. They define a market as a city-pair combination; for example, flights from Washington, D.C. to Chicago, Illinois. Their goal is to estimate the change in prices in city-pairs where a merger reduced the number of competitors. A natural control group is a market containing the same number of competitors pre-merger with no reduction in competition post-merger. By using this control group, Kim and Singal are implicitly assuming that the factors that may cause airline prices to change over time independent of the merger, such as jet fuel prices or changes in wage rates, will affect merger markets and control markets similarly. In their paper, the price effect of the merger is cal-

IN AN ANTITRUST SETTING, FOR EXAMPLE, THERE IS OFTEN A TENSION BETWEEN FINDING PRODUCTS THAT ARE IN DIFFERENT GEOGRAPHIC MARKETS AND THEREFORE NOT AFFECTED BY THE TRANSACTION, WHILE TRULY FACING SIMILAR DEMAND AND COST CONDITIONS.

culated as the (percentage) change in fares in markets affected by the merger relative to the change in fares in control markets.

In many industries, the approach used by Kim and Singal of identifying a control market as a separate region that is both unaffected by the merger and selling identical products is not feasible. Ashenfelter and Hosken,¹⁶ for example, are interested in estimating the price effects resulting from five mergers of firms producing branded consumer products in the motor oil, breakfast syrup, ready-to-eat cereal, feminine hygiene products, and distilled spirits industries. They observe retail prices for each industry brand across different regional markets before and after each merger occurred. Because each of these products is sold nationally, they cannot use, as a control, prices of the same products sold in different regions.

Instead, Ashenfelter and Hosken use private label products (products in the same industry sold under a retailer's brand name) as a control group. The key assumption for estimating the price effect of the merger in this context is that the merging brands' prices, in the absence of the merger, would have changed in the same way as private label products. Private label products have nearly all of the same production costs as branded products, except advertising. For this reason, Ashenfelter and Hosken suggest that exogenous supply or demand shocks affecting the industry should similarly affect private label- and branded-products' prices. Further, private label products are likely relatively distant substitutes to the branded products produced by the merging parties. Thus, we would not expect private label products to increase in price in response to an anticompetitive price effect generated by the merger.

However, even if private label products are important substitutes for the branded products, the bias of the difference-in-differences estimator can be signed if firms compete in prices. Davidson and Deneckere¹⁷ analyze the price effects of mergers using the static Bertrand model which underlies most unilateral effects analysis. They show that for most common demand systems, firms producing substitute products to those of the merging firms will increase their prices following a price increase by the merging firms. Thus, at worst, comparing the change in the prices of the merging firms' products to the change in private label prices will underestimate the effect of the merger, if the underlying model is Bertrand.¹⁸

Whether it is best to control explicitly for supply and demand factors in estimating equation (1) or to identify a control product and estimate the price effects of the merger using a difference-in-difference estimator like equation (3) depends on characteristics of the merger being studied. It is often difficult to identify variables that measure the factors that affect a product's price over time. For this reason, when analyzing mergers where a good control product is available (for example, estimating the price effects of an airline merger), a difference-in-difference estimator is likely best. Even in these situations, however, a researcher should consider alternative controls where feasible to validate the assumption that the control and merger products face similar demand and sup-

ply shocks. In industries where there is no obvious control, a researcher must identify the price effects of the merger by explicitly controlling for those factors affecting supply and demand in the estimating equation. For example, many mergers in gasoline markets affect all cities in a region, while cities in regions unaffected by the merger may have different sources of supply and face different demand shocks (for example, weather). In this situation, the best method for modeling the counterfactual would be to specify a model like that in Chounaird and Perloff.

FOR THIS REASON, WHEN ANALYZING MERGERS WHERE A GOOD CONTROL PRODUCT IS AVAILABLE (FOR EXAMPLE, ESTIMATING THE PRICE EFFECTS OF AN AIRLINE MERGER), A DIFFERENCE-IN-DIFFERENCE ESTIMATOR IS LIKELY BEST.

B. PRICE MEASURE

Defining relevant products and their corresponding prices is almost always an important issue in antitrust analysis. For example, even within relatively homogeneous product categories, such as the retail sale of gasoline, prices can vary substantially within a region. In order to describe the retail price of gasoline in a market some aggregation over products (gasoline sold at different retail outlets) is necessary. Price measurement, too, can be an important issue in merger retrospectives. Researchers are constrained by available data. Publically available data often contains a subset of transactions in the market. Data corresponding to that subset may (or may not) be sufficient to determine the price effects of the merger. The importance of price measurement can best be illustrated by examining recent studies estimating the price effects of mergers in the petroleum industry.

The U.S. petroleum industry has undergone dramatic change over the last 15 years. Many well known petroleum firms have merged, including Exxon and Mobil, Conoco and Phillips, and Marathon and Ashland. At the same time, many large petroleum firms have divested a substantial number of refineries to entrants and rivals. This merger activity, in combination with dramatic volatility in the price of gasoline, has led to concerns that these mergers may have harmed consumers. A number of recent studies have estimated the price effects of mergers affecting the gasoline industry. Some of these studies have focused on wholesale prices (Hastings and Gilbert¹⁹ and GAO²⁰) while others have focused on retail prices (Simpson and Taylor²¹ and Hastings²²) or both retail and wholesale prices (Chounaird and Perloff²³ and Taylor and Hosken²⁴). On initial inspection, the choice of price measure might not appear important in evaluating mergers in gasoline markets. If a merger increased market power in the market for either the refining or the distributing of gasoline, then wholesale prices should increase. The wholesale price increase, in turn, should be passed on to retail prices. If retail markets are very competitive, we would expect something close to a one-to-one pass through of wholesale prices to retail prices.

Some institutional factors in gasoline markets complicate this hypothesized relationship between observed wholesale and retail prices. First, the specific

wholesale price a gasoline retailer faces is determined by the vertical relationship between the retailer and its supplying refiner. There are four primary types of arrangements between gasoline retailers and suppliers, two of which yield publicly observable prices. Gasoline stations that are independently owned and operated typically have the right to purchase gasoline at any wholesale distribution point. If a gasoline station of this type sells a specific brand of gasoline (for example, Exxon) that station must purchase that brand of gasoline. A station selling gasoline under its own name can purchase a generic gasoline. These prices are typically referred to as branded and unbranded “rack prices”²⁵ and are the only wholesale gasoline prices that are observable at high frequency (daily or weekly) for relatively narrow geographic regions (metropolitan areas). Stations that are owned by a refiner but operated by a third party (lessee-dealer stations) also pay an unobserved wholesale price that may vary by station within a metropolitan area (often called a DTW price).²⁶ Finally, some gasoline stations are owned and operated by a refiner. In this case, the refiner directly determines the retail price and the wholesale price is inherently unobservable.

Second, these different wholesale gasoline prices change relative to each other over time. For instance, during supply disruptions refiners often increase the wholesale price charged to retail outlets unaffiliated with their brand relative to the price charged to stations selling their own brand of gasoline, *see* Bulow et al.²⁷ Similarly, DTW prices change relative to rack prices during supply disruptions, *see* Taylor and Hosken.²⁸ Thus, at any point in time it is unclear which wholesale price (rack, branded rack, DTW, lessee dealer, or unobserved transfer price facing

refiner owned and operated stations) is the most relevant wholesale price in determining the retail price in a market.

THE CHOICE OF PRICE MEASURE
CAN LEAD TO DIFFERENT
CONCLUSIONS ABOUT THE PRICE
EFFECTS OF A MERGER.

The choice of price measure can lead to different conclusions about the price effects of a merger. In 2004 the GAO issued a report analyzing the price effects of a number of mergers in the petroleum industry. Their study examined how branded and unbranded rack prices changed in response to mergers. The GAO found that the combination of Marathon and Ashland Petroleum caused a wholesale price increase. Taylor and Hosken²⁹ also analyzed the price effects of this merger and examined both retail and rack prices. Like the GAO, Taylor and Hosken found that the observed wholesale price (rack price) increased; however, they did not find evidence of a retail price increase. In fact, Taylor and Hosken found evidence that the observed increase in rack prices may have reflected a change in the *relative* size of the different wholesale prices.³⁰

Thus, this merger increased some, but not all wholesale prices, and, on net, this change in wholesale prices did not cause retail prices to increase.

While the above example is specific to the gasoline industry, most markets have idiosyncratic features that complicate price measurement. In the hospital industry there are dramatic differences in the costs of serving patients depending

on the type of care they receive. In the retrospective analyses of hospital mergers researchers devote substantial effort to controlling for these costs. Otherwise, they would not be able to determine if prices increased (or decreased) following a merger as a result of an increase in market power or a change in the composition of the patients treated by the hospital.³¹ Similarly, airlines charge many different prices for tickets on flights, often in response to flight-specific demand shocks. Researchers must carefully model this variation to avoid inadvertently attributing a supply or demand shock to a merger effect.

C. DETERMINING PRE- AND POST- MERGER PRICES

To measure the price effects of a merger, a researcher must specify the time periods corresponding to the pre- and post-merger time period. The goal is to identify a time period sufficiently long enough to capture any change in price associated with the change in market structure, but short enough to avoid any contaminating effects from other changes in the market. The pre-merger time period corresponds to the period directly preceding the date at which firms change their pricing behavior. While the HSR Act requires that the merging firms operate independently during the government's review of the merger, there is empirical evidence from both the banking (Prager and Hannan³²) and airline (Kim and Singal³³) industries that the merging firms increase their prices before the merger is consummated. In other industries firms may be limited in their ability to change price for a significant time period following the merger. Hospital prices, for example, are determined by contracts negotiated between hospitals and insurance companies for fixed time periods. Following a merger, a hospital's price will move to its post-merger level as its contracts with insurers are updated. For this reason, researchers often exclude pricing for some period following a merger to obtain a more precise measure of the post-merger price; *see*, for example, Tenn.³⁴ In some cases where the merger leads to a discrete change in the level of prices, the event date might be determined through conventional structural break tests with unknown break date (*see*, for example, Andrews and Ploberger³⁵ and Bai & Perron³⁶). Alternatively, when the date at which the merged firm began coordinating its pricing behavior is unknown and the researcher has a relatively long price series, observations near the consummation date could be dropped to generate reliable estimates of pre- and post-merger pricing; *see*, for example, Ashenfelter and Hosken.³⁷

IT IS IMPOSSIBLE TO OBTAIN A REPRESENTATIVE SAMPLE OF ALL MERGERS BECAUSE THE GOVERNMENT WILL ATTEMPT TO BLOCK OR MODIFY THOSE TRANSACTIONS BELIEVED TO BE ANTICOMPETITIVE. THIS CREATES A CHALLENGE TO BOTH ESTIMATING THE EFFECTS OF A MERGER ON PRICE AND EVALUATING WHETHER ENFORCEMENT ACTIVITY IS AT ITS PROPER LEVEL (CARLTON).

D. SELECTION ISSUES

It is impossible to obtain a representative sample of all mergers because the government will attempt to block or modify those transactions believed to be anti-competitive. This creates a challenge to both estimating the effects of a merger on price and evaluating whether enforcement activity is at its proper level (Carlton³⁸). One approach to solving this problem is to focus on mergers that appeared to be on the enforcement margin. This is the approach of Ashenfelter and Hosken.³⁹ They identified five consumer-product mergers that involved large firms operating in already highly concentrated industries. While it may be that many approved mergers result in no competitive harm, four of the five mergers analyzed in their study resulted in moderate but statistically significant price increases.

IV. Retrospective Studies for Merger Forecast Evaluation

Antitrust policy towards horizontal mergers in the United States is largely prospective; regulators attempt to block those mergers predicted to increase price. A growing number of papers have estimated the effects of different mergers on prices. Unfortunately, given the heterogeneity across industries, the number of merger retrospectives is far too small to make any inference on which market characteristics are correlated with price effects. It is currently impossible to generalize sufficiently from these studies to aid decision makers in developing antitrust policy. Instead, antitrust economists have relied on merger simulations, financial event studies, and retrospective studies of non-merger changes in market structure to inform antitrust decisions. All of these approaches require the validity of some strong assumptions if they are to yield accurate predictions. Existing retrospective merger studies, however, can be used to evaluate the predictive ability of these different merger simulation methods. This section describes different methods used to forecast the effects of mergers and how retrospective evidence can be used to evaluate them.

When sufficient data is available, economists now commonly estimate static oligopoly models and then use these models to simulate the unilateral price effects of mergers in differentiated product markets. These models focus on the incentive to increase prices after a merger that results from the internalization of consumer substitution. Each firm has beliefs about the prices its rivals will choose and, given those beliefs, picks its own prices to maximize its profits given, which are (in equilibrium) correct. When considering a price increase, firms balance the benefits of larger margins on each product sold against the costs of lost consumers who switch to another product. It follows that if two separate firms respectively sell products that are the first and second choices of many consumers, a merger reduces the cost of a price increase and hence results in higher prices. Models that formalize and then quantify this argument are known as

“merger simulations.” This approach was first taken by Baker and Bresnahan⁴⁰ and, because the key ingredients in these models are consumer substitution patterns, modified versions have tracked developments in the demand estimation literature. Key contributions to the literature include Hausman, Leonard, & Zona,⁴¹ Werden & Froeb,⁴² and Nevo.⁴³

Simulating the price effects of a merger requires several strong assumptions. Formally, the magnitude of the price increase in a unilateral effects model depends upon assumptions of consumer preferences and how the firms’ cost of producing a unit of its product varies with total output. Simulating a merger also requires statistical assumptions that are necessary to estimate demand functions. In addition, the standard unilateral effects model also assumes that price is the only locus of competition and that firms’ pricing decisions are static and thus independent of time. The estimated model of oligopoly may predict inaccurate price effects of the merger if any of these assumptions are invalid. Despite the huge amount of resources dedicated to merger review, only two papers have used retrospective evidence to evaluate methods used to simulate mergers. Both of these papers have data covering a period before and after mergers took place. Using only pre-merger data that would be available during merger review, the price effects of the mergers are simulated. Direct retrospective estimates of the mergers are obtained by adding to the sample post-merger data, and the models are evaluated by comparing the indirect, simulated price effects to the directly estimated retrospective price effects.

DESPITE THE HUGE AMOUNT OF RESOURCES DEDICATED TO MERGER REVIEW, ONLY TWO PAPERS HAVE USED RETROSPECTIVE EVIDENCE TO EVALUATE METHODS USED TO SIMULATE MERGERS.

Peters⁴⁴ evaluates merger simulation techniques by comparing the simulated and direct price changes from airline mergers. He uses two different demand systems for fares, an assumption that the marginal cost of a fare is constant, and the assumption of static price competition to simulate six airline mergers. While the direction of the bias depends on which of the two demand systems is used, the direct and the simulated price changes were, on average, ten percentage points different from the actual price changes for both specifications. Further, the simulations reversed the rank order of observed price effects. In Peters’ study, the merger predicted to generate the largest price increase (Northwest/Republic) yielded the smallest observed price increase. Similarly the merger predicted to generate one of the smallest price effects (Continental/People’s Express) generated the largest price increase.

Weinberg and Hosken⁴⁵ evaluated merger simulations with retrospective evidence using data before and after two branded consumer product mergers occurred. They examined the merger of Pennzoil and Quaker State brand motor oils and an acquisition that combined Log Cabin and Mrs. Butterworth brand breakfast syrups. Both of these mergers were particularly well suited to the

assumptions required by the standard merger simulation: the products were well known to consumers; and there was no recent entry, exit, or product repositioning of any importance in either industry. The results are similar to those of Peters in that the simulations reverse the rank order of the price effects. Retrospective evidence reveals the motor oil merger was marginally anticompetitive while the syrup merger had no impact on prices. The simulated price changes, on the other hand, were small for the motor oil merger and quite large in many specifications for the syrup merger.

Another method for forecasting the competitive effects of potential mergers is the financial event study approach of Eckbo⁴⁶ and Stillman.⁴⁷ The Eckbo and Stillman financial event studies of mergers examine the abnormal stock market returns of close competitors of the merging parties to determine if a merger is anticompetitive or not. Assuming that financial markets are efficient so that current stock prices incorporate all available information, events that impact the probability of a potential merger occurring will change current stock market returns in a way that identifies the competitive nature of the merger. On one hand, an anticompetitive merger will increase rival firms' future profits and thus increase the value of their equity. On the other hand, a merger that lowers the marginal cost functions of the merging firms will decrease rival firms' future profits

THEREFORE, FINANCIAL EVENT STUDIES PROVIDE A FORECAST OF WHETHER A MERGER WILL BE ANTICOMPETITIVE OR NOT, BUT DO NOT FORECAST THE MAGNITUDE OF THE MERGER'S PRICE EFFECT.

and lower the value of their equity. Therefore, financial event studies provide a forecast of whether a merger will be anticompetitive or not, but do not forecast the magnitude of the merger's price effect.

McAfee and Williams⁴⁸ used a case study to evaluate the ability of financial event studies to predict whether mergers are anticompetitive.

They analyzed the 1979 merger of two microfilm producers, Xidex Corporation and Kalvar Corporation. In an earlier paper, Barton and Sherman⁴⁹ found that this merger led to large price effects. Therefore, if the predictions of financial event studies are accurate, pre-merger events that increased (decreased) the likelihood of the merger occurring should have led to positive (negative) abnormal returns of rival firms. However, McAfee and Williams found that, in most cases, the exact opposite effects were found and that for nearly all specifications any merger effect from the financial event study was statistically insignificant. They argued that financial event studies had little power because the merging firms in this study received only a small portion (less than 8 percent) of their total revenues from markets affected by the merger. Additional similar evaluation studies of mergers of firms with overlapping product markets accounting for larger portions of their revenue would be valuable.

In some cases, past changes in market structure such as the entry and exit of firms provide an alternative to merger simulation for forecasting the price effects of a merger. This type of analysis was presented by both parties in the proposed

merger between the office supply retailers Staples and Office Depot, and is described in Ashenfelter et al.⁵⁰ The central evidence in this case was that prices were lower in geographic markets where both Staples and Office Depot operated than in markets in which only one of the two firms was present. While suggestive, this observation is not persuasive by itself because whether both Staples and Office Depot or only one of the two were in a market is likely to be systematically related to other unobservable determinants of price such as costs or demand. In light of this, the government used entry and exit to identify the effect of market structure on price. If Staples were to remove Office Depot from markets in which both firms competed after the merger was completed—and there are historical instances of Office Depot exiting local markets where Staples also competed—then data on prices across different markets before and after exit occurred could be used to estimate the merger effect. If the entry and exit of Office Depot impact price in equal but opposite directions, then both entry and exit events could be used. The key assumption needed to identify the effect of market structure on prices using entry and exit is that all unobservable determinants of price are constant over time within a market. If a firm exiting the market affects prices differently from a merger, then entry and exit are not symmetric or entry and exit are driven by other unobservable changes in demand or cost. In this situation, a study of entry or exit may yield biased estimates of the effect of a merger on prices. To our knowledge no one has used post merger data to evaluate this modeling approach.⁵¹

THE KEY ASSUMPTION NEEDED TO IDENTIFY THE EFFECT OF MARKET STRUCTURE ON PRICES USING ENTRY AND EXIT IS THAT ALL UNOBSERVABLE DETERMINANTS OF PRICE ARE CONSTANT OVER TIME WITHIN A MARKET.

V. Conclusions

Effective horizontal merger policy requires antitrust agencies to forecast the effects of mergers on consumer welfare. Despite more than thirty years of active horizontal merger enforcement following the passage of the Hart-Scott-Rodino act, there is relatively little empirical evidence to guide policy makers on how mergers affect competition. Antitrust enforcers and the courts largely rely on the testimony of economic experts, customers, company executives, and company documents to forecast the impact of a merger on consumer welfare. We believe that this information, while extremely useful, should be supplemented by gathering more evidence on the price effects of consummated mergers. By focusing on mergers that were on the enforcement margin, researchers can begin to develop empirical evidence on which types of mergers are likely to be problematic and can provide useful guidance to aid merger enforcement. Economists have developed a number of models that predict the competitive effects of mergers. Merger retrospectives can also be used to evaluate and potentially improve these tools. ▼

- 1 Dennis Carlton, *The Need to Measure the Effect of Merger Policy and How to Do It*, 5(1) COMPETITION POL'Y INT'L (2009).
- 2 Orley C. Ashenfelter & Daniel S. Hosken, *The Effect of Mergers on Consumer Prices: Evidence from Five Selected Case Studies*, NBER Working Paper (2008) (W13859).
- 3 HSR filing and second request figures are taken from the Hart-Scott-Rodino Annual Reports to Congress. The drop in the number of filings and second requests after 2001 is due both to the end of a merger wave and also an increase in the HSR filing threshold from transactions valued at \$15 million or more to \$59.8 million or more.
- 4 3-digit NAICS codes for the merging parties are reported in HSR Premerger Notification and Report Forms.
- 5 Paul Pautler, *Evidence on Mergers and Acquisitions*, 48(1) ANTITRUST BULL. 119 (2003).
- 6 Graeme Hunter, Gregory K. Leonard, & Steven Olley, *Merger Retrospective Studies: A Review*, 23 ANTITRUST 34–41 (2008).
- 7 Matthew C. Weinberg, *The Price Effects of Horizontal Mergers*, 4(2) J. COMPETITION L. & ECON. 433–47 (July 2008).
- 8 Ashenfelter, *supra* note 2.
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- 10 Prices of West Texas Crude, the most commonly traded crude in the United States.
- 11 Hayley Chouinard & Jeffrey M. Perloff, *Gasoline Price Differences: Taxes, Pollution Regulations, Mergers, Market Power, and Market Conditions*, B.E. J. ECON. ANALYSIS & POL'Y (2009).
- 12 Prices increased in Chicago and throughout the Midwest by nearly 60 cents a gallon in a little over a month, while more distant regions (connected by pipeline) experienced much smaller changes in price. See Jeremy I. Bulow, Jeffrey H. Fischer, Jay S. Creswell Jr., & Christopher T. Taylor, *U.S. Midwest Gasoline Pricing and the Spring 2000 Price Spike*, 24 (3) ENERGY J. 121-194 (2003). Despite facing identical input (crude oil) costs, supply shocks in gasoline markets can lead to large changes in relative prices that can take weeks to dissipate.
- 13 The price effects of a number of localized supply shocks are shown in Chapter 4 of United States Federal Trade Commission FTC, *Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition*, Technical Report, United States Federal Trade Commission (2005).
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- 15 E. Han Kim & Vijay Singal, *Mergers and Market Power: Evidence from the U.S. Airline Industry*, (83) AMER. ECON. REV. 549–569 (1993).
- 16 Ashenfelter, *supra* note 2.
- 17 Raymond Deneckere & Carl Davidson, *Incentives to Form Coalitions with Bertrand Competition*, 16 RAND 473-86 (1985).

- 18 The result that rivals firms' prices increase from the pre-merger equilibrium to the post-merger equilibrium in Bertrand models with product differentiation depends upon properties of the demand curve and the shape of the marginal cost curve. If marginal costs are constant or increasing, a sufficient condition is that the cross derivative of demand is small.
- 19 Justine S. Hastings & Richard J. Gilbert, *Market Power, Vertical Integration, and the Wholesale Price of Gasoline*, 53(4) J. INDUS. ECON. 469-492 (December 2005).
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- 23 Chouinard, *supra* note 11.
- 24 Christopher T. Taylor & Daniel S. Hosken, *The Economic Effects of the Marathon-Ashland Joint Venture: The Importance of Industry Supply Shocks and Vertical Market Structure*, 55(3) J. INDUS. ECON 419-451 (2007).
- 25 These wholesale prices are referred to as rack prices in the industry because they are the prices charged at the truck rack where the gasoline is pumped into a delivery truck.
- 26 This is often called a dealer-tank-wagon ("DTW") price because the price of gasoline typically includes a delivery charge. Some independently owned stations enter into long term supply agreements with a refiner and pay a DTW price for gasoline.
- 27 Bulow, *supra*, note 12, at 121-149.
- 28 Taylor, *supra* note 24.
- 29 *Id.*
- 30 Taylor and Hosken note that DTW prices fell relative to observed rack prices, suggesting that not all retailers felt a wholesale price increase.
- 31 This issue is addressed at length in three recent hospital merger retrospectives: Debra Haas-Wilson & Christopher Garmon, *Two Hospital Mergers on Chicago's North Shore: A Retrospective Study*, Bureau of Economics Working Paper, Federal Trade Commission (2009); Steven Tenn, *The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction*, Bureau of Economics Working Paper, Federal Trade Commission (2008); and Aileen Thompson, *The Effects of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover Cape Fear Transaction*, Bureau of Economics Working Paper, Federal Trade Commission 2009.
- 32 Robin A. Prager & Timothy H. Hannan, *Do Substantial Horizontal Mergers Generate Significant Price Effects? Evidence from the Banking Industry*, 46(4) J. IND. ECON. 433-52 (1998).
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- 34 Tenn, *supra* note 31.

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- 40 Jonathan B. Baker & Timothy F. Bresnahan, *The Gains from Merger or Collusion in Product-differentiated Industries*, 33(4) *J. INDUS. ECON.* 427-44 (1985).
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- 50 Orley C. Ashenfelter, David Ashmore, Jonathan Baker, Suzanne Gleason, & Daniel S. Hosken, *Empirical Methods in Merger Analysis: Econometric Analysis of Pricing in FTC v. Staples*, *INT'L J. ECON. BUS.* (2006).
- 51 In Mark D. Manuszak & Charles C. Moul, *Prices and Endogenous Market Structure in Office Supply Superstores*, 56 *J. INDUS. ECON.* (2008), the authors also estimate a reduced form pricing equation for Staples which allows for the endogeneity of market structure and find qualitatively similar results to Ashenfelter, et al.



Why We Need to Measure the Effect of Merger Policy and How to Do It

Dennis W. Carlton

Why We Need to Measure the Effect of Merger Policy and How to Do It

*Dennis W. Carlton**

In this article, I explain the inadequacy of our current state of knowledge regarding the effectiveness of antitrust policy towards mergers. I then discuss the types of data that one must collect in order to be able to perform an analysis of the effectiveness of antitrust policy. There are two types of data one requires in order to perform such an analysis. One is data on the relevant market pre- and post-merger. The second is data on the specific predictions of the government agencies about the market post-merger. A key point of this article is to stress how weak an analysis of only the first type of data is. The frequent call for retrospective studies typically envisions relying on just this type of data, but the limitations of the analysis are not well-understood. As I explain below, retrospective studies that ask whether prices went up post-merger are surprisingly poor guides for analyzing merger policy. It is only when the second type of data is combined with the first type that a reliable analysis of antitrust policy can be carried out. There is a need both to collect the necessary data and to analyze it correctly.

*Booth School of Business, University of Chicago, National Bureau of Economic Research

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I. Introduction—The Need for Measures

The antitrust policies of the United States should be reviewed periodically to make sure that these policies are promoting—not impeding—competition. The recent Antitrust Modernization Commission performed just such a function and concluded that U.S. antitrust policy was basically sound, though the report makes a number of recommendations for improvement.¹ That report relied largely on the qualitative judgment of learned practitioners and scholars. Although the qualitative judgment of such people is important, it is no substitute for quantitative studies and measures. The dearth of such studies and measures means that there is no reliable guide for determining whether our antitrust policy is too lax in some areas and too stringent in others.

I will concentrate my discussion about measures of antitrust policy effectiveness on merger policy because there are numerous merger investigations each year, and therefore a quantitative study of merger policy is possible. This is not true of non-merger policy where at most a handful of cases are brought by government antitrust authorities each year. I will focus on the mergers that the government chooses to investigate (e.g., those that receive a second request for information under the Hart-Scott-Rodino Act) and assume that the others raise no competitive concerns. This is, of course, a simplification, but not an unreasonable one, especially for an initial analysis of the problem.

In this article, I explain the inadequacy of our current state of knowledge regarding the effectiveness of antitrust policy. I then discuss the types of data that one must collect in order to be able to perform an analysis of the effectiveness of antitrust policy. There are two types of data one requires in order to perform such an analysis. One is data on the relevant market pre- and post-merger. The second is data on the specific predictions of the government agencies about the market post-merger. A key point of this article is to stress how weak an analysis of only the first type of data is. The frequent call for retrospective studies typically envisions relying on just this type of data, but the limitations of the analysis are not well-understood. As I explain below, retrospective studies that ask whether prices went up post-merger are surprisingly poor guides for analyzing merger policy. It is only when the second type of data is combined with the first type that a reliable analysis of antitrust policy can be carried out. There is a need both to collect the necessary data and to analyze it correctly.

ALTHOUGH THE QUALITATIVE JUDGMENT OF SUCH PEOPLE IS IMPORTANT, IT IS NO SUBSTITUTE FOR QUANTITATIVE STUDIES AND MEASURES. THE DEARTH OF SUCH STUDIES AND MEASURES MEANS THAT THERE IS NO RELIABLE GUIDE FOR DETERMINING WHETHER OUR ANTITRUST POLICY IS TOO LAX IN SOME AREAS AND TOO STRINGENT IN OTHERS.

II. Why a Comprehensive Study of Antitrust Is Needed

Several commentators feel passionately that antitrust is too lax (e.g., *New York Times*) while some claim just the opposite (e.g., *Wall Street Journal*), but passion is no substitute for evidence. By evidence I mean numbers or studies relying on quantitative data. Imagine that the Federal Reserve Board was trying to control the rate of inflation but did not have access to price statistics. Instead it relied on the opinions of a few non-randomly chosen shoppers about how fast they thought prices were rising. I suspect that the Fed would do a much poorer job of controlling inflation than it now does. Moreover, it is possible that, in the absence of reliable quantitative information, monetary policy could be heavily influenced or could be perceived to be influenced by the ideological views of the people running the Federal Reserve Board.

There are some data on antitrust but they mainly relate to the frequency of enforcement actions, such as the number of cases brought. Those numbers are often analyzed, yet knowing how many cases are brought tells one little about whether there are too few or too many cases brought, and whether the right cases are being brought. Unfortunately, the problem of figuring out what statistics to collect in order to determine whether antitrust policy is working well is a much

THOSE NUMBERS ARE OFTEN ANALYZED, YET KNOWING HOW MANY CASES ARE BROUGHT TELLS ONE LITTLE ABOUT WHETHER THERE ARE TOO FEW OR TOO MANY CASES BROUGHT, AND WHETHER THE RIGHT CASES ARE BEING BROUGHT.

harder problem than the Fed faces in its price data collection efforts. I suggest below what statistics one should collect, and describe the type of analyses one could perform with such data. Surprisingly, the analysis is anything but straightforward. Simple tests, based on sensible intuition, turn out to be misleading, while slightly more refined tests work well.

A fundamental question facing enforcement officials is whether their current merger policy is too lax or too stringent. This question is different from whether a particular merger enforcement decision is correct. It is rather asking whether the government is allowing too many or too few mergers overall. Specifically, is the government analysis of mergers systematically biased? The answer to this question requires one to identify the types of government analyses that are correct and those that are wrong and the circumstances that lead to the most errors. Because this question deals with overall policy, it can only be answered by systematically examining all (or a sample of) mergers. Determining whether, in one particular case, the government turned out to be correct or not tells one very little about whether overall government policy should be altered. Indeed, even if the government policy is set exactly right, it would still be true that the government would make random errors in cases.

Although it would be desirable to minimize such errors, it is not true that the presence of such errors indicates a systematic bias in policy.

This last point, though perhaps obvious, often seems to get ignored when one hears the frequent calls for retrospective studies of past mergers. Because it is an important point, I will highlight it and other key points by labeling them “Result.”

Result 1: A retrospective study of an individual merger tells the analyst nothing about whether there is a *systematic* bias in antitrust policy. At most, the analyst can learn whether a particular merger turned out to harm consumers. But even that observation tells one little about whether the decision to allow the merger was a wise one based on the information available at the time of the merger. Even a merger that has a zero-predicted price increase will turn out, for random reasons, to raise price about half the time.

A RETROSPECTIVE STUDY OF AN INDIVIDUAL MERGER TELLS THE ANALYST NOTHING ABOUT WHETHER THERE IS A SYSTEMATIC BIAS IN ANTITRUST POLICY.

In the next section, I first discuss the types of measures that one might use to gauge the effectiveness of merger policy and the accuracy of the merger analysis that government agencies use. I then discuss biases that are likely to arise when analyzing such measures. Failure to use information about whether mergers are challenged causes one to reach incorrect conclusions. This last point, which has to do with what economists call a self-selected sample, seems to have escaped notice and causes retrospective merger reviews to be quite imprecise guides to policy. Subsequent sections show how to apply the analysis to increasingly realistic settings.

III. The Sample Selection Problem and How to Do the Analysis Correctly

There are two types of data one needs to evaluate antitrust policy. The first is market data pre- and post-merger. The second is the enforcement agency’s predictions of the merger. Any analysis of the data must account for the fact that the merger data one examines—and, to repeat, I only look at mergers that have received a “second request” for more information—already reflects a decision by the government agency about whether to challenge the merger. Virtually all of the data on mergers will represent mergers that the Department of Justice (“DOJ”) has decided not to challenge.² Therefore, as is now well-understood given the work of Nobel Laureate James Heckman and others, an analysis based on such a sample may yield misleading results unless one explicitly understands the implications of how the sample is chosen. Let me explain.

Suppose that a merger is proposed and that if the merger goes through the expected price change, ΔP , due to the merger (i.e., the unbiased prediction made

at the time of the merger evaluation of what the post-merger price change will be) is drawn from some underlying probability distribution (e.g., see Figure 1), *ceteris paribus*. (For simplicity, normalize the initial price to 100 so that ΔP can be thought of as a percentage price change.) If the government agency knew this ΔP , then it would allow the merger if $\Delta P \leq 0$ and would challenge the merger if $\Delta P > 0$. This would be the optimal merger policy.³ Of course, the government could be a poor predictor of ΔP and may make a systematic error, S , in forming predictions. If ΔP_{DOJ} is the DOJ's prediction of ΔP , then

$$\Delta P_{\text{DOJ}} = \Delta P + S. \tag{1}$$

If $S > 0$, the DOJ is systematically biased. It always overpredicts ΔP and therefore is too stringent in challenging mergers. If $S < 0$, the DOJ is systematically biased in under-predicting ΔP , and is therefore too lax in allowing mergers.

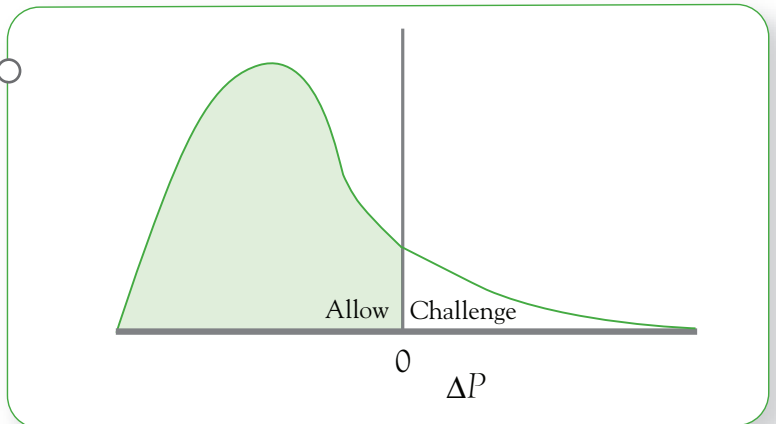
THERE ARE TWO TYPES OF DATA ONE NEEDS TO EVALUATE ANTITRUST POLICY. THE FIRST IS MARKET DATA PRE- AND POST-MERGER. THE SECOND IS THE ENFORCEMENT AGENCY'S PREDICTIONS OF THE MERGER.

Consider the case where $S = 0$. The shaded part of Figure 1 below indicates which mergers the government allows to go through unchallenged. Since all mergers in the shaded part have $\Delta P \leq 0$, an analysis of unchallenged mergers will reveal that on average ΔP is not zero, as some might expect, but negative!

Result 2: If the government is unbiased ($S = 0$), retrospective studies of unchallenged mergers should be expected to indicate that, on average, post-merger price falls. Similarly, if the government is too stringent ($S > 0$), an analysis of unchallenged mergers should be expected to indicate that post-merger prices fall, since the only unchallenged mergers are those with negative ΔP less than $-S$. Therefore, one cannot conclude that merger policy is too stringent merely from observing that post-merger prices fall.

Figure 1

Probability Distribution of ΔP



Result 3: If the government is too lax ($S < 0$), then it is still quite possible that $E(\Delta P) < 0$ where $E(\Delta P)$ is the expectation across all unchallenged mergers of ΔP conditional on a merger being unchallenged.

The reason for Result 3 is easy to see in Figure 1. If the boundary between “allow” and “challenge” moves away from 0 and to the right ($S < 0$),⁴ then it will still be the case that many unchallenged mergers will have $\Delta P < 0$. Only when S gets sufficiently large negatively will $E(\Delta P) > 0$. We therefore have:

Result 4: For a sufficiently biased policy ($S < 0$) of laxity, $E(\Delta P) > 0$.

The consequence of Results 2-4 is that retrospective studies of price change that focus on the average price change will not be a very good way of evaluating merger policy. It is correct that if one finds that ΔP is, on average, positive, then we know the government policy is too lax, but this is a very weak test. The reason is that we know from Result 3 that retrospective studies of price change can show negative price increases even if the government policy is too lax.

THE CONSEQUENCE OF RESULTS 2-4 IS THAT RETROSPECTIVE STUDIES OF PRICE CHANGE THAT FOCUS ON THE AVERAGE PRICE CHANGE WILL NOT BE A VERY GOOD WAY OF EVALUATING MERGER POLICY.

A much better test of government bias would be to combine pre- and post-merger price data, ΔP , with the DOJ’s predicted price changes, ΔP_{DOJ} , and then explicitly calculate S . Notice that from the way equation (1) is set up, the average of ΔP_{DOJ} minus ΔP over all unchallenged mergers will precisely estimate S (in fact, given the model’s assumptions, the difference between ΔP_{DOJ} and ΔP will precisely estimate S for each merger).

We have:

Result 5: The bias S in equation (1) can be estimated as the difference between ΔP_{DOJ} and ΔP across all unchallenged mergers.

Notice that from the simple assumptions underlying equation (1), it follows that S is estimated correctly for each merger as $\Delta P_{\text{DOJ}} - \Delta P$. The contrast between the precision in Result 5 and imprecision in Results 2 or 3 emphasizes why combining pre- and post-merger data with data on the enforcement agency’s assessment is necessary to avoid the imprecision of Results 2 or 3. (In Section V, I show that the same type of results survives in a more realistic setting in which the bias is regarded as a random variable.) According to Result 2, one cannot conclude that antitrust policy is too stringent merely by observing whether price falls post-merger. According to Result 3, retrospective merger studies may fail to detect a lax antitrust policy because retrospective studies may not show a post-merger price increase. Although I have shown the limitation of retrospective merger studies for drawing policy conclusions, I do not wish to suggest that they should

not be done. As my results show, such studies can sometimes provide useful information, though there have been surprisingly few such studies.⁵ But Result 5 shows that any systematic bias in antitrust policy will be reliably detected by more careful studies that combine pre- and post-merger data with data on the DOJ predictions at the time of merger.⁶

IV. Evaluation of Antitrust Analyses

The previous section explained the need to combine pre- and post-merger data with data on the DOJ's merger evaluation. The discussion focused for simplicity only on price. But, of course, during the course of an investigation there are many types of analyses that are done. Each of them can be analyzed for their accuracy, as I now explain.

In many merger investigations, considerations of entry, product repositioning, ability of buyers to vertically integrate, and predictions of price and market share from merger simulations are all used to guide the analysis. Yet we have few, if any, studies investigating the validity of any of these analysis types. For example, suppose that in some of the unchallenged mergers, one finds that the reason for the government agency not challenging the merger is related to the likelihood of entry. We should test whether, in fact, entry turns out to be an important constraining effect on price. How often does entry occur in cases where it is alleged to be easy and therefore a tight constraint on price? When it does not occur, is that because price did not rise? Do government agencies too willingly accept claims that entry can constrain price?

Similarly, in cases where the government relies on merger simulation, how well do the price predictions and market-share predictions turn out? In cases where the government relies on product repositioning, does such repositioning, in fact, occur after the merger? How does the frequency of large buyers using vertical integration as a means to protect themselves against price increases compare to the frequency of the government's reliance on vertical integration as a constraint on a merger's ability to raise price? Again, when it does not occur, is that because price did not rise? Without such studies, there is no way to judge and improve the analysis underlying most merger policy.

In order to perform these types of studies, the DOJ at the end of each merger investigation should fill out a data sheet that summarizes each of their analyses, including price, entry, and product predictions, so that their predictions can be compared to actual industry behavior. Of course, one would have to account for how conditions post-merger have changed (e.g., cost may have exogenously risen, demand conditions may have changed, product quality may have changed, etc.) and figure out how that would change the DOJ predictions, but that type of adjustment is routinely done in econometric studies. Such adjustments no doubt complicate the analysis, but are essential.

V. Extension of Results—A More Realistic Model

In this section, we show that our major results persist in a more realistic and complicated model of bias. We also discuss how to use a dataset on challenged mergers in addition to the dataset on unchallenged mergers.

A. ALLOWING BIAS TO BE RANDOM

Using the same notation as before, I previously defined S , the systematic bias, by equation (1):

$$\Delta P_{\text{DOJ}} = \Delta P + S. \quad (1)$$

Notice that in equation (1), ΔP_{DOJ} and ΔP are both expected prices—not the actual price in the future. In fact, there will typically be many new events that occur between the time of the merger review when the predictions are formed and the time when the actual price is observed. For any particular merger, *ceteris paribus*, the relation between the actual price change, ΔP^* , and the predicted is

$$\Delta P^* = \Delta P + E, \quad (2)$$

where E is a random variable with expectation 0, independent of ΔP . If one can observe ΔP^* for many mergers, then it follows that an estimate of the average ΔP will be given by the average of ΔP^* across all mergers since the average of E will, in expectation, equal 0. The upshot is that the addition of E in equation (2) creates no estimation complications and the procedure described in the earlier section where we ignored E is a valid one for calculating expected price changes.⁷

Equation (1) has the unrealistic implication that the DOJ is off by exactly S in its expected price prediction in each merger. A more realistic model would allow for any systematic bias to be random across mergers, but to have a common average, S . For example, one can think of the DOJ being systematically biased upward in its price predictions on average, but on some mergers it is less so, while others it is more so. For example, one could think of the economist choosing one of many modeling techniques and that the randomness arises because the modeling techniques vary. We therefore rewrite equation (1):

$$\Delta P_{\text{DOJ}} = \Delta P + S + \eta, \quad (3)$$

where η is a random error independent of ΔP and S with expectation equal to 0.

The consequence of this more realistic set-up is that the simplicity of Figure 1 disappears (or is reduced) and a more sophisticated analysis is required. The reason the simplicity vanishes is because the set of unchallenged mergers will now be more complicated to determine than in Figure 1. For example, if $S = 0$, then under the previous assumptions, as Figure 1 shows, the set of all unchallenged

mergers are those in the shaded area to the left of the $\Delta P = 0$ line. Now, however, it is possible that some merger where $\Delta P < 0$, may be challenged if the error η is sufficiently positive. The probability that a merger is challenged will still be monotonic in ΔP , but it will not be either 0 or 1 as in Figure 1. Similarly, a very bad merger (ΔP very high) has a chance of being unchallenged if η is sufficiently negative.

The net effect is that unlike before where

$$E(\Delta P \mid \text{unchallenged}) = \int_{-\infty}^0 \Delta P f_{\Delta P} d(\Delta P) < 0, \tag{4}$$

now,

$$E(\Delta P \mid \text{unchallenged}) = \int_{-\infty}^{\infty} \Delta P f_{\Delta P} \lambda(\Delta P) d(\Delta P), \tag{5}$$

where,

$f_{\Delta P}$ = the probability density of ΔP , and

$\lambda(\Delta P)$ = probability a merger with actual predicted price increase of ΔP will go unchallenged.

Still assuming for illustration purposes that $S = 0$, it is straightforward to calculate $\lambda(\Delta P)$ as the probability that $\Delta P_{\text{DOJ}} \leq 0$ or that $\Delta P + \eta \leq 0$ or $\eta \leq -\Delta P$ which can be written as

$$\lambda(\Delta P) = \int_{-\infty}^{-\Delta P} f_{\eta}(\eta) d\eta < 1,$$

where $f_{\eta}(\eta)$ is the probability density of η .

$\lambda(\Delta P)$ is monotonic in ΔP . By comparing equation (4) to equation (5), we notice that negative ΔP 's in equation (4) no longer receive a weight of 1, but instead the lower weight, $\lambda(\Delta P)$, and positive ΔP 's no longer receive a weight of 0, but instead the positive weight $\lambda(\Delta P)$. This means that having randomness in η will tend to increase any estimate of the post-merger price increase. Indeed,

IN OTHER WORDS, EVEN IF THERE IS NO SYSTEMATIC BIAS AT ALL IN THE DOJ'S PREDICTIONS, RETROSPECTIVE STUDIES COULD VERY WELL SHOW THAT THERE ARE ON AVERAGE PRICE INCREASES FOR UNCHALLENGED MERGERS.

depending on the distribution of η , one could observe a post-merger price increase even though $S = 0$. In other words, even if there is no systematic bias at all in the DOJ's predictions, retrospective studies could very well show that there are on average price increases for unchallenged mergers. This confirms the results from the earlier analysis that retrospective merger studies that focus only on the average of ΔP are quite weak in their implications for the evaluation of merger policy. The intuitive reason for this last result is that those mergers that are unchallenged will tend to be dominated by those where the DOJ was

quite weak in their implications for the evaluation of merger policy. The intuitive reason for this last result is that those mergers that are unchallenged will tend to be dominated by those where the DOJ was

unusually low (negative η) in their price predictions and accordingly allows some mergers with high ΔP to get approved. If there are many such mergers with high ΔP , then the average ΔP over unchallenged mergers will be positive.

The following simple numerical example illustrates the point. Suppose that $S = 0$, so that the DOJ is unbiased. Suppose that ΔP can take on one of two values with equal probability, $\$-5$ or $\$10$. In the absence of η , the DOJ would challenge the merger with $\Delta P = \$10$ and leave unchallenged the merger with $\Delta P = \$-5$. Retrospective studies of unchallenged mergers will show that post-merger pricing is $\$5$ below pre-merger levels. Now suppose that we introduce the error η which takes on one of two values $\$-11$ or $\$+11$ with equal probability. There are now two possibilities for each merger outcome. For the merger where $\Delta P = \$-5$, the DOJ will predict a price change of either $\$-16$ or $\$+6$, so it allows that merger to go through with probability $\frac{1}{2}$. Similarly for the merger with $\Delta P = \$10$, the DOJ will predict a price change of either $\$-1$ or $\$21$, so again it allows the merger to go unchallenged with probability $\frac{1}{2}$. Hence, even when merger policy is unbiased ($S = 0$), retrospective studies of unchallenged mergers will now find that on average the price increase is $\frac{1}{2}(-5) + \frac{1}{2}\$10 = \$2.5$! This example is meant to be illustrative only. However, it underscores the limitations of the inferences that one can draw about merger policy from retrospective studies.

In the earlier analysis, I showed how a combination of pre- and post-merger data together with data from the DOJ analysis can provide a much better guide to assessing merger policy than retrospective studies alone. Does that remain true in the more sophisticated model? The answer is yes, though with some caveats.

For any proposed merger, it follows from equation (3) that

$$S = \Delta P_{\text{DOJ}} - \Delta P - \eta. \quad (6)$$

For mergers that are not challenged, we know that $\Delta P_{\text{DOJ}} \leq 0$, or $\Delta P + S + \eta \leq 0$, or

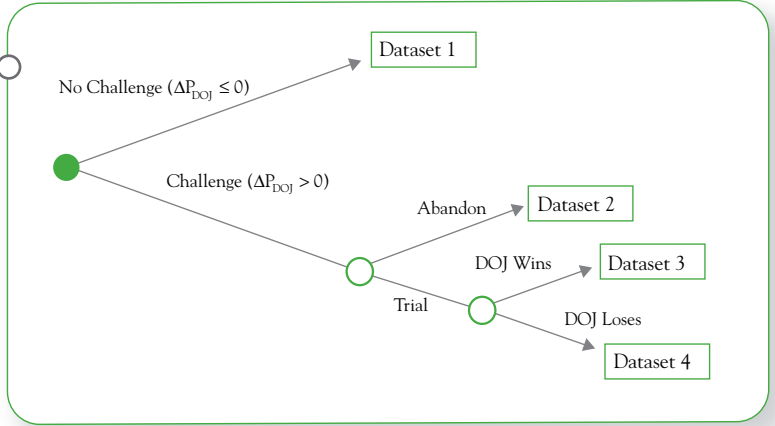
$$\eta \leq -(\Delta P + S). \quad (7)$$

This means that for unchallenged mergers the upper tail of η is not observed, and hence it will not be true that $E(\eta) = 0$. Instead η will be skewed toward being negative and hence $E(\eta \mid \text{unchallenged merger}) < 0$. Therefore, if one estimates S by averaging $\Delta P_{\text{DOJ}} - \Delta P$ over all unchallenged mergers, it follows from equations (6) and (7) that the estimate, \bar{S} , of S will have the property that $E(\bar{S}) < S$. In other words, in the more realistic model of this section, it becomes more difficult than before to estimate S even when one combines pre- and post-merger data with data on DOJ predictions. Because of the self-selected nature of the set of unchallenged mergers, the best one can do, without resorting to more sophisticated modeling, is to obtain an estimate of a lower bound on S . If that lower bound is positive, then we know that antitrust policy is too stringent ($S > 0$). If that lower bound estimate, \bar{S} , is negative, we are unable to say very much

about whether antitrust policy is too lax ($S < 0$) or too stringent ($S > 0$) since either is consistent with $\bar{S} < 0$. However, if one is willing to impose some additional structure on the distribution function of η (e.g., η follows a normal distribution with mean 0 and variance σ^2),⁸ then, under certain circumstances, one can estimate S directly, just as before.

Figure 2

Possible Outcomes



B. CHALLENGED MERGERS—ANOTHER SELF-SELECTED SAMPLE

Finally, we turn to another selected sample that we have so far ignored—namely those mergers that are challenged, go to court, and are allowed to proceed. To understand why this is the only other available data set for analysis, consider Figure 2 which diagrams the major possible outcomes from merger investigations. If the DOJ predicts—perhaps after a “fix” to the terms of the merger—no price increase from the merger, ($\Delta P_{DOJ} \leq 0$), then the merger is unchallenged and goes forward. This set of mergers provides data (labeled dataset 1 in Figure 2) that we have already discussed extensively. But in addition to unchallenged mergers, there are mergers that the DOJ challenges ($\Delta P_{DOJ} > 0$). In those, several outcomes are possible, as Figure 2 illustrates. The parties could alter their proposed merger so that the new merger is unchallenged and thereby becomes part of dataset 1.⁹ The parties could abandon the merger, leading to dataset 2 which contains no information on completed mergers. Alternatively, the parties could go to court, and the court could enjoin the merger. This set of mergers, dataset 3, also contains no information on completed mergers. The final possibility is that the court sides with the merging parties and allows the merger to go through. This set of mergers—that we have ignored so far—comprise dataset 4 which we now analyze.

The set of mergers in dataset 4 resulting from unsuccessful court challenges is a self-selected sample, like dataset 1. It represents mergers that have the property that $\Delta P_{DOJ} > 0$. The analysis of dataset 4 has some similarities to that for dataset 1, though there is now the complication of the court’s decision. In the

case where the DOJ bias is non-stochastic (i.e., equation (1)) and under the assumption that the court is unbiased, the court will allow a merger to proceed only if $\Delta P \leq 0$. Hence, we return to a similar type of result that we had previously in that the expected price change of a completed (challenged) merger pre- and post-merger should be negative. But this time, this finding is independent of S since the court is deciding which mergers go forward. Again, as before, S can be calculated assuming one also has data on the DOJ predictions. [Even if one does not have data on ΔP_{DOJ} , one does observe that the DOJ decided to sue ($\Delta P_{\text{DOJ}} > 0$) and one also observes that the court has concluded that $\Delta P < 0$. Even if one does not observe ΔP_{DOJ} , one can, with sufficient structure on the model, estimate S in a manner similar to that described in endnote 6.]¹⁰

If we now add the complication that the bias, $S + \eta$, is stochastic with η being random with mean 0, we obtain from equation (3) that the challenged mergers that comprise dataset 4, have the property that $(S + \eta)$ will tend to be above average. The reason is that for a challenged merger $\Delta P_{\text{DOJ}} > 0$, which implies $\Delta P + (S + \eta) > 0$, or $S + \eta > -\Delta P$, or that the expectation of η will be positive (i.e., $\eta > -(S + \Delta P)$), since it is truncated at the lower end. Intuitively, this occurs because the DOJ is likely to lose in court when it is overly stringent ($S + \eta$ is large). Therefore, if one tries to estimate S as $\bar{S} = \text{average of } \Delta P_{\text{DOJ}} - \Delta P$, one will obtain an estimate of S that is on average too high ($S < \bar{S}$) and so is an upper bound. If \bar{S} is negative, one can say that antitrust policy is too lax ($S < 0$), but cannot reach such definitive statements if $\bar{S} > 0$ because either a positive or negative S is consistent with a positive \bar{S} . Just as before, it is possible to put a bit more structure on the problem to account for the truncation of η (see endnote 6), and then estimate S .

Finally, there may have been so few litigated cases that estimating S may suffer from small sample estimation problems.

Although I have discussed analyzing datasets 1 and 4, I note that there are other sub-samples of the data that one might think of separately analyzing.¹¹ I list a few suggestions below:

1. For dataset 1, isolate those mergers that were fixed in response to DOJ concerns. Do those mergers differ from the others in dataset 1 in terms of *ex post* merger consequences?
2. For dataset 1, compare the systematic bias and accuracy of price predictions in mergers involving specific types of industries (e.g., those with rapid technological change) or time periods (e.g., Republican vs. Democratic administrations). Specifically, one can attempt to model S as a function of industry and other characteristics.
3. For datasets 2 and 3, what happened to industry concentration after the transaction failed?

4. The Federal Trade Commission (“FTC”) is organized a bit differently than the DOJ. For mergers handled by the FTC, one could define various samples depending on the votes of the five FTC Commissioners.

VI. Conclusion

Without quantitative measures of the effectiveness of merger policy and of the accuracy of the government’s analyses underlying merger policy, judgments about the appropriate antitrust policy will be based on qualitative information that can be subject to alternative interpretations. Merger policy can be an important force for either promoting or impairing competition. Merger policy is too important a policy to let it be set in the absence of detailed quantitative studies of its effects on price and other dimensions of competition. The government agencies should embark on such studies immediately and, if they lack the authority to either collect the data or study it, they should seek it.

Antitrust analysis of individual cases has become increasingly sophisticated. Evaluation of antitrust policy has not. There is a need to gather post-merger industry data and a need to gather the predictions of DOJ merger analysis in order to evaluate whether U.S. policy and analysis can be improved. Strong opinions are not substitutes for quantitative analysis. ▼

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- 1 Antitrust Modernization Report, 2007, available at http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm.
 - 2 I discuss in Section V how to use data on challenged mergers. For simplicity, I use the DOJ as the government agency responsible for mergers. What I say obviously applies also to the FTC.
 - 3 With fixed cost of litigation, one might want to require a positive ΔP , but this is a detail for the point being made in the text. Indeed, the government can challenge a merger only if it “substantially” lessens competition. I am, for simplicity, assuming that the DOJ is using a consumer (not total) surplus standard.
 - 4 If the government is lax (e.g., $S = -5$), then it will allow a merger where $\Delta P = \$5$. Hence, the boundary in Figure 1 between “challenge” and “allow” moves to the right to $\Delta P = \$5$.
 - 5 Orley Ashenfelter & Daniel Hosken, The Effect of Mergers on Consumer Prices: Evidence from Five Selected Case Studies, *NBER WORKING PAPER 13859*, 2008, is a recent exception.
 - 6 In the absence of data on DOJ predictions, it might still be possible to estimate S . If one can observe ΔP for each unchallenged merger, then one can draw the distribution of ΔP . Under the assumptions in the text, the largest observed value of ΔP will approximate $-S$. To see this, notice in Figure 1 that the line $\Delta P = -S$ is the dividing line between the area labeled “challenge” and “allow” when $S \neq 0$. Because ΔP is an expectation, not an actual value, the method just described needs to be adjusted slightly. I discuss this adjustment in Section V. Estimating S as described in the text is likely to produce more accurate estimates of S since it utilizes more data.
 - 7 The addition of a stochastic component, E , means that the procedure to estimate S described in end-note 6 needs to be modified. The actual distribution of ΔP^* for unchallenged mergers is a mixture of

the distribution of ΔP (truncated at $\Delta P = -S$) and the distribution of E . Under certain assumptions on the distributions, one can estimate the (truncated) distribution of ΔP and then estimate S as $\max -\Delta P$.

- 8 If one is willing to define a distribution on η , one could estimate S by maximum likelihood while simultaneously accounting for the truncation in η . Other estimation techniques also exist. See, e.g., WILLIAM GREENE, *ECONOMETRIC ANALYSIS*, Ch. 22 (2003), for how econometric techniques can be used to handle this problem. Using similar techniques, one could attempt to correct for the self-selected nature of a post-merger sample, if one lacked information on ΔP_{DOJ} , and one wanted to do a retrospective merger study of prices. For example, one could postulate that $\Delta P = \eta_1$ and that ΔP is observed only if $X\beta + \eta_2 > 0$ where (η_1, η_2) are jointly normal and X is a vector of characteristics (e.g., HHI, industry profitability) that predict whether the DOJ fails to challenge the merger. One could, for example, estimate a probit model to predict a decision not to challenge and perform a "Heckman" correction. (*Id.*, Ch. 22).
- 9 The group of unchallenged mergers that have been "fixed" might be an interesting one to study separately.
- 10 A more complicated model for dataset 1 could analyze the decision of the merging parties to settle (fix the case or abandon it) based on what their estimates of winning in court are. This would provide additional information to estimate S .
- 11 A specific issue that I do not address is that the underlying distribution of ΔP may depend on S . For example, as merger policy becomes lax, more mergers with high ΔP may be attempted. This means that the distribution of ΔP from merger activity and S should be modeled together. This is a topic for future research.



Assessing the Quality of Competition Policy: The Case of Horizontal Merger Enforcement

William E. Kovacic

Assessing the Quality of Competition Policy: The Case of Horizontal Merger Enforcement

*William E. Kovacic**

This article suggests how a jurisdiction might best go about evaluating the quality of its competition policy system. It urges that competition agencies and collateral institutions strive to improve the ability to measure the economic effects of merger control and to verify the consequences of different approaches to enforcement. The article uses merger control in the United States as its main illustration, but the article's observations apply to other areas of competition policy oversight, as well. The article seeks to encourage the recent trend within the global competition policy community of accepting a norm that focuses greater attention on the evaluation of the economic effects of enforcement decisions—especially by developing better quantitative measures of actual economic effects—and the assessment of the processes by which competition agencies examine individual transactions.

*The author is a Commissioner of the U.S. Federal Trade Commission, on leave from the George Washington University Law School. The views expressed here are the author's alone.

I. Introduction

Horizontal merger policy is an important focus of contemporary discussions about the quality of competition policy.¹ It should be. Horizontal merger policy attempts to forestall combinations that otherwise would permit the merged entities to exercise substantial market power, and it tries to curb the creation of market environments that encourage coordination by rival firms through tacit coordination or the formation of express agreements. Because society also has a major stake in allowing business restructurings that improve economic performance, both in individual transactions and in the preservation of a robust market for corporate control, merger policy ought to go about these tasks without blocking combinations that are benign or procompetitive.

The fulfillment of these objectives has important links to other areas of competition law.² If merger control misses the dominance issue, mergers can create durable market power with consequent adverse effects on prices, quality, and innovation. If merger control overlooks a transaction's contribution to oligopolistic interdependence, a merger can contribute to a market configuration in which the surviving firms either find it easier to establish effective cartels by a direct exchange of assurances or to use indirect means to realize the results that express agreements yield. Because competition law has not addressed dominance or tacit collusion with great success, it matters that merger policy make proper choices about when to intervene.³

In most jurisdictions, the competition agencies evaluate transactions before the parties complete them.⁴ This process is unavoidably predictive and, in a number of instances, speculative. In a wide range of matters, no analytical calculus provides a sure way to distinguish transactions that pose anticompetitive dangers from those which promise to be benign or procompetitive. The examination of a proposed transaction often involves difficult, probabilistic assessments of future commercial developments. This is especially true in markets that display high levels of dynamism owing to technological or organizational innovation, or to developments in trade, transport, and communications that link previously isolated geographic regions into unified commercial markets.

Each possible course of action by a competition agency poses risks. Block the deal improvidently, and valuable economic benefits from consolidation are lost. Accept the wrong divestitures or conduct-related undertakings as conditions of allowing the deal to proceed, and the agency creates an illusion of effective intervention that masks future anticompetitive results. Unwisely allow the deal to proceed as proposed, and consumers suffer the costs of diminished economic performance. The public statements of agencies concerning specific decisions to intervene or take no action ordinarily either acknowledge no risks associated with the choice taken or assert that all risks were thoughtfully and correctly weighed. It takes a high and unusual level of institutional self-assurance to state that the chosen course of action could be wrong.

Seen in the aggregate, public enforcement decisions over time reflect more humility about the analytical quandaries and difficult judgments associated with merger control than do the agencies' portrayal of individual episodes of review. The history of merger review has featured what best can be seen as a series of experiments through which the public agencies have used various analytical and procedural measures to improve the accuracy of the predictive process. Modern commentary tends to accept the view that contemporary analytical methods are superior to predecessor techniques, but that may be because many contemporary commentators played some part in creating the modern techniques. The field is still a work in progress, and much remains to be done to improve procedures and substantive analysis, particularly for what might generally be labeled as the hard cases.

So how are we to tell if a competition system is doing a good job of the important, forward-looking exercise of merger control? A popular and seemingly irresistible technique is to measure the worth of a competition agency by studying how often it blocks deals, allows deals, or subjects proposed transactions to elaborate analysis.⁵ Commentators lean on this method so often and so heavily that they forget its frailties. To say that an agency is doing a lot of things or only a few things does not tell us whether it is doing the right things. In sport, coaches

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admonish athletes not to equate activity with accomplishment.⁶ So it should be for merger control.

There is a debate worth having, and that is whether antitrust oversight of mergers is improving or retarding economic performance. Answers to questions about actual economic

effects will not emerge from the study of activity levels, unless we bravely (and dubiously) assume that specific levels of enforcement activity invariably or typically beget good results. Especially amid larger contemporary debates about the correct form of government intervention in the economy, we cannot rely on these feeble proxies to assess effectiveness. When competition policy agencies ask external audiences to accept the value of antitrust intervention on faith, they are likely to hear variants of the aphorism: In God we trust; all others provide data.⁷ The relevant data cannot be found in simple counts of merger reviews and challenges.

This article suggests how a jurisdiction might best go about evaluating the quality of its competition policy system. It urges that competition agencies and collateral institutions strive to improve the ability to measure the economic effects of merger control and to verify the consequences of different approaches to enforcement.⁸ The article uses merger control in the United States as its main illustration, but the article's observations apply to other areas of competition policy oversight, as well. The article seeks to encourage the recent trend within the global competition policy community of accepting a norm that focuses greater attention on the evaluation of the economic effects of enforcement decisions—

especially by developing better quantitative measures of actual economic effects⁹—and the assessment of the processes by which competition agencies examine individual transactions.¹⁰

The article begins the treatment of evaluation with several normative propositions about what is good merger policy. Part III sketches the pendulum narrative of modern U.S. antitrust enforcement. This narrative figures prominently in discussions about the quality of U.S. merger policy since the early 1960s and relies chiefly on activity-based measures of efficacy to identify dramatic changes in policy over time. The pendulum narrative attributes the observed variations in activity to changes in political leadership. Part IV suggests future focal points for evaluation and means for assessing the quality of merger review. Among other sources, it draws upon the results of a recently completed self-study of the U.S. Federal Trade Commission (FTC).¹¹

II. What Is “Good” Merger Policy? Three Suggested Criteria

Discussions about competition policy tend in a colloquial way to ask whether public enforcement agencies are doing a “good” job of carrying out their responsibilities. This form of discourse seldom involves a careful specification of what constitutes “good” performance. Expressly or implicitly, levels of enforcement activity are the foundation for judgments.

In the case of merger policy, an appropriate assessment of the quality of merger policy should focus on three criteria. First, has merger policy improved economic performance by reducing the price or improving the quality of goods or services? This is the essential question about the effectiveness of merger policy. It is worth asking and debating regularly. A merger review system accomplishes this result by intervening to correct or preclude transactions that pose serious competitive dangers and by allowing combinations that promise to have benign or procompetitive effects.

The second criterion is whether individual competition systems minimize unnecessary implementation costs within and across jurisdictions. Enforcement agencies should seek to achieve a given level of monitoring and enforcement at the lowest possible cost to society.¹² Among other means, a jurisdiction can eliminate unnecessary burdens associated with its own notification procedures and investigations, promote international standardization based on superior techniques, and raise levels of interoperability across competition systems.

The third criterion is whether a competition system has committed itself to a process of continuous reassessment and improvement.¹³ This has two dimensions. The first deals with the testing and improvement of methods to assess (a) the economic consequences of individual decisions to intervene or not to intervene

and (b) the aggregate effects of a system of merger review. The second involves an examination of the procedures for merger review and an analysis of whether the jurisdiction can achieve a given level of oversight at lower cost. Improvements in both dimensions require competition authorities to make meaningful disclosures about decisions to prosecute or not prosecute, to maintain and reveal informative data sets about activity levels, and to refine techniques—with the agency’s resources and in cooperative ventures with external bodies such as research institutions—for measuring actual economic effects of intervention decisions.

III. Modern U.S. Merger Policy: Alternative Narratives

Discussions about the quality of merger policy ought to dwell upon whether a system of competition law satisfies the criteria sketched above. Such discourse frequently does not. In many instances, assessments of merger policy neither define normative criteria clearly nor apply them systematically. In other cases, problems associated with the measurement of merger enforcement consequences cause commentators to run away from the issue of actual economic effects. The means for determining the economic effects of merger policy are not ideal.¹⁴ In practice, it can be difficult to determine how merger control, in individual cases or across a range of intervention opportunities, affects economic performance.

Owing to problems of measurement, the antitrust community ordinarily succumbs to the temptation to duck the ultimate question of economic effects.¹⁵ Discussions about the quality of merger enforcement instead use a variety of effectiveness proxies. Three stand out. The primary fallback is to trace and analyze levels of activity, such as the total number of government interventions over

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a period of time or the percentage of all transactions in which the competition agency conducts an elaborate inquiry or takes action to modify or block a deal. By this measure, enforcement quality is inferred from rates of action or inaction.

A second popular evaluation technique is to seek out the opinions of practitioners about the quality of the competition authority’s performance. Is it challenging too many deals, or too few? Are remedies too weak or too strong? Does the agency have sound processes in place for sorting out the good and the bad? Compared to other eras of competition policy, is it easier, or more difficult, today to get a merger approved by the enforcement agency?

In principle, practitioner views can be valuable source of information, and commentators and competition authorities ought to seek them out. As present-

ed in the literature on merger control, practitioner views tend to be qualitative, unsystematic, and unverifiable. As a group, the accounts of practitioner views generally provide a haze of unattributed impressions that no outsider can test rigorously. Some commentary offers the vastness of the narrator's own experience as authority that an asserted proposition captures a broad, important reality.¹⁶ Other articles and press reports quote unidentified individuals with the suggestion that the speakers have revealed universal, fundamental truths.¹⁷ There have been some efforts to conduct surveys of larger numbers of practitioners, but these seldom specify or discuss the transactions that provide the basis for the participants' qualitative views, and the identities of the participants invariably are anonymous. The anonymity may be necessary to avoid retribution by a competition agency that dislikes the speaker's opinion, but anonymity also relaxes the speaker's incentives to portray events fully and accurately.

The third approach is to present specific enforcement episodes as exemplars of the competition agency's philosophy about merger control. By offering an exemplar, the commentator asks the reader to draw broader conclusions about whether the competition agency's analytical methods and ultimate conclusions are sound.¹⁸ Case studies can be informative in what they say about the agency's philosophy, analytical perspectives, and methodology. Yet individual enforcement episodes too often are analyzed in isolation. To be reliable as a way to make larger judgments about the quality of merger enforcement, one needs a sufficiently large number of case study observations to know how the agency is performing in any single period or across periods. For example, comparisons of enforcement choices in specific sectors over time can help illuminate adjustments in policy and technique, and can offer insights about how a collection of consolidation events affected sectoral performance.

Activity levels, practitioner perspectives, and the occasional case study provide the main ingredients for discussions of U.S. merger policy. Below I describe the most popular approach—the pendulum narrative—that commentators use to assess the quality of merger policy. In this narrative, federal merger enforcement swings dramatically from extraordinary intervention to extraordinary permissiveness as a consequence of political appointments to the two U.S. antitrust authorities, the Department of Justice (“DOJ”) and FTC. The discussion then presents an alternative interpretation of U.S. experience.

A. THE PENDULUM NARRATIVE OF MODERN MERGER ENFORCEMENT

The leading narrative about modern U.S. antitrust enforcement policy uses the metaphor of a swinging pendulum to describe shifts in the government's approach to intervention.¹⁹ This metaphor is popular among academics, journalists, and practitioners as a way to explain patterns of public antitrust enforcement and to assess the quality of merger control in individual eras. The pendulum narrative posits a fundamental instability in U.S. competition policy. Pendulum narrators attribute this instability largely to changes in the country's political lead-

ership, although streaks of raw enforcement agency irrationality divorced from political forces also receive some credit. Thus, in its attempts “to balance possible threats to competition against merger benefits,” modern U.S. merger policy often “has careened from one extreme to another in this balancing process.”²⁰ This is not a flattering characterization of U.S. experience. Reckless drivers careen. Good public policy does not.

As applied to merger policy, the pendulum narrative divides the modern U.S. enforcement experience into four periods. Public enforcement policy toward mergers is said to have been too aggressive in the 1960s and 1970s, too lenient in the 1980s, just right in the 1990s, and too cold again in the first decade of the 21st century. This mimics the classification scheme first introduced in the account of Goldilocks and her encounter with the three bears: U.S. merger policy is first too hot (1960s-1970s), then too cold (1980s), then just right (1990s), and then too cold again (2000s).

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GOOD PUBLIC POLICY DOES NOT.

Scholarly and popular commentary that embraces the pendulum narrative emphasizes what are said to be indefensible lapses in decision making, other than in the just-right era of the 1990s. In the other periods, government enforcement officials and judges appear incapable of well-reasoned, sober-minded thought. Thus, in the 1960s, federal enforcement policy is set by “antitrust witchdoctors,”²¹ “trust-busting zealots ... who saw evil in every big company or merger,”²² and “excessively intrusive Populists.”²³ With this collection of economic primitives in control, the government agencies “challenged everything.”²⁴

In the pendulum narrative’s depiction of the 1980s, federal enforcement policy swings dramatically away from the mindless interventionism of the 1960s and the “extraordinary activism” of the Carter administration in the 1970s.²⁵ Thus begins the modern ice age of antitrust policy that is Ronald Reagan’s presidency. During the Reagan administration, the federal antitrust agencies “trivialized” the U.S. antitrust laws²⁶ and produced “the most lenient antitrust enforcement program in fifty years.”²⁷ In this era, federal antitrust “[e]nforcement ceased;”²⁸ “U.S. Federal merger enforcement ground to a halt;”²⁹ and the federal agencies achieved the “emasculat[i]on of the nation’s merger policy.”³⁰ The Reagan appointees responsible for these developments were characterized as “extremists”³¹ given to “lawlessness”³²—a “garbage barge of ideologues.”³³ Their influence stemmed from brute political force, not the power of ideas. The Reagan administration’s success in altering U.S. antitrust policy was “largely a political victory, not an intellectual or legal one.”³⁴

In the pendulum narrative, the wild swings in merger policy – from the hyper-active 1960s and 1970s to the indolent 1980s—ceased temporarily in the 1990s. Antitrust policy had a lucid interval during the Clinton administration. Through a series of prosecutions and non-litigation policy adjustments in the 1990s, the federal agencies “restore effective and sensible merger enforcement—avoiding the

undue activism of the 1960s and the extreme under-enforcement of the 1980s.”³⁵ Spurring this temporary transformation was the appointment of new leadership to the federal agencies. “Beginning in the 1980s,” observes one account, “we entered a period of calm on the merger front. This was particularly true at the Federal Trade Commission, which was seen as a sleepy agency. Then along came the appointment of Bob Pitofsky as Chair of the FTC [and] the appointment of Jon Baker as the Director of the FTC’s Bureau of Economics.”³⁶ Through the efforts of these appointees and the guidance of Justice Department officials such as Joel Klein, the enforcement pendulum came to rest at a thoughtful, moderate equilibrium.³⁷ Many authors who say federal enforcement policy attained a sensible, moderate equilibrium in the 1990s served as high officials in the antitrust agencies during the Clinton administration and helped mold the antitrust policies of the just-right era.³⁸

In the latest chapter of the pendulum narrative, the presidency of George W. Bush destroys the sensible balance of the 1990s and returns federal merger enforcement to the ice age. Like the experience in the 1980s in the Reagan administration, merger enforcement in the Bush administration features an “extraordinarily low level of government merger enforcement.”³⁹ As the Bush presidency draws to a close in 2008, the merger policy “pendulum has swung too far in the direction of nonintervention.”⁴⁰ The capacity of merger policy to swing toward excessive permissiveness is “particularly evident in the minimalist enforcement agenda of the Antitrust Division during the second term of the Reagan administration and during the George W. Bush administration.”⁴¹ On a good day, the public officials responsible for these developments are merely captives of “the excesses and rigidities of extreme theoretical economic analysis.”⁴² On a bad day, they are intellectually unprincipled. Not only do they employ “extreme interpretations and misinterpretations of conservative economic theory,” they also engage in a “constant disregard of the facts.”⁴³

The three proxies for effectiveness mentioned earlier in this section serve as the factual foundations for the pendulum narrative’s assessment of federal merger enforcement since 2001. First, several commentaries contend that enforcement policy during the George W. Bush administration was significantly more “lenient” than enforcement policy during the Clinton administration.⁴⁴ This deviation from past periods of enforcement is taken to show that the quality of merger policy has deteriorated.⁴⁵

Second, Professors Jonathan Baker and Carl Shapiro surveyed twenty practitioners whose responses are said to indicate agreement with the view that DOJ and the FTC were more likely to approve mergers under the Bush administration than they had been in the previous decade.⁴⁶ In this survey, DOJ is reported to be more permissive than the FTC.⁴⁷ Professors Baker and Shapiro also present

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quotations from news accounts saying that the Bush administration offers the best opportunity for firms to attempt anticompetitive transactions in the hope that permissive Bush antitrust appointees will not attack them.⁴⁸ As with activity rates, the greater permissiveness reported in the survey of practitioners and in the news accounts is said to show that the quality of merger policy has declined.

Third, Professors Baker and Shapiro offer a case study of the Whirlpool-Maytag merger, which DOJ approved in 2006. Professor Shapiro acted as a consultant for the Justice Department and urged DOJ to block the combination of the two producers of washing machines. DOJ did not do so. Professors Baker and Shapiro say DOJ's non-intervention in Whirlpool-Maytag reveals how the DOJ during the Bush administration embraced analytical techniques that improperly biased enforcement decisions toward non-intervention.⁴⁹

In their review of Bush administration merger enforcement policy, Professors Baker and Shapiro expressly embrace the pendulum narrative⁵⁰ and conclude that "the pendulum has swung too far in the direction of nonintervention."⁵¹ Criticizing "the too-ready acceptance by some courts and enforcers of unproven non-interventionist economic arguments about concentration, entry, and efficiencies," they propose measures to "reinvigorate horizontal merger enforcement."⁵²

B. TOWARD AN IMPROVED INTERPRETATION OF MODERN U.S. MERGER POLICY

The pendulum narrative of modern U.S. merger enforcement policy portrays a system whose instability robs it of legitimacy. As Thomas Leary has observed, "How much credence could be given to merger policy if it really were so susceptible to change, depending on the outcome of Presidential elections?"⁵³ President Barack Obama may choose, as he promised during his campaign for the presidency, "to reinvigorate antitrust enforcement" and "step up review of merger activity."

⁵⁴ If the narrative correctly interprets American antitrust experience, the U.S. system is so prone to politically-driven variations in enforcement that future presidential elections could send the merger policy pendulum swinging wildly again. There is no reason to expect that the just-right enforcement approach of the 1990s is the norm rather than an exceptional interlude.

To study the pendulum narrative carefully is to see that, in its struggle to accentuate the swings of the pendulum, it provides an unsupported, unreliable interpretation of modern U.S. merger control. With repeated telling, the pendulum narrative ignores discordant facts and obliterates troublesome complexities in merger enforcement policy. This is a serious obstacle to

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effective public administration. Without an interpretation that more faithfully recounts actual events and forswears superficial explanations in favor of deeper exploration of causes, the antitrust community will neither understand why policy evolved as it did, nor will it identify paths for improvement going ahead. This section discusses some of the pendulum narrative’s main faults and offers an alternative interpretation of modern U.S. merger policy that suggests important elements of continuity and progressive, cumulative development.

1. Failings of the Pendulum Narrative

The narrative depends crucially on fractured accounts of antitrust history to highlight the asserted reasonableness of merger policy in the just-right 1990s. To accomplish this result, the narrative must frame the just-right era between periods of indefensible extremism—the too-hot era of the 1960s and 1970s, and the too-cold periods of the 1980s and the current decade. There is an evident compulsion in the pendulum narrative to achieve rough symmetry in the swings away from the sensible middle of the 1990s—to show that the too-hot and too-cold periods displayed comparable levels of extremism.

The effort to achieve symmetrical, massive swings away from a sensible mean requires unacceptable distortions in the presentation of antitrust history. The narrative depicts the too-hot era as a time of irrational, fanatical intervention undisciplined by sound analysis of individual mergers or thoughtful reflection upon recent experience. For commentators who endorse the pendulum narrative’s account of merger policy and its treatment of the 1990s as a sensible mean between periods of extremism, there appears to be a felt need to single out and disavow the too-hot 1960s as a way of signaling the reasonableness of their views.⁵⁵

Did merger policymaking in the United States in the 1960s, as the pendulum narrative suggests, simply and inexplicably lose its mind? To be sure, merger enforcement standards were highly interventionist.⁵⁶ The interesting question is why they came to be so. Was merger enforcement policy “careening” because it was driven by what the pendulum narrative calls antitrust witchdoctors, zealots, or populist extremists? To reflect upon who made the policy is to see that the pendulum narrative’s fundamental weaknesses. The epithets of irrationality poorly describe FTC Commissioner Philip Elman, who applied his formidable intellect in the 1960s to shape conglomerate merger enforcement doctrine that attracts intense rebuke today.⁵⁷ Nor does Donald Turner resemble the enforcer who single-mindedly seeks to expand the government’s ability to “challenge everything.” In DOJ’s 1968 merger guidelines, Turner took critical steps to retrench the existing zone of government merger enforcement. This self-correcting measure, which existing trends in judicial analysis did not compel DOJ to undertake, proved to be an enormously influ-

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ential exercise in wise self-assessment and prudential self-restraint.⁵⁸ Turner and his 1968 guidelines fit awkwardly in a narrative in which enforcement extremists, zealots, or witchdoctors careen out of control. The pendulum narrative seizes up if such complexities are acknowledged and the apparent capacity of public enforcement agencies to reassess policy and make appropriate refinements is taken into account.

The second pillar of the pendulum narrative's effort to highlight the sensibility of the just-right 1990s is to portray merger enforcement policy in the 1980s and in the 2000s as dramatic swings toward non-intervention. To achieve the desired stark contrasts, the pendulum narrative must side-step or flatten out phenomena that suggest continuity across periods or otherwise reduce the degree of variation. This explains demonstrably false observations that federal merger enforcement "ground to a halt" in the 1980s,⁵⁹ and that the FTC was a "sleepy agency" when it came to merger control.⁶⁰ It also accounts for the perceived imperative to say that enforcement officials from these periods were extremists and ideologues.⁶¹ If their thinking was so cramped, it would have been difficult for these enforcement officials to devise policy measures such as the 1982 DOJ merger guidelines, whose intellectual vision brought about enduring changes in U.S. policy and changed, by way of persuasion, how the world's competition agencies think about merger policy.⁶² Few of the world's merger guidelines today do not owe an intellectual debt to William Baxter and his DOJ guidelines team.

The recent Baker & Shapiro paper evaluates horizontal merger enforcement policy since 2001 with the assistance of the pendulum narrative. The paper is more measured than some in its assessment of the enforcement agencies during the administration of George W. Bush, and its claims are more nuanced than much of the pendulum narrative literature. Professors Baker and Shapiro properly draw attention of the antitrust community to issues associated with the future development of judicial doctrine governing horizontal mergers. The Baker/Shapiro paper usefully helps define issues for future debate about the role of structural presumptions. Their discussion of enforcement agency policy could bring more attention to the pursuit of better techniques for measuring the consequences of merger enforcement choices. These are useful contributions to future policy making.

In its discussion of the work of the federal enforcement authorities since 2001, the Baker/Shapiro paper does little to improve our understanding of the quality of modern merger enforcement policy generally or of the merger programs of the DOJ and the FTC. The paper's findings rest heavily upon an examination of levels of federal agency enforcement activity. It detects a decline in enforcement activities, and it treats this trend as a reliable indication that the quality of merger enforcement policy deteriorated during the presidency of George W. Bush.⁶³

These conclusions, which use activity levels as proxies for the quality of merger control, place unsupportable faith in the reliability and meaning of data on

rates at which the federal agencies engage in enforcement related activities—for example, how often they issue second requests or intervene to block or modify mergers. Assembling an informative data set that permits meaningful comparisons of activity rates between presidential administrations is a difficult undertaking. Calculations based on activity levels require extraordinary care in determining whether observed activity levels across periods are genuinely comparable.⁶⁴ Among other steps, this demands close examination and classification of the type of transactions coming before the agencies at any one time. Relatively small adjustments to account for various factors can change the results materially. The effort to amass activity-related data sets with high levels of comparability is worthwhile for the agencies and collateral institutions, such as research institutes, as one part of the effort to assess merger policy. At best, existing data sets permit conclusions about activity levels that require careful, and perhaps debilitating, qualification.

THESE CONCLUSIONS, WHICH USE ACTIVITY LEVELS AS PROXIES FOR THE QUALITY OF MERGER CONTROL, PLACE UNSUPPORTABLE FAITH IN THE RELIABILITY AND MEANING OF DATA ON RATES AT WHICH THE FEDERAL AGENCIES ENGAGE IN ENFORCEMENT RELATED ACTIVITIES.

Let's suppose that we had absolutely precise and meaningful comparisons of activity over time. It is not clear that variations in activity across periods tell us anything about the larger question posed earlier in this article: How has public merger enforcement affected economic performance? Activity levels say nothing about whether an agency's work has positive or negative economic effects. It is one thing to say that enforcement has become "tougher" or "more lenient" in the sense that the agency is intervening more often or less often as a percentage of all matters to come before it. It is another thing to say that a given level of activity begets specific economic results.

Professors Baker and Shapiro supplement their examination of activity levels with a survey of 20 distinguished practitioners with extensive experience in competition law. The authors do not identify the participants by name, but their identities can be reverse engineered from information provided in the paper. Surveys and interviews can provide useful information about merger enforcement—especially about the effectiveness of the processes by which agencies study individual transactions. On the question of economic effects, surveys have nothing to say, unless the participants have specific data to offer about individual transactions. A general statement that is easier or more difficult to get deals through does not improve our understanding of economic effects unless the speaker at least identifies specific transactions to provide a concrete basis for knowing which deals ought to have been modified or stopped.

The participants in the Baker/Shapiro survey presumably knew what hypothesis the authors were testing and knew how the authors were likely to portray the survey result. Are the authors confident that the participants, owing to past serv-

ice with a specific presidential administration or a preference for a political party in the 2008 elections, would not answer questions in any way strategically to bias the results? The participants provided narrative answers to the survey questions, and the authors coded them on a five-point scale. The aggregate scores are offered as evidence of greater Bush administration permissiveness and, by inference, of weaker enforcement policy quality. Are the authors confident that their own preferences—both worked for the Clinton antitrust agencies in the 1990s—did not affect their scoring of the responses?

The third measurement technique in the Baker/Shapiro paper is a case study of the Whirlpool/Maytag transaction. The authors say they “are deeply concerned that the Whirlpool case is indicative of an overly lax approach to merger enforcement at the current Justice Department.”⁶⁵ Case studies can be informative tools for understanding what an enforcement agency has done and for making judgments about the soundness of its analytical approach. First-person accounts, such as Professor Shapiro’s observations from his perspective as a consultant to DOJ on Whirlpool/Maytag, can be enlightening.

IT TAKES EXTRAORDINARY SELF-DISCIPLINE FOR A FIRST-PERSON NARRATOR TO AVOID THE TEMPTATION TO SKEW THE NARRATION IN WAYS THAT, AT LEAST TO SOME DEGREE, UNDERSCORES THE APPARENT REASONABLENESS OF THE NARRATOR’S VIEWS.

For all of their positive attributes, case studies informed by first person accounts of events also present problems that affect their value. It takes extraordinary self-discipline for a first-person narrator to avoid the temptation to skew the narration in ways that, at least to some degree, underscore the apparent reasonableness of the narrator’s views.⁶⁶ One such problem is selectivity in singling out a case study as the informing exemplar. An example of this selectivity is to

take an individual merger review episode in isolation and attribute great significance to that episode alone. When the narrator presents the single episode as the informing example, is the attitude toward risk exhibited in that episode unique to the incumbent agency leadership, or might their predecessors have made decisions that showed a similar tolerance for risk?

There is a way to avoid misinterpretations of single merger review episodes, and that is to do comparisons over time. A useful way to test whether an agency at any one moment is taking unacceptable risks in allowing mergers to proceed is to use other case studies from other periods to get a rough sense of how the agency in other periods assessed risk and accounted for risk. Did DOJ gamble excessively in allowing Whirlpool and Maytag to combine? We can ask: compared to what? One approach to seeing if Whirlpool/Maytag tells us something important and distinctive about DOJ decision making since 2001 is to look more closely at transactions approved by the Clinton administration in the just-right 1990s.

For example, what does the FTC's decision to allow Boeing to purchase McDonnell Douglas in 1997 tell us about the Clinton administration's treatment of risk in merger analysis? Professor Baker was the FTC's chief economist when Robert Pitofsky and his colleagues reviewed and approved the transaction with no modifications. I consulted for McDonnell Douglas in this merger, and I believe that the FTC properly declined to take any action. Yet the merger involved many defense and commercial aerospace markets that were close calls.⁶⁷ In approving the deal, the Commission took risks about the future of competition in commercial aircraft production and military systems (such as fighter aircraft, aerial refueling tankers, and innovation in the design of weapons generally) that are at least as great as those DOJ took in allowing Whirlpool to buy Maytag. A right-minded person reasonably could have voted to block the Boeing/McDonnell Douglas merger on the ground that these risks were unacceptable. If DOJ behaved unreasonably in Whirlpool/Maytag, was the FTC's decision in Boeing/McDonnell Douglas appropriate?

IF DOJ BEHAVED UNREASONABLY
IN WHIRLPOOL/MAYTAG,
WAS THE FTC'S DECISION
IN BOEING/MCDONNELL
DOUGLAS APPROPRIATE?

The same question about enforcement agency risk-taking across time periods can be posed in connection with the Clinton administration's review of mergers involving the petroleum industry. No sector of FTC competition policy responsibility has received more intense and critical congressional scrutiny in this decade. Since 2001, FTC officials have made many appearances before congressional committees to answer questions about the agency's review of mergers involving petroleum companies, especially transactions that took place during the Clinton administration in the 1990s. A much-repeated charge by members of Congress is that the FTC oversight of mergers in the 1990s was lax—that the Commission improvidently allowed, albeit with substantial divestitures in some cases, Exxon to buy Mobil, Chevron to buy Texaco, BP to buy Arco and then Amoco, and many others. Imagine that these transactions had taken place during the George W. Bush presidency. What would the pendulum narrative have to say if the FTC in the Bush administration had made exactly the same choices as the Clinton administration made in the 1990s? By further point of comparison, recall also that it was during the too-cold period of the Reagan administration that the FTC sued to bar Mobil from buying Marathon Oil Company, the 16th largest U.S. refiner.⁶⁸

In 2004, the Government Accountability Office ("GAO") published a study that sought to measure the price effects of eight mergers that took place during the Clinton administration. It concluded that six of the eight mergers—including Exxon/Mobil—caused prices to increase.⁶⁹ Professors Baker and Shapiro are familiar with a number of the transactions that have received criticism from Congress and from the GAO. Many of the relevant transactions took place during Professor Baker's tenure as the head of the FTC's Bureau of Economics, and

Professor Shapiro advised British Petroleum in support of its acquisition of Amoco.

On the FTC's behalf, I have testified on several occasions since 2001 to defend the Commission's petroleum industry program and to rebut the GAO's criticisms of Clinton administration merger enforcement policy in this sector.⁷⁰ On those occasions I have said, and I believe today, that the FTC's choices in these matters were correct. Even if my assessment is right, there remains the question of how the chances the FTC took in those cases compare to the chances taken by DOJ in Whirlpool/Maytag. How should we assess the competitive risks of the FTC's decision to allow some transactions (e.g., Unocal/Tosco) to proceed without modification, or the risks associated with divestitures required as a condition for allowing other transactions to go through (e.g., Exxon/Mobil)? How do those risks—as well as the sector-wide risks associated with the many petroleum transactions that the Clinton FTC approved in whole or in part—compare to the risks taken by the DOJ in Whirlpool/Maytag?

To consider the wisdom of the enforcement agency's decisions about what risks to take and when to intervene, single episodes of merger review—such as Whirlpool/Maytag—should be analyzed in a larger context when the enforcement agency has made judgment calls no less problematic in other periods that are depicted as eras of sound public administration. The potential adverse economic and social consequences of the FTC getting things wrong in the aerospace and defense sector and in the petroleum industry in the 1990s are at least as grave as the hazards of having DOJ improvidently permit two leading producers of washing machines to merge. In the Baker/Shapiro account of Whirlpool/Maytag, one gets no idea that the Clinton antitrust agencies might have taken risks of equal or greater magnitude. Measured by risks taken and risks avoided, Boeing/McDonnell Douglas and the petroleum deals of the 1990s are as damning of FTC enforcement under Bill Clinton as Whirlpool/Maytag is of DOJ's work under George W. Bush. They ought to be part of the story.

2. An Alternative Interpretation: The Role of Continuity

Horizontal merger policy has changed considerably since the early 1960s. The process of change has involved a significantly greater degree of continuity than the pendulum narrative suggests. The first ingredient has been a gradual narrowing of the zone of liability.⁷¹ This narrowing has been largely continuous rather than sharply discontinuous. Using a rough structural measure, the threshold at which the federal agencies could be counted on to apply strict scrutiny and to be most likely to challenge involved a reduction of the number of significant competitors in the following manner: 1960s (12 to 11), 1970s (9 to 8), 1980s (6 to 5), 1990s (4 to 3), 2000s (4 to 3). These thresholds can be derived from parsing the cases which the government agencies chose to litigate. It is reasonable to debate whether a 4 to 3 deal had a better chance of getting through in this decade than it did in the 1990s. The main point is that the perimeter the feder-

al agencies have been defending has shrunken substantially over the decades. This is a function of the agencies' own reassessments of policy and of interpretations of merger law in the lower federal courts.⁷²

The second ingredient has been an increased willingness on the part of the agencies to engage in fact-intensive analysis that qualifies the application of structural criteria. This is evident in decisions taken in matters such as Boeing/McDonnell Douglas and in Whirlpool/Maytag. It is entirely appropriate to ask whether the agencies have applied qualifying factors correctly. The key point here is that modern experience, especially since the issuance of the 1982 DOJ merger guidelines, has involved greater consideration of non-structural criteria and more willingness to experiment with enforcement approaches short of outright prohibition to resolve competitive concerns.

Seen this way, modern U.S. enforcement policy toward horizontal mergers has not resembled a wildly swinging pendulum. There instead has been a relatively steady progression toward a narrower zone of enforcement for horizontal transactions. The pendulum narrative and its emphasis on enormous periodic policy swings deflect attention away from the larger question raised above: Is this trend of enforcement policy, combined with reinforcing doctrinal developments in the courts, producing desirable economic effects? That question, rather than an examination of aggregate activity levels or single cases, ought to occupy the attention of the competition policy community.⁷³

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III. Conclusion: Institutional Arrangements for Evaluation

The development of a performance evaluation methodology for horizontal merger enforcement and other forms of competition policy can take advantage of a growing body of experience and scholarship with the subject.⁷⁴ Improvements in existing evaluation programs and extensions of the methodological state of the art might proceed along several paths. One is to engage competition authorities and researchers in more extensive collaborative discussions about existing projects and in explorations about evaluation techniques. This can take place in a variety of multinational and regional forums such as the International Competition Network and the Organization for Economic Cooperation and Development. In recent years, these and other organizations have shown an increased interest in operational issues, including performance management. Another way is for competition agencies to form partnerships with major research institutions.

A second element is for competition authorities to expand resources devoted to performance measurement. Agencies can ensure that, in every budget cycle, there are outlays for evaluation. These performance measure exercises can be carried out by agency insiders, external consultants, or some combination of the two. Competition authorities with common interests and common investigations usefully could cooperate to do relevant research. Focal points for collaboration would include the assessment of economic effects and of the processes for merger control. In making budget outlays, agencies should view performance measurement as an integral element of the policy-making life cycle and not simply as a luxury. Performance measurement investments are part of the policy research and development (“R&D”) by which a public competition authority grows smarter.

A third element is to continue and extend the trend of publishing fuller data sets on merger enforcement activity.⁷⁵ For the DOJ and the FTC, this means an acceleration of the recent trend to publish accounts of decisions not to prosecute and to issue reports on major variables affecting the decision to prosecute. These transparency measures could be coupled with workshops and seminars that rely on these and other materials to discuss enforcement trends and effects.

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All of these measures will help to build and reinforce an ethic of self-assessment and continuous improvement. They underscore the importance of institutional improvement as a necessary complement to advances in doctrine or theory. Good policy runs on an infrastructure of institutions, and broadband-quality policy cannot be delivered on dial-up-quality institutions. If one asks whether the U.S. antitrust agencies have got things just right today, the answer yesterday and today is no. If one asks whether there are measures in place to get there, the answer is emphatically yes. Better answers to the question of how to assess actual economic effects of enforcement will be key ingredients of reaching that destination.

1 For a representative discussion of current issues, see *Roundtable Discussion on Developments—and Divergence—in Merger Enforcement*, 23 ANTITRUST 9 (Fall 2008).

2 See William E. Kovacic et al., *Quantitative Analysis of Coordinated Effects*, ANTITRUST LAW JOURNAL (forthcoming 2009) (discussing connections between merger policy and learning from antitrust enforcement against cartels).

3 In an unpublished lecture at the Federal Trade Commission in the early 1980s, I recall Phillip Areeda borrowing a Cold War metaphor from George Kennan to describe merger control. Areeda said merger policy was antitrust law’s program of “containment” because it sought to avoid the expansion of dominance and the growth of oligopolistic market structures which invited tacit coordination that yielded cartel-like results but generally evaded effective intervention by competition bodies.

- 4 Many competition policy regimes oblige the parties to notify the public enforcement agency of a proposed transaction. In these systems, the parties may not complete the consolidation until the agency has had a period of time to analyze the likely competitive effects. In a number of other systems, pre-merger notification and review are optional, but many companies choose to report proposed mergers in advance and allow the authority to review them before the integration of assets takes place.
- 5 In U.S. parlance this is the "second request." In the European Union, it is the second phase inquiry.
- 6 This advice seems to have primeval, untraceable antecedents.
- 7 I thank David Hyman for bringing this caution to my attention.
- 8 For an earlier treatment of this theme, see William E. Kovacic, *Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy*, 9 *GEORGE MASON L. REV.* 843 (2001).
- 9 The case for increased efforts to conduct quantitative studies of the effects of merger policy is presented in Dennis W. Carlton, *The Need to Measure the Effect of Merger Policy*, 22 *ANTITRUST* 39 (Summer 2008).
- 10 These trends are reviewed in William E. Kovacic, *Using Ex Post Evaluation to Improve the Performance of Competition Policy Authorities*, 31 *J. CORP. L.* 503 (2006).
- 11 The Federal Trade Commission at 100: Into Our 2d Century (January 2009), available at <http://www.ftc.gov/os/2009/01/ftc100rpt.pdf>.
- 12 For statements of this normative aim and critical assessments of the efforts of the U.S. enforcement agencies to achieve this goal, see Joe Sims et al., *Merger Process Reform: A Sisyphean Journey?*, 23 *ANTITRUST* 60 (Spring 2009); Joe Sims & Deborah Herman, *The Effect of Twenty Years of Hart-Scott-Rodino on Merger Practice: A Case Study of Unintended Consequences Applied to Antitrust Legislation*, 65 *ANTITRUST L.* J.865 (1997).
- 13 The Federal Trade Commission at 100, *supra* note 11, at 22-23.
- 14 See Carlton, *supra* note 9, at 23 (noting that the dearth of quantitative studies and measures of effectiveness "means that there is no reliable guide for determining whether our antitrust policy is too lax in some areas and too stringent in others").
- 15 Professor Carlton observes: "Antitrust analysis of proposed mergers has become increasingly sophisticated. Evaluation of antitrust policy has not." *Id.* at 42.
- 16 See, e.g., Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration*, 33 *ANTITRUST BULL.* 211, 228 (1988) ("Our experience has been that the U.S. business community has read the enforcement actions of the Reagan administration as an invitation to everyone to merger with anyone.").
- 17 See, e.g., Thomas L. Greaney, *Merger Mania Has Gone Too Far*, *ST. LOUIS POST-DISPATCH*, Feb. 27, 1991, at 3B ("At the height of the Reagan administration's permissiveness toward corporate mergers, a former assistant attorney general with the Carter administration summarized the advice he was giving clients: 'I simply tell them that there's no merger not worth trying.'").
- 18 See, e.g., Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in *How CHICAGO OVERSHOT THE MARK* 235, 248-51 (Robert Pitofsky ed., 2008) (discussing DOJ decision not to oppose the merger of Whirlpool and Maytag).

- 19 The popularity of the pendulum metaphor is traced in William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377 (2003).
- 20 Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 196 (1992).
- 21 Arthur Austin, *Antitrust Reaction to the Merger Wave: The Revolution vs. the Counterrevolution*, 66 N. C. L. REV. 931, 939 (1988).
- 22 The New Enforcers, THE ECONOMIST, Oct. 7, 2000, at 79, 80.
- 23 Robert A. Skitol, *The Shifting Sands of Antitrust Policy: Where It Has Been, Where It Is Now, Where It Will Be in Its Third Century*, 9 CORNELL J. L. & PUB. POL'Y 239, 253 (1999).
- 24 *Klein Spurs Consumer Action to Address Challenges of Information Age, Globalization*, 76 Antitrust & Trade Regulation Report (BNA) 559, 560 (May 20, 1999) (*hereinafter* Klein Spurs Consumer Action) (quoting Joel Klein, Assistant Attorney General for Antitrust, U.S. Department of Justice).
- 25 Janet L. McDavid & Robert F. Leibenluft, *What Impact Will Bush Have?*, NAT'L L.J., Feb. 5, 2001, at B8.
- 26 Eleanor M. Fox & Robert Pitofsky, *The Antitrust Alternative*, 62 N.Y.U. L. REV. 931, 931 (1987).
- 27 Robert Pitofsky, *Does Antitrust Have a Future?*, 76 GEO. L.J. 321, 321 (1987).
- 28 Lawrence A. Sullivan & Wolfgang Fikentscher, *On the Growth of the Antitrust Idea*, 17 BERKELEY J. INT'L L. 197, 206 (1998).
- 29 Eleanor M. Fox, *Can We Control Merger Control? – An Experiment*, in POLICY DIRECTIONS FOR GLOBAL MERGER REVIEW 79, 84 (GLOBAL COMPETITION REVIEW: SPECIAL REPORT BY THE GLOBAL FORUM FOR COMPETITION AND TRADE POLICY, 1999). See also Jonathan B. Baker & Robert Pitofsky, *A Turning Point in Merger Enforcement: Federal Trade Commission v. Staples*, in ANTITRUST STORIES 311, 315 (Eleanor M. Fox & Daniel A. Crane eds., 2007) (“during the second term of the Reagan Administration, merger enforcement came close to disappearing”).
- 30 Walter Adams & James W. Brock, *Reaganomics and the Transmogrification of Merger Policy*, 33 ANTITRUST BULL. 309, 309 (Summer 1988).
- 31 See Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust – Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936, 945 (1987) (describing the role of William Baxter, Reagan's first Assistant Attorney General for Antitrust, in altering federal enforcement policy in the 1980s: “It is often said that extremists are necessary to move tradition a short step. This is, perhaps, what Baxter and the Chicago School have done.”).
- 32 Lloyd Constantine, Remarks Concerning How Antitrust Should Assess the Role of Imports in Market Definition 1, 1 (Oct. 19, 1995) (statement at Federal Trade Commission Hearings on Global and Innovation-Based Competition), available at <http://www.ftc.gov/opp/global/speech.htm>.
- 33 *ABA Annual Meeting Emphasizes Competitiveness, International Trade*, 53 Antitrust & Trade Regulation Report (BNA) 311, 315 (Aug. 20, 1987) (remarks of Senator Howard Metzenbaum).
- 34 Fox & Sullivan, *supra* note 31, at 947.
- 35 Baker & Pitofsky, *supra* note 29, at 315-16.

- 36 Eleanor M. Fox & Daniel A. Crane, *Introduction*, in *ANTITRUST STORIES* 1, 4 (Eleanor M. Fox & Daniel A. Crane eds, 2007).
- 37 Klein Spurs Consumer Action, *supra* note 24, at 560 (reporting that Joel Klein “expressed belief that the antitrust ‘pendulum’ on his watch had swung back to the ‘middle,’ where ‘big was not necessarily bad’ but government prudently cracked down on anti-consumer deals and practices”); James Toedtman, *Ball Is in His Court*, *NEWSDAY*, June 7, 1998, at F8 (quoting Joel Klein, Assistant Attorney General for Antitrust: “The pendulum is in the middle.”).
- 38 See, e.g., Baker & Pitofsky, *supra* note 29, at 315-16. During their tenure with the enforcement agencies, the Clinton antitrust officials took pains to position their program as occupying the sensible middle ground. See Robert Pitofsky, Chairman, Federal Trade Commission, *An Antitrust Progress Report for the FTC: Past, Present, and Future, Remarks Before the Antitrust 1996 Conference of Business Development Associates Inc. 2* (Mar. 4, 1996) (“The Commission of the 1990s has tried to strike a middle ground between what many people believe was an excessively active enforcement in the 1960s and the minimalist enforcement of the 1980s.”), available at <http://www.ftc.gov/speeches/pitofsky/speech4.htm>.
- 39 Robert Pitofsky, *Reinvigorating Merger Enforcement That Has Declined as a Result of Conservative Economic Analysis*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK* 233, 233 (Robert Pitofsky ed., 2008).
- 40 Baker & Shapiro, *supra* note 18.
- 41 *Id.* at 269 n. 31.
- 42 Pitofsky, *Reinvigorating Merger Enforcement That Has Declined as a Result of Conservative Economic Analysis*, *supra* note 39, at 234.
- 43 Robert Pitofsky, *Introduction: Setting the Stage*, in *How the Chicago School Overshot the Mark* 3, 6 (Robert Pitofsky ed., 2008).
- 44 Baker & Shapiro, *supra* note 18, at 251.
- 45 *Id.* at 244-46.
- 46 *Id.* at 247-48.
- 47 *Id.* at 247.
- 48 *Id.* at 244.
- 49 *Id.* at 248-51.
- 50 *Id.* at 269 & n. 31.
- 51 *Id.* at 240.
- 52 *Id.* at 266-67.
- 53 Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 *ANTITRUST L.J.* 105, 106 (2002).
- 54 Statement of Senator Barack Obama for the American Antitrust Institute 1 (Feb. 20, 2008), available at <http://www.antitrustinstitute.org/Archives/obama2.ashx>.

- 55 See, e.g., Baker & Shapiro, *supra* note 18, at 266 (“We certainly do not propose a return to the horizontal merger control policies and precedents of the 1960s.”).
- 56 The standards of legality established by Supreme Court merger decisions and government enforcement policy in the 1960s and through the early 1970s are described in Kovacic, *Enforcement Norms*, *supra* note 19, at 433-34.
- 57 Among other contributions, Elman authored the Commission decision that the Supreme Court ultimately upheld in *Federal Trade Commission v. Procter & Gamble Co.*, 386 U.S. 568 (1967). For a summary of modern criticism of *Procter & Gamble*, especially its suggestion that efficiencies caused by a merger either were irrelevant to the assessment of legality or might serve to condemn the transaction, see Ernest Gellhorn et al., ANTITRUST LAW AND ECONOMICS IN A NUTSHELL 462-63, 466-67 (5th Ed. 2004).
- 58 Turner’s role as Assistant Attorney General for Antitrust from 1965 to 1968 and his contributions to improving the economic foundations of DOJ antitrust enforcement are examined in Oliver E. Williamson, *Economics and Antitrust Enforcement: Transition Years*, ANTITRUST 61 (Spring 2003), available at <http://groups.haas.berkeley.edu/bpp/oww/Spring03-Williamson.pdf> (last viewed 4/12/09).
- 59 Fox, *supra* note 29, at 84. Federal merger enforcement activities from 1981 to 1986 are documented in Ronald W. Davis, *Antitrust Analysis of Mergers, Acquisitions, and Joint Ventures in the 1980s: A Pragmatic Guide to Evaluation of Legal Risks*, 11 DEL. J. OF CORP. L. 25 (1986). Other surveys of the federal enforcement experience in this period include Leary, *supra* note 53, at 111-21 and Kovacic, *supra* note 19 at 435-47.
- 60 Fox & Crane, *supra* note 36, at 4. One gets a sense of the alertness of the FTC in the 1980s by reading noteworthy court of appeals opinions involving some of the enforcement decisions. These include *Hospital Corp. of America v. Federal Trade Commission*, 807 F.2d 1381 (7th Cir. 1986); *Federal Trade Commission v. PPG Industries*, 798 F.2d 1500 (D.C. Cir. 1986); *Federal Trade Commission v. Warner Communications, Inc.*, 742 F.2d 1156 (9th Cir. 1984). These are not obscure cases.
- 61 See *supra* notes 31-33 and 42-43 and accompanying text.
- 62 The contributions of the 1982 DOJ merger guidelines to competition policy are examined in William B. Blumenthal, *Clear Agency Guidelines: Lessons from 1982*, 68 ANTITRUST L. J. 5 (2000); Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 ANTITRUST L.J. 253 (2003).
- 63 Another recent paper that travels largely the same path, with similar conclusions, based on activity levels is John D. Harkrider, *Antitrust Enforcement During the Bush Administration—An Economic Estimation*, 22 ANTITRUST 43 (Summer 2008).
- 64 These frailties are examined in Timothy J. Muris, *Facts Trump Politics: The Complexities of Comparing Merger Enforcement over Time and Between Agencies*, 22 ANTITRUST 37 (Summer 2008); *Roundtable Discussion, Advice for the New Administration*, 22 ANTITRUST 8, 13 (Summer 2008) (remarks of Timothy Muris).
- 65 Baker & Shapiro, *supra* note 18, at 250.
- 66 For a discussion of this pitfall and other limitations of first-person narrations of antitrust history, see William E. Kovacic, *Review of Antitrust Stories*, 4 Competition Policy International 241 (2008).
- 67 The transaction’s competition issues are examined in detail in William E. Kovacic, *Transatlantic Turbulence: The Boeing-McDonnell Douglas Merger and International Competition Policy*, 68 ANTITRUST L. J. 805 (2001).

- 68 The FTC's opposition to Mobil's attempted purchase of Marathon and to Gulf Oil's attempted purchase of Cities Service is discussed in Kovacic, Enforcement Norms, *supra* note 19, at 444.
- 69 U.S. Government Accountability Office, Energy Markets: Effect of Mergers and Market Concentration in the U.S. Petroleum Industry (2004).
- 70 See, e.g., Market Forces, Anticompetitive Activity, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets: Hearing on the Status of the U.S. Refining Industry Before the House Committee on Energy and Air Quality (July 15, 2004) (prepared statement of William E. Kovacic, FTC General Counsel), available at <http://www.ftc.gov/os/2004/07/040715gaspricetestimony.pdf>.
- 71 See Kovacic, *Norms*, *supra* note 19, at 433-438 (discussing merger enforcement trends over time); Kovacic et al., *supra* note 2.
- 72 The relevant jurisprudential developments are described in Kovacic, Enforcement Norms, *supra* note 19, at 433-47; Andrew I. Gavil et al., Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy 436-38, 451-55, 467-68, 553-54 (2d Ed. 2008).
- 73 Kovacic et al, *supra* (discussing how recent judicial merger decisions may underestimate competitive dangers).
- 74 Kovacic, Ex Post Evaluations, *supra* note 10, at 516-32; FTC at 100, *supra* note 11, at 146-53, 166-69.
- 75 For a discussion of initiatives in the United States, see FTC at 100, *supra* note 11, at 100-09.



Dominant Firms' Duties To Deal With Pharmaceutical Parallel Traders Following *Glaxo Greece*

Robert O'Donoghue & Louise Macnab

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EU competition policy on dominant firms and pharmaceutical parallel trade—wholesalers taking advantage of arbitrage possibilities to export drugs from a low-priced Member State to a higher-priced one—reminds one of a debate between

GRAPPLING WITH SUCH OPPOSING POLICY PERSPECTIVES WAS NEVER GOING TO BE EASY FOR THE EU COURTS AND INSTITUTIONS. THIS APPLIES NOT LEAST GIVEN THEIR HISTORICAL FIXATION WITH THE INTEGRATION OF THE SINGLE EU MARKET AND THE NOTION THAT COMPETITION LAW IS (IN PART) A FEDERATING TOOL IN THIS REGARD.

two famous economists. Each of them had taken opposing sides in a case and, after several discussions, they each remained wholly unpersuaded of the other's view. In a fit of exasperation, one economist said to the other "I agree with you, but you are completely wrong!"

So it is with parallel trade. The virtuous wholesalers say that they bring much-needed price competition to the (higher-priced) market. The no-less-virtuous pharmaceutical companies say that this is true, if at all, only in the short term, and that it comes at the expense of appropriation of manufacturer profits that fund

expensive research & development ("R&D")—so there is, they say, less competition in the medium- to long-term. Both may be correct, for different reasons and from different perspectives.

Grappling with such opposing policy perspectives was never going to be easy for the EU Courts and institutions. This applies not least given their historical fixation with the integration of the single EU Market and the notion that competition law is (in part) a federating tool in this regard.

*Respectively, barrister, Brick Court Chambers (London & Brussels) and *stagiaire* Brick Court Chambers (Brussels).

The EU Courts had something of a false start in *Syfait* where a preliminary reference from the Greek courts squarely raising the issue of when, if ever, it is abusive for a dominant firm to refuse to meet orders from parallel traders was declared inadmissible by the Court of Justice (“ECJ”), following an Opinion by Advocate General Jacobs.¹ Round two has now come in the shape of the ECJ’s recent judgment in *Sot. Lélos kai Sia EE and Others v GlaxoSmithKline AEVE*² (hereinafter “*Glaxo Greece*”), which, very unusually in competition cases, was a judgment of the full court (as opposed to a smaller chamber).

The judgment is, in many respects, a work of art because it largely avoids taking a firm view, either way, on the underlying policy considerations that affect the assessment of parallel trade as abusive unilateral conduct. Instead, the ECJ adopted an essentially pragmatic approach that a dominant pharmaceutical company may refuse to meet an order that is “out of the ordinary in terms of quantity” even if the refusal is openly designed to restrict parallel trade. This avoids saying whether parallel trade is inherently “good” or “bad” as a competition policy matter in favor of imposing essentially an upper limit on the manufacturer’s duty to supply—broadly limited to the quantities ordinarily supplied on the domestic (exporting) market in question. It should be immediately obvious therefore that the upshot of the case is relatively favorable to manufacturers, at least where unilateral refusals to deal with parallel traders are concerned. But, as developed in more detail in this piece, such pragmatism comes at the expense of legal reasoning that is dubious in certain respects.

The judgment seems to us all the poorer for not grappling with the underlying policy issues in any serious, forensic way. Two well-resourced competing sets of interest were before the ECJ, and plenty of information and evidence were undoubtedly presented to the court. The ECJ also had the power to ask for more if needed. Indeed, the case was unusual in that there were two ECJ references in the same case, as well as various decisions of the national competition agency and courts dealing with the issue. The ECJ thus had a pretty much unblemished 8-year record of what happened in the export and import markets. A text book assessment could therefore have been made without too much difficulty. Important issues like a dominant firm’s unilateral freedom to deal with parallel traders should not be decided by the Grand Chamber of the highest EU court essentially in a vacuum, on the basis that a pragmatic outcome can be devised to avoid dealing with the real underlying issues. The contrast between Advocate General Jacobs in *Syfait* and the Advocate General and ECJ in *Glaxo Greece* is striking in this regard.

That said, the ECJ’s pragmatic conclusion does mean that, in general, the dominant firm is not obliged to supply much more than ordinary domestic con-

THIS CONCLUSION IS A FAIRLY RADICAL SHIFT IN THE ECJ’S HISTORIC APPROACH TO PARALLEL TRADE, WHICH WAS TO REGARD IT AS MORE OR LESS SACRED BECAUSE IT HELPED “INTEGRATE” THE EU MARKETS— I.E., A POLITICAL IDEAL.

sumption. This conclusion is a fairly radical shift in the ECJ's historic approach to parallel trade, which was to regard it as more or less sacred because it helped "integrate" the EU markets—i.e., a political ideal. But some of the remnants of the old approach remain. Whether this grown-up approach will be maintained by the ECJ in the context of agreements restricting parallel trade under Article 81 will be fascinating to watch in the imminent *Glaxo Spain* appeal.³

This short paper tries to do two things. First, it conveys to the reader the essential points in the *Glaxo Greece* judgment. Second, it looks in more detail at the competition law issues raised by the judgment, including by reference to the wider policy issues at stake.

I. What the ECJ Found

The essential facts are as follows: A Greek subsidiary of GlaxoSmithKline ("GSK"), GSK AVEE, imports, warehouses, and distributes pharmaceutical products of the GSK group in Greece. A big issue in Greece is parallel trade because prices there are among the lowest in the EU.

GSK AVEE initially suspended supplies to the Greek wholesalers, citing a shortage of the products at issue for which it denied responsibility. GSK AVEE then began to distribute medicines directly to Greek hospitals and pharmacies. Three months later, GSK partially resumed the supplies, but only in quantities sufficient to meet the demand of the local market. The Greek wholesalers, as well as some Greek associations of pharmacists, started proceedings before the Greek Competition Commission arguing that the actions of GSK constituted an abuse of a dominant position under Article 82 EC. The Greek court made a reference to the ECJ for a preliminary ruling, in *Syfait*, as to the application of Article 82 to the refusal by an allegedly dominant pharmaceuticals supplier to meet wholesalers' orders for the purpose of limiting exports to other Member States. That case was declared inadmissible, since only "courts or tribunals" can make a reference under the Article 234 EC preliminary reference procedure.

Proceedings in the Athens Court of First Instance nonetheless continued in parallel and, after an appeal was brought before the Athens Court of Appeal, led to a reference of essentially the same questions as raised before in *Syfait*.

It is fair to say that the two sets of proceedings—*Syfait* and *Glaxo Greece*—are materially different in their approach on key issues on essentially the same facts (see table in Annex). But the latter will now be the governing law, since, unlike *Syfait*, it did result in an ECJ judgment on the substantive issues.

In 2004 Advocate General Jacobs found that the refusal to deal with the Greek parallel traders was capable of justification, and hence not abusive, as a reasonable and proportionate measure in defense of the undertaking's commercial interests. This is the case, he said, where the price differential giving rise to

the parallel trade is a result of State intervention in the country of export to fix the price at a level lower than that which prevails elsewhere in the EU, combined with the specific economic and regulatory characteristics of the pharmaceutical industry. He did, however, consider it “plausible” that an intention on the part of the dominant undertaking to limit parallel trade “should be one of the circumstances which will ordinarily render abusive a refusal to supply” because such conduct is normally aimed at removing a source of competition for the dominant undertaking in the country of import.⁴ Nevertheless, he found that, in parallel trade cases, the partitioning of the market was not usually the primary intent, but, given the characteristics of the market, an inevitable consequence of the attempt by the manufacturer to protect what it saw as its legitimate commercial interests and the distortions of trade that stemmed from unharmonized national price control systems for medicines.

In simple terms therefore, Advocate General Jacobs was pretty sympathetic to the notion that there are unusual features of the pharmaceutical industry and its regulation that may justify a termination or reduced supplies to parallel traders. His conclusion is significant, since he is one of the most respected Advocates General and, moreover, was the author of many of the key opinions on parallel trade issues under the EU’s free movement of goods rules.

Four years later in 2008, however, Advocate General Ruiz-Jarabo Colomer effectively went against Advocate General Jacobs’ opinion and advised the Court to qualify the limitation of supplies as abusive where there was a refusal to meet “ordinary” orders in order to prevent parallel trade. Whether the orders placed by the Greek wholesalers were reasonable was an issue that had to be referred back to the Greek courts for a final ruling. He also took different views to Advocate General Jacobs on the main policy issues raised by parallel trade and concluded that, while perhaps relevant, they do not provide objective justification for a refusal to deal with parallel traders.

AS A MATTER OF (HIGH LEVEL) PRINCIPLE, THE ECJ ACCEPTED THAT A DOMINANT FIRM IS NOT OBLIGED TO MEET ORDERS “WAY OUT OF THE ORDINARY” AND THAT IT CAN TAKE STEPS TO PROTECT ITS OWN “COMMERCIAL INTERESTS” IF ATTACKED.

The ECJ’s conclusions were similar, in upshot, to Advocate General Colomer’s, although its conclusions on the policy issues are interestingly different. The ECJ began by essentially inverting the legal test and saying that where a refusal would lead to the elimination of “effective competition” from parallel importers there is an abuse unless “objective considerations” justify the refusal.⁵

As a matter of (high level) principle, the ECJ accepted that a dominant firm is not obliged to meet orders “way out of the ordinary” and that it can take steps to protect its own “commercial interests” if attacked.⁶

The ECJ then turned to a series of objective justifications advanced by GSK as legitimizing its refusal to deal:

A. THE CONSEQUENCES OF PARALLEL TRADE FOR THE ULTIMATE CONSUMERS

The first argument was that parallel trade does not have much benefit for final consumers: Parallel traders are simply engaged in arbitrage from low price to high price countries and will therefore rationally sell as close as possible to the prevailing price in the import country (which is often regulated anyway).

On this point the ECJ concluded that a manufacturer cannot “base its arguments on the premise that the parallel exports which it seeks to limit are of only minimal benefit to the final consumers.”⁷ This was on the basis that the benefits to the final consumer result from: (1) the general price pressure that parallel imports exert in the destination market; and (2) the additional choice that parallel imports represent for entities that purchase through public procurement procedures.⁸

B. THE IMPACT OF STATE PRICE AND SUPPLY REGULATION IN THE PHARMACEUTICALS SECTOR

The ECJ then analyzed the possible effect of State regulation of medicine prices on the assessment whether the refusal to supply is an abuse. In the EU, there is no harmonization of national price controls in medicines, with each Member State having autonomy in this regard—leading to a diversity of methods of regulation. Different mechanisms are used to set and control prices, including direct price controls, profit caps, negotiated prices, agreed reimbursement rates, and reference pricing (i.e., when prices are set by reference to prices in other Member States), and internal reference pricing where the price would be based on groupings of supposedly similar products in that Member State. Indeed, parallel trade only exists because of the arbitrage possibilities between Member States that result from different national regulations. So the manufacturers argue that competition is *already* distorted because of national regulation, which is permitted under EU law, and that they are objectively justified in refusing, in effect, to allow one Member State to export aspects of its chosen regulation to another, thereby avoiding a “race to the bottom.”

The ECJ found that the control exercised by Member States over the selling prices or the reimbursement of medicines was varied and did not entirely remove the prices of those products from the law of supply and demand.⁹ It added that the producers of the medicines take part in the negotiations, where their price proposals act as a starting point and end with the setting of the prices and the amounts of reimbursement to be applied.¹⁰ Thus, the degree of regulation did not remove the scope for competition to an extent that the competition rules did not apply at all.

However, the ECJ added that “it cannot be ignored that such State intervention is one of the factors liable to create opportunities for parallel trade” and that undertakings should not be placed in the invidious position that, “in order to defend its own commercial interests, the only choice left for a pharmaceuticals company in a dominant position is not to place its medicines on the market at all in a Member State where the prices of those products are set at a relatively low level.”¹¹

Accordingly, the ECJ accepts that the dominant firm can take steps “that are reasonable and in proportion to the need to protect its own commercial interests,”¹² meaning it has no obligation to meet orders “out of the ordinary” relative to the domestic consumption in the export Member State.¹³ This was elaborated to mean ordinary “in the light of both the size of those orders in relation to the requirements of the market in the first Member State and the previous business relations between that undertaking and the wholesalers concerned.”¹⁴

C. IMPACT ON R&D

One of the more fundamental objections made to parallel trade by manufacturers is that it involves parallel exporters expropriating profits that would otherwise be invested in R&D—a major feature and cost in pharmaceutical manufacturing—by manufacturers.¹⁵ Thus, they say, the gain to consumers, if any, is short-lived and there will be a reduction in R&D in the medium- to long-term as average prices are forced closer and closer to marginal cost, which will result in less competition not more. The ECJ declined to rule on this issue.¹⁶

II. What to Make of All This?

From the perspective of pharmaceutical manufacturers the *Glaxo Greece* judgment will largely come as a welcome relief. As embarrassing as it may sound, the notion that it would be *per se* abusive for a dominant firm to unilaterally refuse to meet wholesaler orders if intended to limit parallel trade has been an idea with some serious traction in the EU. The Commission actually advanced an argument in *Syfait* that ran fairly close to a *per se* rule, citing the EU’s market integration objectives as support.¹⁷

The ECJ did not specifically endorse any such argument in *Glaxo Greece*, but remnants of it remain in the judgment. The Advocate General went out of his way to say that there should be no *per se* rules under Article 82 EC, which is a generally helpful conclusion, but he too seemed to think that the political objective of market integration affects competition law analysis. We’ll return to this issue later.

FROM THE PERSPECTIVE OF PHARMACEUTICAL MANUFACTURERS THE GLAXO GREECE JUDGMENT WILL LARGELY COME AS A WELCOME RELIEF.

In pragmatic terms, pharmaceutical manufacturers' lot has also been improved by the important limiting principle that the dominant firm does not need to supply all quantities that the wholesalers asks for, but can refuse to supply more than the "ordinary" quantities. Equally, the dominant firm needs to guess what the wholesalers might do with the quantities actually supplied (i.e., for export or domestic consumption). Any such rule would have been precarious in the extreme and might actively encourage wholesalers to lie. Instead, the ECJ seems to favor a broadly objective principle, based on anything that would fall outside "ordinary" orders for the domestic market.

Unhelpfully, the ECJ refused to elaborate on what "ordinary" means. It certainly could have said more, since it had the basic facts in the case before it and the question must in part at least have a legal meaning.¹⁸ Indeed, the ECJ made matters worse by adopting different formulations at different places, later saying that the test is whether the orders are "out of all proportion to those previously sold by the same wholesalers to meet the needs of the market in that Member State"¹⁹—a more permissive test for wholesalers—as compared to the formulation used elsewhere ("out of the ordinary in terms of quantity").

THE UPSHOT IS THAT THE MANUFACTURER DOES NOT NEED TO SUPPLY MUCH MORE THAN DOMESTIC CONSUMPTION. IN THESE CIRCUMSTANCES, EVEN IF THE WHOLESALER COULD, SUBJECT TO ANY PUBLIC SUPPLY OBLIGATION, DECIDE TO EXPORT ALL OF ITS SUPPLY FOR PARALLEL TRADE, THERE IS AN UPPER LIMIT ON THE MANUFACTURER'S DUTY TO SUPPLY (AND THEREFORE EXPOSURE).

But the qualification that "ordinary" is to be interpreted "in the light of both the size of those orders in relation to the requirements of the market in the first Member State and the previous business relations between that undertaking and the wholesalers concerned" is reasonably helpful. This seems to suggest a two-stage inquiry: First, that the dominant firm can refuse if the *individual* orders placed by the wholesaler materially exceed what it ordered before; and Second, that the dominant firm might still be able to refuse to meet an individual order if the

total *aggregate* amount supplied in the Member State already materially exceeded domestic consumption (assuming, perhaps, that there is some evidence of the requesting wholesaler also having engaged in parallel trade).

Thus, one might argue that, subject to questions of how the ECJ's test will apply in practice, the overall thrust of the ECJ's conclusion is much more manufacturer- than parallel exporter-friendly. The upshot is that the manufacturer does not need to supply much more than domestic consumption. In these circumstances, even if the wholesaler could, subject to any public supply obligation, decide to export all of its supply for parallel trade, there is an upper limit on the manufacturer's duty to supply (and therefore exposure).

But the route by which the ECJ got to its conclusions is pretty confused and difficult to fathom in many respects. A few brief points should be highlighted.

A. WHY DOES THE DOMINANT FIRM EVEN NEED A DEFENSE OF OBJECTIVE JUSTIFICATION?

The ECJ's analysis posits that a refusal to supply that would result in the elimination of supplies from a parallel trader is *prima facie* abusive unless objectively justified by, e.g., the manufacturer's need to take reasonable steps to protect its commercial interests.

This inverted analysis assumes away rather a lot. Most obviously, it assumes that a dominant firm in general has no unilateral right to refuse to deal in circumstances where the object of the refusal is a parallel traded good. Thus, the fact that the goods in question are intended to cross the border of another Member State apparently makes all the difference: That act takes away any basic right that the dominant firm might otherwise have had to refuse to deal with a third party.

But why does the dominant firm need a defense as a general matter in parallel trade cases? Why does the burden shift to it to show objective justification straight away? Surely it has the basic right, in general, to refuse to deal? The idea that a refusal to deal with a parallel trader is unlawful unless there is an objective justification for the refusal is curious. There are only a handful of very unusual cases in which EU competition law has compelled firms to deal with third parties. Those cases are subject to very strict conditions—in particular the circumstances that the product in question is “indispensable” for rivals; the refusal would eliminate all effective competition in the market; and the decision lacks objective justification.

Not a shred of this forms part of the ECJ's analysis in parallel trade cases. Why not? Indeed, if anything, where, as in parallel trade, the only competition in question concerns resale/distribution, there is arguably even less reason to intervene since it is purely intra-brand competition based on the exact same products—in contrast to refusal-to-deal case law where the issue was access to an input that rivals needed to make their own value-added or innovative finished products.

The ECJ did cite some Article 82 parallel trade cases in support of its view that limiting parallel trade by unilateral refusals to deal is *prima facie* abusive (absent objective justification). But none of them, properly analyzed, really supports its view. *United Brands* did concern a decision by a dominant firm to terminate supplies to its distributor, Oelsen, on the grounds that the distributor had participated in an advertising campaign for a competitor of the supplier. But the rationale was that this was a reprisal abuse, aimed at reducing the distributor pool available to a rival of the dominant firm.²⁰ The case also involved the dominant firm imposing a clause prohibiting the sale of green bananas (yellow bananas would deteriorate too quickly to allow transportation to other Member States). But this

was an outright agreement excluding all parallel trade, for no good reason, which would probably be *per se* illegal under Article 81 EC anyway. So the case does not say that unilateral conduct limiting parallel trade is an abuse.

Likewise, the cited automotive cases, *British Leyland*²¹ and *General Motors*²² were more concerned with the circumstance that the dominant firm has a 600 percent price difference for performing the same service (issuing certificates for left- and right-hand drive cars). This was an example of unlawful excessive pricing whether or not it happened to involve a comparison between imported cars and domestic cars.

The other legal principle cited by the ECJ—that a refusal to deal with a parallel trader is *prima facie* abusive where it is “liable to eliminate a trading party as a competitor”²³—also makes an elementary error. The mere fact, if it is a fact, that a particular wholesaler would exit the market has no necessary connection with any adverse effects on competition. There may for example be plenty of other wholesalers (intra-brand competition) or, more importantly, competition from other brands (inter-brand). To suggest otherwise is to say that competitors must be protected under EU competition law, which the Commission has recently emphasized is not the case under Article 82.²⁴

TREATING A REFUSAL TO DEAL AS
PRIMA FACIE ABUSIVE DEPENDING
ON WHETHER IT INVOLVES
PARALLEL TRADE OR NOT IS ALSO
ECONOMICALLY INCOHERENT.

Treating a refusal to deal as *prima facie* abusive depending on whether it involves parallel trade or not is also economically incoherent. A simple example shows why. Suppose a manufacturer, Big Bad Pharmaco, is dominant in a particular class of drug in Greece. It sells Wonderdrug to a Greek wholesaler, called Virtuous, at 10 EURO and the (regulated) retail price in Greece is 12 EURO. Big Bad Pharmaco also sells Wonderdrug to wholesalers in France at 15 EURO. The (regulated) retail price in France of Wonderdrug is 20 EURO. So Virtuous buys in Greece at 10 EURO and exports for sale in France where, quite rationally, it has incentives to price at 20 EURO. Big Bad Pharmaco then refuses to sell to Virtuous (because it is exporting to France) and also simultaneously refuses to sell to the French wholesalers (because it wishes to reduce over-supply in France).

On the ECJ's logic, the former refusal would be *prima facie* illegal (i.e., absent objective justification) whereas the latter would be legal (since there is no cross-border element). But the two situations are, in terms of economic effects, identical. Of course you might say that Virtuous has more margin to play with and so could offer lower prices in France. But this assumes that parallel trade always benefits consumers, a point to which we return later in the paper.²⁵

Does it matter that the ECJ effectively reverses the burden of proof and requires the dominant firm to show that its intention to limit parallel trading is objectively justified? Potentially, yes. The (partial) reversal of the burden of

proof could have important consequences, for example, in litigation. Most jurisdictions, for example, allow striking out unmeritorious claims at an early stage to avoid pointless, expensive trials.²⁶ But if, following *Glaxo Greece*, it is abusive—absent objective justification—to refuse to supply parallel traders, then it may be much more difficult for a manufacturer to have claims struck out, since a parallel trader would be able to establish a *prima facie* abuse for which the manufacturer then needs to advance an objective justification. In the English courts at least, there is some evidence that judges faced with difficult choices in competition law cases will often simply decide that the party bearing the burden of proof has not discharged it.²⁷ This could be important in practice, since, if a claim survives a strike out, it is more likely to thereafter settle on terms favorable to the parallel trader.²⁸ By contrast, had the ECJ given more weight, as it should have, to the dominant firm's basic legal right to refuse to deal with anyone, issues like this would be avoided, or at least minimized.

B. UNILATERAL ACTS ARE DIFFERENT

Another flaw in the ECJ's reasoning is that it gives no recognition to unilateral acts being fundamentally different, in competition law terms, to agreements between two or more undertakings. The mere fact that a unilateral act would resemble or have similar effects to an agreement does not mean that they are equivalent in competition law terms. To take an obvious example, an agreement between two competing undertakings not to sell in a particular territory or to limit their output is a hardcore cartel, but a unilateral decision by a firm not to sell in a particular country or to reduce the volumes in that country it sells must, without additional abusive conduct, be legal, even if a firm is dominant. Any firm, dominant or not, has the general right to decide, unilaterally, to whom or where it sells and how much.

ANOTHER FLAW IN THE ECJ'S REASONING IS THAT IT GIVES NO RECOGNITION TO UNILATERAL ACTS BEING FUNDAMENTALLY DIFFERENT, IN COMPETITION LAW TERMS, TO AGREEMENTS BETWEEN TWO OR MORE UNDERTAKINGS.

Remnants of this flawed logic (and conflation of two different things in competition law terms) remain in *Glaxo Greece*. For example, the ECJ noted the strict policy on agreements that limit trade under Article 81²⁹ and seemed to use that as a basis for justifying the treatment of unilateral acts under Article 82 in a similar fashion.³⁰ This is wrong: the two cannot be conflated in this way.

Similarly, Advocate General Colomer seemed to attach importance to the fact that *Glaxo Greece* had moved from a situation of vertical integration to one in which it had contracts with independent distributors, thus suggesting, implicitly but clearly, that the latter arrangements could be analogized with Article 81-type issues,³¹ and therefore more deserving of sanction than a situation of vertical integration. But this too is a bogus distinction: Whether a dominant firm is limiting parallel trade through unilateral vertical integration or by unilaterally reducing

supplies to independent distributors is economically indistinguishable. It makes no sense to suggest that the latter is worthy of sanction but the former is not.

The reasons for conflating the analysis of agreements and unilateral acts with facially similar effects is of course bound up in the EU institution's long-held view that, sometimes anyway, EU competition law must be interpreted in a manner that advances the political objective of market integration between Member States. Indeed, the Commission has stated that "it is inconceivable that competition policy could be applied without reference to the priorities fixed by the Community,"³² which include an internal market without frontiers. The Commission has also spoken of the "federating" role of EU competition law,³³ which explains why the integration of national markets has featured prominently in EU competition case law.

THE IDEA THAT EU COMPETITION LAW MAY MEAN DIFFERENT THINGS DEPENDING ON WHETHER A BORDER IS CROSSED OR NOT IS ODD AND LARGELY UNHELPFUL.

The idea that EU competition law may mean different things depending on whether a border is crossed or not is odd and largely unhelpful. One obvious problem already noted is that the law cannot be different depending on the happen-

stance of whether a product or service is provided cross-border. Another concern is that the meaning of Article 82—which the Commission at least has gone to great lengths to attempt to clarify in its recent Article 82 Guidance Paper³⁴—is likely to be much less clear if it also includes the broad, and generally poorly-defined, political objective of furthering market integration. It is also not clear why parallel traders have typically been regarded as so virtuous by the EU institutions and manufacturer conduct to limit parallel trade so heinous. One could argue that an innovator has a higher moral claim than a reseller because it creates something.³⁵

There are signs though of a shift in approach (quite apart from the overall gist of *Glaxo Greece*, which, as noted, seems in pragmatic terms ultimately quite favorable to manufacturers). It is notable that the recent Article 82 Guidance Paper does not mention the single market objectives of the EC Treaty as potentially broadening the interpretation of Article 82. Also, the Court of First Instance in *Glaxo Spain* recently noted that:

"the mere fact that an agreement is intended to restrict parallel trade is not sufficient to support the conclusion that there is an infringement of Article 81(1) EC. In effect, the objective assigned to that provision is to prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the final consumer of the products in question."³⁶

The imminent ECJ appeal in the case will therefore be watched with great interest.

C. POLICY-LITE

The ECJ's treatment of the underlying policy questions affecting the pharmaceutical industry is also superficial. While, ultimately, the ECJ's adopting a pragmatic test based on whether the orders are "ordinary" or not avoided the need to review these policy questions in any serious way, its apparently unwillingness or inability to do so is regrettable. It is, after all, the EU's highest court and this was the second preliminary reference in the same case. One suspects that the ECJ was unwilling to decide a legal case, either way, against the backdrop of complex, diverse, and constantly evolving national pharmaceutical regulation policies in 27 Member States.

But a number of the issues raised did involve eminently testable assumptions. For example, the ECJ dismissed the argument that parallel trade does not benefit the ultimate consumers on the basis that it might have some (indirect) positive price effects. This is a pretty fundamental point, since, absent consumer price benefits, a competition law policy that supported parallel trade would, very clearly, be based on the notion that forcing wealth transfers from manufacturers to distributors is a legitimate competition law objective—i.e., protecting competitors. And it is also a point that can be assessed in a fairly reliable quantitative way.

THE ECJ'S TREATMENT OF THE UNDERLYING POLICY QUESTIONS AFFECTING THE PHARMACEUTICAL INDUSTRY IS ALSO SUPERFICIAL.

There was no serious analysis at all of this issue in the judgment—only throw-away remarks that had no apparent empirical or objective basis. This issue merited proper attention. There is plenty of evidence, including from the Commission itself, that parallel trade produces minimal/no final consumer benefits.³⁷ The ECJ had two well-resourced competing interest groups before it, so it is not clear why the evidence was not assessed in a serious and forensic way. While it may ultimately have been difficult for the ECJ to be categorical, either way, on this issue, the conclusions to be drawn from the preponderance of evidence ought to have had very important implications for the analysis. For example, if indeed it is the case that there are limited consumer benefits, one wonders whether treating refusals to deal with parallel traders as even *prima facie* capable of being abusive is a good idea at all.

The same sort of poor reasoning applies to the other key policy questions that the ECJ was confronted with. For example, one issue raised by the manufacturers is that the period of effective patent protection is relatively short (even allowing for legal extensions such as supplementary protection certificates ("SPCs")) so that the ability to limit arbitrage between countries is an important factor in supporting efficient price discrimination to support recovery of fixed R&D costs.

The Advocate General's response to this was to say that, while there was not "any" evidence before the court, he nonetheless felt able to surmise that "the long delay was due to the internal cost structures of pharmaceutical undertak-

ings.”³⁸ For good measure, he was also able to “hazard a guess” that the same was true in “other” unspecified “sectors.”³⁹ This is not really high quality analysis. Also it’s pretty obvious to most observers that a major contributory factor in shortened patent life is burdensome regulatory approval schemes. This is the main reason why we have, for example, the SPC regime in the EU.

It is also fair to point out that there are policy factors that may potentially go in the other direction. The pharmaceutical sector is said to be the single most profitable business sector in the economy,⁴⁰ with 15-25 percent plus margins being quite common.⁴¹ Equally, it is striking that major pharmaceutical companies spend far more on marketing than they do on R&D—in many cases, by multiples.⁴² This is a plausible explanation for why off-patent branded drugs still manage to maintain significant price premiums over generic products, i.e., marketing, not therapeutic innovation, sells. The oft-heard cry that regulatory or competition law interventions would rob the industry of essential funds for R&D must be seen in this context. Finally, the recent EU Commission sector inquiry and on-going US Federal Trade Commission enforcement in relation to patent settlements and impediments to generic entry raise at least a suspicion that an important parameter of competition has nothing to do with innovation but gaming various processes and legal settlements.⁴³

On the other hand, advances in pharmaceuticals, biotechnology, and genetics (e.g., monoclonal therapies for cancer, HIV/AIDS treatments) make the economic and non-economic benefits of innovation undeniable and of profound importance to society. The costs of innovation are also staggering and success is fleeting. Bringing a new drug to market, for example, costs an average of \$800 million in capitalized costs for pre-regulatory approval research and development and \$95 million for post-approval research and development.⁴⁴ Only one in approximately every 435 drugs that are considered ever makes it to the market.⁴⁵ So the rewards for the few successes need to compensate for the many failures.⁴⁶

In fairness to the ECJ though, its job is to decide the cases that come before it, not to make policy. These policy questions are also undoubtedly hard and may, in some respects, be too intractable to develop immutable legal rules. They are also questions that go far beyond the esoteric realms of competition law and raise fundamental questions of industrial and social policy for the EU economy (and others), as well as what type of public health policy it wants. A proper assessment also cannot ignore the industrial policy issues of whether the EU is content with relatively low levels of R&D based in the EU, with U.S.-based research being relied upon to a large extent. These are big questions and ones moreover than cannot, in an interdependent world, be looked at in terms of EU geography only. And very few of them will be answered in any satisfactory way as a result of the EU Commission’s competition sector inquiry in the pharmaceutical sector,⁴⁷ which, to the extent any follow-up action results, will largely focus on agreements and practices that limit competition from generic and patent settlements.

But these questions are also unavoidably central to at least informing—and we would argue dictating—what sensible competition law and policy should be doing with questions like parallel trade. Of course the ECJ is a supreme court of law, not an enforcement agency or central planner. But this cannot lead to its abdicating a responsibility to examine the key policy issues in a serious, forensic, and measured way. Substituting all of this in favor of the pure pragmatism of imposing some upper limit on the duty to supply—“ordinary” supplies—is the legal equivalent of putting a Band Aid on a gaping wound. ▼

III. Annex: *Syfait* and *Glaxo Greece* Compared

Issue	AG Jacobs in <i>Syfait</i>	AG Ruiz–Jarabo Colomer in <i>Glaxo Greece</i>	ECJ in <i>Glaxo Greece</i>
The uniqueness of the pharmaceutical market	<p>“It is impossible, when assessing conduct of the kind at issue in the present proceedings, to ignore the pervasive and diverse regulation to which the pharmaceutical sector is subject both at national and Community levels, and which appears to me to set it apart from all other industries engaged in the production of readily traded goods.” (¶77)</p> <p>“I think it is highly unlikely that any other sector would exhibit the characteristics which have led me to conclude that a restriction of supply in order to limit parallel trade is defensible in relation to pharmaceutical products.” (¶102)</p>	<p>“We must rule out the idea that there are in this case objective reasons relating to State intervention in the market which would justify its conduct.” (¶98)</p>	<p>The ECJ found that there are no grounds for treating restrictions to parallel trade in pharmaceuticals differently.</p>
Economic justifications	<p>“I consider that a restriction of supply by a dominant pharmaceutical undertaking in order to limit parallel trade is capable of justification as a reasonable and proportionate measure in defence of that undertaking’s commercial interests. . . . Given the specific economic characteristics of the pharmaceutical industry, a requirement to supply would not necessarily promote either free movement or competition, and might harm the incentive for pharmaceutical undertakings to innovate.” (¶100)</p>	<p>“Apart from the description of the ‘horrors’ caused by parallel trade, GSK does not indicate any positive aspect resulting from its restriction of supplies of medicinal products to the wholesalers, except that its profit margins recover, which is irrelevant for the purposes of classifying the conduct as an abuse, or for the purposes of justifying it.” (¶118)</p>	<p>“Even if the degree of regulation regarding the price of medicines cannot prevent any refusal by a pharmaceuticals company in a dominant position to meet orders sent to it by wholesalers involved in parallel exports from constituting an abuse, such a company must nevertheless be in a position to take steps that are reasonable and in proportion to the need to protect its own commercial interests.” (¶70)</p>

Issue	AG Jacobs in <i>Syfait</i>	AG Ruiz-Jarabo Colomer in <i>Glaxo Greece</i>	ECJ in <i>Glaxo Greece</i>
Consumer benefit of parallel trade	<p>“The fact that Member States have adopted radically different price levels for pharmaceutical products in their territories, and are themselves the main purchasers of pharmaceutical products, casts doubt upon the notion that parallel trade will in fact benefit the purchasers of such products.” (¶88)</p>	<p>“Allowing preconceived and formalistic ideas on abuse of a dominant position to prevail would mask the fact that sometimes dominance can benefit consumers.” (¶73)</p>	<p>“Even in the Member States where the prices of medicines are subject to State regulation, parallel trade is liable to exert pressure on prices and, consequently, to create financial benefits not only for the social health insurance funds, but equally for the patients concerned, from whom the proportion of the price of medicines for which they are responsible will be lower.” (¶56)</p>
Impact on R&D	<p>“Innovation is an important parameter of competition in the pharmaceuticals sector.” (¶89) “If low-price Member States were able to resist the pressure for price rises, and pharmaceuticals undertakings did not withdraw or delay products, the revenue generated by products in respect of which dominance was found would be cut. The incentive for a pharmaceutical undertaking to invest in research and development would to that extent be reduced, given the lower returns which such an undertaking could expect to enjoy during the period of its patent protection.” (¶93)</p>	<p>“I cannot see that there is necessarily any causal link between any possible negative impact on R&D investment and parallel trade, since, in the first place, GSK and the writers in question have not provided any information relating to the reasons for the period during which the patent is not revenue producing.” (¶109)</p>	<p>The ECJ declined to address the issue of a possible link between the losses incurred by pharmaceutical companies as a result of parallel trade and their ability to invest in R&D. (¶70)</p>

- 1 Case C-53/03 *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v GlaxoSmithKline plc and GlaxoSmithKline AEVE*, [2005] ECR I-4609 (“*Syfait*”).
- 2 Joined Cases C-468/06 to C-478/06, judgment of 16 September 2008, not yet reported. (*Glaxo Greece*)
- 3 Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969, currently on appeal with an oral hearing scheduled in March 2009.
- 4 *Syfait*, *supra* note 1, per Advocate General Jacobs at ¶70.
- 5 *Glaxo Greece*, *supra* note 2, ¶35, 39.

- 6 *Id.* ¶49, 50.
- 7 *Id.* ¶57.
- 8 *Id.* ¶56.
- 9 *Id.* ¶62.
- 10 *Id.* ¶63.
- 11 *Id.* ¶67, 68.
- 12 *Id.* ¶69.
- 13 The ECJ also held that the right to refuse to meet orders out of the ordinary answered the objection that a duty to supply parallel exporters could lead to shortages in the export country (which actually happened in Greece) (*Id.* ¶74).
- 14 *Id.* ¶77.
- 15 See J.S. Venit & P. Rey, *Parallel Trade and Pharmaceuticals: A Policy in Search of Itself*, Eur. L REV 153 (2004).
- 16 *Glaxo Greece*, *supra* note 2, ¶70.
- 17 *Syfait*, *supra* note 1, ¶150 per Advocate General Jacobs:
- Given that any attempt by a producer to restrict supply in order to limit parallel trade is usually motivated by a concern to restrict intra-brand competition on the market of import, such a restriction is normally to be regarded as abusive. Partly, also, the Commission relies upon the market-partitioning object of the conduct at issue. The Court has consistently interpreted Articles 81 and 82 EC as prohibiting conduct aimed at dividing the common market.
- 18 GSK AEVE had delivered quantities of medicines corresponding to the monthly average sold in Greece during the first 10 months of 2000, while certain wholesalers asked for those quantities to be increased by a certain percentage, which was fixed by some of them at 20 percent (see *Glaxo Greece*, *supra* note 2, ¶72). The ECJ also held that the right to refuse to meet orders out of the ordinary answered the objection that a duty to supply parallel exporters could lead to shortages in the export country (which actually happened in Greece) (*Id.*, ¶74).
- 19 *Id.* ¶76.
- 20 *Case 27/76, United Brands Company and United Brands Continentaal BV v Commission* [1978] ECR 207.
- 21 *Case 226/84, British Leyland v Commission* [1978] ECR 207.
- 22 *Case 26/75, General Motors Continental v Commission* [1986] ECR 3263.
- 23 *Glaxo Greece*, *supra* note 2 ¶34.
- 24 See DG COMP Guidance on its enforcement priorities in applying Article 82 to abusive exclusionary conduct by dominant undertakings, official version published on February 9, 2009, available at http://ec.europa.eu/competition/antitrust/art82/guidance_en.pdf, (the "Article 82 Guidance Paper")

("The Commission will focus on those types of conduct that are most harmful to consumers", ¶15) (Section B, "Foreclosure leading to consumer harm"), and ¶19.

- 25 Another oddity of the ECJ's analysis is the focus on the manufacturer's dominance in the exporting market (here, Greece). But, surely, if the only plausible benefit of the parallel trade activity is to the importing Member State, the real issue is the state of competition in that market, not the market where the goods come from. It is perfectly possible that there could be much more inter-brand competition in the importing market such that a refusal to supply more products for intra-brand competition does not impact on effective competition overall.
- 26 See, e.g., Rule 3.4 of the Civil Procedure Rules in England & Wales.
- 27 See, e.g., *Chester City Council v. Arriva plc* [2007] EWHC 1373 (Ch), [2007] UKCLR 1582.
- 28 Matters are also complicated by the fact that it is not entirely clear from *Glaxo Greece* whether the dominant firm bears only an evidential burden (i.e., to put forward a *prima facie* case showing that the order is not "ordinary") or the entire legal burden of showing that its conduct is not abusive. One assumes the former, since this is how objective justification under Article 82 usually works and anything more would be contrary to the burden of proof rules in Council Regulation (EC) No 1/2003 of December 16, 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ [2003] L 1/1.
- 29 *Glaxo Greece*, *supra* note 2 ¶165.
- 30 *Id.* ¶166.
- 31 *Id.* ¶111.
- 32 XXIIIRD REPORT ON COMPETITION POLICY (1993), p. 1.
- 33 XXVIITH REPORT ON COMPETITION POLICY (1997), foreword by the then Commissioner responsible for competition policy, Karel Van Miert.
- 34 See DG COMP Preliminary Report of November 28, 2008, *Pharmaceutical Sector Inquiry*, document available at http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/preliminary_report.pdf (last visited on February 28, 2009).
- 35 It is also striking how the EU institutions' policy in this regard has been selective. For example, the EU has a strict competition policy intended to promote parallel trade in automotive vehicles. But it has, at the same time, refused to take any action against national vehicle registration taxes and policies that, quite explicitly in some cases, are designed to off-set the savings made by purchasing the vehicle in another Member State. (Some might say, unfairly, that there is one rule for arbitrage that would offset disparities in national public fiscal policies and another where private interests such as pharmaceutical manufacturing are at issue.)
- 36 Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969, ¶ 10.
- 37 In 1998, the Commission stated that "parallel trade creates inefficiencies because most, if not all, of the financial benefit accrues to the parallel trader rather than to the health care system or patient." See Commission Communication on the *Single Market in Pharmaceuticals*, COM (1998) 588. See also P.M. Danzon & A. Towse, *Differential Pricing for Pharmaceuticals: Reconciling Access, R&D and Patents*, AEI-Brookings Joint Centre Working Paper No. 03-7 (July 2003), pp. 13-14 and A. Towse, *What are the Short and Long Run Implications for the UK of Parallel Trade in Pharmaceuticals?*, Working Paper, 1997, London, Office of Health Economics, pp. 1-20.

- 38 *Glaxo Greece*, *supra* note 2 ¶111.
- 39 *Id.* ¶111.
- 40 See, e.g., data in *2002 Drug Industry Profits: Hefty Pharmaceutical Company Margins Dwarf Other Industries*, Congress Watch, June 2003, Figure 5, document available at http://www.citizen.org/documents/Pharma_Report.pdf.
- 41 See L. Davidson & G. Greblov, *The Pharmaceutical Industry in the Global Economy*, mimeo, Indiana University School of Business, Summer 2005, Table 2.8.
- 42 *Id.*, Figure 3. See also M. Angell, *Excess in the Pharmaceutical Industry*, *CMAJ* 2004 December 7; 171(12): 1451–1453.
- 43 *Supra* note 34.
- 44 J.A. Dimasi, R.W. Hansen, & H.G. Grabowski, *The Price of Innovation: New Estimates of Drug Development Costs*, 22 *J. HEALTH ECON.* 151–85 (2003).
- 45 Based on figures from H. Grabowski, *Patents, Innovation and Access to New Pharmaceuticals*, mimeo, Duke University, July 2002; and J.A. Dimasi, *Research and Development Costs For New Drugs by Therapeutic Category*, 7 *PHARMACOECONOMICS* 152–169 (1995).
- 46 See generally European Federation of Pharmaceutical Industries and Associations (EFPIA), *Article 82 EC: Can It Be Applied To Control Sales By Pharmaceutical Manufacturers To Wholesalers?*, Research Paper, November 2004.
- 47 *Supra* note 34.



Review of How the Chicago School Overshot the Mark

William Kolasky

Review of *How the Chicago School Overshot the Mark*

By William Kolasky*

During his successful presidential campaign, Barack Obama repeatedly described our current financial crisis as “the final verdict on a failed philosophy” of government, “a philosophy that views even the most common-sense regulation as unwise and unnecessary.”¹ While these remarks were not directed at antitrust in particular, they could well have been. As Robert Pitofsky’s timely new book *How the Chicago School Overshot the Mark* shows, during the eight years of the Bush Administration both the federal enforcement agencies and the federal courts applied this same laissez faire philosophy to the enforcement of our antitrust laws. The result was a historically low level of enforcement activity. In one essay, Carl Shapiro and Jonathan Baker document that merger enforcement activity at both agencies in 2005-2006 fell below even the previous historic lows seen during the second Reagan administration. The mergers cleared by the two agencies included one merger to monopoly in satellite radio (XM/Sirius) and a merger of the last two major domestic washer/dryer manufacturers (Whirlpool/Maytag), with a combined market share of over 70 percent, following which the merged company increased prices in the face of declining demand. Even more remarkably, after having brought three major monopolization cases in the last three years of the Clinton administration (*Microsoft*, *American Airlines*, and *Dentsply*), the Justice Department did not bring a single monopolization case during the eight years George Bush was in office.

As federal antitrust enforcement activity declined, the federal courts showed increasing hostility to efforts by private plaintiffs to fill the gap. It has been more than 15 years since an antitrust plaintiff last won a case in the Supreme Court,

*William Kolasky is a partner in WilmerHale’s Regulatory and Government Affairs Department, and a member of the Antitrust and Competition Practice Group. This article reviews *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* (Robert Pitofsky, ed. 2008).

as defendants have racked up a 16-0 record. The record is more mixed in the intermediate courts of appeals, but with conservative Republican appointees dominating 11 of the 13 circuits, the number of pro-plaintiff decisions in the lower courts is now declining as well.

A senior official in the Bush Antitrust Division has defended these judicial decisions as signaling “not less antitrust, but better antitrust.”² How the Chicago School Overshot the Mark seeks to debate this proposition. The contributors to the book, which include some of the nation’s most distinguished antitrust scholars, argue forcefully that while many of the Supreme Court’s decisions over the last 30 years were a necessary midcourse correction from the overly interventionist antitrust jurisprudence of the Supreme Court during Earl Warren’s tenure as Chief Justice, the federal antitrust agencies and the courts have now “overshot the mark” in adopting too laissez-faire an approach to antitrust enforcement. More importantly, they seek to offer specific proposals for reinvigorating antitrust enforcement, something Barack Obama has promised that his administration will do.³ With his new administration having just taken office in January, this book could not be more timely.

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The first group of essays examines how we got to where we are. As the essays explain, the fundamental cause for the shift in antitrust law over the last half century is a redefinition of the objectives of antitrust. During the Warren years, the Supreme Court was quite explicit in viewing the antitrust laws as designed to protect small enterprises in order to maintain a pluralist society, even if that resulted in some loss of efficiency.⁴ The central tenet of the so-called “Chicago School” is that this populist view of antitrust was mistaken, and that the sole goal of the antitrust laws is to promote economic welfare by protecting competition, not competitors. I put “Chicago School” in quotation marks because, as the essays in this book show, this narrower view of the objectives of antitrust was advocated not just by economists and lawyers teaching at the University of Chicago, but also by Donald Turner, Philip Areeda, and Stephen Breyer, all of whom taught at the Harvard School. None of them had any connection to Chicago, other than that one of their former students, Richard Posner, became one of the most prolific and influential members of the Chicago School.

Interestingly, none of the contributors to the Pitofsky book proposes that we revert to the Warren Court’s more populist view of antitrust, using those laws to protect small inefficient firms from large, more efficient rivals. Instead, the contributors frame the debate in terms that accept the central premise of the Chicago School, but attempt to eat away at the margins. Thus, Eleanor Fox worries that we have moved too far in the direction of trying to determine whether the outcome of a particular merger or conduct will be efficient, rather than protecting the competitive process itself, which she defines in terms of

rivalry. Similarly, John Kirkwood and Robert Lande re-examine the legislative history of the Sherman Act in an effort to show that the antitrust laws are concerned with consumer welfare, not total welfare, and that the laws should therefore be enforced in a manner that outlaws mergers and conduct that will result in transferring consumer surplus to producers. There is substantial merit behind both arguments, either of which would reduce the risk of false negatives in antitrust litigation by making it easier for plaintiffs to show that conduct is “anticompetitive.”

WE NEED TO FOCUS MORE
ATTENTION—AS ANTITRUST DID
IN THE PAST—ON THE IMPACT OF
THE MERGER ON THE BROADER
“LINE OF COMMERCE” IN WHICH
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This is a debate that is particularly timely. Over the last several months, we have witnessed the government having to rescue company after company because they were deemed “too large to fail.” We have also seen examples of companies that have grown through mergers and whose failure to integrate the acquired businesses has contributed to serious management fail-

ures. It is by no means clear that antitrust weapons are the right tools to use in these cases, but these cases do suggest that we may need to broaden the lens of our antitrust analysis of proposed mergers beyond a myopic focus on their immediate impacts on narrow markets, as defined using the current Merger Guidelines SSNIP test. We need to focus more attention—as antitrust did in the past—on the impact of the merger on the broader “line of commerce” in which the merging firms compete.

The second half of *How the Chicago School Overshot the Mark* focuses on how we could reinvigorate antitrust enforcement in four specific areas: dominant firm conduct; exclusionary vertical restraints; vertical distribution restraints; and mergers. These essays are in many ways of greater immediate relevance as a new administration comes into office with a commitment to reinvigorating antitrust enforcement. Together, they provide an excellent roadmap toward achieving that objective.

The first two essays, by Herb Hovenkamp and Harvey Goldschmidt, address the thorny issue of how the antitrust laws should be used to regulate dominant firm conduct. This is a topic that has recently been the subject of loud debate in Washington. In September, the Justice Department released a report entitled *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*.⁵ In that report, the Justice Department argues in favor of a narrow role for the antitrust laws in policing the conduct of dominant and near-dominant firms. The report proposes what it calls a “substantial disproportionality” test, under which the Department would not bring a Section 2 enforcement action unless a firm with monopoly or near-monopoly power engages in conduct, the anticompetitive effects of which are “substantially disproportionate” to its pro-competitive justifications. The same day, the FTC released a stinging rebuke signed by three of the four sitting commissioners, attacking the Justice Department report

as “a blueprint for radically weakened enforcement of Section 2 of the Sherman Act,” that “would place a thumb on the scales in favor of firms with monopoly or near-monopoly power” and against the interests of consumers.⁶ These conflicting views illustrate how wide the gulf is between those, like the three commissioners, who believe that dominant-firm conduct should be a major focus of antitrust enforcement, and those, like the outgoing Bush Justice Department officials, who believe that markets are inherently self-correcting and that single-firm conduct, even by dominant firms, will rarely, if ever, cause durable harm to competition.

Professor Hovenkamp’s essay was written before the Justice Department released its report, but it is clear that his views fall somewhere between the Justice Department report and the three commissioners. Rather than supporting anything akin to the Department’s “substantial disproportionality” test, or its more radical cousin, the “no economic sense” test, Professor Hovenkamp argues in favor of using a more neutral test that defines monopolistic conduct as acts that: “(1) are reasonably capable of creating, enlarging, or prolonging monopoly power by impairing the opportunities of rivals; and (2) that either (2a) do not benefit consumers at all, or (2b) are unnecessary for the particular consumer benefits that the acts produce, or (2c) produce harms disproportionate to the benefits.” The Justice Department report basically adopts this same analytical framework, but modifies the last part of the test (2c) to require that the harms be “substantially disproportionate” to the benefits in order to reduce the risk of false positives.

As I have written elsewhere, I think that the analytical framework proposed by Professor Hovenkamp asks exactly the right questions, but overlooks an important element in terms of how the test should be applied in practice in order to reduce the risk of both false positives and false negatives.⁷ As the Supreme Court recognized in *California Dental Ass’n v. FTC*,⁸ in the context of Section 1 of the Sherman Act, the rule of reason requires a stepwise analysis, in which the courts should apply a sliding scale at each step of the analysis. Thus, the stronger the showing of harm to competition in step (1), the closer the court should scrutinize the claimed benefits and the availability of less restrictive alternatives to achieve them. Applying this sliding scale, it should rarely be necessary for a court to reach the final, most difficult step of having to balance the competitive harms and benefits of the conduct at issue.

This sliding scale approach is similar to the approach the courts use in enforcing both the First Amendment and the Equal Protection Clause, scrutinizing in various degrees the proffered governmental justifications depending on the seriousness of the alleged infringement. There is no reason the same sliding scale could not be used to enforce Section 2, as well as Section 1. Doing so would avoid the need for the type of ad-hoc balancing the Justice Department seems to fear, while still allowing a much wider ambit for strong antitrust enforcement against monopolistic single-firm conduct than the “no economic sense” or “substantial disproportionality” tests would.

The next two essays, by Steven Salop and Stephen Calkins, address exclusionary vertical conduct, including tying and exclusive dealing. Both essays make a persuasive case in showing that the Chicago School critique of tying and exclusive dealing has been read too broadly and that there are, indeed, circumstances in which both types of arrangements can harm competition. Professors Salop and Calkins agree, however, that the Chicago School was right in arguing that neither form of conduct should be *per se* unlawful, and that both should be evaluated under the rule of reason. Their essays provide useful suggestions for the agencies and private plaintiffs as to how to present a convincing rule of reason case against these types of exclusionary vertical agreements.

BOTH ESSAYS MAKE A PERSUASIVE CASE IN SHOWING THAT THE CHICAGO SCHOOL CRITIQUE OF TYING AND EXCLUSIVE DEALING HAS BEEN READ TOO BROADLY AND THAT THERE ARE, INDEED, CIRCUMSTANCES IN WHICH BOTH TYPES OF ARRANGEMENTS CAN HARM COMPETITION.

The penultimate two essays, by Warren Grimes and Marina Lao, deal with vertical distribution arrangements. In them, Professors Grimes and Lao recognize, as Professors Salop and Calkins do, that vertical restraints should generally be evaluated under the rule of reason, rather than condemned as *per se* unlawful. But they correctly caution against the too-easy acceptance of facile free-rider arguments, which would make vertical distribution restraints, including resale price maintenance, virtually *per se* legal. Like Professors Salop and Calkins, Professors Grimes and Lao attempt to identify the conditions in which both price and non-price vertical restraints may harm interbrand competition; proposing a set of presumptions that could be used to make the rule of reason an effective tool against such restraints. Their proposals seem generally sound, and, if followed, should serve to make the rule of reason a more effective enforcement tool against anti-competitive vertical restraints.

The final two essays, by Jonathan Baker and Carl Shapiro, focus on merger policy. As noted at the beginning of this review, they do a superb job of documenting what is wrong with merger policy today, but they do an equally effective job of proposing ways in which merger enforcement could be strengthened. Following in the footsteps of Derek Bok's path-breaking 1963 article in the *Harvard Law Review*, "Section 7 of the Clayton Act: The Merger of Law and Economics,"¹⁰ they correctly observe that because merger challenges necessarily have to predict what is likely to happen in the future, effective merger enforcement requires a set of rebuttable presumptions the government can rely on to block a merger, with the parties then having the burden of showing that their merger will not, in fact, lessen competition. Baker and Shapiro do not, however, propose to return to the purely structural presumptions of the 1960s. They suggest, instead, a set of other factors the agencies and courts should examine before presuming that a merger is likely to facilitate either a unilateral or coordinated price increase. The more nuanced presumptions they propose appear sensible as

a matter of economics, while still being reasonably administrable, and they plainly deserve serious consideration by the next administration.

In summary, Robert Pitofsky has rendered a real service by publishing this slender volume of essays at this moment in time. His contributors, all of whom have spent long careers studying the antitrust laws, plainly deserve to be listened to. My one regret is that he did not reach out more to the next generation of antitrust scholars, who will have to play the central role in reinvigorating antitrust enforcement in the way that these authors, most of whom are now nearing retirement, recognize needs to be done. ▼

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- 1 Statement by Barack Obama, "Blamed for Obama: 'Failed Philosophy' Blamed for Financial Meltdown," as reported by Susan G. for the Daily Kros, available at <http://www.dailykros.com/storyonly/2008/9/15/11025/7807>.
 - 2 See David L. Meyer, *We Should Not Let the Ongoing Rationalization of Antitrust Lead to the Marginalization of Antitrust* (Oct. 31, 2007), available at <http://www.usdoj.gov/atr/public/speeches/227399.htm>.
 - 3 Barack Obama, U.S. Senator (D-Ill.), Statement for the American Antitrust Institute (Sept. 27, 2007), available at http://www.antitrustinstitute.org/archives/files/aa-i-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf.
 - 4 *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 344 (1962) ("But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.").
 - 5 U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (Sept. 2008), available at <http://www.usdoj.gov/atr/public/reports/236681.htm>.
 - 6 See Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt>.
 - 7 William Kolasky, *Reinvigorating Antitrust Enforcement in the United States: A Proposal*, ANTITRUST, Spring 2008, at 85, 87-89.
 - 8 526 U.S. 756 (1999).
 - 9 Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).



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Introduction to The Neal Report and the Crisis in Antitrust & A Reprint of the Neal Report

Herbert Hovenkamp

Introduction to The Neal Report and the Crisis in Antitrust

*Herbert Hovenkamp**

I. Introduction

The Neal Report¹ (“Report”) was secretly commissioned by President Lyndon Johnson in late 1967. The President asked Phil C. Neal, Dean of the University of Chicago Law School, to lead a group of distinguished lawyers and economists in reporting on the state of competition in American industry and recommend reforms of the antitrust laws. President Johnson requested the Report by June 30, 1968, about four months prior to the election, and its release was intended to be part of the LBJ re-election strategy. However, Johnson’s political standing was severely damaged by the unpopular war in Vietnam, and in March, 1968, he announced that he would not run for reelection. The authors finished the Report nevertheless, and it was submitted to President Johnson in July, 1968, and released to the public early in 1969.²

This reprint of the Neal Report includes the authors’ Summary of the Report, as well as the main body’s most important components, which are an introduction on market structure and the role of competition; and a section on oligopoly, monopoly and industrial concentration, including the Report’s controversial proposal of a “Concentrated Industries Act.” Omitted are a section on conglomerates and conglomerate mergers, as well as concluding sections on the Robinson-Patman Act and patents.

The authors of the Report included six law professors who were teachers and scholars of antitrust,³ three economists,⁴ and three practicing antitrust attorneys.⁵ The entire project took only seven months to complete, involved no new research, and contains virtually no citation. Yet it proposed expansive antitrust reforms, including most centrally a “Concentrated Industries Act” which gave the Attorney General a mandate to “search out” oligopolies⁶ and order divesti-

I *Ben V. & Dorothy Willie Professor of Law, University of Iowa.

tures to the point that no firm would end up with a market share exceeding 12 percent. In addition, the Report recommended a much more aggressive merger provision that essentially would have condemned mergers in any large industry where the four-firm concentration ratio (“CR4”) exceeded 50 percent and one of the firms involved in the merger exceeded a market share of 10 percent. It is worth noting that such a market could have a Herfindahl-Hirschman Index (“HHI”) as low as 650, well under the 1000 HHI that the government’s Merger Guidelines currently in force regard as “unconcentrated,” and in which mergers have a virtual safe harbor. In addition, the Report recommended several amendments to the Robinson-Patman price discrimination statute, many of which were designed to weaken it. The Report also recommended patent reform that went not to the quality and quantity of issued patents, but rather to their licensing and use. The principal recommendations were a requirement that all patent licenses be registered, and that if a patent was licensed to one licensee it must be licensed to all other prospective licensees on nondiscriminatory terms. Finally, the Report recommended that a repository of economic data concerned mainly with industry structure and profits be collected and disseminated.

A couple of historical footnotes: First, Robert H. Bork wrote a stinging dissent from the Report’s recommendations and firmly aligned himself with the Chicago School critique.⁷ William F. Baxter kept silent but would largely repudiate the Report later as he learned more about economics.⁸ Second, all of the recommendations in the Neal Report were ignored, in part because the change in Administration from Johnson to Nixon killed any political momentum for massive antitrust reform. President Nixon appointed a second, competing Commission, this one chaired by George J. Stigler, another prominent member of the University of Chicago faculty, although this time in the economics department, as well as several of his colleagues.⁹ The Stigler Report was never officially released,¹⁰ but it leaked out in May, 1969.¹¹ The Stigler Report disagreed with the industrial concentration warnings in the Neal Report, largely rejected the correlation between market concentration, profits, and anticompetitive results that the Neal Report purported to find, and made several technical recommendations for revision of the antitrust laws. At least in the short term, its recommendations fared no better than those contained in the Neal Report.

Reading the Neal Report today is a trip to another world. But, in fact, it represented the received orthodoxy of its day. The tragedy of the Neal Report is that the model it represented was just on the verge of complete, catastrophic replacement. The views expressed there reflected the culmination of thirty years of industrial organization thinking that we today identify as the “structure-conduct-performance” (S-C-P) paradigm.¹² Indeed, the publication of the Neal Report played no small part in instigating a massive reaction among younger academics that eventually cast the S-C-P paradigm onto the dung heap of defunct economic doctrines.

INDEED, THE PUBLICATION OF THE NEAL REPORT PLAYED NO SMALL PART IN INSTIGATING A MASSIVE REACTION AMONG YOUNGER ACADEMICS THAT EVENTUALLY CAST THE S-C-P PARADIGM ONTO THE DUNG HEAP OF DEFUNCT ECONOMIC DOCTRINES.

The S-C-P paradigm was one of the most elegant and certainly the most tested model of industrial economics up to its time. Indeed, its greatest perceived virtues were its simplicity and its robustness. The theory represented the high point of structuralism in industrial organization economics, resting on the proposition that certain market structures were highly concentrated and experienced high barriers to entry, making certain types of conduct inevitable. Oligopolists simply could not avoid setting prices above costs and continuously and excessively differentiating the products. The result was high short-run profits, excessive investment in product differentiation and advertising, reluctance to cut price in order to grow market share, and general stagnation. The theory appeared to be verified by numerous studies showing positive correlations between industrial concentration and profits—the more concentrated the industry, the higher its price-cost margins.¹³ By contrast, the relationship between conduct and poor performance was thought to be virtually impossible to quantify.

Under the principle of excluded middle, if the structure dictated the conduct and the conduct dictated the performance, then conduct dropped out as an interesting subject of study. Thus the S-C-P paradigm led directly to the conclusion that structure and not conduct is what antitrust policy should be about. Thus the Neal Report could state that:

“Effective antitrust laws must bring about both competitive behavior and competitive industry structure. In the long run, competitive structure is the more important since it creates conditions conducive to competitive behavior.”¹⁴

This emphasis on structure and de-emphasis of conduct also motivated Donald F. Turner’s proposal in the early 1960s that firms in oligopolistic industries should be broken up because price competition in such markets could not be expected to emerge.¹⁵ The editors of the *Antitrust Law and Economics Review*, who were deeply sympathetic to the Neal Report and hostile toward the Stigler Report, introduced their publication of the latter with a proposed set of “Guidelines” for the antitrust enforcement agencies. The Guidelines were entitled *A Structure-Conduct-Performance Questionnaire*, and consisted of queries about the size of markets, the level of concentration, the amount of product differentiation, and the height of entry barriers. A few conduct questions were tacked on to the end.¹⁶

Today we can find much to criticize and even mock in the Neal Report. But it was largely faithful to the dominant industrial economics and law of its day. Its recommendations were built on some of the best theory coming out of an economic model that was just in the process of ending its period of domination. The tragedy of the Neal Report is that, while it was highly sensitive to where the intellectual winds were blowing from, it paid too little attention to where they were going.

Initially the S-C-P paradigm had offered a robust solution to problems that had festered within competition theory ever since the rise of marginalist economics in the late nineteenth century.¹⁷ Prior to the Great Depression, industrial economists had been unable to solve a problem that Alfred Marshall had observed already in his *Principles of Economics* in 1890: In the presence of fixed costs, competition tends to drive prices down to marginal cost without enough left over to cover fixed costs, leading to “ruinous” competition.¹⁸ During an era when technological progress was greatly increasing the proportion of fixed costs in production, this theory seemed to explain why so many economists opposed the antitrust laws and tended to favor collusion-facilitating cooperative ventures such as trade associations.¹⁹ The prevailing models assumed fungible products and “representative” firms—i.e., firms that were all more-or-less the same in significant characteristics.

Edward Chamberlin’s *Theory of Monopolistic Competition* largely solved the equilibrium problem in 1933,²⁰ but did so by abandoning the Marshallian notion that firms in multifirm markets pursued relentless price competition. Instead, they competed by differentiating their products. Further, this differentiation was “excessive,” in the sense that it was driven by pursuit of mini-monopolies rather than by consumer interest in an optimal variety of products at competitive prices. While the Marshallian story denigrated antitrust, Chamberlin’s theory seemed to call for a great deal of it. Indeed, this change in dominant models explains why the Roosevelt Administration so abruptly shifted its policy from virtual abandonment of antitrust and encouragement of collusion to one of aggressively enforcing the antitrust laws.

But that left open the question how the antitrust laws should be applied. While Marshall tended to see firms as similar, the Chamberlin story was one of extreme diversity in both strategy and behavior. The one unifying element was structure,

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a result of the picture that Chamberlin painted of firms ever searching to distinguish themselves from others so that they could operate in as small a market as possible. An important characteristic of industrial organization models at this time were formulas that related the markup of price over cost to two principal variables: the number of firms in the market and their size disparities.

Monopolistic competition largely solved the fixed-cost problem and made equilibrium possible. Chamberlin's equilibrium would always be suboptimal, however, with prices above marginal cost, continuous excess capacity, and excessive investment in product differentiation. In 1940 John Maurice Clark published his pathbreaking essay, *Workable Competition*, which argued that antitrust policy should not trouble itself with the pursuit of perfect competition.²¹ Rather, it should be satisfied with a set of compromises. Clark's genius lay in his observations that market imperfections have a way of cancelling each other out—for example, product differentiation made perfectly competitive equilibria impossible, but it also made collusion much more difficult to maintain. The interesting cases for Clark were the middles ones that fell between the monopolistic and the highly competitive, where policy making could have its most important role.

A few years later Joe Bain, the most prominent industrial organization economist prior to the rise of the Chicago School, exalted the strong link between market structure and the workability of competition. In the process, Bain laid the foundation for an antitrust policy whose principal goal was to ensure that industry did not become excessively concentrated, but would maintain just enough firms to ensure that price competition remained a part of business strategy and that product differentiation did not become excessive.²² For Bain, one of the most important problems was high concentration accompanied by high barriers to entry. Chamberlin's basic model of monopolistic competition and product differentiation had assumed that entry was easy. Competition seemed to be more workable, with prices driven to total costs, when entry was easy. But high concentration accompanied by high entry barriers led to the worst of both worlds—namely, excessive product differentiation and excessive profits.²³ To the extent the theory offered a set of ideas that were useful for policy purposes, they were ideas about structure. In his market-dominating book, *Industrial Organization*, which was published in 1959, Bain concluded that conduct was too heterogenous and too difficult to evaluate. The verifiable conditions for workable competition could be stated only by reference to industry structure. "We eschew," he wrote, "any general attempt to state an operational criterion of the conduct conditions of workable competition, and adhere in the main to a suggestion only of structural conditions."²⁴

Bain's work and that of his Harvard teacher Edward S. Mason have come to be identified with the "Harvard School" of industrial organization and the S-C-P Paradigm.²⁵ The theory was unquestionably dominant among the industrial economist and policy-making gentry in the 1960s, including most of those in Neal's group. But when Neal and his colleagues began penning their Report it had already begun to crumble. Chicago School writers had already exploded the lever-

age theory of tying²⁶ and provided competitively benign explanations for resale price maintenance.²⁷ Stigler had written a formative article arguing that strict assumptions about oligopoly should be relaxed, that the number of firms was only one of many factors that indicated whether a market was prone to noncompetitive pricing, and that there was much more room for competition in highly concentrated markets than previously thought. The real key for Stigler was information—who had it and did not have it, and how easily it flowed from one market participant to another.²⁸ The Bainian definition of entry barriers was in dispute.²⁹ Richard Posner, a member of the competing Stigler task force, had written an answer to Turner’s argument for structural solutions to the oligopoly problem, relying heavily on Stigler’s competing theory of oligopoly.³⁰ A broad-based attack was being launched against the proposition that one could infer monopoly power from high accounting profits.³¹ Finally, Robert H. Bork, a dissenting member of the Neal Commission, and Ward Bowman, who was on the Stigler Commission, had already published their influential *The Crisis in Antitrust*.³²

One could continue with this list,³³ which makes it easy to criticize the S-C-P paradigm as structuralism run amok, to see it as preoccupied with making firms smaller, and as completely insensitive to economies of scale or scope. There is even a tendency to see it as anticonsumer, aided in no small part by some of the characterizations in Bork’s and Bowman’s famous *Crisis* essay.³⁴

But the Neal Report was clearly not anticonsumer on its own terms. In fact, it concluded that “consumer welfare is . . . in the forefront of antitrust policy.”³⁵ The difference between the milieu that came to an end just about the time the Neal Report was published—indeed, in part because of it—was not that the older regime was unconcerned about consumer welfare while the successor regime was. Rather, it lay in the set of economic premises upon which the theories were built. Nothing in the Neal Report favored the protection of small business for its own sake at the expense of consumers, and the authors specifically mentioned high prices as one of the evils produced by high concentration.³⁶ The whole premise of the Bainian analysis of entry barriers as factors that deter entry even while profits are high, or the use of accounting data to infer a relationship between concentration and high profits, was that high prices were in fact the evil to be addressed. The questions pertained to the set of economic assumptions that would get the job done. To that end, the turning point marked by the Neal Report and the reaction to it was at least as much a change in prevailing economic theory as in antitrust policy. ▼

THE DIFFERENCE BETWEEN THE MILIEU THAT CAME TO AN END JUST ABOUT THE TIME THE NEAL REPORT WAS PUBLISHED—INDEED, IN PART BECAUSE OF IT—WAS NOT THAT THE OLDER REGIME WAS UNCONCERNED ABOUT CONSUMER WELFARE WHILE THE SUCCESSOR REGIME WAS. RATHER, IT LAY IN THE SET OF ECONOMIC PREMISES UPON WHICH THE THEORIES WERE BUILT.

- 1 Report of the White House Task Force on Antitrust Policy (May 27, 1969), originally published at 115 CONG. REC. 11, 13890, reprinted here at 227.
- 2 See Stephen Calkins, *Antitrust Modernization: Looking Backwards, Symposium, The Antitrust Enterprise: Principle and Execution*, 31 J.CORP.L. 421 (2006).
- 3 Phil C. Neal (chair, and Dean of the Univ. of Chicago Law School); William F. Baxter (Stanford Law School); Robert H. Bork (Yale Law); Carl H. Fulda (University of Texas Law School); William K. Jones (Columbia University Law School); James A. Rahl (Northwestern University Law School).
- 4 Paul W. MacAvoy (MIT), James W. McKie (Vanderbilt), and Lee E. Preston (Univ. of California, Berkeley).
- 5 Dennis G. Lyons (Arnold & Porter), George D. Reycraft (Cadwalader, Wickersham & Taft), and Richard E. Sherwood (O'Melveny & Myers).
- 6 Defined as $CR4 > 70$ —that is, using the four-firm concentration ratio, the sums of the market shares of the four largest firms in the industry exceeded 70 percent.
- 7 Separate Statement of Robert H. Bork, 2 ANTITRUST L. & ECON. 53 (Winter 1968).
- 8 See Richard Schmalensee & Bill Baxter, *Antitrust Arena: an Economist's Appreciation*, 51 STAN. L. REV. 1317, 1319 (1999).
- 9 The members were George J. Stigler (University of Chicago, chair), Ward S. Bowman, Jr. (Yale, law and economics), Ronald H. Coase (Univ. of Chicago, economics), Roger S. Cramton (University of Michigan Law School), Kenneth W. Dam (University of Chicago Law School), Raymond H. Mulford (President, Owens-Illinois, Inc.), Richard A. Posner (Univ. of Chicago Law School), Peter O. Steiner (Univ. of Michigan law and economics), and Alexander L. Stott (vice president, AT&T).
- 10 It was subsequently published, however, at 115 CONG. REC. 12, 15933-15942 (June 16, 1969); and reprinted in 2 ANTITRUST L. & ECON. R. 13 (No. 3, Spring, 1969). The editors of that journal did not disguise the fact that they sided with the Neal Report and largely rejected the recommendations of the Stigler Report.
- 11 See Louis M. Kohlmeier, *Study of Conglomerates for Nixon Urges No Antitrust Suits to Block Their Mergers*, WALL ST. J., May 23, 1969. This article was published two days after the Neal Report was released. See Calkins, *supra* note 2, at 433.
- 12 See E. S. MASON, ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM (1964).
- 13 See Leonard Weiss, *The Concentration-Profit Relationship and Antitrust*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING, (Harvey J. Goldschmid, H. Michael Mann, & J. Fred Weston, eds., 1974) (summarizing numerous pre-1970s studies). See also Joe S. Bain, *Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940*, 65 Q.J.ECON. 293 (1951). Other important work includes H. M. Mann, *Seller Concentration, Barriers to Entry, and Rates of Return in Thirty Industries, 1950-1960*, 48 REV. ECON. & STAT. 296 (1966).
- 14 Neal Report, *supra* note 1 at 227.
- 15 Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV.L.REV. 655 (1962). These recommendations appeared earlier in more truncated form in C. KAYSER & D. TURNER, ANTITRUST POLICY 110-119, 266-272 (1959). Turner went on to be head of the Antitrust Division from 1965-1968, in the years leading up to the Neal Report.

- 16 See *Appendix: A Structure-Conduct-Performance Questionnaire*, 2 ANTITRUST L. & ECON R. 8 (Spring, 1969).
- 17 See Herbert Hovenkamp, *The Neoclassical Crisis in U.S. Competition Policy, 1890-1955*, MINN L. REV. (to be published in 2009).
- 18 ALFRED MARSHALL, PRINCIPLES OF ECONOMICS (1890). See D.H. Robertson, Piero Sraffa & G.F.S. Shove, *Increasing Returns and the Representative Firm* 50, reprinted in JOHN CUNNINGHAM WOOD & ALFRED MARSHALL, CRITICAL ASSESSMENTS (1993).
- 19 On the impact of the fixed cost controversy in antitrust policy prior to the 1930s, see HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836-1937 at 308-322 (2001).
- 20 EDWARD CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (1933). On the theory's profound impact on Marshallian equilibrium theory, see MARK BLAUG, ECONOMIC THEORY IN RETROSPECT at 375 (5th ed. 1996).
- 21 John Maurice Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 243 (1940).
- 22 Joe S. Bain, *Workable Competition in Oligopoly: Theoretical Considerations and Some Empirical Evidence*, 40 AM. ECON. REV. 35 (papers and proceeding) (1950). *Id.* at 38-39:
- Whatever the degree of association within oligopolies between competitive behavior and results, it seems quite likely that such behavior may be in turn either influenced or determined by certain characteristics of the underlying market structure. If so, a demonstrated association between market structure and results would establish the more fundamental determinants of workability of competition (and, also, determinants more easily influenced by conventional public policy measures).
- 23 JOE S. BAIN, BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES (1956).
- 24 JOE S. BAIN, INDUSTRIAL ORGANIZATION 427 (1959).
- 25 Although Bain was educated at Harvard he spent nearly his entire academic career (1939-1975) at the University of California, Berkeley economics department.
- 26 Ward Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957).
- 27 Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).
- 28 George J. Stigler, *A Theory of Oligopoly*, 72 J.POL.ECON. 45 (1964).
- 29 GEORGE J. STIGLER, THE ORGANIZATION OF INDUSTRY 67 (1968).
- 30 Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L.REV. 1562 (1969). See also R. Posner, *Oligopolistic Pricing Suits, the Sherman Act, and Economic Welfare*, 28 STAN. L.REV. 903 (1976) (recapping the debate).
- 31 The literature is summarized in Franklin M. Fisher & John J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 AM. ECON. REV. 82 (Mar. 1983). See also Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J.L. & ECON. 351 (1971); and Harold Demsetz, *Two Systems of Belief About Monopoly*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 164 (Harvey J. Goldschmid, H. Michael Mann, & J. Fred Weston, eds., 1974).
- 32 R. Bork & W. Bowman, *The Crisis in Antitrust*, FORTUNE (Dec. 1963); and 65 COL.L.REV. 363 (1965).

33 For differing perspectives, see Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA L. REV. 925 (1979); Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 U. PA. L. REV. 1104, 1105 (1979).

34 R. Bork & W. Bowman, *supra* note 32, at 364:

Long-standing contradictions at the root of antitrust doctrine have today brought it to a crisis of policy. From its inception with the passage of the Sherman Act in 1890, antitrust has vacillated between the policy of preserving competition and the policy of preserving competitors from their more energetic and efficient rivals. It is the rapid acceleration of the latter "protectionist" trends in antitrust that has brought on the present crisis. Anti-free-market forces now have the upper hand and are steadily broadening and consolidating their victory. The continued acceptance and expansion of their doctrine, which today constitutes antitrust's growing edge, threaten within the foreseeable future to destroy the antitrust laws as guarantors of a competitive economy.

35 Neal Report, *supra* note 1 at 231.

36 *Id.* at 234.

The Neal Report

*Report of the White House Task Force on Antitrust Policy**

I. Summary

A. WE RECOMMEND SPECIFIC LEGISLATION ON THE SUBJECT OF OLIGOPOLIES, OR HIGHLY CONCENTRATED INDUSTRIES.

The purpose of such legislation would be to give enforcement authorities and courts a clear mandate to use established techniques of divestiture to reduce concentration in industries where monopoly power is shared by a few very large firms. Up to now such measures have been employed only in the rare instances where the monopolistic structure of an industry takes the form of a single firm with an overwhelming share of the market. Specific legislation dealing with entrenched oligopolies would rectify the most important deficiency in the present antitrust laws.

Effective antitrust laws must bring about both competitive behavior and competitive industry structure. In the long run, competitive structure is the more important since it creates conditions conducive to competitive behavior. Competitive structure and behavior are both essential to the basic concern of the antitrust laws—preservation of the self-regulating mechanism of the market, free from the restraints of private monopoly power on the one hand and government intervention or regulation on the other. In one important respect the antitrust laws recognize the necessity for competitive market structure: the 1950 amendment to section 7 of the Clayton Act has effectively prevented many kinds of mergers which would bring about less competitive market structures. Our proposed remedy, which would deal with existing noncompetitive market structures, is a necessary complement to section 7.

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Highly concentrated industries represent a significant segment of the American economy. Industries in which four or fewer firms account for more than 70% of output produce nearly 10% of the total value of manufactured products; industries in which four or fewer firms account for more than 50% of output produce nearly 24%. An impressive body of economic opinion and analysis supports the judgment that this degree of concentration precludes effective market competition and interferes with the optimum use of economic resources. Past experience strongly suggests that, in the absence of direct action, concentration is not likely to decline significantly.

While new legal approaches might be developed to reduce concentration under existing law—a result which should be encouraged—the history of antitrust enforcement and judicial interpretation do not justify primary reliance on this possibility. For this reason, we recommend a specific legislative remedy directed to the reduction of concentration. Our proposed Concentrated Industries Act, . . . , establishes criteria and procedures for the effective reduction of industrial concentration.

B. WE RECOMMEND ADDITIONAL LEGISLATION PROHIBITING MERGERS IN WHICH A VERY LARGE FIRM ACQUIRES ONE OF THE LEADING FIRMS IN A CONCENTRATED INDUSTRY.

This legislation would supplement section 7 of the Clayton Act, which prohibits mergers which may tend substantially to lessen competition. The primary impact of the new legislation would be on diversification or “conglomerate” mergers. Under section 7 of the Clayton Act, such mergers may be prevented if adverse effects on competition can be anticipated. But the detection of such effects frequently depends on factual and theoretical judgments that are highly speculative. As a result, some mergers with potentially adverse effects on competition may escape attack and mergers which will not harm competition will be prohibited because the effects cannot readily be predicted. Because of the inherent limitations of the competitive standard of section 7, the recently published Merger Guidelines do little to resolve these difficulties.

Our proposed legislation would prevent some possibly anticompetitive mergers which might have gone unchallenged because of the difficulty of applying section 7 standards, and thus would act as an effective supplement to existing policy. In addition, the proposed legislation would have affirmative aspects in channeling merger activity into directions likely to increase competition. If large firms are prevented from acquiring leading firms in concentrated industries, they will seek other outlets for expansion which may be more likely to increase competition and decrease concentration.

This policy of deflecting conglomerate mergers into desirable channels is preferable to any rule that would limit mergers without regard to considerations of market structures. Although the number of conglomerate mergers has

increased sharply in recent years, there is only a moderate tendency toward increase in the overall concentration of manufacturing assets in American industry. Nor does the present merger movement threaten to reduce the aggregate number and proportion of smaller firms. Remedial measures based on size alone would constitute a radical innovation in our antitrust policy and no rationale is available for determining the appropriate upper limit on the size to which a single firm may grow.

We therefore believe that restrictions on mergers should continue to be based on considerations related to competitive market structure. The policy we recommend would permit the continued growth of firms by diversification as well as by internal expansion but would, we believe, promote the development of more competitive structures. . . .

C. WE RECOMMEND A THOROUGH REVISION OF THE ROBINSON-PATMAN ACT TO REMOVE FEATURES THAT UNDULY RESTRICT THE FREE PLAY OF COMPETITIVE FORCES.

It has long been recognized that many aspects of the Robinson-Patman Act in its present form have serious anticompetitive effects. The course of enforcement and interpretation of the Act have in many instances aggravated those effects. In addition, the ambiguities and complexities of the statute as written have posed unusual difficulties of compliance. Experience with the Act and the extensive criticism to which it has been subjected provide the basis for a general revision that will make it consistent with the major aims of antitrust policy. In our view such a revision is long overdue.

The purpose of the Robinson-Patman Act is to eliminate price discrimination that unduly favors national over local sellers or confers unjustified advantages on large purchasers merely because of their size. But not all price differentials represent discrimination and not all discrimination is undesirable. Some price discrimination does have anticompetitive effects. But in other cases price discrimination improves the functioning of the competitive system. A statute designed to restrict price discrimination should therefore be narrowly drawn, so that the important benefits of competition as evidenced in price differentials will not be lost in an excessive effort to curb limited instances of harm. Our proposed revision is intended to leave room for price behavior which is related to the improved functioning of the competitive system.

The Robinson-Patman Act contains several prohibitions supplementing the price-discrimination prohibition. These prohibitions should be repealed. They accomplish little that could not be accomplished by a properly drawn price-discrimination prohibition. In their present form, they often impair competition; they discourage legitimate transactions; and they promote irrational distinctions. . . .

D. WE RECOMMEND LEGISLATION TO ESTABLISH THE PRINCIPLE THAT A PATENT WHICH HAS BEEN LICENSED TO ONE PERSON SHALL BE MADE AVAILABLE TO ALL OTHER QUALIFIED APPLICANTS ON EQUIVALENT TERMS.

Patents are one of the principal sources of monopoly power, since they confer upon the patentee the right to exclude others from the field covered by the patent. An important goal of antitrust policy is to prevent the use of a patent by the patentee in collaboration with others to create a monopoly broader than the patent itself. That goal will be served by denying the patentee the right to confine use of the patent to a preferred group and requiring that if the patent is licensed it shall be open to competition in its application. Such a principle does not prevent the owner of a valid patent from fully exploiting the monopoly conferred by the patent. Our proposal does not fix or limit the royalty to be charged by the patentee, nor does it involve compulsory licensing. It merely requires that if the patentee chooses to license others rather than exploiting the patent himself he shall make such licenses available on nondiscriminatory terms to as many competitors as may desire it.

Supplementary provisions in our proposal would require the public filing of all patent license agreements and would bar enforcement of a patent against particular infringers if the patent owner has not take reasonable steps to enforce the patent against others. We believe that each of these measures has some independent value in deterring misuse of patents and that they could be adopted independently of the requirement of nonexclusive licensing.

E. WE RECOMMEND THAT STEPS BE TAKEN TO IMPROVE THE QUALITY AND AVAILABILITY OF ECONOMIC AND FINANCIAL DATA RELEVANT TO THE FORMULATION OF ANTITRUST POLICY, THE ENFORCEMENT OF THE ANTITRUST LAWS, AND THE OPERATION OF COMPETITIVE MARKETS.

Specifically, we recommend formation of a standing committee of representatives of the Census Bureau and other Government agencies which gather or use economic information to consider (1) improving the gathering and presentation of economic information within the statutory limits on disclosure of information on individual firms; (2) new interpretations of existing law or, eventually, new legislation to minimize restrictions on disclosure of types of information which are not highly sensitive from the point of view of individual firms but are of great value in the formulation of policy and the application of law; and (3) machinery for developing information on the competitive structure of relevant economic market, because such markets do not necessarily coincide with Census industry and product classifications. These recommendations could be implemented immediately, without new legislation or appropriations.

In addition, the role of financial information in the operation of competitive markets should be reflected in the formulation of financial reporting require-

ments by the Securities and Exchange Commission. These requirements are now imposed pursuant to the Securities Exchange Act of 1934, which is oriented to investor protection. We recommend that the Act be amended to recognize the role of financial information in the operation of a competitive economy, and to require that the SEC consult with antitrust enforcement agencies in formulating reporting requirements.

Pending adoption of this recommendation, the antitrust enforcement agencies should be requested to consider submitting recommendations to the SEC in connection with the current divisional reporting inquiry.

F. WE HAVE A NUMBER OF ADDITIONAL RECOMMENDATIONS FOR FURTHER ACTION OR FURTHER STUDY.

These include advance notification of mergers and a reasonable statute of limitations on lawsuits attacking mergers; a limit on the duration of antitrust decrees; an examination of the effects of the income tax laws on merger activity and market concentration; a review of the extent to which competition may be substituted for regulation in the regulated industries; and the abolition of resale price maintenance.

II. Introduction

The antitrust laws reflect our Nation's strong commitment to economic freedom and the material benefits that flow from this freedom. The antitrust laws are based on the recognition that optimum use of economic resources and maximum choice and utility for consumers can best be obtained under competition. Moreover, they assume that the preservation of a large number and variety of decision-making units in the economy is important to ensure innovation, experimentation and continuous adaptation to new conditions. While consumer welfare is thus in the forefront of antitrust policy, important corollary values support the policy. Not only consumers, but those who control the factors of production—labor, capital and entrepreneurial ability—benefit when resources are permitted to move into the fields of greatest economic return; competition induces such movement and monopoly inhibits it. Antitrust policy also reflects a preference for private decision-making; a major value of competition is that it minimizes the necessity for direct Government intervention in the operation of business, whether by comprehensive regulation of the public utility type or by informal and sporadic interference such as price guidelines and other ad hoc measures.

The function of the antitrust laws in the pursuit of these goals is twofold; they are concerned both with preventing anticompetitive behavior and with preserving and promoting competitive market structures. Our Task Force has understood its assignment to be to examine the antitrust laws in broad perspective and consider ways in which they might be made more effective in this dual role.

In relation to the principal kinds of anticompetitive behavior, such as price-fixing, market division and other forms of collusive action among independent firms, we believe the present laws are generally adequate. Their effectiveness depends principally upon vigilance to provide sufficient enforcement resources and the vigorous use of enforcement power. We have identified three areas, however, in which modification of present laws would assist the effort to maximize competitive behavior. *First*, it is important to ensure that laws aimed at preserving competition do not themselves unduly restrict the free play of market forces. The Robinson-Patman Act in its present form has such effects and we recommend its revision to eliminate its anticompetitive tendencies. *Second*, patents are susceptible of being used to facilitate collusive arrangements in ways difficult to disentangle from legitimate exploitation of the patent monopoly. We recommend certain restrictions on patent licensing that are designed to discourage such use. *Third*, we share the view that the provisions of law permitting resale price maintenance encourage anticompetitive practices and we favor the repeal of these provisions.

Our consideration of the present state of the antitrust laws focuses to a considerable extent on problems of market structure. The principal laws presently concerned with competitive market structure are section 7 of the Clayton act, dealing with mergers, and section 2 of the Sherman Act, which is addressed to cases of monopoly. We believe these laws can be made more effective by certain additional legislation on mergers and on oligopoly industries.

Market structure is an important concern of antitrust laws for two reasons. *First*, the more competitive a market structure (the larger the number of competitors and the smaller their market shares) the greater the difficulty of maintaining collusive behavior and the more easily such behavior can be detected. *Second*, in markets with a very few firms effects equivalent to those of collusion may occur even in the absence of collusion. In a market with numerous firms, each having a small share, no single firm by its action alone can exert a significant influence over price and thus output will be carried to the point where each seller's marginal cost equals the market price. This level of output is optimal from the point of view of the economy as a whole.

Under conditions of monopoly—with only a single seller in a market—the monopolist can increase his profits by restricting output and thus raising his price; accordingly, prices will tend to be above, and output correspondingly below, the optimum point. In an oligopoly market—one in which there is a small number of dominant sellers, each with a large market share—each must consider the effect of his output on the total market and the probable reactions of the other sellers to his decisions; the results of their combined decisions may approximate the profit-maximizing decisions of a monopolist. Not only does the small number of sellers facilitate agreement, but agreement in the ordinary sense may be unnecessary. Thus, phrases such as “price leadership” or “administered pricing” often do no more than describe behavior which is the inevitable result of

structure. Under such conditions, it does not suffice for antitrust law to attempt to reach anticompetitive behavior; it cannot order the several firms to ignore each other's existence. The alternatives, other than accepting the undesirable economic consequences, are either regulation of price (and other decisions) or improving the competitive structure of the market.

We believe that the goals of antitrust policy require a choice wherever possible in favor of attempting to perfect the self-regulating mechanism of the market before turning to public control. It is for this reason that we favor steps that will increase the effectiveness of the antitrust laws in promoting competitive market structure. Such steps are desirable, not only because the problem of concentrated industries is significant in economic terms, but because the existence of such concentration is a continuing (and perhaps increasing) temptation for political intervention. In a special sense, therefore, our recommendations have preventive as well as corrective purposes.

In devising antitrust measures for such purposes, alternative techniques or approaches may be considered. Under one approach, general standards expressed in terms of broad policy goals require the trier of fact to make ad hoc judgments as to the relevant scope of inquiry in any case. The general effect of such an approach is to require consideration of a wide range of complex and difficult issues, some of them of marginal significance. Such issues may include economic issues which are beyond our present capacity to gather and evaluate economic information; they may include issues such as motive and intent, which are both elusive and of marginal relevance to the central issue of market structure; and they may include an indirect measurement of competitive behavior or structure through an evaluation of performance, an approach requiring judgments more appropriate to regulation than to antitrust policy. Such an approach generally expands the scope and complexity of lawsuits and makes decisions less useful as precedents.

The other approach uses rules which are based on easily ascertainable criteria and avoids individualized consideration of complex factors which would be unlikely to affect the outcome. This approach simplifies litigation. More importantly, it provides businessmen and law enforcement officials with a better idea of what will be lawful and what will be unlawful.

The judgment of members of the Task Force is that it is virtually impossible to gather all the data relevant to any particular case, and even the best of judges could not properly take account of all such data. Therefore, we believe that carefully drawn rules yield results superior to highly general admonitions to weigh all relevant factors. Accordingly, our proposals generally rely on fairly closely articulated rules. They are drafted to reflect general economic experience and theory, and they make allowance for actors which may be significant in individual cases. But they do not call for proof of an exactness beyond the present limits of economic knowledge. Of necessity, they are predicated, not on rigorously proven

theorems, but on a consensus of informed economic judgment which admittedly fragmentary economic knowledge tends to confirm.

III. Oligopoly, or Concentration in Particular Markets

The evils of monopoly are well known and the antitrust policy of the United States has sought from its beginning to provide safeguards against them. But those evils are not confined to situations conforming to the literal meaning of monopoly, i.e. an industry with but a single firm. In the years since the Sherman Act was adopted there has been growing recognition that monopoly is a matter of degree. A firm with less than 100% of the output of an industry may nevertheless have significant control over supply, and thus be in a position to impose on the economy the losses associated with monopoly: lower output, higher prices, artificial restraints on the movement of resources in the economy, and reduced pressure toward cost reduction and innovation. Likewise, a small number of firms dominating an industry may take a similar toll, either because the small number makes it easier to arrive at and police an agreement or because, without agreement, each will adopt patterns of behavior recognizing the common interest.

In general, it may be said that the smaller the number of firms in an industry—at least where that number is very small or where a very small number is responsible for the overwhelming share of the industry's output—the greater the likelihood that the behavior of the industry will depart from the competitive norm.

These propositions have found general acceptance in economic literature in the past 25 or 30 years. They have also found recognition in the policy of the antitrust laws: a major aim of section 7 of the Clayton Act, as amended in 1950 and as interpreted by judicial decision and the new Merger Guidelines, is not merely to prevent monopolies but also to prevent all combinations of business firms that significantly increase market concentration or reduce the number of firms in an industry.

Interpretation of the Sherman Act itself, however, has lagged behind these developments. Early cases involving giant firms emphasized the purposes and methods by which a firm was created as the basis of illegality, and looked for evidence of predatory or abusive exercise of power rather than the power of a firm or group of firms to control prices and output. Decisions affecting market concentration were confined to instances, such as the old Standard Oil and American Tobacco cases, where a single firm commanding nearly the entire market had been assembled by mergers of many previous competitors. Even such major combinations as United States Steel Corporation, United Shoe Machinery Company, and the International Harvester Company escaped condemnation by the Supreme Court. An important advance was registered when

Judge Learned Hand announced in the Alcoa case that a single firm, not resulting from merger, might be guilty of “monopolizing” merely by acquiring a sufficiently large market share and retaining its market share over a substantial period of time, if that market share was not the inevitable result of economic forces. That holding adopted and extended Judge Hand’s early insight, in the Corn Products case of 1916, that “it is the mere possession of an economic power, acquired by some form of combination, and capable, by its own variation in production, of changing and controlling price, that is illegal.” The United Shoe Machinery decision of 1953 applied and reinforced the new doctrine represented by the Alcoa case. In both of those cases, however, the monopoly section of the Sherman Act was invoked against a single firm with a predominant share of the market. While Judge Hand had intimated that a share as low as 65% might suffice, no subsequent case has tested that proposition or explored the limits of the Alcoa doctrine. Nor has any case yet provided a basis for treating as illegal the shared monopoly power of several firms that together possess a predominant share of the market, absent proof of conspiracy among them.

Thus a gap in the law remains.¹ While section 7 of the Clayton Act provides strong protection against the growth of new concentrations of market power in most instances, existing law is inadequate to cope with old ones.

This gap is of major significance. Highly concentrated industries account for a large share of manufacturing activity in the United States. . . . The highly concentrated industries . . . include such major and basic industries as motor vehicles, flat glass, synthetic fibres, aircraft, organic chemicals, soap and detergents, and many others, as well as a host of smaller but nevertheless significant industries.

If competitive pressures could be relied on to erode concentration in the reasonably foreseeable future, the direct reduction of concentration would be less urgent. But concentration does not appear to erode over time; rather, the evidence indicates that it is remarkably stable. In those industries with value of shipments greater than \$100 million and four-firm concentration ratios by value of shipments greater than 65% in 1963, average concentration ratios were stable or declined insignificantly—by less than half a percentage point. Even though section 7 of the Clayton Act has generally been effective in forestalling increases in concentration through mergers and by other means, the antitrust laws and economic forces have not brought about significant erosion of existing concentration. The problem is not one which will disappear with time.

The adverse effects of persistent concentration on output and price find some confirmation in various studies that have been made of return on capital in major industries. These studies have found a close association between high levels of concentration and persistently high rates of return on capital, particularly in those industries in which the largest four firms account for more than 60% of sales. High profit rates in individual firms or even in particular industries are of course consistent with competition. They may reflect innovation, exceptional

efficiency, or growth in demand outrunning the expansion of supply. Above-average profits in a particular industry signal the need and provide the incentive for additional resources and expanded output in the industry, which in due time should return profits to a normal level. It is the persistence of high profits over extended time periods and over whole industries rather than in individual firms that suggests artificial restraints on output and the absence of fully effective competition. The correlation of evidence of this kind with the existence of very high levels of concentration appears to be significant.

We recognize the need for further refinement of economic evidence of this type and for additional knowledge, theoretical and empirical, about the behavior of oligopolistic industries. It would be less than candid to pretend that economic science has provided a complete or wholly satisfactory basis for public policy in this field. But public policy must often be made on the basis of imperfect knowledge, and the failure to adopt remedial measures is in itself the acceptance of a policy. The judgment of most of the members of the Task Force is that enough is known about the probable consequences of high concentration to warrant affirmative government action in the extreme instances of concentration. Moreover, as we have noted, such action does not require acceptance of a new premise for public policy. A conviction that concentration is undesirable underlies the present stringent policy toward horizontal mergers. The same premise supports a policy of attempting, within conservative limits, to improve the competitive structure of industries in which concentration is already high and apparently entrenched.

Endorsement of such a policy implies a judgment that the potential gains from reducing market shares and increasing the number of competitors in an industry will not be offset by losses in efficiency. We think there is little basis for believing that significant efficiencies of production are dependent on generally maintaining high levels of concentration.

There is little evidence that economies of scale require firms the size of the dominant firms in most industries that are highly concentrated. Evidence to the contrary is the fact that in most such industries very much smaller firms have survived in competition with the large firms. On the basis of studies covering a large number of industries Professor Stigler concluded that, "In the manufacturing sector there are few industries in which the minimum efficient size of firm is as much as 5 per cent of the industry's output and concentration must be explained on other grounds."² Similarly, there is no evidence of any correlation between size or market concentration and research and development activities.

The success of very large firms may, of course, be explained on the basis of efficiencies other than economies of scale, such as superior management talent or other unique resources. To the extent that such efficiencies exist, however, they may ordinarily be transferred and thus would not necessarily be lost by reorganization of the industry into a larger number of smaller units. The same is true of

advantages that inhere in legal monopolies, such as an accumulation of patents. It must also be borne in mind that efficiencies belonging to or achieved by a firm with some degree of monopoly power may be reflected only in higher profits rather than lower prices. Reduction of concentration would increase the chance that such efficiencies would be passed on to consumers through competition; indeed, a net gain from the consumer standpoint might result even though some efficiencies were lost in the process of reducing concentration.

The statute we propose would, however, take account of possible adverse effects on efficiency resulting from divestiture by forbidding relief that a firm establishes would result in substantial loss of economies of scale. It would be expected that a court would consider, among other factors relevant on this issue, the minimum size that experience has indicated is necessary for survival in the industry.

For the foregoing reasons we conclude that remedies to reduce concentration should be made available as part of a comprehensive antitrust policy. To assist in translating that conclusion into workable legislation we have drafted in some detail a proposed statute embodying our views.³ That statute, entitled the Concentrated Industries Act, is attached to this report as Appendix A. While we believe, as hereafter noted, that some relief against concentration might be obtained through new interpretations of the Sherman Act, we also think that a statute such as the one we propose has several distinct advantages over reliance on existing law: (1) it would provide a clear determination of legislative policy and establish clear criteria for the application of that policy; (2) it would establish appropriate special procedures; and (3) it would limit the policy to remedial ends.

The Act establishes clear criteria for its application. It applies only to those industries in which four or fewer firms have accounted for 70% or more of industry sales, and it provides for steps to reduce the market shares of firms with 15% market shares in such industries. The act contains other provisions to limit its application to industries which are of importance in the economy as a whole and in which concentration has been high and stable over considerable periods of time. The criteria laid down in the Act are designed to minimize the likelihood that output levels over a short period of time will affect the applicability of the Act. Moreover, even if the Act does apply, there are no penalties but only prospective relief. Thus the possibility is minimized that corporations will resort to output-restricting strategies in order to avoid application of the Act.

The Act also lays the basis for defining relevant markets in terms that are more closely related to economic realities than are the definitions developed under existing antitrust laws. By and large, the Act limits the scope of inquiry to facts which are of relevance to its primary concern, the reduction of concentration, and which may be determined with reasonable precision. For these reasons, litigation under the Act should be relatively simple.

The Act establishes special procedures appropriate to the reduction of concentration. Under existing law, complex antitrust actions may be conducted by judges who have had little opportunity to become familiar with the kinds of questions involved, and who must rely on expert testimony offered by the parties. Expanding on the recently enacted provisions of 28 U.S.C. section 1407, the Act would establish a special panel of district judges and circuit judges to conduct deconcentration proceedings. In addition, it would enable the court to draw on the specialized knowledge and experience of its own economic experts. This feature of the Act should be of importance in arriving at appropriate market definitions. In addition, court appointed experts would assist in evaluating the probable effect of proposed decrees.

Finally, the Act is limited to prospective relief designed to reduce concentration. Unlike existing law, it makes no provision for criminal penalties or for private actions seeking treble damages. The absence of these collateral effects makes the Act a more appropriate tool for reducing concentration.

Those who support the proposed Concentrated Industries Act believe, in varying degrees, that more can be done about concentration than has been done under existing law. We recommend that the Attorney General be encouraged to develop appropriate approaches under existing law and to bring carefully selected cases to test those theories.

Under existing law, three statutory provisions might be brought to bear. Section 2 of the Sherman Act prohibits monopolization or attempts to monopolize any part of interstate or foreign commerce. Section 1 of the Sherman Act prohibits any contract, combination, or conspiracy in restraint of interstate or foreign commerce. Section 7 of the Clayton Act prohibits acquisitions which may tend substantially to lessen competition. While existing precedents and the history of antitrust enforcement do not justify widespread use of these statutes against concentrated industries, we believe that appropriate precedents might be developed which would be useful in some cases.

Courts may be reluctant to expand the scope of these statutes, because their application would expose defendants to criminal penalties and treble damage liability. Moreover, existing law does not readily lend itself to the establishment of sufficiently clear and workable criteria. While expanded enforcement efforts might make some inroads in reducing concentration, they would not preclude the need for new legislation. ▼

1 This gap has been recognized by noted authorities. See, e.g., KAYSER & TURNER, *ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS*, 44 (1959)[hereinafter Kaysen & Turner]; Stigler, *The Case Against Big Business*, *FORTUNE* (May 1952), reprinted in E. MANSFIELD, *MONOPOLY POWER AND ECONOMIC PERFORMANCE*, 3 (1964); cf. J. K. GALBRAITH, *THE NEW INDUSTRIAL STATE* (1967).

2 G. STIGLER, *THE THEORY OF PRICE*, 223, (3rd Ed. 1966).

- 3 The idea of such legislation is not new, and our proposal was influenced by Kaysen & Turner (*supra* note 1). However, it differs from the Kaysen-Turner proposal in important respects.



Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust

Joshua Wright

OVERSHOT THE MARK? A SIMPLE EXPLANATION OF THE CHICAGO SCHOOL'S INFLUENCE ON ANTITRUST

Joshua D. Wright¹

I. "IT TAKES A THEORY TO BEAT A THEORY"

In his Nobel lecture, economist George Stigler declared this proposition as "the fundamental rule of scientific combat," asserting that "no amount of skepticism about the fertility of a theory can deter its use unless the skeptic can point to another route by which the scientific problem of regulation can be studied successfully.¹ These rules of engagement are to scientific and intellectual combat in the marketplace of ideas as antitrust is to competition in product markets. Stigler argued that this form of intellectual rivalry should be resolved by evidence of the explanatory power of the competing theories.² Of course, the proposition that the selection of theoretical models for application to policy problems should be guided by consistency with the phenomena the models attempt to explain is not original to Stigler. It is a principle that is fundamental not only to economics, but science generally.³

It is with Stigler's rules of intellectual engagement as my guide that I set forth on my current task: a critical review of former Federal Trade Commission Chairman Robert Pitofsky's *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust*, a collection of essays devoted to challenging the Chicago School's approach to antitrust in favor of a commitment to Post-Chicago policies.

The Post-Chicago School challenge to the previous dominant model, often described as the "Chicago School,"⁴ is well known. The developments of the past 25 years, especially the new game theoretic tools applied to problems of vertical contracting to generate possibility theorems, have changed the landscape of antitrust economics considerably. The important debate between whether the existing body of economic knowledge or the new Post-Chicago contributions provide the best guide for antitrust policy has always been one concerning which "models" offered a more predictive and robust account of antitrust-relevant behavior.

¹ Assistant Professor, George Mason University School of Law (on leave); Visiting Professor, University of Texas School of Law. This article reviews *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust* (Robert Pitofsky, ed., Oxford University Press 2008). I thank Jonathan Baker, Bruce Kobayashi, William Kovacic and Geoff Manne for helpful comments, discussions, and provocative challenges to my thinking on these issues which should not be interpreted as an endorsement of any of the views expressed herein. I am also grateful to Sarah Berens for superb research assistance.

Unfortunately, much of the "Chicago versus Post-Chicago" debate (and yes, Harvard too) has not been fought on the scientific terms.

Overshot the Mark is a new and important contribution to this debate. The book is clear that in its purpose to marshal arguments and evidence resulting in the rejection of the Chicago School, in favor of an antitrust regime founded on the Post-Chicago alternative. Professor Pitofsky usefully describes the essential theme of *Overshot the Mark* in the introduction's concluding sentence: "Because extreme interpretations and misinterpretations of conservative economic theory (and constant disregard of facts) have come to dominate antitrust, there is reason to believe that the United States is headed in a profoundly wrong direction."⁵

In support of its claims, the essays center on an attempt to demonstrate that the Chicago School: (1) is wrong on the economics, (2) ideologically ignores facts and evidence when convenient, and (3) has misled courts into extreme interpretations of the antitrust laws to the detriment of consumers.⁶ While much effort is expended throughout the volume on asserting and defending these and other claims, *Overshot the Mark's* most glaring weakness is that insufficient attention is paid to supporting not only those claims, but also the implicit corollary that the Post-Chicago possibility theorems outperform the models of their predecessors, on scientific terms relating to theoretical robustness or empirical support.⁷

To be sure, *Overshot the Mark* is an important book and one that will be cited as intellectual support for a new and "reinvigorated" antitrust enforcement regime based on Post-Chicago economics.⁸ Its claims about the Chicago School's stranglehold on modern antitrust, despite the existence of a superior economic model in the Post-Chicago literature, are provocative. If the premise is accepted that the Post-Chicago School provides a sounder economic basis for antitrust than that offered by the incumbent Chicagoans, that presents a puzzle. The puzzle is to explain why the Chicago School continues, by all accounts, to dominate modern antitrust discourse, particularly in the courts, in the face of this obviously superior alternative?

To its credit, *Overshot the Mark* does offer an implicit (and sometimes explicit) answer to this question, an answer which should be familiar to antitrust readers: A conspiracy. That the volume offers an answer to such an interesting puzzle is the good news. The bad news is that these are the types of conspiracy allegations that would not survive the Supreme Court's new "plausibility" test.⁹ The supposed cartel consists of Chicago-oriented antitrust lawyers, economists, enforcement agency officials, and both conservative *and* liberal judges. The aim of their collusive scheme is to halt the common law evolutionary process that would have led to the adoption and incorporation of these superior economic norms into antitrust doctrine but for the conspiracy.

There is another interesting aspect of this puzzle for economists. For several decades, Post-Chicago economics has overwhelmingly been taught to graduate economics students in industrial organization economics courses in top departments in the United States and Europe. Top economics journals publish Post-Chicago theoretical models. If the Post-Chicago School

offers superior economics, and provides more elegant models with greater explanatory power, why haven't they succeeded in persuading the courts?

The central task of this review will be to evaluate the underlying premise that Post-Chicago economics literature provides better explanatory power than the "status quo" embodied in the existing body of theory and evidence supporting Chicago School theory. I will conclude that the premise is mistaken. However, the mistaken premise only partially obviates the need to solve the puzzle of the hypothetical adoption and persistence of inefficient economic norms. A review of the empirical evidence overwhelmingly demonstrates that Chicago School economic insights and policy prescriptions remain the best available foundation for modern antitrust policy. As will be discussed in Part III, the most fundamental weakness of *Overshot the Mark* is the failure to acknowledge, and grapple with, the substantial body of empirical evidence in support of Chicago School views, while simultaneously failing to provide empirical support for Post-Chicago anticompetitive theories.

In short, *Overshot the Mark* does not offer a persuasive account for Chicago's continued dominance. Following Stigler's admonition, I offer a simple alternative hypothesis to explain the Chicago School's continuing dominance of antitrust law: it provides a more robust theoretical and empirical account of the business practices we observe in the real world along with their competitive effects. It is often said that economic knowledge is incorporated into antitrust law with a significant lag. For example, many of the Chicago School insights of the 1960s and 70s were incorporated into antitrust doctrine (and remain a central part of its intellectual foundation) decades later. By way of contrast, Post-Chicago economics has now dominated the industrial organization economics literature for nearly thirty years without, thus far, substantial impact on antitrust doctrine. Economic science has moved toward the production of highly formalized and mathematically elegant models, based on highly stylized assumptions from which it is difficult to draw policy implications. Relatively superior empirical support provides an alternative account for the persistent influence of the Chicago School on antitrust doctrine. Before turning to providing support for this simple explanation, a few preliminary notes are in order.

The target of the book is clear: The Chicago School of Antitrust Economics. But what exactly does this "School" consist of? Throughout *Overshot the Mark*, the most persistent and puzzling ambiguity is the conflation of Chicago School antitrust economics with something labeled "conservative economics." Both terms escape simple definitions that command universal agreement. Stigler, a Chicago School founding member if there ever was one, described the Chicago School as "a hypothetical kingdom" and seemed to resent uses of the label, noting that it "has always been a phrase whose accuracy varied inversely to its content."¹⁰ Whether a hypothetical construction or otherwise, it is conventional wisdom that there is some body of economic knowledge that can be attributed to the Chicago School, and that this body of knowledge has been and continues to be a dominant intellectual force behind the evolution of antitrust law.¹¹ The Chicago School's contributions to antitrust policy are many, and are not denied by the essayists.¹²

Overshot the Mark accepts the premise that the Chicago School provided antitrust its intellectual foundation, and subsequently saved it from the state of incoherence that would motivate Robert Bork's seminal effort to incorporate the economic reasoning emanating from the University of Chicago, and Aaron Director in particular, into the Sherman Act.¹³ While a precise definition is elusive, the Chicago School of antitrust economics can be defined in a reasonable though imperfect manner.¹⁴ However, *Overshot the Mark* is unsuccessful in its attempt to locate the body of economic knowledge that it aims to target, in large part because it equates the Chicago School with something called "conservative economics."

This label generates more questions and confusion than clarity. Is "conservative" meant as analytically identical to the Chicago School? If so, why use two different words? If not, what's the difference? The most intuitively plausible explanation for this choice is that the label is a rhetorical device designed to score some easy political points and frame the relevant policy debate as one centered around ideology rather than economic science. This is not to claim that antitrust debates have ever been or ever will be invariant to ideology. My claim here is that the ideology-to-economics ratio has become too high, and that the framing of Chicago School economics as "conservative" is evidence in support of that proposition. But the choice to frame the debate in this manner also comes with its costs. In this case, the "conservative" label leads to an inevitable imprecision in many of the claims pressed throughout the book. The label is also misleading when one considers the scope of the well-known contributions of Chicago School scholars. Consider, for example, that the theoretical underpinnings of the "raising rivals' cost" theories of anticompetitive conduct at the core of the Post-Chicago movement are based on the work of Aaron Director, the father of the Chicago School.¹⁵ Moreover, Chicago-affiliated scholars have made significant contributions to our understanding of anticompetitive behavior and are responsible for documenting foundational empirical examples of Post-Chicago phenomena in the real world.¹⁶ Perhaps the lesson to be learned from a more accurate economic history of the Post-Chicago movement, whether one likes it or not, is that we are all Chicagoans now.

Overshot the Mark's second weakness is related to the first. Little or no attempt is made to isolate the effect of Chicago's influence on modern doctrine, relative to other important factors. There is reason to believe that this is not harmless error. Kovacic's persuasive historical account of the intellectual foundations of modern antitrust law rejects the Chicago/Post-Chicago narrative, making room for the Harvard School.¹⁷ While the Harvard and Chicago approaches have converged in many areas of antitrust law, such as predatory pricing doctrine, there are also important differences. Professor Elhauge has also recently argued that it is the Harvard School, and not the Chicago School, which characterizes the Supreme Court's modern antitrust jurisprudence.¹⁸ *Overshot the Mark* suffers from its presumption that the Chicago School is the cause of the state of modern doctrine, with which the authors find themselves dissatisfied. Indeed, recognition that the current state of monopolization doctrine is best explained by a convergence of both Chicago and Harvard principles is at tension with the narrative of the singlehanded ideological stranglehold that is pressed throughout the volume. Failure to recognize the dual nature of the intellectual foundations of antitrust law allows one to characterize the Chicagoans as outliers and extremists. An alternative hypothesis exists, but it

is one that is unsettling for the essayists—perhaps the convergence of Harvard and Chicago on much of modern antitrust jurisprudence suggests that those advocating a deviation from the status quo are the extremists.

Overshot the Mark makes a provocative claim: That conservative economic analysis has, in recent years, had a pernicious effect on consumers. Throughout the various essays these claims are pressed in different forms, but boil down to the following essential theme: Chicago School economics caused courts to adopt erroneous economic principles and get specific cases wrong; develop sub-optimal legal rules; or otherwise influence antitrust policy in the wrong direction.¹⁹ One of the most valuable contributions of economics to law is that it brings about rigor by demanding hypotheses that can be tested against real world data. Ideological policy disputes, unlike in other fields of law unencumbered by any attachment to scientific method or economic methodology, can be settled with evidence rather than by assertion. When the claims in the book are held up to data, it becomes evident that *Overshot the Mark* does not carry its burden of rejecting the simple null hypothesis that the Chicago School's persistence is owed to its superiority on economic terms.

In Part II I will offer a set of definitional principles that guide Chicago School antitrust economics, in order to set the stage for evaluating specific claims that contributions from Chicago have “gone too far.” A more rigorous examination of the actual body of knowledge produced by Chicago School lawyers and economists suggests a much more detailed picture than the “conservative” label allows. While these shorthand labels make for good slogans, they come at the significant cost of inviting conclusory and superficial evaluations that facilitate misleading descriptions of their targets, and can lead to mistaken policy recommendations.²⁰ Without a firm and workably precise definition of the Chicago School of antitrust economics, it would be impossible to evaluate *Overshot the Mark* and its claims about the relative explanatory power of Chicago and Post-Chicago economics.

In Part III we take a scientific approach to evaluating the claim that Post-Chicago economics has greater explanatory power than the approaches of the Chicago School. Specifically, we evaluate claims about the relative merits of Chicago and Post-Chicago approaches to resale price maintenance and exclusive dealing in light of the existing empirical evidence.

In Part IV, the focus shifts from economics to law. We evaluate *Overshot the Mark's* the claim that courts, driven by the undue influence by Chicago economics, have adopted extreme interpretations of the law to the detriment of consumers.

Part V proposes a scientific approach, one that does not require allegiance any particular branch of economic theory, to identify the best possible set of antitrust liability rules and enforcement policies conditional on our existing set of theoretical and empirical knowledge. I describe this approach as “evidence based antitrust.”

II. DEFINING THE CHICAGO SCHOOL²¹

The Chicago School of Economics has been described many ways. David Wall once described three basic characteristics of the Chicago School of economics: “First, that theory is of

fundamental importance; second, that theory is irrelevant unless set in a definite empirical context; and third, that in the absence of evidence to the contrary, the market works.”²² To others, to invoke the term Chicago School is to describe a reflexively anti-interventionist position that typically involves irrational disdain for government regulation. While current financial times render it somewhat in vogue to casually toss around caricatured versions of entire schools of economic thought without regard to accuracy or evidence, antitrust commentators have generally avoided such style of commentary in favor of careful analysis of competing theories and evidence.²³

The contributions of the Chicago School are well known, and no sensible antitrust commentator denies that policies based on these contributions have rendered antitrust an intellectually respectable body of law.²⁴ Commentators of all political and economic stripes agree that antitrust is, despite some quibbles around the margins, an economically rational body of law. Perhaps more important than its internal economic coherence, the Chicago School revolution allowed courts and antitrust agencies to harness the power of the Sherman Act in order to act as a shield against truly harmful business practices, while limiting its use as a sword by private and public plaintiffs bent on attacking efficiencies.

The history of the Chicago School’s influence on antitrust analysis has been well documented. Professors Jonathan Baker and Timothy Bresnahan divide the Chicago School’s influence on antitrust into two separate components: “the Chicago School of industrial organization economics,” and “the Chicago School of antitrust analysis.”²⁵ The Chicago School of industrial organization economics consists of the work in industrial organization economics that aimed, and succeeded, at debunking the structure-conduct-performance paradigm and its hypothesized relationship between market concentration and price or profitability.²⁶ Especially influential in the dismantling of the structure-conduct-performance hypotheses was UCLA economist Harold Demsetz.²⁷ Demsetz’s work was central to exposing the misspecification of this relationship in previous work by Joe Bain and followers, as well as offering efficiency justifications for the observed correlation—that firms with large market shares could earn high profits as a result of obtaining efficiencies, exploiting economies of scale, or creating a superior product.²⁸

The second component, “the Chicago School of antitrust analysis,” primarily contributed empirical work in the form of case studies demonstrating that various business practices previously considered to be manifestly anticompetitive could, in fact, be efficient and pro-competitive. Perhaps the most well known contribution of the Chicago School of antitrust is the “single monopoly profit theorem,” which is built upon the observation that only a single monopoly profit is available in any vertical chain of distribution. The theorem posits that a firm with monopoly power at one level of distribution would prefer competition at every other level of the supply chain because that will reduce the price of the product to consumers, increase sales, and maximize total profits. It is now understood that the theorem applies in limited circumstances. Nonetheless, this theoretical insight placed significant pressure on economists to think more rigorously about explaining the efficiency justifications for various vertical

contractual arrangements as well as the conditions under which they prove to be anticompetitive.

The basic features of this second component are generally attributable to the work of Aaron Director²⁹ and others from 1950 to the mid 1970s.³⁰ A group of eminent antitrust scholars including Richard Posner, Robert Bork, and Frank Easterbrook followed in Director's footsteps, building on these studies and on economic analysis, and advocating bright-line presumptions, including *per se* legality, which reflected the growing consensus that most conduct is efficient most of the time.

This is not to say that the Chicago School's contributions to antitrust economics were completed by the 1970s, or that they were limited to the ultimate rejection of the structure-conduct-performance paradigm. For example, "Chicago School" industrial organization economists have continued to contribute to our economic understanding of various business practices, despite the fact that developments in industrial organization economics for the past 20 years have relied primarily on game-theoretic modeling techniques.³¹ Recent Chicagoan contributions to antitrust economics include work on exclusive dealing,³² slotting contracts,³³ and vertical restraints theory.³⁴

There is little doubt that the Chicago School's influence on antitrust law and policy has been substantial, particularly in the Supreme Court. Important Supreme Court precedents have been influenced by Chicago School thinking, including *Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*, *State Oil Co. v. Khan*, *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, and *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*, in addition to the development of the 1982 *Horizontal Merger Guidelines* by Assistant Attorney General William Baxter.³⁵ The 1970s and 1980s were marked by a dramatic shift in antitrust policies, a significant reduction in enforcement agency activity, and calls from Chicago School commentators for the use of bright line presumptions,³⁶ *per se* legality for vertical restraints,³⁷ and even repeal of the antitrust laws altogether.³⁸ Perhaps the Chicago School's most important and visible victory has been the assault on the *per se* rule of illegality, which, at least for now, exists only in naked price-fixing cases and, in a weakened form, in tying cases.

The leading alternative to the Chicago School approach is the Post-Chicago School.³⁹ The Post-Chicago approach challenges the conditions under which Chicago results hold, such as the single monopoly profit theorem. Indeed, authors in the Post-Chicago movement have been able to produce a series of models in which a monopolist in one market has the incentive to monopolize an adjacent product market.⁴⁰ Post-Chicago economists also have created literature focusing on the possibility of vertical foreclosure. This raising rivals' costs strand of literature has become the most influential Post-Chicago contribution, and has provided a theoretical framework for a number of theories that explore the possibility of anticompetitive effects of various exclusionary business practices.⁴¹ For example, such theorems have demonstrated that it is possible for tying, exclusive dealing, and predatory pricing to generate anticompetitive effects under certain conditions, including an assumed absence of any pro-competitive justifications for the conduct examined.⁴²

Despite the Post-Chicago School's dominance in modern economics departments, ownership of the dominant share of pages in top economics journals relative to any other category of antitrust, and successful infiltration of antitrust policy in the European Union, the Post-Chicago economic framework has only had a modest impact on U.S. competition law. The watershed mark of Post-Chicago analysis is the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services, Inc.*, which seemed to open the door, if only for a moment, to Post-Chicago arguments.⁴³ However long *Kodak* held open a window that would have facilitated a paradigm shift in the federal courts from Chicago School antitrust to Post-Chicago principles, the antitrust jurisprudence of the Roberts Court appears to have closed it.

The contrast between the Chicago and Post-Chicago Schools often tempts commentators to adopt a "pendulum narrative" when describing the history of antitrust thought.⁴⁴ First, by introducing economic analysis to antitrust, the Chicago School supplanted the pre-Chicago "structural" view that often resulted in condemning business practices without understanding them, and exhibited hostility towards market concentration even when such increased concentration was likely to benefit consumers. Next, it became apparent that the Chicago School insights immunizing certain conduct from antitrust scrutiny went "too far" as Post-Chicago economists exposed the myth endorsed by Chicago School proponents that "everything is efficient" by generating models debunking Chicago assertions that various business practices could never be inefficient or anticompetitive. Because Chicagoans ignore the possibility theorems produced by the Post-Chicago literature, it is argued, the Chicago School necessarily "went too far."

This convenient narrative portraying Post-Chicago antitrust economics as a reasonable compromise between the pre-economics era and the policies generated by Chicago School insights pervades *Overshot the Mark*. Of course, economic science allows us to settle disputes between competing theoretical models by means superior to compromise. Further, as Federal Trade Commission (FTC) Commissioner Kovacic has recently argued, this "just right" narrative is not an accurate intellectual history of antitrust in the United States because it misses, or minimizes, the contributions of the Harvard School.⁴⁵ Kovacic also points out that this narrative overstates the differences between Chicago and Post-Chicago thinking.⁴⁶ It is always more difficult to characterize a position as extreme if many diverse groups hold it. To the extent that Chicago and Harvard have indeed converged on much in modern antitrust jurisprudence, assertions about the reflexive and ideological opposition to antitrust intervention in Chicago are less likely to persuade without evidence.

Unfortunately, the Chicago/Post-Chicago narrative has also tempted commentators to adopt extreme and misleading descriptions of one camp or the other. Several commentators in *Overshot the Mark* succumb to this temptation by describing the Chicago School economists as a monolithic entity that always favors free markets over regulation, allows ideology to trump evidence, and is not interested in advancing the discourse of antitrust economics in a scientific manner.⁴⁷ In reality, this is a gross mischaracterization of the Chicago School. Indeed, Chicagoans are well known to have anticipated the raising rivals' cost literature by recognizing the insight that a dominant firm might harm competition by foreclosing rivals from

distribution,⁴⁸ and have contributed to the economic literature by documenting some of the only empirical examples of raising rivals' costs theories⁴⁹ and economically-rational predation theories.⁵⁰ They have also contributed to the theory of collusion,⁵¹ and explored the use of tying and other practices to monopolize adjacent markets.⁵² These caricature-like descriptions of the Chicago School, however, threaten to nonsensically turn "Chicago School" into a pejorative term, and do little other than mislead and discourage meaningful discourse.

The aim of this section is not to simply point out the ways in which the Chicago School has been mischaracterized. Rather, it is to provide an accurate and workable definition of the Chicago School, against which we can measure *Overshot the Mark's* claims. I offer an alternative definition of the Chicago School of antitrust which turns on the following three methodological commitments: (1) rigorous application of price theory; (2) the centrality of empiricism; and (3) emphasis on the social cost of legal errors in the design of antitrust rules.

1. Rigorous Application of Price Theory

The first defining characteristic of the Chicago School is a rigorous application of economic theory, especially but not exclusively neoclassical price theory, to problems of antitrust analysis. Richard Posner once stated that the key distinguishing attribute of the Chicago School of antitrust was that it "view[ed] antitrust policy through the lens of price theory."⁵³ Because I suspect that most commentators will agree that the application of price theory is indeed a distinctive characteristic of the Chicago School of antitrust, I will not expand on this point other than to offer the following two caveats.

The first is that Chicago's application of price theory does not imply that both Post-Chicago and Harvard School applications of economic theory to antitrust lack rigor. Although this criticism has been leveled at the Harvard School's contributions to industrial organization economics in the 1950s and 1960s, most criticisms of the Post-Chicago movement have focused on its excessive mathematical complexity and highly stylized models, rather than a lack of theoretical rigor.⁵⁴ The primary difference between the Chicago and Post-Chicago Schools with respect to economic theory is that the former rejects game theory as a useful tool for policy analysis, while the latter embraces it as a primary weapon. Game theory has been criticized on the grounds that it produces too many equilibria to be useful, so the Chicago School favors price theory for its ability to generate testable data for the purpose of empirical testing.⁵⁵

The second caveat is to recognize that many of the Chicago School's contributions, especially in the area of vertical restraints, do not rely solely upon neoclassical price theory and the model of perfect competition. Several of the key contributions by Chicagoans actively shed the confines of the neoclassical price theory model of perfect competition, in favor of reliance on the new institutional economics and focus on institutional details and transaction costs. In a series of articles, Professor Alan Meese has correctly noted that strict adherence to the perfect competition model envisioned in neoclassical economics is not consistent with the Chicago explanations of vertical restraints, which depend on the presence of downward sloping demand curves.⁵⁶ While noting that this objection is not without some force, I adopt an inclusive view of the philosophical underpinnings of the Chicago School, which includes these contributions.

Adherence to neoclassical price theory was no doubt a hallmark characteristic of Chicago analysis—and much progress was made in advancing antitrust analysis with a simple application of price theory. However, embracing a one-to-one correlation between perfect competition and Chicago would be overly narrow and would not capture the contributions of many members of the Chicago movement. Chicago School economists frequently deviated from the confines of the model of perfect competition whenever such deviation was useful to generate helpful insights about various business practices.⁵⁷ In fact, Chicagoans were among the first to criticize reliance on the model of perfect competition as a useful benchmark for antitrust analysis.⁵⁸

2. The Centrality of Empiricism

The second defining feature is the centrality of empiricism to the research agenda of Chicago antitrust analysis. Recent empirical surveys of vertical restraints strongly support the view that these practices are not likely to produce anticompetitive effects, and therefore favor a presumption of legality.⁵⁹ The question I address here, however, is not whether Chicago School models have superior predictive power relative to their Post-Chicago counterparts. Rather, my claim is merely that empirical testing is a central feature of the Chicago School analysis.

There is at least one set of generally undisputed empirical contributions from Chicago School economists—the debunking of the purported relationship between concentration and price that was asserted by proponents of the structure-conduct-performance paradigm.⁶⁰ However, even setting aside the contributions of these “early” Chicagoans, it is clear that the relative weight attached to empirical evidence by later Chicago antitrust scholars was also relatively high.

Perhaps the most striking example of a Chicago School scholar who offered substantial empirical contributions to antitrust literature was George Stigler. Seminal Chicago School figures Ronald Coase and Harold Demsetz have both noted Stigler’s dedication to empiricism with a note of admiration. Coase describes Stigler as moving effortlessly “from the marshaling of high theory to aphorism to detailed statistical analysis, a mingling of treatments which resembles, in this respect, the subtle and colourful Edgeworth. It is by a magic of his own that Stigler arrives at conclusions which are both unexpected and important.”⁶¹ Demsetz eloquently elaborates on this theme:

Housed in Stigler’s mind, neoclassical theory had more than the usual quality of material with which to work. It was coupled with a joy in verification and with a strong work ethic and sense of duty to his profession. Intelligence, insight, wit, and style were evident in his writings. His articles and essays could not be ignored. They provoked readers to think and often to follow his lead. For some readers, they simply provoked. Stigler’s passion for evidence gathering is also evident in his work, and he made no secret of it.⁶²

Stigler’s work exemplified the billing described by these prominent Chicagoan colleagues and displayed an unmistakable passion for empirics. It is the empirical flavor of his economic analysis that landed Stigler the Nobel Prize in 1982 for his “seminal studies of industrial structures, functioning of markets and causes and effects of public regulation.”⁶³

However, in an ironic twist, Stigler was initially rejected by the University of Chicago economics department for being “too empirical.” In his 1964 presidential address to the American Economic Association, Stigler announced that the “age of quantification is now full upon us,” and noted that this age would be characterized by policy analysis informed by empirical evidence.⁶⁴

Stigler’s body of work in industrial organization economics, which he often referred to as “microeconomics with evidence,” is powerful proof of the centrality of empiricism to his own approach. For example, Stigler offered an early study of the effects of the antitrust laws,⁶⁵ an empirical assessment of block booking practices,⁶⁶ and a study of the economies of scale⁶⁷ introducing the survivorship principle. Perhaps the strongest evidence of Stigler’s dedication to the role of empirical evidence in the development of antitrust policy was his change in position in favor of deconcentration policy in the early 1950s. This change was in response to empirical evidence that debunked the consensus views concerning the relationship between concentration and profitability.⁶⁸

The uniquely Stiglerian commitment to empiricism is a noteworthy feature of the Chicago School’s contribution to antitrust analysis in its own right, but there are others who demonstrate a similar commitment. For example, the case studies offered by many Chicagoans have played an important role in antitrust policy. Former FTC Chairman Timothy Muris has recognized the contributions of Benjamin Klein’s case studies emphasizing the role of vertical restraints in facilitating dealer supply of promotional services, when performance is difficult to measure.⁶⁹

In sum, the Chicago School of antitrust analysis places a strong emphasis on empiricism, through both statistical analysis and case studies of specific restraints. One might view the Chicago commitment to price theory—and even measured deviations from price theory where useful to explain economic phenomenon—as an extension of the emphasis on empiricism because of the testable implications that follow from its application.

3. Adoption of the Error-Cost Framework

A third defining feature of the Chicago School of antitrust analysis is its emphasis on the relationship among antitrust liability rules, judicial error, and the social costs of those errors. From an economics perspective, it is socially optimal to adopt the rule that minimizes the expected cost of false acquittals, false convictions, and administrative costs. Not surprisingly, the error-cost approach is distinctively Chicagoan because it was pioneered by Judge Frank Easterbrook of the U.S. Court of Appeals for the Seventh Circuit, who is a prominent Chicagoan.⁷⁰ Subsequently, several commentators have adopted this framework as a useful tool for understanding the design of antitrust rules.⁷¹

The error-cost framework begins with the presumption that the costs of false convictions in the antitrust context are likely to be significantly larger than the costs of false acquittals, since judicial errors that wrongly excuse an anticompetitive practice will eventually be undone by competitive forces. Conversely, judicial errors that wrongly condemn a pro-competitive

practice are likely to have significant social costs, because such practices are abandoned and not offset by market forces.

The insights of Judge Easterbrook's error-cost framework, combined with the application of price theory and a sensitivity to the state of empirical evidence, can be a powerful tool for improving antitrust policy. For example, David S. Evans and Jorge Padilla demonstrate that such an approach to tying favors a modified *per se* legality standard, in which tying is deemed pro-competitive unless the plaintiff presents strong evidence that the tie was anticompetitive.⁷² Their conclusion is based upon the formulation of prior beliefs concerning the likely competitive effects of tying, and grounded in an assessment of the empirical evidence evaluating both Chicago and Post-Chicago economic theories.⁷³ While Evans and Padilla describe this approach as "Neo-Chicagoan" because it adds the error-cost framework to the conventional Chicago approach, I attribute the intellectual origins of the error-cost framework as applied in the antitrust context to Judge Easterbrook, and thus continue to use the original term.⁷⁴

This is not to say that the Chicago School possesses an exclusive claim on the placing of significant weight on error and administrative costs in the design of antitrust standards. Indeed, FTC Commissioner Kovacic has persuasively demonstrated that the Harvard School has played an integral role in promoting the administrability of antitrust rules, which is a predecessor of the error-cost framework discussed above.⁷⁵ Perhaps the most well known proponents of this position are Professors Phillip Areeda and Donald Turner, who have consistently argued that antitrust rules should be administrable.⁷⁶ The Harvard School's then-Judge Stephen Breyer incorporated the insights of the Harvard approach into antitrust doctrine in *Barry Wright Corp. v. ITT Grinnell Corp.*, noting that "antitrust laws very rarely reject . . . 'beneficial birds in hand' for the sake of more speculative . . . 'birds in the bush.'"⁷⁷ Again, the Harvard School's sensitivity to the possibility of deterring pro-competitive conduct as a result of judicial error is largely related to the Chicago School's error-cost framework. The powerful intellectual foundations of the error-cost framework, grounded in basic decision theory and accepted by Chicago, Harvard, and most economists, is one reason why the framework has become a building block for modern competition policy.

Having defined the Chicago School and its methodological commitments, a central challenge from *Overshot the Mark* remains to be answered. In Section III, I scrutinize claims that the Chicago School gets the economics wrong, while focusing on *Overshot the Mark's* insistence that Chicago economists have "gone too far" when it comes to our understanding of various business practices. In Section IV, I turn to the provocative claim that the Supreme Court has perhaps been blinded by "conservative" Chicago School economics, and subsequently ignored evidence in favor of a reflexively pro-business approach to antitrust.

III. A SIMPLE EXPLANATION OF THE CHICAGO SCHOOL'S PERSISTENT DOMINANCE OF U.S. ANTITRUST POLICY

Overshot the Mark's critiques of the Chicago School literature have one theme in common: That the Chicago School's preference for theory and ideology rather than empirical

evidence has led to antitrust policy that is too lenient compared to policy informed by the more predictive Post-Chicago economic theories.⁷⁸ Fortunately, assertions that Chicago School economics “gets it wrong” can be evaluated with objective data. Moreover, so can the relative predictive power of Chicago and Post-Chicago theories. We do so in this section. Specifically, motivated by *Overshot the Mark's* claims about the failures of Chicago School economics in these areas, we evaluate the state of available theoretical and empirical knowledge concerning resale price maintenance (RPM) and exclusive dealing.⁷⁹

A. Resale Price Maintenance: Economic Theory and Evidence

One of the most persistent debates in antitrust has been over the appropriate antitrust treatment of RPM. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*⁸⁰ was a major event in this debate. Relying extensively on the existing theoretical and empirical economic literature, the Supreme Court overturned *Dr. Miles'* century old *per se* prohibition against minimum RPM in favor of a rule of reason approach.⁸¹ Justice Kennedy's majority opinion concluded that the *per se* rule was inappropriate because, while there was universal agreement between economists that RPM could be anticompetitive, the theory and evidence simply did not demonstrate that the practice “always or almost always tend[s] to restrict competition and decrease output.”⁸²

The result was unsurprising on economic grounds. Economists nearly universally agree that while RPM can generate anticompetitive outcomes in some instances (for example as part of a manufacturers' cartel), it is generally pro-competitive.⁸³ However, despite this consensus, many legal commentators continue to take the position that *Dr. Miles*, or some truncated rule of reason approach placing an initial burden on firms adopting the practice to demonstrate that their RPM contracts fit into a specified list of acceptable uses, is more appropriate.⁸⁴ These commentators argue that the efficiency justifications most frequently offered for RPM either don't fit the existing cases or are logically invalid.⁸⁵ Indeed, proposed legislation which would revive the *per se* rule against RPM under the Sherman Act currently awaits Congressional attention.⁸⁶

One side of the debate views *Leegin* as a long overdue symbol of the Chicago School's continued attack on anachronistic antitrust rules from the “pre-economics” era of competition policy. Advocates of a Post-Chicago approach to antitrust enforcement view *Leegin* quite differently. Post-Chicagoans, and authors in *Overshot the Mark*, point to the death of the *per se* prohibition against RPM as a primary example that the Supreme Court has favored ideology over sensible economic theory and empirical evidence.

Much of this debate has revolved around the economic concept of free-riding. Particularly in the context of RPM, the debates have focused on the potential for free-riding on the promotional efforts of retailers—that were funded by manufacturers—by ensuring a higher margin with RPM. Advocates of the *per se* rule argue that the free-riding concept has spun out of control and now is used to attempt to justify the use of vertical restraints in areas where the concept clearly does not apply. Further, they argue that the empirical literature demonstrates conclusively that RPM generates higher retail prices. They are right on both counts. But on both counts, they've also asked the wrong questions.

Let us start with the objection to the overuse of the free-riding prevention justification for the use of RPM and other vertical restraints. Since the Supreme Court's watershed decision in *Sylvania*, it has been widely recognized that RPM can prevent the problem that "discounting retailers can free-ride on retailers who furnish services and then capture some of the increased demand those services generate."⁸⁷ This form of "discount dealer" free-riding takes place when consumers first visit the full-service retailer to obtain valuable promotional services (such as obtaining product information) before purchasing the product from a "discount dealer" who does not provide those services, and therefore can sell at a lower retail price. RPM is used to prevent this form of discounting by eliminating retail discounting.⁸⁸

While this efficiency justification for RPM is now well accepted, Robert Pitofsky and other commentators have noted that many of the observed uses of RPM do not fit the "discount dealer" story.⁸⁹ Chicago School economists have agreed that the "discount dealer" free-riding story is not, by itself, sufficient to explain the prevalence of RPM. For instance, Benjamin Klein observed that "the attempt by defendants to place all cases of resale price maintenance within the prevention of free-riding framework has led to absurd, clearly pretextual explanations."⁹⁰ The failure of the "discount dealer" free-riding justification to explain many instances of RPM has led many commentators to conclude that where this narrow explanation does not apply, it is appropriate to conclude that RPM is likely to generate anticompetitive results.⁹¹

The Post-Chicago commentators who have correctly noted the overuse of the "discount dealer" justification and, therefore, concluded that a *per se* rule is appropriate, have made a fundamental error. They have either ignored or failed to understand the role of RPM in facilitating the provision of efficient promotional services in the absence of free-riding. Because they fail to understand the pro-competitive role of RPM in the absence of free-riding, they have incorrectly concluded that either *per se* analysis or a truncated rule of reason, allowing a limited defense to defendants if their use of RPM appears to fit the narrow "discount dealer" story, is appropriate.

These commentators are in distinguished company. Justice Breyer's dissent in *Leegin* concedes confusion about what possible efficiency gains might derive from the use of RPM in the absence of free-riding:

"I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need resale price maintenance. Why, on these assumptions, would a dealer not 'expand' its 'market share' as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it. And I do not think that we should place significant weight upon justifications that the parties do not explain with sufficient clarity for a generalist judge to understand."⁹²

In *Overshot the Mark*, Warren Grimes and Marina Lao echo Justice Breyer's view that RPM either cannot or does not solve free-riding on promotional services. Both argue that *Leegin* is misguided because it misunderstands the economics of RPM, granting too much deference to the "discount dealer" free-rider theory espoused in *Sylvania*. For example, Professor Grimes

claims that “[a] manufacturer’s desire to limit free riding by its dealers cannot provide a justification for either upstream or downstream power vertical restraints.”⁹³ Professor Lao similarly asserts that RPM simply cannot provide incentives for the supply of retailer promotional services in the absence of dealer free-riding, calling the very idea “fundamentally flawed” and observing that “it is not clear how free riding can plausibly occur, much less become a severe problem that must be remedied through distribution restraints.”⁹⁴ Professor Lao goes on to conclude that “as long as free riding is not a likely risk, then, in a free market, we would expect dealers to voluntarily invest to provide the enhancements truly valued by consumers.”⁹⁵ Justice Breyer as well as Professors Lao and Grimes are mistaken in their understanding of the economics of RPM and its role in facilitating the provision of efficient promotional services in the absence of free-riding.

The fundamental economic question is why, in a competitive retail market with zero free-riding, retailers lack a sufficient incentive to adequately promote the manufacturer’s product?⁹⁶ In other words, why don’t retailers in a competitive retail market, when left to their own devices, provide the efficient level of promotional services? Professors Lao and Grimes conclude that they do. Justice Breyer searches for an answer. Interestingly, Justice Kennedy’s majority opinion in *Leegin* provides one, citing Klein and Murphy’s seminal article on the economics of vertical restraints which provided the answer to this question 20 years ago.⁹⁷

Klein and Murphy demonstrate that retailers will undersupply promotional services because manufacturers do not take into account the incremental profit margin earned by the manufacturer on promotional sales when some, but not all, consumers value the promotional service. There is an important incentive conflict between manufacturers and retailers with respect to retailer supply of point-of-sale promotional effort. The conflict derives from two economic factors common in markets where RPM is observed. The first is that manufacturers’ profit margins (difference between wholesale price and marginal cost of production) on an incremental sale induced by retailer promotion are generally much larger than the retailer’s margin (difference between retail price and wholesale price paid). This is highly likely to be the case where manufacturers produce branded, differentiated goods and face substantially less elastic demand than retailers. Because retailers do not take into account the additional profit margin earned by the manufacturer on promotional sales, they will generally have an insufficient incentive to provide promotion from the manufacturer’s point of view.⁹⁸

The second factor is that the manufacturer’s incremental sales produced by the retailer’s manufacturer-specific efforts are often greater than the retailer’s overall incremental sales. When a retailer provides incremental services to promote a specific manufacturer’s product, there is no larger retail increase in total sales that is capable of offsetting the lower retail profit margin. In fact, when a multi-product retailer supplies promotional services for a specific brand, for example Coca-Cola, the primary effect is demand-shifting among manufacturers.⁹⁹ In other words, promotion-induced sales of Coca-Cola are likely to be at least partially offset by a decrease in the sales of other soda products.

Given these general economic conditions—manufacturer profit margins that exceed retailer profit margins on promotional incremental sales, the absence of significant inter-retailer

demand effects from the supply of promotional effort, and promotion that results primarily in manufacturer “brand-shifting”—retailers will not have an adequate incentive to supply manufacturer-specific promotional efforts. It is critical to note that these conditions are pervasive in the modern economy of differentiated products, downward sloping demand curves, and competitive retail industries. Under these conditions, whether or not there is also “discount dealer” free-riding, manufacturers and retailers have a strong economic motivation to solve this incentive conflict by devising contractual arrangements assuring that the jointly profit-maximizing level of promotional services is supplied.

While these conditions provide the incentives for manufacturers to compensate retailers for the supply of promotional services, there are a number of possible contractual arrangements the parties might adopt. For example, manufacturers might compensate retailers with a per unit time slotting payment, a wholesale price reduction, or RPM. The fundamental objective of these payments is to provide a premium stream to retailers for the provision of promotional services. This premium stream facilitates performance and is self-enforcing in the economic sense.¹⁰⁰ In other words, because the desired performance might include promotional services that are difficult and costly to specify, manufacturers ensure performance not by litigating but by monitoring retailer efforts and then terminating retailers that the manufacturers determine are not performing adequately or in accord with the specified and unspecified elements of the parties’ agreement.¹⁰¹ The self-enforcing nature of these contractual arrangements, and the costs associated with contracting for difficult-to-specify retailer promotional efforts, also expose the flaw in economic arguments that compensation arrangements, other than those that would completely specify desired performance, should be suspect under the antitrust laws.¹⁰²

Understanding the economic role of RPM in resolving incentive conflicts between manufacturers and retailers in the absence of dealer free-riding does not imply that RPM is always pro-competitive. The anticompetitive theories of RPM are well known—facilitating cartels or allowing manufacturers to compensate retailers in a manner that excludes rivals from access to efficient distribution. But if it does indeed “take a theory to beat a theory,” it makes sense to completely understand the underlying economics of both the pro-competitive and anticompetitive theories at issue with respect to RPM before choosing which economic model has the greatest predictive power. RPM skeptics, however, have largely justified their position—that the anticompetitive theories are more likely to explain RPM—by assertion. But what does the empirical evidence actually show?

In *Overshot the Mark*, Professor Lao assesses the state of economic evidence, both theoretical and empirical, and concludes that “the procompetitive case that is made for minimum RPM is largely theoretical, with at most some weak supporting empirical evidence. In contrast, the anticompetitive effects of RPM are real, significant, and sometimes well-documented.”¹⁰³ Professor Lao also notes that “there is virtually no dispute that RPM almost always leads to higher consumer prices,”¹⁰⁴ and argues that despite the fact that higher prices could be consistent with both pro-competitive and anti-competitive theories of RPM, this finding supports application of a truncated rule of reason approach.¹⁰⁵

From a consumer welfare perspective, it is true that measuring the impact of RPM on prices tells us little about the competitive effects of RPM, since both pro- and anti-competitive theories predict higher prices. Analyzing the impact of RPM on output, where the theories offer predictions in opposing directions, would resolve this problem. It is also important to note that a prohibition on RPM will not necessarily result in lower retail prices because manufacturers and retailers will substitute more inefficient distribution arrangements (often using other vertical restraints or vertical integration).¹⁰⁶

While measuring the welfare effects of vertical restraints can be especially difficult in the absence of a natural experiment, over the last 25 years there has been a concerted effort to add empirical knowledge to our large menu of theoretical models.¹⁰⁷ Two recent empirical surveys summarize the existing empirical literature. The first, authored by a group of Federal Trade Commission and Department of Justice economists, reviews 24 papers published between 1984 and 2005 providing empirical effects of vertical integration and vertical restraints.¹⁰⁸ The second, by Francine Lafontaine and Margaret Slade, reviews 23 papers with some overlap with the Cooper et al. survey.¹⁰⁹ While the reader is referred to these surveys for methodological details concerning individual studies, a careful review of the relevant studies reveals that both surveys offer a synthesis of the evidence. Cooper et al. observe that “empirical analyses of vertical integration and control have failed to find compelling evidence that these practices have harmed competition, and numerous studies find otherwise,” and while “some studies find evidence consistent with both pro- and anticompetitive effects,” **“virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition.”**¹¹⁰

Lafontaine and Slade reach a similar conclusion. Summarizing and synthesizing the evidence that they reviewed, the authors conclude that “it appears that when manufacturers choose to impose restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision . . . the evidence thus supports the conclusion that in these markets, manufacturer and consumer interests are apt to be aligned.”¹¹¹ In a more recent analysis of the vertical restraints literature, Dan O’Brien notes that three additions to the literature provide new evidence that vertical restraints mitigate double marginalization and promote retailer effort.¹¹² O’Brien goes on to conclude that “with few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons,” and supports “a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases.”¹¹³

In *Overshot the Mark*, Professors Lao and Grimes do not confront this literature. Perhaps sensing the overwhelming empirical evidence stacked against them, Lao and Grimes attempt to recast the theoretical debate and even go so far as to claim that the empirical evidence favors the anticompetitive theories. These attempts fail. A scientific, Bayesian approach to the design of optimal antitrust policy requires that we update our prior beliefs based on the available empirical evidence. In order to select the best performing economic models from those available, antitrust decision-makers must rigorously examine the existing evidence. In the context of RPM and vertical restraints, it is impossible to evaluate the existing empirical

literature without reaching the conclusion that these practices are nearly always efficient. Applying explanatory power as our selection criteria for the proper economic model, the evidence overwhelmingly rejects replacing the Chicago School approach to vertical restraints with a more interventionist approach. As O'Brien concludes, "if there were a Hippocratic Oath among antitrust practitioners, this is where a scientific approach would lead."¹¹⁴

B. Exclusive Dealing: Economic Theory and Evidence¹¹⁵

The primary anticompetitive concern with exclusive dealing contracts is that a monopolist might be able to utilize exclusivity to fortify its market position, raising rivals' costs of distribution, and ultimately harming consumers. In *Overshot the Mark*, Steven Salop usefully summarizes the raising rivals' cost (RRC) principle, which he originated, and its application to exclusionary contracts, distinguishes it from predatory pricing theories, and places the RRC principle in the context of Post-Chicago economics.¹¹⁶

The most common scenario of antitrust relevance involving exclusive dealing contracts concerns an upstream supplier, *S*, entering into an exclusive dealing contract with retailers, *R*, who in turn sells the product to final consumers. The potentially anticompetitive motivation associated with exclusive dealing contracts is clearly related to the limitation placed by that contract on *R*'s ability to sell rival products to final consumers. The possibility of anticompetitive exclusion occurring from these types of contracts generally arises only if *S* is able to foreclose rival suppliers from a large enough fraction of the market to deprive those rivals of the opportunity to achieve minimum efficient scale.¹¹⁷

The well known critique of that line of reasoning comes from the Chicago School argument that *R* will not have the incentive to agree to contracts that facilitate monopolization upstream, because they will then suffer the consequences of facing that monopolist in their chain of distribution.¹¹⁸ As a general matter, one can think of this criticism as drawing the analogy to a conspiracy among retailers, *R*, organized by the monopolist *S* to exclude *S*'s rivals from access to distribution.¹¹⁹ Like any other conspiracy, it is generally the case that each *R* has the incentive to deviate and remain outside the agreement by contracting with *S*'s rivals and expanding output at the expense of rival retailers.¹²⁰ In other words, retailers have the incentive to avoid entering agreements that will ultimately harm them, and *S* will generally not be able to compensate retailers enough to enter into the anticompetitive exclusive contract.¹²¹ The critique goes on to argue that observed exclusive dealing contracts must generate efficiencies rather than anticompetitive effects.

The economic literature has grown in recent years to include a series of theoretical models that contemplate scenarios where *S* can sufficiently compensate retailers to join and remain within the conspiracy, and therefore accomplish an anticompetitive purpose. These anticompetitive theories of exclusive dealing generally assume that *S* supplies a product that is essential to *R*'s viability and that there are substantial economies of scale in manufacturing.

One such theory considers the case where the monopolist *S* adopts exclusive contracts rather than merely collecting its monopoly profit from the sale of the essential product, and relies on the existence of dynamic economies of scale such as network effects.¹²² Under this

dynamic theory of exclusion, *S*'s exclusive contracts prevent *S*'s rivals or potential entrants from developing into future rivals, thereby protecting *S*'s future market power. Because *S*'s rivals must operate at a cost disadvantage that drives them out and prevents entry, *S* is able to increase the duration and scope of its market power.¹²³

A second set of models explores the possibility that coordination problems between buyers prevent the foiling of *S*'s anticompetitive use of exclusive dealing contracts. There is substantial industrial organization literature analyzing the conditions under which these types of coordination problems between buyers generate the possibility of anticompetitive exclusion. The seminal article of this type is by Rasmussen, Ramseyer, and Wiley ("RRW"),¹²⁴ and later refined by Segal and Whinston ("SW").¹²⁵ The unifying economic logic of these models is that the potential entrant (or current rival) must attract a sufficient mass of retailers to cover its fixed costs of entry, but *S*'s exclusive contracts with retailers prevent the potential entrant from doing so. It is then necessary to work out the conditions under which such exclusion is not possible, possible, or probable.

A number of factors, in addition to the degree of downstream retail competition, have been identified in the exclusive dealing literature as either favoring the theoretical possibility of exclusion or rendering it less likely or impossible. Significant economies of scale in distribution militate against exclusion because, in that case, a potential entrant may need to attract only a single buyer in order to achieve minimum efficient scale. Similar logic suggests that a small number of buyers will be able to coordinate in order to support the excluded rival. Further, the exclusionary equilibrium in these models is relatively fragile and the models also often generate multiple equilibria in which buyers reject exclusivity also exists.¹²⁶

Recent extensions of these models that focus on the case where buyers are competitive downstream retailers rather than final consumers have produced a wide range of conflicting results under various conditions.¹²⁷ Fumagalli and Motta consider the role of retail competition in the RRW-SW framework and demonstrate that the incentives to exclude can disappear in this setting as one buyer becomes large enough to support the entry or viability of a rival.¹²⁸ Simpson and Wickelgren derive a model that produces the opposite result, arguing that downstream competition enhances the incentive to exclude because the benefits to a single buyer of resisting exclusion are minimal if all retailers are equally disadvantaged, because retail competition will allow retailers to pass those costs on to consumers.¹²⁹

The development of this literature has increased our knowledge about the potential theoretical impact of exclusive dealing contracts. However, the models generating anticompetitive exclusion generally rely on strict assumptions concerning the existence of significant economies of scale, barriers to entry, the nature of both upstream and downstream competition and, importantly, the complete absence of efficiency justifications for the contracts. Where the necessary conditions of those models are satisfied, they demonstrate that exclusive dealing contracts may harm consumers and thus are an appropriate subject for antitrust scrutiny and further analysis.

Like RPM, exclusive dealing has become an area of antitrust debate in which possibility theorems of anticompetitive vertical contracting practices challenge the pre-existing “Chicago School” economic view. The approach in this review has been to resolve such competing theoretical claims with the empirical evidence. First, however, we must discuss the standard pro-competitive account of exclusive dealing.

Exclusive dealing arrangements are often efficient, and result from the normal competitive process. Exclusive dealing contracts are frequently observed between firms that lack any meaningful market power, implying that there must be efficiency justifications for the practice. Indeed, the economics literature is replete with pro-competitive explanations for exclusives and partial exclusives.¹³⁰

The standard pro-competitive account of exclusive dealing contracts involves use of those contracts to prevent free-riding dealers from using manufacturer-supplied investments to promote rival products.¹³¹ Manufacturer-supplied investments may take the form of purchasing display fixtures or training salespeople, among others. Dealer free-riding on these investments involves using these investments to promote rival brands. The classic example of this type of free-riding in the antitrust context is *Ryko Manufacturing Co. v. Eden Services*,¹³² where a manufacturer of car wash equipment used exclusive territories and exclusive dealing contracts to prevent its dealers from switching consumers to other brands. By facilitating dealer performance, the exclusive dealing contract allows manufacturers to collect a return on their investments and increase output.

A recent article by Benjamin Klein and Andres Lerner expands our understanding of the use of exclusive dealing by demonstrating how exclusivity minimizes free-riding in two cases where there are no manufacturer-supplied investments: First, free-riding on manufacturer-financed promotions in order to sell rival products, and Second, free-riding in the form of failing to supply the promotion paid for by the manufacturer altogether, even in the absence of dealer switching.¹³³ Since manufacturers often compensate retailers for the provision of promotional services such as premium shelf space,¹³⁴ dealers have incentives to use these additional promotional efforts to switch consumers to other products upon which the dealer earns a greater profit. Exclusive dealing can be used to prevent this type of free-riding in an analytically identical manner to the way it prevents free-riding on manufacturer-supplied investments.¹³⁵

The second type of free-riding examined by Klein and Lerner also involves manufacturer-financed promotion. Because dealers are being compensated for promotional effort on the basis of total sales (both marginal and infra-marginal), and non-performance is costly to detect, dealers have an incentive not to supply the agreed upon promotional inputs.¹³⁶ Exclusive dealing mitigates the incentive to free-ride in this way by increasing the dealer’s incentive to promote the manufacturer’s product. Courts have recognized this somewhat intuitive justification for the use of exclusive dealing in *Joyce Beverages*¹³⁷ and *Roland Machinery*, noting the incentive effects of “dedicated” or “loyal” distribution.¹³⁸ Klein and Lerner provide an economic basis for understanding the mechanism by which dealers more actively promote

the manufacturer's product in this case, and consider whether *Dentsply's* "dealer loyalty" justification for its use of exclusive dealing was improperly rejected.¹³⁹

Outside of the expanded analysis of dealer free-riding, there are other efficient uses of exclusive dealing. One such use involves the role of exclusive dealing by individual retailers, including those without any market power, in order to intensify competition by manufacturers for their business and to improve purchase terms. By offering manufacturers access to the retailer's loyal customer base, a retailer is able to commit a substantial fraction of its customers' purchases to the "favored" supplier and thereby dramatically increase each supplier's perceived elasticity of demand by making rival products highly substitutable.¹⁴⁰ I have previously extended this analysis to explain the use of category management contracts, where the particular quantity and type of shelf space devoted to the manufacturer's products is not contractually set by the retailer, but is flexibly determined over time by the category captain, a firm selected by the retailer to assist and influence decisions concerning which products in a product category are stocked, as well as how they are displayed, promoted, and priced.¹⁴¹ In contrast to the case where optimal shelf space commitments are stable, well known, and easily specified by contract, and where non-performance is easily detected by the manufacturer, category management contracts offer increased flexibility where such commitments are imprecise and change over time.

Building on the insights of the RRC and Post-Chicago possibility theorems as his foundation, Professor Calkins argues that courts have responded inadequately to the lessons from this literature.¹⁴² Professor Calkins purports to adopt the "evidence based" approach advocated in this review, which recommends selecting from the available economic models of exclusive dealing the ones with the greatest predictive power. However, Professor Calkins appears to assume that the Post-Chicago possibility theorems, which demonstrate that exclusive dealing contracts can generate anticompetitive effects under some conditions, are the best available models without a rigorous critique of the available evidence. Rather, he proceeds to offer a critique of the various obstacles that lie in front of a plaintiff seeking to prevail on a monopolization claim under an operating assumption that these obstacles are a bad thing for consumers.¹⁴³ To be fair, in the closing sentences of Professor Calkins' article, and only after he has concluded that various changes in exclusive dealing law are necessary to ensure that the "Chicago approach" does not persist, he acknowledges that there is not "nearly enough empirical work" and that "we need all the help we can get about how the world really works."¹⁴⁴ However, Professor Calkins does not reject the possibility that the best available empirical evidence does not support the presumption that the Post-Chicago models do a better job of explaining exclusive dealing and therefore should provide the economic foundation upon which we rely to design legal rules.

But what if we took the approach advocated here? What if we looked first to the existing empirical evidence, and then designed our antitrust approach to exclusive dealing contracts based upon whether the Post-Chicago possibility theorems or pro-competitive explanations for exclusivity generated superior predictive power?

Existing empirical evidence of the impact of exclusive dealing is scarce, but generally favors the view that exclusive dealing is much more likely to be output-enhancing than anticompetitive. Heide et al. conducted a survey of managers responsible for distribution decisions and found that the incidence of exclusive dealing was correlated with the presence of “free-ridable” investments.¹⁴⁵ Both Asker and Sass separately examine the welfare consequences of exclusive dealing in the beer market by observing the effect of exclusive dealing on total market output, as well as the output and prices of rival distributors, concluding that exclusive dealing is output increasing and does not generate foreclosure.¹⁴⁶ Lafontaine and Slade’s survey of the existing empirical literature, including both exclusive dealing contracts and vertical integration, concludes that the practices are generally efficient and not associated with anticompetitive outcomes.¹⁴⁷

While we have limited our analysis to RPM and exclusive dealing contracts for the purposes of this review, our approach points towards firm conclusions with respect to the optimal antitrust approach to both practices. Rather than providing support for *Overshot the Mark’s* hypothesis that Post-Chicago economics’ possibility theorems provide a sounder basis for antitrust policy than the pre-existing body of economic knowledge associated with the Chicago School, the empirical evidence on RPM overwhelmingly rejects the hypothesis. The empirical evidence on exclusive dealing also does not support *Overshot the Mark’s* hypothesis, with the scarce evidence pointing in favor of the pro-competitive economic accounts of exclusivity.

Having generated significant improvements of our economic knowledge of various business practices by all accounts, the burden of persuasion lies with the challenging body of theory to displace the existing theoretical paradigm. In this case, it is for the Post-Chicagoans to demonstrate both that the Chicagoans did indeed overshoot the mark and that the newer theoretical contributions could produce an antitrust enforcement policy much closer to the ideal target. Applying a simple scientific approach to antitrust policy, based on updating prior beliefs concerning the probability that a specific business practice is anticompetitive based on the available empirical evidence, *Overshot the Mark* fails to satisfy its burden of proof. The simple hypothesis that the persistence of Chicago School economic models and ideas in the courts is motivated by their superior explanatory power not only cannot be rejected, but finds substantial support in the data.

This finding is fatal to *Overshot the Mark’s* primary mission: to explain why inferior Chicago School economics persists in the face of a superior challenger. *Overshot the Mark* also offers a secondary claim of only somewhat less significance: That the Supreme Court has been a party to a conspiracy to favor Chicago School economics. Our analysis in this Section provides, in our view, a more persuasive explanation for the persistence of Chicago School economics in the federal courts. Nonetheless, we evaluate this claim on its own merits against the available evidence in Section IV.

IV. THE CHICAGO SCHOOL AND THE SUPREME COURT

In addition to *Overshot the Mark's* overstated and, as we've shown, unsupported claims about the predictive superiority of the Post-Chicago economic models, the volume also presses the proposition that conservative economic analysis has, in recent years, had a pernicious effect on consumers by causing courts to adopt erroneous economic principles and get specific cases wrong, develop sub-optimal legal rules, or otherwise influence antitrust policy in the wrong direction.¹⁴⁸

Because all parties agree that the early Chicago School contributions gave intellectual coherence to antitrust, and at least started out moving it in the "right" direction for consumers, the burden lies with the challengers to demonstrate persuasively that the efficient evolutionary path of antitrust was stalled as the result of the Chicago School's influence on the courts. The challenger must gather enough evidence to reject the simple alternative hypothesis that the persistence of the Chicago School's economic legacy in the federal courts is explained by the proposition that the judges have relied on the body of economic knowledge with the greatest explanatory power. Our analysis thus far already does the bulk of the work toward undermining the intellectual predicate for this claim. Arguments that the Chicago School approach to RPM, for instance, generates an inferior legal rule are simply unsupported by data on the competitive consequences of the practice. Perhaps an appeal to the underlying empirical evidence supporting the competing economic theories is enough to settle the matter.

Perhaps not. To be sure, if the underlying economic claim was correct and supported by the existing empirical evidence, *Overshot the Mark* would present an interesting puzzle concerning the persistence of antiquated Chicago School economics in the face of a superior alternative. Scholars of the efficiency of legal rules could use antitrust as a laboratory in which to study how the common law guides us to inefficient rules. But the underlying economic claim is not correct. Nonetheless, it is worth exploring *Overshot the Mark's* would-be explanation for this state of affairs. Quite simply, the explanation is a kind of conspiracy theory. The theory goes as follows: One significant reason for the persistence of what the Post-Chicagoans perceive to be inefficient legal rules is a supposed cartel consisting of Chicago oriented antitrust lawyers, economists, enforcement agency officials, and both conservative *and* liberal judges. Together these groups, the theoretical narrative continues, derailed the common law evolutionary process that could have led to the adoption and incorporation of these superior economic norms into antitrust doctrine. Conservative economists, it appears, have successfully and even knowingly misled the Supreme Court of the United States over the past several decades into the adoption of inefficient legal norms based on inferior economic foundations.

While claims that the Supreme Court has fallen victim to this conspiracy appear throughout *Overshot the Mark*, the most notable proponent of this conspiracy theory explanation for the persistence of the Chicago School in the federal courts, and the Supreme Court in particular, is Professor Fox.¹⁴⁹ Professor Fox accepts that the Court was headed in the "right" direction, but asserts that for the past several decades "a conservative Court swung the pendulum from one inefficient position (too much antitrust because it disregarded incentives

and efficiencies of dominant firms) to another (too little antitrust because it disregards incentives and efficiencies of firms without power)."¹⁵⁰

As evidence in favor of this proposition, Professor Fox walks through four Supreme Court cases: *Brooke Group*,¹⁵¹ *California Dental Association*¹⁵², *Trinko*,¹⁵³ and *Leegin*,¹⁵⁴ concluding that each is decided not by efficiency but by a commitment to conservative economics, which allows theory and ideology to trump evidence and efficiency. In *Brooke Group*, Professor Fox argues that the Court's presumption that predatory pricing was rare was "based on theory only, as adumbrated by conservative economists," while other "scholarship establishes, to the contrary, that selective price predation is a recurring phenomenon; it is used effectively to eliminate young rivals and to deter potential entry into noncompetitive markets."¹⁵⁵ Professor Fox presumes, based on her assessment of the relative frequency of anticompetitive predatory pricing, that a plaintiff victory would have been efficient and did not occur because of "conservative economics, which consistently privileged theory over facts."¹⁵⁶

Professor Fox criticizes the Court's *Brooke Group* decision for relying on economic literature suggesting the rarity of anticompetitive predatory pricing and emphasizing the benefits of low prices because it is too theoretical and insufficiently empirical. By way of contrast, Professor Fox points to scholarship that "establishes" and presumably does not favor theory over facts. One might expect to see a citation here to an empirical study documenting the anticompetitive effects of predatory pricing. But that is not the case. To criticize the theoretical nature of the Chicago School critique of predatory pricing, Professor Fox cites to a well known discussion of *game theoretic models* which suggest various conditions under which price predation might be plausible.¹⁵⁷ A rigorous examination of the empirical evidence in order to establish the frequency of anticompetitive predation, as well as the social costs of both false positives and false negatives, would be required to understand whether the rule announced in *Brooke Group* was indeed inefficient. Professor Fox does neither, which is particularly troublesome when advocating that predation policy be based upon strategic agency models which are notoriously difficult to administer, highly stylized and formal, and whose application is likely to substantially increase the probability of false positives.

Professor Fox makes similar arguments with regard to *Cal Dental* and *Trinko*, arguing that the tie-breaking vote in the former was due to conservative economics. With respect to *Trinko*, Professor Fox asks "was *Trinko* efficient? The principles it recites certainly had efficiency properties," as would a "judgment more sympathetic to the abused rivals."¹⁵⁸ Nonetheless, Professor Fox argues that we can attribute "Justice Scalia's remarkable and unprecedented formulation of pro-dominant-firm antitrust law principles" to "conservative economics."¹⁵⁹ Finally, channeling volume contributors Professors Lao and Grimes' views on RPM and *Leegin*, Professor Fox describes the decision as driven by "conservative economics-based theory rather than fact."¹⁶⁰

While a complete defense of each of the Supreme Court's decisions over the past 25 years is beyond the scope of this review, a critique of the theme emerging from Professor Fox's critique of the Supreme Court's antitrust jurisprudence is not. We've already discussed *Leegin* and suggest that rule of reason approach to RPM is mandated by an overwhelming empirical

showing that RPM is generally efficient.¹⁶¹ It is also important to notice that the critique of the Supreme Court decisions generally takes the form of announcing a preferred rule as efficient, showing that some economic theory exists in support of the particular position, and then proceeding to fault the Court for failing to adopt that position in favor of other economic theories. One reason for the Supreme Court to adopt one body of theory over another, and the possibility explored in Section III, is that the body of theory produces the most predictive power relevant to antitrust policy problems. An alternative theory, and the one explored by Professor Fox in *Overshot the Mark*, is that *conservative* economics' pernicious influence on the Supreme Court has misled its members into favoring inferior economics upon which to base antitrust policy.

Like the proposition that the Post-Chicago theories exhibit superior predictive power, this theory can also be tested against available data. While a rigorous quantitative empirical test of this ideological conspiracy theory may be difficult to execute, the theory does generate some testable implications. Perhaps the most obvious of these testable implications is that Supreme Court jurisprudence of the past several decades ought to be split among ideological lines, with decreasing consensus as conservative judges push the conservative economic agenda against their unwilling liberal counterparts.

The data tells a different story, which is impossible to reconcile with Professor Fox's simple tale of ideological conspiracy. In an excellent analysis of Supreme Court antitrust decisions from 1967-2007, Leah Brannon and Judge Douglas Ginsburg examine recent trends in Supreme Court voting patterns.¹⁶² Contrary to the predictions that ideological adoption of conservative economics in the Supreme Court would reduce consensus and produce voting along ideological lines, Brannon and Ginsburg find a remarkable degree of consensus in antitrust decisions.¹⁶³ In the benchmark period from 1967-1976, the Supreme Court decided 44 antitrust cases. Eighty percent of these decisions were decided by a supermajority of two-thirds or more. In this initial time period, 55 percent of the supermajority decisions favored plaintiffs and 25 percent favored defendants. From 1977 to 2006, approximately 77 percent of the 73 antitrust decisions were decided by a supermajority with 34 of these decisions favoring defendants and 22 for plaintiffs.¹⁶⁴ If one focuses on the most recent time period from 1997-2006, 85 percent of all antitrust decisions were decided by a supermajority margin, and each in favor of the defendant. Conservative and liberal Supreme Court justices alike are apparently equally persuaded by the economic logic of Chicago School arguments.

Is this the voting pattern of an ideological antitrust court? Consider the vote counts for the decisions during the Bush administration from 2004-2008. The total vote count for these decisions was 77-9. Six of ten decisions were decided unanimously with only one, *Leegin*, attracting more than two votes for the dissent.¹⁶⁵ Including the Supreme Court's recent and unanimous *linkLine* decision,¹⁶⁶ these numbers change to 86-9, with seven of the eleven decisions unanimous. Of course, these voting counts are not evidence that the Supreme Court does not consider political ideology when deciding antitrust cases. Nor does this data reject the possibility that political ideology explains the persistence of the Chicago School's influence in lower courts. It does however suggest that the simple conspiracy story, which alleges that the

judiciary is an active participant in an ideologically motivated program to produce inefficient antitrust rules that harm consumers, is not supported by the data.

Both the voting behavior of the Supreme Court's conservative and liberal justices as well as the available empirical economic evidence on specific business practices such as RPM and exclusive dealing support the simple hypothesis that the persistence of the Chicago School's influence can be explained by the robustness of the economic models and their explanatory power. This simple story may not satisfy those searching for a more exciting explanation, but it is the story supported by the data.

V. WHAT'S NEXT: A ROLE FOR EVIDENCE-BASED ANTITRUST?

It is by now fairly commonplace for antitrust policy debates in the United States, as well as between the United States and Europe, to adopt a Chicago against Post-Chicago meme. These debates, far too often in my view, focus on shorthand slogans and labels rather than the relevant economic questions. For example, much is made of the fact that both the United States and Europe have adopted an “effects-based” analysis aimed towards promoting “consumer welfare.” But there is little doubt that, at least in some instances, these words do not mean the same thing to enforcers on both sides of the Atlantic. Aggressive and interventionist antitrust programs attach themselves to the Post-Chicago economics movement, while those that are skeptical of such intervention attach themselves to the Chicago School. The fine details of the economics and evidence are not always but too frequently left on the sidelines to play only a complementary role rather than take center stage. *Overshot the Mark* also adopts this frame of reference for understanding whether changes in United States antitrust doctrine have helped or harmed consumers. This debate has become increasingly ideological, and too insensitive to empirical evidence, to produce progress toward sounder policy and enforcement decisions.

The evidence based approach is faithful neither to the Chicago or Post-Chicago approaches. The approach identifies the best possible set of antitrust liability rules and enforcement policies conditional on our existing set of theoretical and empirical knowledge. Some key characteristics of such an “evidence based antitrust” approach would be that it: (1) reflects a commitment to reliance on the economic theories that provide the strongest foundation for predicting how specific business practices will impact competitive outcomes; (2) uses predictive power, as determined by the best available empirical evidence, as the selection criteria applied in order to identify the appropriate economic theories to inform policy and judicial decision-making; and (3) applies the tools of decision-theory with the goal of producing liability rules that minimize the social and administrative costs of erroneous decisions. Neither subjecting economic theories to empirical testing to assess their validity and policy relevance nor application of decision theory to assist in updating our prior beliefs about the likelihood of competitive harm flowing from a particular business practice should be controversial.

Evidence-based antitrust policies could be based on a combination of Chicago and Post-Chicago insights, as well as having room for theoretical contributions that owe allegiance to neither School. In principle, such a policy program could recommend a Post-Chicago approach to predatory pricing and a Chicago School approach to exclusive dealing. One size need not fit

all. The determinative criteria would be to select the theoretical foundation with the greatest predictive power, as determined by credible and reliable empirical evidence. It is also important to note that such a program allows for change over time, as new evidence is introduced that may tilt our prior beliefs concerning the likelihood that any given business practice is anticompetitive, or the magnitude of social benefits or harms arising out of a practice.

To be sure, many antitrust commentators have applied this approach to specific business practices by evaluating competing theories against the available evidence through the lens of the error-cost approach.¹⁶⁷ However, a more broadly based shift in the policy debate from theoretical allegiance toward a scientific approach which takes seriously the existing empirical evidence is in order to resolve the important debates in antitrust law that exist both within the United States and between the United States and Europe concerning the appropriate antitrust approach to single-firm conduct and other yet unresolved debates.

A complete evaluation of United States antitrust law under the evidence-based approach is beyond the scope of this review. However, the existing economic evidence presented in Part III with respect to RPM, exclusive dealing, tying, and mergers suggests that the simple hypothesis that the Chicago School still provides the “best available” economic foundations for antitrust law and policy cannot be rejected. Indeed, the simple hypothesis performs quite well relative to the competing hypothesis that the continued influence of the Chicago School on United States antitrust law and policy is due to a collusive arrangement between enforcement agencies and federal judges of all political stripes in the face of allegedly superior economic theory. The collusive theory for the Chicago School’s continued dominance offered in *Overshot the Mark* explains neither the fact that the majority of modern Supreme Court antitrust decisions attract a bipartisan supermajority nor the fact that the best available empirical evidence still favors the Chicago School with respect to issues such as vertical contracting. Indeed, it is doubtful that this particular cartel story would survive the Supreme Court’s newly imposed “plausibility” requirement.

Overshot the Mark is an important collection of essays presenting a challenge to the Chicago School’s dominating influence on United States antitrust jurisprudence. It offers a proposal to supplant the Chicago School theoretical foundations of modern antitrust in favor of a Post-Chicago enforcement regime. Applying Stigler’s admonition that explanatory power must determine the winner of a battle of competing theories, I conclude that despite a valiant effort well worth reading for any party interested in the future of antitrust policy, *Overshot the Mark* falls short of hitting its own.

¹ George Stigler, Graduate School of Business, University of Chicago, Nobel Memorial Lecture: The Process and Progress of Economics (Dec. 8, 1982), in NOBEL LECTURES, ECONOMICS 1981-1990 (Karl-Göran, Mäler ed., World Scientific Publishing Co., Singapore 1992) at 67.

² Id. at 67-69.

³ Rhetorical battles over whether economics qualifies as a science aside, there is no serious debate that the antitrust economics literature conforms to the scientific method and that there is universal agreement that economics should inform antitrust analysis.

⁴ See Daniel P. O’Brien, The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems, in REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 80 Konkurrensverket, Swedish Competition Authority, 2008), available at http://www.konkurrensverket.se/upload/Filter/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_vertical_restraints.pdf. O’Brien refers to this body of literature as the “1984 Synthesis,” rather than the “Chicago Synthesis,” because the latter has

mistakenly come to be associated with an unscientific, non-interventionist view toward the antitrust treatment of vertical practices." While O'Brien's point is well taken, because one purpose of this review is to confront these mistaken associations directly, we elect to use Chicago School without loss of generality.

⁵ Robert Pitofsky, Introduction: Setting the Stage, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST*, at 3, 6 (Robert Pitofsky ed., Oxford Univ. Press 2008).

⁶ See *id.* at 5-6, for the assertions that conservative economic analysis has impacted U.S. antitrust enforcement such that it is characterized by "preferences for economic models over facts...[and] outright mistakes in matters of doctrine," and that "extreme interpretations and misinterpretations of conservative economic theory (and constant disregard of facts) have come to dominate antitrust," to the detriment of consumers.

⁷ See O'Brien, *supra* note 4.

⁸ President Obama, for instance, has promised to "direct my administration to reinvigorate antitrust enforcement." Posting of Joshua D. Wright to Truth On The Market, <http://www.truthonthemarket.com/2008/11/05/antitrust-under-president-obama-i-will-direct-my-administration-to-reinvigorate-antitrust-enforcement/> (Nov. 5, 2008, 9:53 EST). President Obama's respective nominee to head the Federal Trade Commission, Commissioner Leibowitz, has already cited favorably to *OVERSHOT THE MARK* in a policy speech. Jon Leibowitz, Commissioner, FTC, Remarks at Section 5 Workshop (Oct. 17, 2008) (available at <http://ftc.gov/speeches/leibowitz/081017section5.pdf>). Similarly, Christine Varney has publicly applauded the American Antitrust Institute Transition Report, which adopts an explicitly Post-Chicago vision of antitrust enforcement, noting that "'a great framework that starts it and I do endorse the conclusion.'" Posting of Joshua D. Wright to Truth On The Market, <http://www.truthonthemarket.com/2009/02/22/doj-aag-designate-christine-varney-on-section-2-europe-google-a-puzzling-statement-about-error-costs/> (Feb. 22, 2009 21:10 EST).

⁹ See *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (for discussion of plausibility standard).

¹⁰ JOHAN VAN OVERTVELDT, *THE CHICAGO SCHOOL: HOW THE UNIVERSITY OF CHICAGO ASSEMBLED THE THINKERS WHO REVOLUTIONIZED ECONOMICS AND BUSINESS* (Agate B2 2007).

¹¹ See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (The Free Press 1993) (1978); Edmund W. Kitch, *The Fire of Truth: Remembrance of Law and Economics at Chicago, 1932-1970*, 26 J.L. & ECON. 163 (1983); William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSPECTIVES 43 (2000); Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PA. L. REV. 1 (1997); William H. Page, *The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, 75 VA. L. REV. 1221 (1989); Richard A. Posner, *The Chicago School of Antitrust*, 127 U. PA. L. REV. 925 (1969).

¹² See, e.g., Pitofsky, *supra* note 5, at 3, 5; Daniel L. Rubinfeld, *On the Foundations of Antitrust Law and Economics*, in *OVERSHOT THE MARK*, *supra* note 5, at 51, 52; Richard Schmalensee, *Thoughts on the Chicago Legacy in U.S. Antitrust*, in *OVERSHOT THE MARK*, *supra* note 5, at 11, 22.

¹³ For discussions of Bork's efforts, see Frank H. Easterbrook, *The Chicago School and Exclusionary Conduct*, 31 HARV. J.L. & PUB. POL'Y 439 (2008); Douglas H. Ginsburg, *Judge Bork, Consumer Welfare, and Antitrust Law*, 31 HARV. J.L. & PUB. POL'Y 449 (2008); George L. Priest, *The Abiding Influence of The Antitrust Paradox*, 31 HARV. J.L. & PUB. POL'Y 455 (2008).

¹⁴ Joshua D. Wright, *The Roberts Court and the Chicago School of Antitrust: The 2006 Term and Beyond*, 3 COMPETITION POL'Y INT'L 24 (2007) (arguing that Chicago School economic principles successfully characterize the Roberts Court antitrust jurisprudence).

¹⁵ See Steven C. Salop, *Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark*, in *OVERSHOT THE MARK*, *supra* note 5, at 141, 144 (for the claim that "it is important to recognize that [the Post-Chicago] approach has its root in the economic analysis of Chicago School commentators," referring to the work of Aaron Director & Edward H. Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281 (1956); Peter C. Carstensen, *Director and Levi After 40 Years: The Anti-Antitrust Agenda Revisited*, 17 MCLR 37, 40 (1996) (for the proposition that Director and Levi's analysis was a precursor to the raising rivals' costs hypothesis); Comment, *Vertical Forestalling Under the Antitrust Laws*, 19 U. CHI. L. REV. 583 (1952).

¹⁶ See, e.g. Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The Standard Oil Case*, 39 J.L. & ECON. 1 (1996); Dennis Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194 (2002).

¹⁷ See William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago-Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1 (2007).

¹⁸ Einer Elhauge, *Harvard, Not Chicago: Which Antitrust School Drives Recent U.S. Supreme Court Decisions?*, 3 COMPETITION POL'Y INT'L 59 (2007).

¹⁹ For claims that Chicago School economics caused courts to adopt erroneous economic principles and get specific cases wrong, see e.g. Schmalensee, *supra* note 12, at 19, 20; Thomas E. Kauper, *Influence of Conservative Economic Analysis on the Development of the Law of Antitrust*, in *OVERSHOT THE MARK*, *supra* note 5, at 40, 44; Herbert Hovenkamp, *The Harvard and Chicago Schools and the Dominant Firm*, in *OVERSHOT THE MARK*, *supra* note 5, at 109, 113; Harvey J. Goldschmid, *Comment on Herbert Hovenkamp and the Dominant Firm: The Chicago School Has Made Us Too Cautious About False Positives and the Use of Section 2 of the Sherman Act*, in *OVERSHOT THE MARK*, *supra* note 5, at 123, 126; Warren S. Grimes, *The Sylvania Free Rider*

Justification for Downstream-Power Vertical Restraints: Truth or Invitation for Pretext?, in *OVERSHOT THE MARK*, supra note 5, at 181, 191; Marina Lao, Free Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance, in *OVERSHOT THE MARK*, supra note 5, at 196, 201. For claims that the Chicago School caused courts to develop sub-optimal legal rules, see e.g. Schmalensee, supra note 12, at 19; Kauper, id. at 42; Eleanor M. Fox, The Efficiency Paradox, in *OVERSHOT THE MARK*, supra note 5, at 77, 79-80; John B. Kirkwood & Robert H. Lande, The Chicago School's Foundation is Flawed: Antitrust Protects Consumers, Not Efficiency, in *OVERSHOT THE MARK*, supra note 5, at 89, 90; Hovenkamp, id. at 111. For claims that the Chicago School influenced antitrust policy in the wrong direction, see e.g. F.M. Scherer, Conservative Economics and Antitrust: A Variety of Influences, in *OVERSHOT THE MARK*, supra note 5, at 30, 36-37; Rubinfeld, supra note 12, at 52; Fox, id. at 81; Kirkwood & Lande, supra, at 90; Hovenkamp, id. at 111.

²⁰ Posting of Joshua D. Wright to Truth On The Market, <http://www.truthonthemarket.com/2007/07/25/chicago-post-chicago-post-post-chicago-on-using-shorthand-labels-responsibly/> (July 25, 2007, 13:07 EST).

²¹ This section relies on my earlier work on the influence of the Chicago School on the Roberts Court's antitrust jurisprudence. See Wright, supra note 14.

²² *CHICAGO ESSAYS IN ECONOMIC DEVELOPMENT* vii (David Wall, ed., Univ. of Chicago Press 1972).

²³ For remarks on how the current financial crisis demonstrates that the Chicago School is "on life support, if it is not dead," see J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, New York Bar Association Annual Dinner: Implications of the Financial Meltdown for the FTC (Jan. 29, 2009), <http://ftc.gov/speeches/rosch/090129financialcrisisnybarspeech.pdf>.

²⁴ The Chicago School does not deserve all of the credit for this revolution. Kovacic convincingly demonstrates that the intellectual foundations of monopolization doctrine were generated by both Chicago and Harvard, and with substantial convergence between the two. See Kovacic, supra note 17. Additionally, Elhauge argues that the Roberts Court's antitrust jurisprudence represents a shift away from Chicago and toward Harvard. See Elhauge, supra note 18.

²⁵ Jonathan B. Baker & Timothy F. Bresnahan, Economic Evidence in Antitrust: Defining Markets and Measuring Market Power 23-26 (Stanford Law School, Working Paper No. 328, 2006).

²⁶ See, e.g., YALE BROZEN ET AL., *CONCENTRATION, MERGERS, AND PUBLIC POLICY* (The Free Press 1982) (questioning the causal link between market concentration and price, and providing alternative efficiency-based explanations for the correlation); HARVEY J. GOLDSCHMID ET AL., *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (Little Brown and Co. 1974).

²⁷ Professors Demsetz and Armen Alchian are frequently associated with the Chicago School despite the fact that both spent the bulk of their careers at the University of California, Los Angeles (UCLA). As any UCLA economist should note, the antitrust community has sometimes allowed the Chicago School to take credit for many of the contributions from UCLA economists such as Alchian, Demsetz, Benjamin Klein, and others. The contributions of the UCLA economists to antitrust analysis are discussed by former FTC Chairman, and UCLA alumnus, Timothy J. Muris. See Timothy J. Muris, Improving the Economic Foundations of Competition Policy, 12 *GEO MASON L. REV.* 1 (2003).

²⁸ Harold Demsetz, Two Systems of Belief About Monopoly, in *INDUSTRIAL CONCENTRATION*, supra note 26. The contributions of Demsetz and other participants in the famous Airlie House Conference are discussed in Timothy J. Muris, Economics and Antitrust, 5 *GEO. MASON L. REV.* 303 (1997).

²⁹ See *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 227-33, 601-05 (Peter Newman ed., Macmillan Reference 1998); see also Sam Peltzman, Aaron Director's Influence on Antitrust Policy, 48 *J.L. & ECON.* 313 (2005).

³⁰ Seminal contributions from the Chicago School literature include, but are not limited to, Robert H.

Bork, Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception, 22 *U. CHI. L. REV.* 157 (1954); Aaron Director & Edward H. Levi, Law and the Future of Trade Regulation, 51 *NW. U. L. REV.* 281 (1956) (reprinted in 3 *COMPETITION POL'Y INT'L* 253 (2007); Ward S. Bowman, Tying Arrangements and the Leverage Problem, 67 *YALE L.J.* 19 (1957); John S. McGee, Predatory Price Cutting: The Standard Oil (NJ) Case, 1 *J.L. & ECON.* 137 (1958); Lester G. Telser, Why Should Manufacturers Want Fair Trade?, 3 *J.L. & ECON.* 86 (1960).

³¹ See, e.g., Louis Kaplow & Carl Shapiro, Antitrust, in 2 *HANDBOOK OF LAW AND ECONOMICS* 1073 (A. Mitchell Polinsky & Steven Shavell eds., Elsevier B.V. 2007) available at <http://faculty.haas.berkeley.edu/shapiro/antitrust2007.pdf>.

³² Howard P. Marvel, Exclusive Dealing, 25 *J.L. & ECON.* 1 (1982); Benjamin Klein & Andres V. Lerner, The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty, 74 *ANTITRUST L.J.* 473 (2007); Benjamin Klein & Kevin M. Murphy, Exclusive Dealing Intensifies Competition for Distribution, 75 *ANTITRUST L.J.* 433 (2008).

³³ Benjamin Klein & Joshua D. Wright, The Economics of Slotting Contracts, 50 *J.L. & ECON.* 473 (2007); Joshua D. Wright, Slotting Contracts and Consumer Welfare, 74 *ANTITRUST L.J.* 439 (2007); Joshua D. Wright, Antitrust Law and Competition for Distribution, 23 *YALE J. ON REG.* 169 (2006).

³⁴ Benjamin Klein & Kevin M. Murphy, Vertical Restraints as Contract Enforcement Mechanisms, 31 *J.L. & ECON.* 265 (1988).

³⁵ *Cont'l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977); *State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209

(1993); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007); *Pac. Bell Tel. Co. v. linkLine Commc'ns., Inc.*, No. 07-512, 2009 U.S. Lexis 1635 (U.S. Feb. 25, 2009).

³⁶ See, e.g., Frank Easterbrook, *The Limits of Antitrust*, 65 *TEX. L. REV.* 1 (1984).

³⁷ Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 *U. CHI. L. REV.* 6 (1981).

³⁸ See, e.g., DOMINICK. T. ARMENTANO, *ANTITRUST POLICY: THE CASE FOR REPEAL* (Ludwig von Mises Institute 2007) (1986).

³⁹ On the Post-Chicago approach to antitrust, see Jonathan B. Baker, *A Preface to Post-Chicago Antitrust*, in *POST-CHICAGO DEVELOPMENTS IN ANTITRUST LAW* 60 (Antonio Cucinotta et al. eds., Edward Elgar Publishing 2003).

⁴⁰ A seminal paper in this literature is Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 *AM. ECON. REV.* 837 (2000).

⁴¹ See Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 *YALE L.J.* 209 (1986).

⁴² See, e.g., Whinston, *supra* note 40; Carlton & Waldman, *supra* note 16; see also Bruce Kobayashi, *Does Economics Provide A Reliable Guide to Regulating Commodity Bundling By Firms? A Survey of the Economic Literature*, 1 *J. COMPETITION L. & ECON.* 707 (2005) (surveying the bundling literature); Eric B. Rasmusen, Mark J. Ramseyer & John Shepard Wiley Jr., *Naked Exclusion*, 81 *AM. ECON. REV.* 1137 (1991); Douglas Bernheim & Michael Whinston, *Exclusive Dealing*, 106 *J. POL. ECON.* 64 (1998); John Simpson & Abraham L. Wickelgren, *Naked Exclusion, Efficient Breach, and Downstream Competition*, 97 *AM. ECON. REV.* 1305 (2007); Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 *GEO. L.J.* 2239 (2000).

⁴³ *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). In aftermarket "lock-in" cases most closely resembling the Post-Chicago theories in Kodak, lower courts have "bent over backwards to construe Kodak as narrowly as possible." See Herbert Hovenkamp, *The Reckoning of Post-Chicago Antitrust*, in *POST-CHICAGO DEVELOPMENTS IN ANTITRUST*, *supra* note 39, at 8; see also David A.J. Goldfine & Kenneth M. Vorrasi, *The Fall of the Kodak Aftermarket Doctrine: Dying A Slow Death in the Lower Courts*, 72 *ANTITRUST L.J.* 209 (2004); Bruce H. Kobayashi & Joshua D. Wright, *Federalism, Substantive Preemption, and Limits on Antitrust: An Application to Patent Holdup*, *J. COMPETITION L. & ECON.* (forthcoming 2009) (extending Goldfine and Vorrasi's analysis through 2007 and confirming their results).

⁴⁴ William E. Kovacic, *The Modern Evolution of Competition Policy Enforcement Norms*, 71 *ANTITRUST L.J.* 377 (2003).

⁴⁵ See Kovacic, *supra* note 17. Kovacic's primary theme is that the Chicago/Post-Chicago narrative minimizes the contributions of the Harvard School scholars such as Professors Phillip Areeda and Donald Turner, as well as Justice Stephen Breyer.

⁴⁶ A view endorsed by one of the Chicago School's more prominent contributors. See Richard A. Posner, *Keynote Address: Vertical Restrictions and "Fragile" Monopoly*, 50 *ANTITRUST BULL.* 499, 500 (2005).

⁴⁷ See, e.g., Pitofsky, *supra* note 5, at 4-5; Irwin M. Stelzer, *Some Practical Thoughts About Entry*, in *OVERSHOT THE MARK*, *supra* note 5, at 24, 28-29; Fox, *supra* note 19, at 82, 86, 88; Lao, *supra* note 19, at 199.

⁴⁸ See *supra* text accompanying note 15.

⁴⁹ See Granitz & Klein, *supra* note 16.

⁵⁰ Tom Hazlett, *Predation in Local Cable TV Markets*, 40 *ANTITRUST BULL.* 609 (1995).

⁵¹ George J. Stigler, *The Theory of Oligopoly*, 72 *J. POL. ECON.* 44 (1964).

⁵² Carlton & Waldman, *supra* note 16.

⁵³ Posner, *Chicago School of Antitrust*, *supra* note 11, at 928; accord BORK, *THE ANTITRUST PARADOX*, *supra* note 11, at 117.

⁵⁴ See, e.g., Posner, *Chicago School of Antitrust*, *supra* note 5, at 928-29:

It is still fair to ask why the application of price theory to antitrust should have been a novelty. The answer, I believe, is that in the 1950s and early 1960s, industrial organization, the field of economics that studies monopoly questions, tended to be untheoretical, descriptive, "institutional," and even metaphorical. Casual observations of business behavior, colorful characterizations (such as the term "barrier to entry"), eclectic forays into sociology and psychology, descriptive statistics, and verification by plausibility took the place of the careful definitions and parsimonious logical structure of economic theory. The result was that industrial organization regularly advanced propositions that contradicted economic theory.

⁵⁵ See Bruce H. Kobayashi, *Game Theory and Antitrust, A Post-Mortem*, 5 *GEO. MASON L. REV.* 411, 412 (1997) (criticizing the application of game theory in antitrust on the grounds that "game theoretic models of [industrial organization] have not been empirically verified in a meaningful sense"). See also David Evans & Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 *U. CHI. L. REV.* 73, 98 (2005) ("it has yet to demonstrate a capacity to produce what we would call identification theorems—useful descriptions of the circumstances determining whether a practice is procompetitive or anticompetitive").

⁵⁶ See, e.g., Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 *UCLA L. REV.* 143 (1997); Alan J. Meese, *Exclusive Dealing, The Theory of the Firm, and Raising Rivals' Costs: Toward a New Synthesis*, 50 *ANTITRUST BULL.* 371 (2005); Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 *U. ILL. L. REV.* 77 (2003); Alan J. Meese, *Market Failure and Non-Standard Contracting: How the Ghost of Perfect Competition Still Haunts Antitrust*, 1 *J. COMPETITION L. & ECON.* 21 (2005).

⁵⁷ See, e.g., George J. Stigler, *The Economics of Information*, 69 *J. POL. ECON.* 213 (1964) (analyzing the economics of information from a search cost perspective, whereas search costs would not exist under perfect competition); Telsler, *supra* note 30

(analyzing resale price maintenance); Klein & Murphy, *supra* note 34; Benjamin Klein, Market Power in Aftermarkets, 17 *MANAGERIAL & DECISION ECON.* 143 (1996); Klein & Lerner, *supra* note 32 (analyzing the role of exclusive dealing contracts in preventing dealer free-riding).

⁵⁸ See Harold Demsetz, 100 Years of Antitrust: Should We Celebrate?, Brent T. Upson Memorial Lecture, George Mason University School of Law, Law and Economics Center (Sept. 21, 1989).

⁵⁹ See James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, Vertical Antitrust Policy as a Problem of Inference, 23 *INT'L J. INDUS. ORG.* 639 (2005); Francine Lafontaine & Margaret Slade, Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy (Sept. 2005) (unpublished paper, available at <http://www2.warwick.ac.uk/fac/soc/economics/staff/faculty/slade/wp/ecsept2005.pdf>).

⁶⁰ See Brozen, *supra* note 26; Demsetz, *supra* note 28.

⁶¹ R.H. COASE, George J. Stigler, in *ESSAYS ON ECONOMICS AND ECONOMISTS* (University of Chicago Press 1995).

⁶² Harold Demsetz, George J. Stigler: Midcentury Neoclassicalist with a Passion to Quantify, 101 *J. POL. ECON.* 793 (1993).

⁶³ Press Release, The Royal Swedish Academy of Sciences, The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1982 (Oct. 20, 1982), http://nobelprize.org/nobel_prizes/economics/laureates/1982/press.html.

⁶⁴ See, e.g., George J. Stigler, The Economist and the State, 55 *AM. ECON. REV.* 1, 17 (1965):

It will become inconceivable that the margin requirements on securities markets will be altered once a year without knowing whether they have even a modest effect. It will become impossible for an import-quota system to evade calculus of gains and costs . . . Studies will inevitably and irresistibly enter into the subject of public policy, and we shall develop a body of knowledge essential to intelligent policy formation.

⁶⁵ George J. Stigler, The Economic Effects of the Antitrust Laws, 9 *J.L. & ECON.* 225 (1966).

⁶⁶ George J. Stigler, *United States v. Loew's: A Note on Block Booking*, 1963 *SUP. CT. REV.* 152 (1963).

⁶⁷ George J. Stigler, The Economies of Scale, 1 *J.L. & ECON.* 54 (1958).

⁶⁸ GEORGE J. STIGLER, *MEMOIRS OF AN UNREGULATED ECONOMIST* 97-100 (University of Chicago Press 1988).

⁶⁹ See Muris, *supra* note 27, at 17. The seminal article from Klein & Murphy, *supra* note 34, includes a detailed discussion of Coors' use of vertical restraints to solve dealer free-riding problems.

⁷⁰ Easterbrook, *supra* note 36.

⁷¹ See, e.g., Evans & Padilla, *supra* note 55; C. Frederick Beckner III & Steven C. Salop, Decision Theory and Antitrust Rules, 67 *ANTITRUST L.J.* 41 (1999); Keith N. Hylton & Michael Salinger, Tying Law and Policy: A Decision-Theoretic Approach, 69 *ANTITRUST L.J.* 469 (2001); Luke Froeb et al., Vertical Antitrust Policy as a Problem of Inference, 23 *INT'L J. INDUS. ORG.* 639 (2005).

⁷² Evans & Padilla, *supra* note 55. Others have applied the error-cost framework in a similar manner. See *supra* note 71.

⁷³ See *id.* at 88.

⁷⁴ See *id.* at 75.

⁷⁵ See Kovacic, *supra* note 17.

⁷⁶ PHILLIP AREEDA & DONALD TURNER, *ANTITRUST LAW* 31-33 (1978).

⁷⁷ *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983).

⁷⁸ See Fox, *supra* note 19, at 79-80, 82, 86, 88; Lao, *supra* note 19, at 199, 208. See also Stephen Calkins, Wrong Turns in Exclusive Dealing Law, in *OVERSHOT THE MARK*, *supra* note 5, at 156, 165-67.

⁷⁹ We exclude mergers from our analysis here for a number of reasons. The first is that *OVERSHOT THE MARK* largely ignores mergers with the exception of Baker & Shapiro, *Reinvigorating Horizontal Merger Enforcement*. One of the primary points made in that article is that, during the George W. Bush administration, the Department of Justice did not vigorously enforce the Clayton Act. Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in *OVERSHOT THE MARK*, *supra* note 5, at 235, 246-7. Baker & Shapiro offer some evidence that the percentage of merger challenges relative to transactions identified by the Hart-Scott-Rodino filing requirements fell. *Id.* at 246. The second is that others have defended against, discussed, and picked apart these claims in great detail. See, e.g., Timothy J. Muris, *Facts Trump Politics: The Complexities of Comparing Merger Enforcement over Time and Between Agencies*, *ANTITRUST*, Summer 2008, at 37; John D. Harkrider, *Antitrust Enforcement During the Bush Administration—An Econometric Estimation*, *ANTITRUST*, Summer 2008, at 43. The third reason is that, even if one accepts the questionable statistical foundation of Baker and Shapiro's claims that the Bush II Department of Justice (and to a lesser extent the FTC) gave a pass to anticompetitive mergers, there is little evidence to support that such a result (including the split between the DOJ and FTC on merger enforcement) is attributable to Chicago School economics. Finally, there is growing convergence on the relevant antitrust economics of mergers. This literature focuses on empirical methods designed to improve post-merger pricing predictions and is not inherently ideological. For a survey of the state of empirical evidence on the competitive effects of mergers, see Matthew Weinberg, *The Price Effects of Horizontal Mergers*, 4 *J. COMPETITION L. & ECON.* 433 (2008); Dennis W. Carlton, *Why We Need to Measure the Effect of Merger Policy and How to Do It* (Nat'l Bureau of Econ. Research, Working Paper No. 14719, Feb. 2009); Paul Pautler, *Evidence on Mergers and Acquisitions*, 48 *ANTITRUST BULL.* 119 (2003); Kaplow & Shapiro, *supra* note 32, at 1152-57. See also Orley Ashenfelter & Daniel Hosken, *The Effect of Mergers on Consumer Prices: Evidence from Five Selected Case*

Studies (Nat'l Bureau of Econ. Research, Working Paper No. 13859, Mar. 2008); Graeme Hunter, Gregory K. Leonard & G. Steven Olley, *Merger Retrospective Studies: A Review*, ANTITRUST, Fall 2008, at 34.

⁸⁰ Leegin, 127 S. Ct. 2705. On Leegin and its antitrust implications, see Wright, *supra* note 14.

⁸¹ See Thomas A. Lambert, *Dr. Miles is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance*, WM. & MARY L. REV. (forthcoming 2009).

⁸² Leegin, 127 S. Ct. at 2709. The Supreme Court overruled the per se rule against maximum RPM ten years earlier in *State Oil v. Khan*, 522 U.S. at 3. See Benjamin Klein, *Distribution Restrictions Operate by Creating Dealer Profits: Explaining the Use of Maximum Resale Price Maintenance in State Oil v. Khan*, 7 SUP. CT. ECON. REV. 1 (1999).

⁸³ See Brief of Amici Curiae Economists in Support of Petitioner at 16, *Leegin Creative Leather Prods. V. PSKS, Inc*, 127 S. Ct. 2705 (No. 06-480), 2007 WL 173681 (stating that “[i]n the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects”). The best estimate of the prevalence of collusion allegations in RPM cases is no greater than 15 percent. See Pauline Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 270 (1991).

⁸⁴ Warren S. Grimes, *The Path Forward After Leegin: Seeking Consensus Reform of the Antitrust Laws of Vertical Restraints*, 75 ANTITRUST L.J. 467 (2008).

⁸⁵ See, e.g., Grimes, *supra* note 19, at 182, 189, 191, 195; Lao, *supra* note 19, at 199, 203, 209.

⁸⁶ *Discount Pricing Consumer Protection Act*, S. 148, 111th Cong. (2009).

⁸⁷ *Sylvania*, 433 U.S. at 55.

⁸⁸ This economic rationale for RPM is typically associated with Telser, *supra* note 30.

⁸⁹ Robert Pitofsky, *Why ‘Dr. Miles’ Was Right*, 8 REGULATION 27, 29 (1984). Robert Pitofsky, *Are Retailers Who Offer Discounts Really “Knaves”?: The Coming Challenge to the Dr. Miles Rule*, ANTITRUST, Spring 2007, at 61, 63; Grimes, *supra* note 19, at 187.

⁹⁰ Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding* (Feb. 10, 2009) (draft for FTC Hearings on Resale Price Maintenance, Feb. 17, 2009), available at <http://ftc.gov/opp/workshops/rpm/docs/bklein0217.pdf>.

⁹¹ See, e.g. Robert L. Hubbard, *Protecting Consumers Post-Leegin*, ANTITRUST, Fall 2007, at 41.

⁹² *Leegin Creative Leather Products., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2733 (2007).

⁹³ Grimes, *supra* note 19, at 195.

⁹⁴ Lao, *supra* note 19, at 203.

⁹⁵ *Id.*

⁹⁶ A second critical economic question is why the compensation for the desired promotional services takes its particular form, e.g. RPM, a lump sum per unit time payment such as a slotting fee, or a wholesale price discount. For a discussion of the relative merits of volume based payment schemes such as RPM and wholesale price discounts in comparison to slotting fees, see Klein and Wright, *supra* note 33.

⁹⁷ Leegin, 127 S. Ct. at 2716 (citing Klein & Murphy, *supra* note 34, at 295. Klein has recently revisited the economics of resale price maintenance as first articulated by Klein and Murphy, in Klein, *supra* note 90).

⁹⁸ This is not the case where the services desired have significant inter-retailer demand effects and consumers shift their purchases from one retailer to another in response to the retailer’s supply of the service. However, these large inter-retailer demand effects are not likely to be present for many desired services, such as the provision of premium shelf space. A more complete economic analysis of the incentive conflict based inter-retailer demand effects is presented in Ralph Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q. J. ECON. 61 (1993), and in Klein & Wright, *supra* note 33.

⁹⁹ See Wright, *supra* note 33.

¹⁰⁰ See Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

¹⁰¹ See Klein, *supra* note 90 (describing how RPM facilitates self-enforcement).

¹⁰² See, e.g., Grimes, *supra* note 84, at 477-78.

¹⁰³ Lao, *supra* note 19, at 209.

¹⁰⁴ *Id.* at 210.

¹⁰⁵ *Id.* at 211.

¹⁰⁶ See Klein, *supra* note 90, at 42.

¹⁰⁷ See Dan O’Brien, *supra* note 4, for an excellent and extensive discussion of the relevant theoretical and empirical literature on RPM and vertical restraints generally.

¹⁰⁸ Cooper et al., *supra* note 59.

¹⁰⁹ Francine Lafontaine & Margaret Slade, *Empirical Assessment of Exclusive Contracts*, in *HANDBOOK OF ANTITRUST ECONOMICS* (Paolo Buccirossi ed., The MIT Press 2008).

¹¹⁰ Cooper et al., *supra* note 59, at 18 (emphasis added).

¹¹¹ Lafontaine & Slade, *supra* note 59, at 22.

¹¹² O'Brien, *supra* note 4, at 72-73 (citing Sofia Berto Villas-Boas, *Vertical Relationships between Manufacturers and Retailers: Inference with Limited Data*, 74 *REV. ECON. STUD.* 625 (2007); Julie H. Mortimer, *Vertical Contracts in the Video Rental Industry*, 75 *REV. ECON. STUD.* 165 (2008); Giorgio Zanarone, *Vertical Restraints and the Law: Evidence from Automobile Franchising*, 52 *J.L. & ECON.* (forthcoming 2009)).

¹¹³ *Id.*

¹¹⁴ O'Brien, *supra* note 4, at 82.

¹¹⁵ This section relies on the discussion in Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing* (George Mason Law & Economics Research Paper No. 08-37) (forthcoming in *ANTITRUST LAW AND ECONOMICS*, Keith N. Hylton, ed., Edward Elgar Publishing, 2009).

¹¹⁶ Salop, *supra* note 15, at 142-44. Salop also acknowledges that the RRC concept has its roots in the work of earlier Chicago commentators such as Aaron Director and Edward Levi, who recognized the potential for anticompetitive effects arising from exclusive dealing contracts. *Id.* at 144.

¹¹⁷ This anticompetitive strategy using exclusive contracts belongs to the more general class of strategies analyzed in the raising rivals' costs literature. See Krattenmaker & Salop, *supra* note 41; Stephen C. Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 *AM. ECON. REV.* 267 (1983).

¹¹⁸ This line of reasoning is conventionally associated with Robert Bork. See, e.g., BORK, *supra* note 11, at 309 ("A seller who wants exclusivity must give the buyer something for it. If he gives a lower price, the reason must be that the seller expects the arrangement to create efficiencies that justify the lower price. If he were to give a lower price simply to harm his rivals, he would be engaging in deliberate predation by price cutting, and that, as we have seen in Chapter 7, would be foolish and self-defeating behavior on his part").

¹¹⁹ This analogy is explored and used to derive the economic conditions necessary for exclusive contracts to cause anticompetitive effects in Benjamin Klein, *Exclusive Dealing as Competition for Distribution on the Merits*, 12 *GEO. MASON L. REV.* 119, 122-28 (2003).

¹²⁰ See Granitz & Klein, *supra* note 16.

¹²¹ Bernheim & Whinston, *supra* note 42, formally derive this result.

¹²² See Carlton & Waldman, *supra* note 16.

¹²³ An alternative, but related, theory of exclusion operates by driving out competing retailers and allowing S to monopolize distribution and also collect its monopoly price on the distribution of rival products. See Whinston, *supra* note 40. This alternative theory also requires substantial economies of scope or scale in the supply of distribution services. Economies of scope in distribution may be present if, for example, S's product is essential to the economic viability of R.

¹²⁴ Rasmussen, Ramseyer & Wiley, *supra* note 42.

¹²⁵ Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 *AM. ECON. REV.* 296 (2000).

¹²⁶ But see *id.*, and MICHAEL D. WHINSTON, *LECTURES ON ANTITRUST ECONOMICS* (MIT Press, 2008), for arguments that the ability to make discriminatory or sequential offers to buyers increases the support for exclusion.

¹²⁷ See, e.g., Chiara Fumagalli & Massimo Motta, *Exclusive Dealing and Entry When Buyers Compete*, 96 *AM. ECON. REV.* 785 (2006) (exclusion is not likely with downstream retail competition where potential entrant can achieve scale through distribution with a small number of retailers); Simpson & Wickelgren, *supra* note 42 (exclusion is possible with downstream retail competition because each individual retailer has little to gain from holding out from the exclusive and the increased benefits of upstream competition are largely passed on to final consumers); John Simpson & Abraham L. Wickelgren, *Exclusive Dealing and Entry, When Buyers Compete: Comment* (mimeo, June 2005) (same).

¹²⁸ Fumagalli & Motta, *supra* note 126.

¹²⁹ Simpson & Wickelgren, *supra* note 126.

¹³⁰ A description of other commonly accepted justifications for exclusive dealing is presented in Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 *ANTITRUST L.J.* 311, 357-60 (2002).

¹³¹ Marvel, *Exclusive Dealing*, *supra* note 32.

¹³² 823 F.2d 1215 (8th Cir. 1987). See also Klein & Lerner, *supra* note 32, at 481-83 (discussing Ryko as an example of this type of free-riding).

¹³³ Klein & Lerner, *supra* note 32.

¹³⁴ See Klein & Wright, *supra* note 33, which extends the original analysis of inadequate dealer incentives to promote and the use of vertical restraints in solving this dealer incentive problem in Klein & Murphy, *supra* note 34.

¹³⁵ Klein & Lerner, *supra* note 32, at 497-502.

¹³⁶ *Id.* at 502-04.

¹³⁷ *Joyce Beverages of N.Y., Inc. v. Royal Crown Cola Co.*, 555 F. Supp. 271, 276-77 (S.D.N.Y. 1983). See also *Hendricks Music Co. v. Steinway, Inc.*, 689 F. Supp. 1501 (N.D. Ill. 1988) ("it is perfectly legitimate and, in fact, procompetitive, for manufacturers to insist that their dealers devote undivided loyalty to their products and not to those of their competitors").

¹³⁸ *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380 (7th Cir. 1984).

¹³⁹ Klein & Lerner, *supra* note 32, at 507-18. See generally *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d 387 (D. Del. 2003), *rev'd*, 399 F.3d 181 (3d Cir. 2005), *cert. denied*, 126 S. Ct. 1023 (2006). Klein and Lerner conclude that creating “undivided dealer loyalty” was a plausible justification in *Dentsply*, but that “we do not know if a more complete analysis would have found the net effect of *Dentsply*’s exclusive dealing to be procompetitive or anticompetitive,” and “what is clear is that further analysis of the undivided loyalty rationale for exclusive dealing should have been undertaken.” Klein & Lerner, *supra* note 32, at 518.

¹⁴⁰ See Klein & Murphy, *supra* note 32. This explanation is related to, and provides the economic basis for, the argument that exclusives “instigated” by customers should enjoy a presumption of legality. See also Richard M. Steuer, *Customer Instigated Exclusive Dealing*, 68 *ANTITRUST L.J.* 239 (2000).

¹⁴¹ Joshua D. Wright, *Antitrust Analysis of Category Management: Conwood Co. v. United States Tobacco Co.*, 17 *SUP. CT. ECON. REV.* (forthcoming 2009).

¹⁴² Calkins, *supra* note 78, at 156-57.

¹⁴³ For example, Professor Calkins criticizes the trend in lower courts toward presuming legality for distribution contracts of less than one year. See also Salop, *supra* note 15. But see Wright, *supra* note 33 (providing a defense of presumptive legality for short term contracts).

¹⁴⁴ Calkins, *supra* note 78, at 167.

¹⁴⁵ Jan B. Heide et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 *J.L. & ECON.* 387 (1988).

¹⁴⁶ See John Asker, *Diagnosing Foreclosure Due to Exclusive Dealing* (NYU Working Paper No. EC-04-36, 2005); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the US Beer Industry*, 23 *INT'L J. INDUS. ORG.* 203 (2005).

¹⁴⁷ Lafontaine & Slade, *supra* note 108.

¹⁴⁸ See *supra* text accompanying note 19.

¹⁴⁹ Fox, *supra* note 19, at 83. See also Robert Pitofsky, *supra* note 5, at 6 (“Because extreme interpretations and misinterpretations of conservative economic theory (and constant disregard of facts) have come to dominate antitrust, there is reason to believe that the United States is headed in a profoundly wrong direction”).

¹⁵⁰ Fox, *supra* note 19, at 81.

¹⁵¹ *Brooke Group*, 509 U.S. 209.

¹⁵² *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999).

¹⁵³ *Trinko*, 540 U.S. 398.

¹⁵⁴ *Leegin*, 127 S. Ct. 2705.

¹⁵⁵ Fox, *supra* note 19, at 82.

¹⁵⁶ *Id.*

¹⁵⁷ Fox, *supra* note 19, at 82 (citing Joseph F. Brodley, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 *GEO. L.J.* 2239 (2000)). But see Kenneth G. Elzinga & David E. Mills, *Predatory Pricing and Strategic Theory*, 89 *GEO. L.J.* 2475, 2475 (2001) (“Although strategic theories of predatory pricing are exemplary in their coherence and rigor, their potential to add value to antitrust policy is much more modest than the authors admit.”). Indeed, the economic literature does provide some evidence of profitable predation. See, e.g., U.S. DEP'T OF JUSTICE, *COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT* (2008), at 56, note 85 (collecting studies). See generally Bruce H. Kobayashi, *The Law and Economics of Predatory Pricing* (forthcoming in *ANTITRUST LAW AND ECONOMICS*, *supra* note 114).

¹⁵⁸ Fox, *supra* note 19, at 84.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 86.

¹⁶¹ See *supra* text accompanying notes 81, 82.

¹⁶² Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court, 1967-2007*, 3 *COMPETITION POL'Y INT'L J.* 3 (2007).

¹⁶³ *Id.* at 20.

¹⁶⁴ *Id.* at Table 4.

¹⁶⁵ See Einer Elhauge, *supra* note 18, at 64 (speculating that the fact that “Breyer’s dissent referred no less than six times to the stare decisis considerations that were cited in an abortion case made it hard to avoid the conclusion that this case had gotten mixed up with abortion politics.”)

¹⁶⁶ Linkline, No. 07-512, 2009 U.S. Lexis 1635.

¹⁶⁷ See Cooper, et al, *supra* note 59; Hylton & Salinger, *supra* note 71; David S. Evans & Michael A. Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 *YALE J. ON REG.* 37 (2005).



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Reflections on Bush Administration M&A Antitrust Enforcement and Beyond

Ilene Knable Gotts & James F. Rill

Reflections on Bush Administration M&A Antitrust Enforcement and Beyond

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I. INTRODUCTION

The election of Barack Obama as President—and the culmination of the Bush Administration—mark an appropriate time to reflect on the Bush Administration’s legacy for M&A antitrust enforcement. As noted below, the past eight years have seen impressive improvements in the merger review process, use of economics and reliance on evidence in merger analysis, and U.S. participation in international policy fora. Increased transparency has been an important element in achieving these objectives. Nevertheless, charges have been made by some antitrust economists and practitioners that federal antitrust enforcement has been lax during the Bush Administration.¹ The “record,” however, critics rely upon is far from clear, particularly given the complexities in trying to make those comparisons.² Paradoxically, while attacking the agencies for under-enforcement, the critics point to a poor track record in court to suggest that “anything goes” on the merger front. The perceptions of the level of enforcement can be skewed by a few high-profile decisions by the enforcement agencies not to challenge a merger and a limited set of court decisions that were highly fact-specific and of marginal bearing for future jurisprudence. Moreover, such perceptions are often “lagging indicators” of present or future outcomes. This article will describe some of the achievements during the past eight years that the new antitrust leadership can build upon. We will also discuss the perception of lax enforcement, as well as what we believe is the actual status quo, as a basis for forecasting what future enforcement policy might be. Finally, this article recommends some changes the new administration could undertake that would increase the efficiency and efficacy of merger enforcement.³

II. MILESTONES IN ENFORCEMENT

The criticism directed at the antitrust agencies’ enforcement program overlooks a wide range of accomplishments and initiatives that the U.S. Department of Justice (the “DOJ”) and Federal Trade Commission (the “FTC”) have achieved during the past eight years. These undertakings, described below, involve both procedural and substantive advances in both

* 2008 I.K. Gotts and J.F. Rill. Mrs. Gotts is a partner in the New York law firm of Wachtell, Lipton, Rosen & Katz and Mr. Rill is a partner in the Washington, D.C. office of Howrey LLP.

domestic and international fronts. The new administration would do well to continue and to build upon these efforts.

A. Merger Review Process Initiatives Should Have Continuing Effect in Next Administration

Procedural changes at both the DOJ and the FTC have significantly impacted enforcement statistics and should universally be viewed as positive developments. Throughout the Bush Administration's tenure, both agencies engaged in a variety of projects to increase the efficiency of the merger review process—and were more successful than prior administrations in achieving progress. In 2001, each agency announced initiatives to increase the efficiency of investigations, including a reduction in the length of merger reviews.⁴

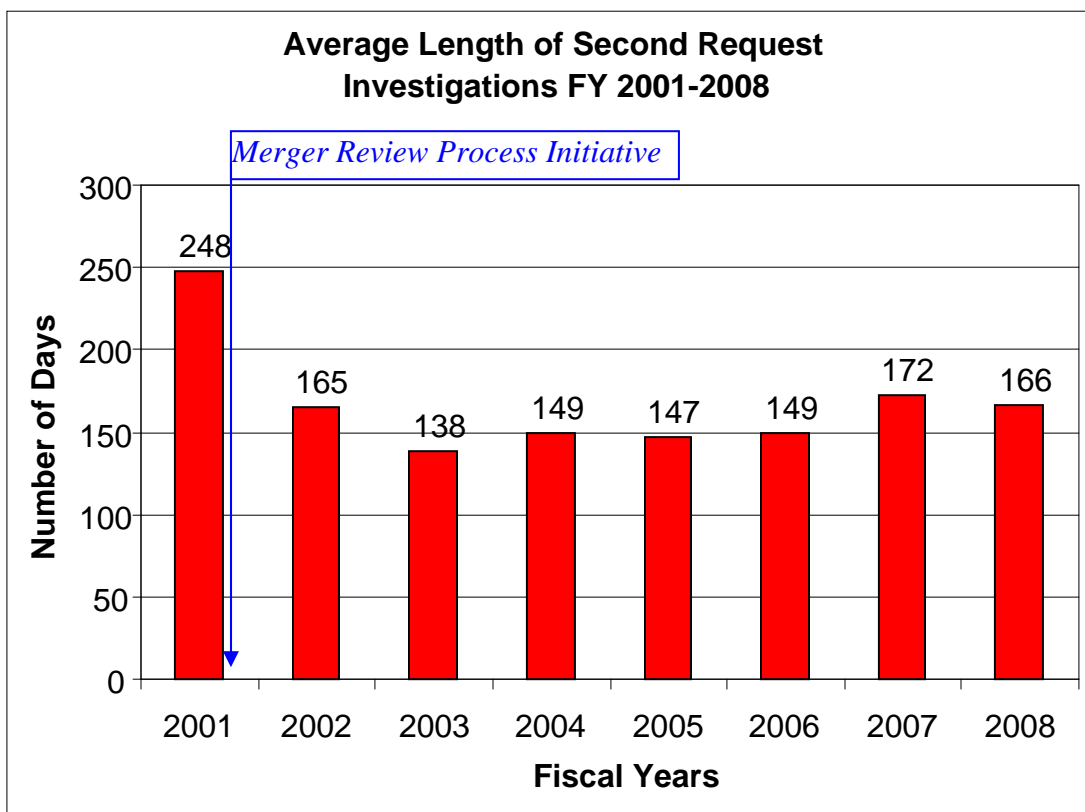
Perhaps the single-most positive development involves the effective use of the initial waiting period, which is likely a major reason that, as illustrated in Appendix A, there has been a significant decrease in the number of second requests issued, particularly at the DOJ.

In contrast to the two fiscal years before the DOJ initiative (FY 2000-2001)—when approximately 40 percent of the agency's preliminary investigations resulted in second requests—in recent years, the data show that around 30 percent of such investigations receive second requests. Although there may be variations from year-to-year based on the nature of transactions being proposed (e.g., strategic versus financial), the trend has been fairly consistent. The DOJ's recent track record is in line with that of the FTC's during the Clinton Administration, with the FTC continuing to grant, on average, fewer second requests in cleared transactions than the DOJ.⁵ The staff and transaction parties have further eliminated the need for issuance of second requests in some transactions by extending the initial waiting period in transactions with discrete issues, through one or more "pull and refile" of the notifications, thereby restarting the clock.⁶ The DOJ reports that in FY 2008 alone, 24 transactions were pulled and refiled; of those, only six subsequently received a second request.⁷ This practice has become particularly useful in cash-tender offer situations, given the shorter initial waiting period.⁸

The agencies still issue second requests in about 25-30 percent of transactions investigated, and a large part of their resources is used in conducting such full investigations of these transactions. Given the public and private costs of a second request review, both agencies seek to limit the second request process to those transactions highly likely to raise concerns. Indeed, the FTC's strategic plan issued in late 2006 set a goal of 90 percent for the percentage of second request transactions that resulted in a positive enforcement outcome (i.e., challenge, consent, or deal abandonment).⁹ To date, however, there has not been a consistent track record meeting this objective, although, in the last two years, a very high percentage of such transactions resulted in enforcement.

There has been some improvement in the agencies limiting the burden of the second request. Both agencies acknowledge the burdens of second requests and undertook during the Bush years (as had prior administrations) to decrease the length of the second request by

issuing revised model second requests,¹⁰ best practices for data and remedies, and a consultative procedure whereby the staff and transaction parties can discuss the issues and, where appropriate, stage discovery to focus on potentially discrete dispositive issues.¹¹ These initiatives appear to have had an impact. The average length of the DOJ's second request investigations, for instance, dropped by 46 percent from mid-2001, when the initiatives were announced, to FY 2005, and although there has been a slight increase since then on average, the decrease remains significant:



In November 2007, the DOJ indicated that between June 1, 2006 and July 31, 2007 it had closed, within 90 days of the expiration of the initial waiting period, approximately 60 percent of the investigations in which a second request was issued.¹² Moreover, of the 16 second requests that the DOJ issued and completed during FY 2008, almost two-thirds were decided without full compliance with the second request, including 7 of the 9 transactions in which the DOJ took enforcement action.¹³

But both agencies condition the availability of the second request modifications on the parties conceding certain timing and discovery rights. The quid pro quo component for obtaining these reductions and adopting a cooperative dialogue with the staff at the agency provides the agency with leverage over timing of the investigation and negates the certainty of

the timing provided in the HSR Act itself. Although blatant abuses of the process are not common, a 2000 Congressional mandate¹⁴ sought to inject procedural due process into the second request process. Both agencies established procedures for resolving disputes that may arise in connection with the breadth of, or compliance with, second requests.¹⁵ Despite the implementation of these internal review procedures, there have been very few transactions in which parties have exercised the appeals process, and none of these appeals has resulted in material reductions of what the staff has insisted on retaining within the second request. There also remains no litigated legal standard on what constitutes substantial compliance.¹⁶ Thus, the true potential for an impartial check on agency action during the second request has yet to be realized, and the system's workings depend on the good faith conduct of the staff and agency officials.

B. Increased Transparency

1. Increased Transparency Demonstrates Reliance on Economic and "Sticky Facts" in Agency Decision-making

Transparency is an important part of policy enforcement and serves the objective of ensuring that both agency staff and the business community are informed regarding the standards that will be applied in merger review. Increased transparency can impact enforcement statistics, to the extent that the business community foregoes transactions that are likely to be blocked. Throughout the Bush Administration, both agencies provided greater transparency and guidance in their decision-making process through the issuance of statements in certain transactions not requiring relief. These statements cite, among other things, ease of entry and expansion,¹⁷ efficiencies,¹⁸ changed market conditions,¹⁹ and countervailing-buying power²⁰ as the bases for not challenging the respective transactions. These closing statements also provide insight into the rigorous evidentiary and economic analysis undertaken by the staff in full reviews.²¹

The closing statement in connection with merger review of rival contenders Carnival Corporation and Royal Caribbean Cruises Ltd. for P&O Princess Cruises plc constituted the first example of the new transparency initiative. The statement revealed the degree to which economic analysis and data mining could impact ultimate agency decision-making in the Bush Administration. The merger was procedurally and substantively prolonged and complex, with dueling bidders—involving the review of different antitrust authorities—only adding to the complexity. In November 2001, Royal and Princess announced their proposed \$3.7 billion merger utilizing a dual-listed company ("DLC") structure.²² Due to the DLC structure of the transaction and the respective operations of the parties, the Royal/Princess transaction was not reportable in the European Union ("EU") or under HSR. Nevertheless, the competition authorities of the United Kingdom, Germany, and the United States reviewed the transaction. In December 2001, rival Carnival responded by announcing a \$5.5 billion hostile bid for Princess.²³ The EU and the United States reviewed the Carnival/Princess transaction. Both transactions faced initial skepticism and intense scrutiny by the applicable competition authorities. At the

time, Carnival was the world's largest cruise company, with 43 ships and about a 32 percent share of worldwide cruise sales; Royal held the number two position, with 23 ships and about 24 percent share of worldwide cruise sales; and Princess was in third place, with 19 ships and just over an 11 percent share of worldwide cruise sales.²⁴

After initially expressing "serious doubts" about Carnival's bid, on July 24, 2002, EU Commissioner Mario Monti announced that the EU would approve the transaction.²⁵ After noting how closely the EU and the United States had worked together on this transaction,²⁶ Commissioner Monti suggested that the U.S. situation was markedly different in terms of structure of demand and supply.²⁷

As reflected in the FTC's Carnival closing statement, the staff concluded, based on the quantitative data, that the transaction was unlikely to raise concerns under either a unilateral-effects theory or a coordinated-interaction theory.²⁸ The staff found that any market definition resulting in a uniform price increase would have enlarged the market to such a magnitude that it would negate the establishment of a competitive effect.²⁹ On October 4, 2002, a majority of the FTC adopted the staff's views, with Commissioners Mozelle W. Thompson and Sheila F. Anthony issuing a dissenting statement.³⁰ The dissent indicated that the extremely high post-merger concentration levels in the North American cruise markets create a presumption of coordinated interaction.³¹ Moreover, Commissioners Anthony and Thompson were unconvinced that entrance by new firms or expansion by smaller rivals would thwart these potential effects.³²

Then Bureau of Competition Director Joseph Simons aptly summarized: "The ultimate lesson of the cruise investigation is that the Guidelines mean what they say. High concentration creates a presumption of problems—but that presumption can be rebutted by the facts in a specific matter. Here, the facts—particularly quantitative and financial analyses—rebutted the presumption."³³

The FTC's closing statement in the proposed acquisition of Adelphia Communications Corporation by Comcast Corporation and Time Warner Cable, Inc., and the accompanying cable distribution swaps, similarly describes a rigorous evidentiary and economic analysis exploring whether: (1) The transaction would foreclose satellite, over-builder, and telephone distribution competitors' access to regional sports networks; and (2) even if such foreclosure occurred, consumers would be worse off. The FTC considered, and rejected, the possibility that increased "clustering of systems"—i.e., the common ownership of adjacent cable distribution systems in certain metropolitan areas—would reduce competition.³⁴

In the Federated/May transaction, the closing statement explained why the FTC deviated from the previously established market definition consisting of traditional or conventional department stores.³⁵ Under the traditional definition, this transaction would have resulted in creating "high levels of concentration among conventional department stores in many parts of the country, and thus facially appeared to raise issues of competitive concerns."³⁶ The FTC statement detailed the evolution of the retail industry and concluded that the evidence

of pricing patterns “provides the most compelling, objective demonstration that . . . conventional department stores are not in a distinct market.”³⁷ Instead, the FTC found that department stores face competition from multiple retail formats and must take these alternative formats into account when they make inventory and pricing decisions. Accordingly, the FTC’s statement clearly reflected a diametric shift in the treatment of department store transactions due to the changes that have occurred in the retail industry in the last decade.³⁸

The use of closing statements continued in FY 2008. On December 20, 2007, the FTC issued a statement in connection with its four-to-one vote to close its eight-month investigation of Google’s proposed acquisition of DoubleClick Inc.³⁹ The staff reportedly conducted over 100 interviews and obtained more than two million pages of documents from the parties, as well as the records of documents from third parties. The agency staff analyzed three principal theories of potential competitive harm. First, it considered—and rejected—whether the combination would eliminate direct and substantial competition between the two companies. Second, the agency examined, under potential competitive theories, the implications of Google’s continuing efforts to enter the third-party ad serving markets. The staff would have been concerned if these efforts had the potential to eliminate a competitor that was uniquely positioned to have a pro-competitive effect. The staff found, however, that current competition in the market is vigorous and Google’s entry would not significantly impact such competition. Third, the agency considered whether the acquisition would allow Google to exploit DoubleClick’s position in the third-party ad serving markets to benefit Google’s ad intermediation product, AdSense. The FTC found that, since the evidence did not show DoubleClick had market power in the third-party ad serving markets, it was unlikely that Google could foreclose competition or manipulate DoubleClick’s products to disadvantage Google’s competitors. Nor did the evidence demonstrate that any aggregation of data would harm competition in the ad intermediation market.

Commissioner Pamela Jones Harbour issued a dissenting statement on the basis of “alternative predictions on where this market is heading, and the transformative role the combined Google/DoubleClick will play if the proposed acquisition is consummated.” Commissioner Harbour raised concerns regarding network effects and the likelihood of tipping. She expressed concerns regarding the data integration aspects of the merger and recommended continuing the investigation to analyze further the parties’ post-merger intentions. In addition, Commissioner Harbour suggested that the Commission could have required a firewall to ensure that, for some period of time, the databases would remain separate. Commissioner Liebowitz issued a concurring statement explaining his reluctance “to condition a merger (or vote to block a deal) for conduct that might take place afterwards, especially without substantial anxiety from the potentially disadvantaged parties—that is, the Internet publishers and advertisers—and especially in such a dynamic industry where competing would not be under the same impediments.” The FTC coordinated its investigation with foreign competitive agencies, including those from Australia, Canada, and the EU.⁴⁰

The DOJ similarly issued a statement regarding the closing of its investigation of Hearst Corporation's proposed acquisition of newly created "tracking stock" of MediaNews Group Inc. ("MNG").⁴¹ The transaction parties had revised the initial transaction so as to limit the 30 percent equity stake in MNG's newspaper business to operations outside of the San Francisco area, where both MNG and Hearst own and publish newspapers. The DOJ focused on whether the proposed investment would give one party an incentive to compete less vigorously in the Bay Area or would provide sources of influence by Hearst or MNG over the other's Bay Area activities. Because Hearst's minority investment in MNG will not bring the companies under common ownership or control, interactions among them will continue to be subject to scrutiny under Section 1 of the Sherman Act.

On March 24, 2008, the DOJ issued a statement announcing the closing of its investigation of the proposed merger of XM Satellite Radio Holdings Inc. ("XM") and Sirius Satellite Radio Inc. ("Sirius").⁴² The DOJ indicated that the evidence did not show that the merger would enable the parties—two satellite radio providers—to increase prices to satellite radio customers for several reasons, including: a lack of competition between the parties in important segments even without the merger; the competitive alternative services available to consumers; technological change that is expected to make those alternatives increasingly attractive over time; and efficiencies likely to flow from the transaction that could benefit consumers.

The DOJ concluded that the parties are not likely to compete absent the merger because customers must acquire specialized, non-interchangeable equipment, and there has not been significant competition for customers who have already subscribed to one or the other service. For potential new subscribers, past competition had resulted in long-term (i.e., through 2012 or beyond), sole-source contracts that provided incentives to all of the major auto manufacturers to install their radios in new vehicles, such that there is not likely to be significant further competition between the parties in this channel for many years. In the retail channel, where the parties might continue to compete absent the merger, the DOJ found that the evidence did not support narrowly defining the market to satellite radio, but instead should include various alternative sources for audio entertainment (e.g., AM/FM radio, HD radio, MP3 players, iPods, and wireless telephone offerings).

XM and Sirius seek to attract subscribers in a wide variety of ways, including commercial-free music, exclusive programming, niche music formats, out-of-market sporting events, and a variety of news and talk formats. These offerings reflect an effort to attract consumers with highly-differentiated interests and tastes, such that, while the radio offerings of these two companies are likely to be close substitutes for some customers, they do not appear to be so for other customers. For example, for a customer interested in baseball games on XM, the closest substitute would be baseball games on terrestrial radio, not Sirius, which does not carry baseball. The DOJ also did not find that the parties had the ability to identify and price-discriminate against those actual or potential customers that viewed the two firms as the closest substitutes.

In addition, the DOJ noted that a number of technology platforms are under development that would likely offer new or improved alternatives to satellite radio, including next-generation wireless networks capable of streaming Internet radio to mobile devices. The DOJ believed that these alternatives mitigated the potential competitive concerns for the time when the long-term contracts with the car manufacturers expire.

The DOJ believed that, even if there were concerns regarding the ability for the combined firm to increase prices in the mass-market retail channel, the efficiencies from the transaction “likely would undermine any such concern.”⁴³ The DOJ “confirmed” that the parties would likely realize significant variable and fixed cost savings through the merger, the magnitude of which could not be estimated with precision. The DOJ believed, however, that the likely variable cost savings, which are the savings that would most likely be passed on to consumers in the form of lower prices, would be substantial. The DOJ cited as an example the ability to consolidate development, production, and distribution efforts on a single line of radios, thereby eliminating duplicative costs and realizing economies of scale.

The DOJ also closed an eight-month investigation of the joint venture between SABMiller plc (“Miller”) and Molson Coors Brewing Company (“Coors”) that will combine their beer operations in the United States and Puerto Rico.⁴⁴ The DOJ indicated that a key part of its investigation entailed verifying that the venture would likely produce substantial and credible savings that would significantly reduce the companies’ costs of producing and distributing beer, including large reductions in variable costs.

2. Agency Studies and Reports Increase Transparency and Embrace Understanding of Agency Antitrust Approach

The FTC is currently conducting an extensive internal review and retrospective self-evaluation in connection with its 100th anniversary. The FTC previously held a series of workshops and issued reports, particularly regarding horizontal merger enforcement. The FTC held a public workshop on February 12, 2008 on unilateral effects analysis in merger review.⁴⁵ In 2003, then FTC Chairman Muris noted that, “more than 20 years have passed since the introduction of the Herfindahl-Hirschman Index (“HHI”) as an important initial factor in the review of horizontal mergers.”⁴⁶ A 2003 report and a subsequent workshop constituted significant steps to undertake a dialogue with the private bar regarding the role of concentration in agency decision-making. The report shows that the vast majority of government challenges from 1998-2003 involved market concentration levels (both in terms of post-merger HHI and increases in HHI) far above the safe-harbor thresholds set forth in the Merger Guidelines. The data indicate that less than 5 percent of the challenged markets had concentration below 1,800 (and almost all of these were in the petroleum sector). Only 13 percent of the challenged markets involved concentration levels of 2,500 or below. Indeed, more than half of the challenged markets involved post-merger concentration levels of more than 4,000.⁴⁷

The agencies issued several reports with data for FYs 1996-2007.⁴⁸ The reports provide data for transactions in which the FTC closed the investigation or took enforcement action (i.e., by entry into a consent or the challenge/abandonment of the transaction) separately based upon the market concentration, number of competitors, presence or absence of “hot documents,” “strong customer complaints,” and easy “entry conditions.” During the reported period, the FTC issued second requests in 326 merger investigations. Excluded from the data were transactions involving (1) non-horizontal theories of competitive concerns; (2) the elimination of potential competition; and (3) partial ownership interests. Also, the data did not include investigations that were closed prior to the development of a complete record concerning market structure. Enforcement decisions were provided separately for concentration levels for the oil, grocery, pharmaceutical, and chemicals industries (“Key Enforcement Sectors”). Outside of the Key Enforcement Sectors, the data showed the challenge rate to be as follows: three to two transactions, 86 percent; four to three transactions, 72 percent; five to four transactions, 61 percent; and in markets with five or more competitors post-transaction, only one in 13 were challenged.

As evidenced by the released data, the pronouncements of agency officials, the enforcement decisions, and the actions of the agencies, the focus of the officials at both agencies has been reviewing the data, documents, and customer and competitor views to obtain a complete picture of the structure and workings of the affected markets. The computer and internet era has made possible the collection and modeling of data for certain industries that were simply unthinkable a decade ago. Such econometric and natural experiments should result in better predictions of potential effects from transactions. This may also explain some of the drop-off in absolute enforcement statistics.

In March 2006, the FTC and the DOJ jointly released a Commentary on the Horizontal Merger Guidelines.⁴⁹ The Commentary explains how the FTC and the DOJ apply particular Horizontal Merger Guidelines principles in the context of actual merger investigations. The Commentary provides a more elaborate articulation of the practice of the agencies than the Guidelines. It identifies the creation or enhancement of market power as the core concern of the antitrust laws. Underlying the intensively fact-driven nature of merger investigations, the Commentary discusses the use of evidence in addressing the multiple analytical elements that are part of the agencies’ “integrated approach to merger review.” The agencies describe their analytical approach as adopting an integrative analytic approach rather than a linear, step-by-step progression through the Guidelines’ relevant market definition and competitive effects sections. Particularly useful is the Commentary’s discussion of efficiencies and its role in the antitrust review process.

Earlier in the Bush years as well, the FTC staff sponsored a series of public workshops to receive public opinion regarding the merger review process. In March 2002, the FTC issued a FAQs on Merger Remedies;⁵⁰ in November 2002, the FTC’s Bureau of Economics released Best Practices for Data and Economic and Financial Analyses in Antitrust Investigations,⁵¹ and the FTC’s Bureau of Competition announced a new set of Guidelines for Merger Investigations in

December 2002,⁵² and Guidelines for Negotiating Merger Remedies in April 2003.⁵³ The overall pattern of increased transparency is commendable and has had a marked impact on the quality of merger analysis and fact-gathering both by the private bar and by the enforcement agencies and is to be commended.

C. Federal Agencies Leadership Role in International Transactions and International Fora

During the Bush Administration, the federal agencies' role expanded on the international front as the agencies actively pursued the development of joint working initiatives for merger reviews, took leadership roles in international fora, and assisted in capacity-building in emerging competition authorities worldwide. Such initiatives are essential to effective merger enforcement and critical to our business community. The number of jurisdictions around the world that have established merger review regimes has burgeoned. There are now over 100 jurisdictions that have a merger review regime. At the same time, businesses are expanding across multiple jurisdictions, and often multiple continents. The confluence of these two trends creates an international business environment in which an increasing number of transactions may be subject to review in multiple jurisdictions.

The complexities are further compounded to the extent that authorities take an expansive view of their jurisdictional reach. Indeed, it is not unusual for a transaction involving multinational corporations to be subject to review by over a dozen separate competition authorities.⁵⁴ As merger review regimes proliferate, the potential for inconsistent—or even contradictory—outcomes increases for so long as there are substantive and procedural differences between jurisdictions and uncoordinated enforcement actions undertaken by the reviewing authorities. Close coordination and cooperation to avoid inconsistent outcomes is needed—and it is important to the U.S. business community that the U.S. agencies take a leadership role.

1. Coordination of Reviews

Outcome-determinative clashes in approaches in specific transactions are fortunately rare. GE/Honeywell⁵⁵ provided the most recent such large conflict between the United States and the European Union and served as a wake-up call for the international business community, as well as the agency officials. GE/Honeywell served as the impetus for competition authorities to renew and expand discussions regarding how to improve the coordination of merger review processes. After the rhetoric subsided in the very public fight between U.S. and EU officials regarding the GE/Honeywell decision, these two leading authorities in merger review reinvigorated their Merger Working Group, which consists of staff lawyers and economists from the EU, the DOJ, and the FTC, in the fall of 2001.⁵⁶ On October 30, 2002, the United States and EU issued a joint statement of Best Practices for coordinating their respective competition reviews of mergers.⁵⁷ A number of the points included in the Best Practices statement had already been employed informally by the agencies.⁵⁸ The Best Practices

statement does not contain specific recommendations on case scheduling. Instead, it provides a general approach for setting a timetable in individual merger cases.⁵⁹

The United States has also entered into cooperation agreements with Australia, Brazil, Canada, Germany, Israel, Japan, and Mexico.⁶⁰ These agreements are helpful when one authority is actively investigating the transaction and the other jurisdiction or jurisdictions are willing to let one (or a combination) of those authorities take the lead.⁶¹ Where a number of authorities are actively investigating the transaction, these agreements are of limited utility.⁶² Moreover, without a waiver from the parties, the agencies are unable to discuss confidential information received from the parties. Nevertheless, in a number of transactions during the Bush Administration, competition authorities have worked cooperatively during the investigation stage to reach a common (or at least parallel and complementary) determination.⁶³ Similarly, in several recent transactions, competition authorities cooperated at the remedies stage.⁶⁴ The way these transactions were handled reflects the formal and informal frameworks that the United States has developed with the various jurisdictions to reduce divergent outcomes of merger reviews and to expedite merger reviews.

2. Leadership Role in International Fora

Some initiatives with possible broader applicability to developing antitrust authorities are the product of projects undertaken by such international bodies as the Organization for Economic Cooperation and Development (the “OECD”) and the International Competition Network (the “ICN”).⁶⁵ Both the FTC and DOJ have had an active leadership role in these organizations. This role has been key to minimizing potential clashes in individual merger reviews due to: (1) increased mutual trust and respect among authorities; (2) convergence on key aspects of substantive merger analysis; and (3) some procedural harmonization.

The United States’ participation in international competition organizations is by no means new. Since the 1960s, the OECD has promoted cooperation among authorities in the major industrial nations on antitrust matters, including the issuance of a number of non-binding recommendations. The U.S. Department of Justice has been a key member of the working groups that developed these initiatives, including in recent years serving as the Chair of the Working Party on International Cooperation of the Competition Committee. In 2005, the OECD issued a Recommendation on Merger Review that prescribed best practices, including coordination and cooperation among competition authorities in merger cases.⁶⁶ The OECD Recommendations address, among other issues, notification and review procedures, coordination and cooperation between reviewing authorities, and provision of sufficient resources and powers to the enforcement authorities. To some extent, the creation of the ICN reinvigorated the OECD. In the past 5 years, the OECD held Best Practice Roundtables to encourage convergence on substantive merger analysis on such topics as Dynamic Efficiencies in Merger Analysis (2007),⁶⁷ Vertical Mergers (2007),⁶⁸ Competition in Bidding Markets (2006),⁶⁹ Barriers to Entry (2005),⁷⁰ Competition on the Merits (2005),⁷¹ Merger Remedies (2004)⁷² and Media Mergers (2003).⁷³

The ICN is perhaps even more influential than the OECD, particularly with emerging jurisdictions. The ICN was the direct outgrowth of the deliberations and report of the International Competition Policy Advisory Committee to the Attorney General and Assistant Attorney General for Antitrust in 2000. On October 25, 2001, an international coalition of antitrust officials announced the launch of the ICN as a global competition initiative. The ICN provides a platform “to make international antitrust enforcement more efficient and effective” by focusing on improving worldwide cooperation and enhancing convergence through dialogues.⁷⁴ Although the ICN’s creation could be attributable to the Clinton Administration, the credit for its establishment into a major international forum and achievements since formation truly belongs to the Bush Administration. The ICN Merger Review Working Group (which is chaired by the DOJ) aims to “promote the adoption of best practices in the design and operation of merger review regimes in order to: (i) enhance the effectiveness of each jurisdiction’s merger review mechanisms; (ii) facilitate procedural and substantive convergence; and (iii) reduce the public and private time and cost of multijurisdictional merger reviews.”⁷⁵ The ICN Merger Review Working Group consists of two subgroups: Notification and Procedures, and Merger Investigation and Analysis.⁷⁶ The work of each of these subgroups is reviewed below.

ICN Notification and Procedures Subgroup. The Notification and Procedures Subgroup has developed eight Guiding Principles for Merger Notification and Review⁷⁷ and a set of 13 Recommended Practices for Merger Notification Procedures.⁷⁸ The eight guiding principles are: (1) convergence; (2) sovereignty; (3) transparency; (4) nondiscrimination on the basis of nationality; (5) procedural fairness; (6) efficient, timely, and effective review; (7) coordination; and (8) protection of confidential information. The Notification and Procedures Subgroup also prepared a report (based on available survey and anecdotal information) on the costs and burdens of multi-jurisdictional merger review, which it recently updated.⁷⁹ The Recommended Practices advocate: (1) sufficient nexus between the transaction’s effects and the reviewing jurisdiction; (2) clear and objective notification thresholds; (3) flexibility in the timing of merger notifications; (4) merger review periods; (5) requirements for initial notification; (6) conduct of merger investigations; (7) procedural fairness; (8) transparency; (9) confidentiality; (10) interagency merger review coordination; (11) remedies; (12) competition agency powers; and (13) review of merger control provisions.⁸⁰

The interagency coordination Recommended Practice stresses that: (1) competition agencies should seek to coordinate their review of mergers that may raise competitive issues of common concern; (2) interagency coordination should be conducted in accordance with applicable laws and other legal instruments and doctrines; (3) interagency coordination should be tailored to the particular transaction under review and the needs of the competition agencies conducting the merger investigation; (4) competition agencies should encourage and facilitate the merging parties’ cooperation in the merger coordination process; and (5) reviewing agencies should seek remedies tailored to cure domestic competitive concerns and endeavor to avoid inconsistency with remedies in other reviewing jurisdictions.

At the 2005 ICN meeting, the ICN adopted Recommended Practices on remedies and competition agency powers.⁸¹ The remedies' Recommended Practices indicate that a remedy should address the identified competitive harm arising from the proposed transaction. The merger review system should provide a transparent framework for the proposal, discussion, and adoption of remedies. Procedures and practices should be established to ensure that remedies are effective and easily administrable. Appropriate means should be provided to ensure implementation, monitoring of compliance, and enforcement of the remedy. The Recommended Practices on competition agency powers stress the need for objective application and enforcement of merger review laws.

In April 2006, the Notification and Procedures Subgroup released the Implementation Handbook, which contains examples of legislative text, rules, and practices from various competition agencies that conform to selected ICN Recommended Practices.⁸² The handbook is intended to be a tool for agencies interested in understanding and implementing the Recommended Practices. The ICN also held a workshop in 2006 to promote implementation of the Guiding Principles and Recommended Practices⁸³ and held an interactive workshop in 2008 to promote greater understanding and further implementation of the ICN's Recommended Practices for Merger Notification and Review Procedures.

ICN Merger Investigation and Analysis Subgroup. The Investigation and Analysis Subgroup focuses on the analytical framework and investigative techniques for merger review, including the substantive standards for prohibiting mergers, the criteria for applying those standards, and the tools and techniques used for developing reliable evidence. The Investigation and Analysis Subgroup issued an Analysis of Merger Guidelines report in Spring 2004⁸⁴ that identifies merger guidelines around the world, catalogues their common features and meaningful differences, and offers a template of illustrative analytical practices from the various guidelines to assist other jurisdictions in preparing their own guidelines. In addition, the Investigation and Analysis Subgroup provided a draft Merger Guidelines Workbook in June 2005 and produced the final Workbook in May 2006.⁸⁵ The Workbook is intended for use by jurisdictions preparing new or revised merger guidelines. The Investigation and Analysis Subgroup presented the final document at the May 2006 ICN meeting.⁸⁶ This Subgroup held a merger investigative techniques workshop in March 2007. The Investigation and Analysis Subgroup also issued a report on its review of merger remedies in June 2005.⁸⁷

The investigative techniques work focuses on the development of best practices for investigating mergers, including: (1) methods for gathering reliable evidence; (2) effective planning of a merger investigation; and (3) the use of economists and the evaluation of economic evidence. In 2005, the Investigation and Analysis Subgroup issued an investigative techniques handbook for merger review.⁸⁸ The handbook is designed to inform ICN members of the various tools and techniques used in merger review, to help members organize and use their tools more efficiently, and to provide for an effective process for the evaluation of evidence.

The Merger Working Group also adopted three Recommended Practices for Merger Analysis during the meeting held in Kyoto, Japan in April 2008.⁸⁹ These Recommended Practices are derived from the Merger Guidelines Workbook and are intended to complement the detailed descriptions of merger analysis in the Workbook. The Recommended Practices address: (1) the efficacy of an agency's legal framework for analyzing proposed mergers; (2) the use and role of presumptions and safe harbors or thresholds; and (3) the analysis of entry and expansion.⁹⁰ The ICN announced that the Merger Working Group would be developing additional recommended practices on unilateral and coordinated effects in 2008-2009.⁹¹

III. NOTEWORTHY ENFORCEMENT AND JUDICIAL TRENDS

A. Enforcement Primarily, But Not Exclusively, Focused on Horizontal Mergers and Unilateral Effects

Although officials from both agencies expressed interest in pursuing coordinated effects theories, most of the concerns identified in merger investigations continue to involve "unilateral effects" theories in horizontal mergers.⁹² Officials from both agencies during the first term of the Bush Administration expressed renewed interest in bringing matters premised on coordinated interaction theories of competitive harm.

Indeed, only a few consents⁹³ and court challenges⁹⁴ were premised solely on perceived coordinated effects. As Assistant Attorney General ("AAG") Thomas D. Barnett indicated on June 26, 2008:

The agencies formally introduced the specific terminology of unilateral effects analysis in the 1992 revision to the Horizontal Merger Guidelines. Since that time, my perception is that agency use of these theories has changed significantly. While I have not attempted to go all the way back to 1992, the last seven years are illustrative. The Division filed 58 merger complaints during the period from fiscal year 2001 to the present. Forty-one included only a unilateral effects claim, six included only a coordinated effects claim, and the remaining eleven contained both. There seems little doubt that recent merger challenges have focused more extensively on unilateral effects claims that was the case prior to 1992. It is worth examining the reasons for this apparent shift. I perceive at least two key factors.

First, the economy has evolved in a direction that makes unilateral effects more likely to be a relevant concern. Our world has become increasingly complex, with increasingly sophisticated and differentiated products and services to match. We no longer live in a world where products in a given category are virtually identical in terms of functionality, with the principal differences being price and perhaps reliability. . .

Second, the economic tools that we have been developing in recent years lend themselves more readily to unilateral effects analysis than to coordinated effects analysis.⁹⁵

The track record recently in bringing cases premised/based solely on unilateral effects, however, has been unfavorable to the government, with courts finding the asserted market definitions counter to intuition or common sense.

As with the prior administration, although almost all enforcement actions invoked horizontal concerns,⁹⁶ the vertical transactions requiring relief arose typically due to input foreclosure of what is tantamount to an “essential” component⁹⁷ or because it facilitated coordinated effects downstream.⁹⁸ These vertical concerns were more likely to be addressed through behavioral relief,⁹⁹ although, in some cases, the agency required a divestiture of some of the upstream assets.¹⁰⁰ In a few transactions, concerns arose due to minority ownership interests, with the agency sometimes being willing to impose behavioral relief,¹⁰¹ but usually forcing the divestiture of the overlapping interest.¹⁰² A small percentage of merger investigations involved potential competition- or buyer-power (monopsony) theories.¹⁰³ Both agencies have become increasingly sophisticated in their knowledge of intellectual property law, sometimes focusing the relief in consents upon intangible assets and rights,¹⁰⁴ or including in consents, as part of the relief, provisions that alter the merging party’s litigation rights in order to lower or eliminate entry barriers for others to compete in the affected market.¹⁰⁵

B. Agencies Brought a Number of Consummated Merger Challenges

The agencies’ enforcement record must include post-consummation challenges. The HSR Act provides the federal agencies with the opportunity to investigate and, where appropriate, to challenge pre-consummation (under Clayton Act § 7) those transactions that likely would substantially lessen competition. In addition, the agencies can challenge a consummated transaction in a federal district court or, in the FTC’s case, as an administrative case before an administrative law judge (“ALJ”). The agencies brought 18 post-consummation challenges during the Bush Administration, with four of these challenges still pending when the Obama Administration assumed the Presidency.¹⁰⁶

Initially, the FTC decided to use the post-consummation challenge option in the hospital merger area—an industry in which the FTC had almost always lost when bringing its pre-merger challenges. Clearly, establishing the anticompetitive effects becomes easier post-consummation—particularly if prices increase or output decreases. But, as the Evanston Hospital challenge described below demonstrates, the FTC post-consummation “victory” may be difficult to effectuate—particularly if relief occurs several years post-consummation. The background of this case is worthy of discussion.

On August 6, 2007—three and one half years after the FTC started its administrative challenge—the Commission issued an unanimous administrative opinion finding that ENH’s acquisition of Highland Park seven years earlier violated Clayton Act § 7.¹⁰⁷ The FTC found that the hospitals had exercised market power and the anticompetitive effects were not offset by merger-specific efficiencies.¹⁰⁸ The FTC’s opinion recited the statements of senior officials that demonstrated they expected prices to be higher due to increased bargaining leverage. The FTC found that the econometric analysis performed by both the staff’s and parties’ economists

supported this conclusion. Moreover, the FTC rejected the argument that these increases reflected ENH's attempts to correct a multi-year failure by ENH's senior officials to charge market rates to many of its customers or to reflect increased demand for Highland Park's services due to post-merger improvements. Notably, however, the FTC indicated that "while structural remedies are preferred for § 7 violation . . . this is a highly unusual case in which a conduct remedy rather than a divestiture, is more appropriate. . . . The long time that has elapsed would make a divestiture more difficult, with greater risks of unforeseen costs and failures." Chairman Majoras' opinion indicates that if the hospital were sold, a key cardiac surgery unit that resulted from the integration might be closed. No explanation was given, however, regarding why a joint venture would have not been successful for retaining these benefits. Rather, the FTC required ENH to establish separate and independent conduct negotiation teams for each hospital to allow managed care organizations ("MCOs") to negotiate separately for the competing hospitals, thereby "re-injecting competition between them for the business of MCOs."¹⁰⁹

The ENH case may be an extreme case of the challenges the FTC can face in post-merger challenges. Moreover, the recently proposed changes in Part III proceedings may be helpful in shortening the process somewhat, but are still not going to eliminate the potential for frustration of effective relief. On December 16, 2008, the FTC took the unusual step of commencing a civil action in federal district court in Minnesota challenging the legality of Ovation's 2006 acquisition of the drug NeoProfen rather than merely challenging the acquisition in an administrative proceeding; the FTC seeks, among other relief, disgorgement of profits.¹¹⁰ Nevertheless, post-consummation challenges are likely to be a last-recourse act, by the FTC, particularly to the extent that the FTC's new litigation strategy deployed in Whole Foods and Inova (discussed below) is proven to be successful for the FTC.

C. Effect of Court Challenges in Enforcement Policy

The success rate of court challenges provides an important exogenous factor in both agency enforcement decisions (and statistics) as well as business community perceptions and actions. Certain critics of the Bush Administration conclude that "under the current administration, the federal enforcement agencies have most commonly not prevailed in litigation, though there are only a small number of such cases."¹¹¹ The Bush Administration's track record in court is as follows: the FTC tried five preliminary injunction challenges in district court, winning one¹¹² and losing four¹¹³ (one of which, Whole Foods, has been subsequently reversed by the D.C. Circuit).¹¹⁴ In another of the "losses," Equitable Resources, the FTC obtained an injunction pending appeal of the state action issues and the transaction parties abandoned the transaction.¹¹⁵ The FTC considers such an outcome a "victory." In addition to the five tried challenges, the FTC brought a challenge to Inova's purchase of Prince William Hospital System.¹¹⁶ Faced with the likelihood of an injunction and FTC administrative proceeding, the parties abandoned that transaction.¹¹⁷ In the first 100 days of FY 2009 (when Bush Administrative appointees remained in power), the FTC commenced simultaneous administrative proceedings and federal district court preliminary injunction challenges to block

CCS Corporation's acquisition of Newpark Environmental Services;¹¹⁸ the merger of CCC Information Services and Mitchell International Inc;¹¹⁹ and Oldcastle Architectural Inc.'s acquisition of Pavestone Companies.¹²⁰ In both CCS/Newpark and Oldcastle/Pavestone, the parties abandoned the transaction after the FTC commenced litigation. Thus, taking into account these abandoned transactions and the reversal, the FTC's litigation record is at least 67 percent—and improving.

The DOJ tried three preliminary injunction actions—winning one¹²¹ and losing two.¹²² At the end of FY 2008, one post-consummated merger challenge remained pending.¹²³ In the first 100 days of FY 2009, the DOJ brought two new court challenges—one action to block the combination of JBS and National Beef Packing Co.¹²⁴ and another to unwind the July 2008 acquisition of Semicoa by Microsemi.¹²⁵ As with enforcement actions generally, almost all of these court challenges were premised on unilateral effects—not coordinated effects. In most of the losses, the court explicitly rejected the asserted relevant market. In some of the losses, the court found that customers had other actual or potential choices.¹²⁶ The courts either did not believe the customers that testified for the agency or found their testimony unpersuasive in the absence of corroborating economic evidence.¹²⁷ The courts also tended to side with the economists, industry experts, and competitors presented by the defendants.

The American Antitrust Institute (“AAI”) attributes the recent string of court losses in part to the fact that the judges were generalist judges with limited antitrust experience and perhaps a lessening of litigation skills or experience at the antitrust enforcement agencies.¹²⁸ Courts expected the government to prove its case with pricing data and other economic modeling—in addition to corroborating testimony. Harmful company documents were either ignored¹²⁹—or put into context as being only a less reliable subset of the company's documents,¹³⁰ dated and/or inaccurate¹³¹ when factoring in the other evidence. On the other hand, the courts almost universally concluded that the transaction parties failed to meet their burden in establishing an efficiencies defense.¹³²

Thus, equally applicable to both sides, the party bearing the burden of proof in court has been tasked with presenting a consistent view of the market based on customer and/or industry expert testimony, company documents, and economic data. Bare assertions alone are not enough to prevail—albeit whether based on economic theory, customer statements, or a portion of internal documents. Rather, courts expect to see all three—economic analysis supported by testimony and documents—in support of the case. As one commentator recently noted, “like a stool, a merger case will not stand with only two of these three legs.”¹³³

The FTC has developed a challenge strategy recently that, if left unchanged, could tip the balance decidedly in its favor in the future. On July 29, 2008, a divided three-judge panel of the United States Court of Appeals for the District of Columbia Circuit reversed the district court's ruling that had denied the FTC's request for an injunction against the merger of Whole Foods and Wild Oats. Although on November 21, 2008 Judge Tatel no longer “joined” in Judge Brown's opinion but instead “concurred” in the decision, thereby changing that status of Judge

Brown's opinion from a "majority opinion" to the "opinion of the court." It is unclear what the precedential impact of the decision will be long-term. The FTC may argue in future cases that the Whole Foods decision absolves it of the need to establish the primary elements of a Clayton Act § 7 case when it seeks a PI. Both Judges Brown and Tatel held that the FTC need not settle on a single product or geographic market definition or a theory of harm at the PI phase. Both judges indicate, for example, that the FTC need not commit to a specific relevant product and geographic market definition because "it is quite conceivable that the FTC might need to seek such relief before it has settled on the scope of the product and geographic markets implicated by a merger."¹³⁴ Rather, the FTC "just has to raise substantial doubts about a transaction. One may have such doubts without knowing exactly what arguments will eventually prevail."¹³⁵

This language cannot help but remind one of what antitrust merger law used to be like under many now long-discredited U.S. Supreme Court decisions from the 1960s. Not surprisingly, the reasoning of the majority opinion prompted the dissenting judge, Judge Kavanaugh, to take the majority to task for essentially "allow[ing] the FTC to just snap its fingers and block a merger."¹³⁶ Judge Kavanaugh notes that the opinions of Judge Brown and Judge Tatel dilute the standard for preliminary injunction relief such that the FTC need not demonstrate a likelihood of success on the merits and finds the "serious questions" approach they adopt to be inconsistent with the relevant statutory test and the approach recently repudiated by the U.S. Supreme court in *Munaf v. Geren*.¹³⁷ Judge Kavanaugh concludes that, under the proper standard, "the FTC may obtain a preliminary injunction only by establishing a likelihood of success—namely, a likelihood that, among other things, the merged entity would possess market power and could profitably impose a significant and non-transitory price increase."¹³⁸

In future cases, the FTC is likely to combine the petition for a PI in the D.C. Circuit with the simultaneous commencement of an administrative proceeding with an aggressive schedule. The FTC took this dual track approach in its recent challenge of Inova Health System Foundation's ("Inova") proposed acquisition of Prince William Health System ("PWHS"), which operates a hospital in Manassas, Virginia. With five hospitals, Inova is the largest hospital system in Northern Virginia. After a two-year investigation, the FTC challenged the proposed acquisition. The FTC commenced an administrative proceeding on May 9, 2008 and took the unusual step of designating Commissioner J. Thomas Rosch as the ALJ. The administrative complaint alleged that because of the close competition between Inova and PWHS, health plans are able to negotiate to keep health care prices down. In contrast, the defendants argue that Inova would have upgraded the hospital facility, similar to what it had done with a hospital it purchased in Loudoun, Virginia. On May 12, 2008, the FTC (and the Virginia Attorney General) also sought a PI pending the conclusion of the administrative proceeding.

The Inova district court judge ruled on May 30, 2008 that the motion for PI would be decided solely on the papers filed by the parties. The FTC's decision to commence an administrative proceeding with a Commissioner serving as the ALJ, and to seek its preliminary

injunction, seems to be a strategy to counter arguments by a transactions partner that the administrative proceeding process takes a couple of years to complete.¹³⁹ Even with the expedited administrative process, however, most transactions will not be able to survive the time it will take, particularly to achieve judicial oversight of the FTC's decision. In Inova, faced with the potential delay, the transaction parties abandoned the merger on June 6, 2008.¹⁴⁰

Several observations can be made concerning the impact of court decisions on merger enforcement. First, it is somewhat inconsistent for critics to attack the agencies for being excessively timid in enforcement decisions and, simultaneously, to criticize their win-loss record in court. Second, the agencies are constrained by court review and it seems clear that, in general, the courts are demanding more convincing proof of likely competitive injury in merger cases than in the past. Third, we question the FTC's attempt to circumvent full court view at the preliminary injunction stage by revision of its Part III rules.¹⁴¹ This effort seems not only to suggest a judicial rubber stamp of agency action but to threaten the due process rights of merging parties.

IV. HAS ANTITRUST ENFORCEMENT BEEN MATERIALLY LOWER DURING THE BUSH ADMINISTRATION?

Business news assertions in the recent few years have sent the message to the business community that antitrust enforcement is lax. In January 2007, for instance, The Wall Street Journal indicated that "The federal government has nearly stepped out of the antitrust enforcement business, leaving companies to mate as they wish."¹⁴² Similarly, two months later, the New York Times declared that XM/Sirius had "reason to be optimistic" about DOJ clearance: "the Bush Administration has been more permissive on antitrust issues than any administration in modern times."¹⁴³ These press stories were reinforced by a widely-publicized paper of two economists—Jonathan B. Baker and Carl Shapiro—in April 2007 (and subsequently updated) that shows "using merger enforcement data and a survey [they] . . . conducted of merger practitioners that the decline in antitrust enforcement is ongoing, especially at the current Justice Department."¹⁴⁴ Subsequent antitrust articles have debated some of the findings. This section will discuss: (1) the Baker/Shapiro "results"; (2) the fallacy and limitations to the Baker/Shapiro results; and (3) the reasons why enforcement levels might differ at the two agencies.

A. Baker/Shapiro: The "Basis" for Lax Enforcement Perceptions

Baker and Shapiro's research "updates" the results of a study developed by former FTC Commissioner Thomas Leary to compare the Reagan, Bush I, and Clinton Administrations' enforcement levels. The key statistic used to measure enforcement level is the agency enforcement actions as a fraction of HSR filings. Commissioner Leary assigned years to presidential terms with a one-year lag to account for the delay in transitioning of the new administration's officials into office. The use of multiyear averages smoothes year-to-year variations in the data and helps eliminate the problem of information for a particular year being

skewed because the filing year and the year the enforcement action occurs are not the same. The results reported by Commissioner Leary are as follows:

Merger Enforcement Challenges as a Percentage of Adjusted HSR Filings

	1982-85 Reagan I	1986-89 Reagan II	1990-93 Bush	1994-97 Clinton	1998-2000 Clinton II
FTC	1.0%	0.7%	1.5%	1.1%	0.7%
DOJ	0.8%	0.4%	0.8%	0.9%	1.1%
Total	1.8%	1.1%	2.3%	2.0%	1.8%

In updating the study, Baker and Shapiro recognize the challenge in accounting for the changes in the HSR reporting rules that became effective in February 2001, most notably raising the reporting threshold to \$50 million. They conclude that filings after the change were 40 percent of what they would have been had the reporting rules been the same; based on the level of second requests in FY 2000 that were issued for the below-\$50 million transactions; 0.98 percent of these transactions received second requests; and, based on enforcement levels from 1990-2000 on transactions requests, determined that for every 1000 transactions not filed that previously would have been filed, there would have been six additional enforcement actions. Baker and Shapiro then proportion the enforcement results between the DOJ and FTC on a one-third-to-two-thirds basis, consistent with prior enforcement levels. Based on these adjustments, Baker and Shapiro report the following results:

Merger Enforcement Challenges as a Percentage of Adjusted HSR Filings

	2002-05 George W. Bush I	2006-07 George W. Bush II ^P
FTC	0.8%	0.6%
DOJ	0.4%	0.4%
Total	1.2%	1.0%

P = Preliminary Estimates

They conclude that “[d]uring the first term of the GW Bush administration, the rate of merger challenges for DOJ and the total for both agencies were below the average of those reported by Commissioner Leary, while the FTC figure was close to the average. The DOJ number was identical to the merger enforcement rate observed during the second term of the Reagan administration, which was the lowest in modern history. According to the preliminary

estimates for the second term, the merger enforcement rate at DOJ remained at the same low level observed during the previous years. Because the FTC rate simultaneously declined to a below-average figure, the total federal merger enforcement rate for the second term dropped below the lowest level previously recorded.”

They further state that, in the raw data for 2002 to 2005 if not corrected to account for the change in the reporting rules, the FTC enforcement rate was 1.5 percent of adjusted HSR filings and the DOJ enforcement rate was 0.75 percent of adjusted HSR filings. Baker and Shapiro then indicate that to be equivalent to the 0.9 percent average rate for agency enforcement under the pre-2001 rules that each agency would need to be at the 1.8 percent level. Finally, Baker and Shapiro indicate that even within the GW Bush years, the trend toward lax enforcement has increased: “had the two federal enforcement agencies challenged mergers during 2006 and 2007 at the rate the FTC did during the first term of the current administration (which was slightly below the historical average), the agencies would have challenged twenty-four more mergers each year (fifteen more at the Antitrust Division and nine more at the FTC).” Moreover, Baker/Shapiro indicate that the “data from the [Reagan] period are consistent with contemporaneous reports that senior officials frequently overruled staff recommendations to challenge acquisitions, and the few mergers that were challenged were typically mergers to very high levels of concentration.”¹⁴⁵

Baker and Shapiro purport to have “confirmed our interpretation that merger enforcement became much more lenient during the current administration by surveying twenty experienced antitrust practitioners [identified as 20 of the 24 ‘leading individuals’ in antitrust in DC, 2006 chambers USA]. The survey respondents consistently reported that the ‘likelihood of successful agency review for the merging firm’ for a given horizontal merger is sharply higher now (March 2007) than it would have been ten years ago (when Joel Klein ran the DOJ and Robert Pitofsky headed the FTC).”¹⁴⁶

Baker and Shapiro acknowledge at various points in their paper, as potential reasons for deviation in results, the following: (1) the composition of HSR filings (e.g., more private equity/financial filings versus strategic filings, percentage of the filings that are not horizontal, or involve minority/passive investors); (2) the mix of deals in terms of the severity of antitrust issues; (3) the industries in which the transactions occur; and (4) greater transparency permitting the antitrust bar to predict better enforcement decisions, therefore discouraging firms from proposing transactions that would generate enforcement actions. They summarily dismiss each of these factors in turn, however, as not materially changing the conclusions they reach. As to the composition of the merger filings and the mix of deals, Baker/Shapiro indicate that they “are skeptical of this benign interpretation of the low merger enforcement rate during the current administration. . . . It cannot rationalize the recent drop in DOJ enforcement actions unless an implausibly large fraction of all HSR filings now involve non-horizontal deals. . . .”¹⁴⁷

B. Problems with Baker/Shapiro “Findings” Overall

The Baker/Shapiro study is based upon a series of assumptions, each of which, if tweaked slightly, could significantly impact the rigor of their findings. This section will highlight some of the potential flaws in their assumptions, not with the purpose of proving a high level of enforcement, per se, but to establish why the Baker/Shapiro findings create an unreliable sense of empirical accuracy and authority.

First, it may simply not be possible to compare enforcement results for pre-2001 and post-2001 because of the impact that the number of filings could have had on the staff resources (which may, for instance, account for some of the differences in enforcement levels in 2002-2003, after the sharp decline in merger activity from the dot.com burst, versus the record M&A levels of 2005-2007), inflation, and a variety of non-HSR-related factors that could impact the competitiveness and size of companies and sectors of the economy. Putting that general concern aside, however, the methodology Baker/Shapiro use appears to be flawed. Appendix C provides the statistics relating to 1994-2000 HSR filings that fell below \$50 million. The data for filings over this entire time frame (rather than the regression log utilized by Baker/Shapiro) so as to adjust for yearly variations, indicate that just over 50 percent of reported transactions were below \$50 million (Baker/Shapiro adjust their findings by 60 percent). Next, using just FY2000, Baker/Shapiro calculate that only 0.98 percent of the smaller transactions received second requests. If the entire Clinton Administration period for which data are available (1994-2000) is used instead, then the percentage of smaller transactions that received second requests from 1994-2000 would be 1.3 percent instead of 0.98 percent.

As mentioned above, it is simply not possible to treat transactions reported pre-2001 and post-2001 as the same, since major changes in the Hart-Scott-Rodino filing requirements irrevocably changed the volume and type of transactions presented to the agencies. Baker/Shapiro believe that the average percentages from the pre-2001 period need to be doubled to adjust for the lower filing levels. It is unclear why this should be the case, given that it is a percentage of the transactions rather than simply a numbers count. Also, the leadership within each administration does not neatly correlate to a different “leader” or “leaders,” and, given the potential distortion from small number samplings, this paper aggregates both Clinton Administration terms and GW Bush Administration terms (less the first year of office in each case, as Commissioner Leary did in his study). A difference of views also exists regarding whether the type of deal has changed significantly during the two time frames. For instance, former FTC Chairman Muris analyzed the overlap codes to show that fewer overlaps occurred in more recent deals than in prior deals (e.g., in 1998, 65 percent of mergers had a horizontal overlap, compared to 49 percent in 2007).¹⁴⁸ Former AAG Hewitt Pate stated at the Spring 2008 ABA Section of Antitrust Law Roundtable:

I think, frankly, on the statistical merger game—and we will undoubtedly talk about Baker and Shapiro measuring whether there is as much enforcement during this period as others—the agencies don’t choose the cases that come to them. I think these statistics provide

very little. We've had, for example, a predominance of private equity activity in changes of corporate control recently, which provide less occasion for enforcement. . . . The real question is: Was the right analysis applied? Are there cases that should have been brought that weren't? Let's talk about that on the merits.¹⁴⁹

Further support for the variability of enforcement activity based on the type of transactions that are in vogue at a given time period can be seen by comparing the relatively higher volume of leveraged buyout ("LBO") and private equity ("PE") transactions in Appendix D with the corresponding level of enforcement actions in Appendix A. The impact of an almost two-fold increase in the absolute number of financial transactions is likely even greater given the decrease in filings between the two time periods. The drop off in FY2004-FY2007 also appears to correspond to a significant up tick in these strategic transactions (as well as in the number of filings that the staff needed to review overall). This may also, at least in part, explain the "results" that Baker/Shapiro find empirically.¹⁵⁰

Perhaps there is a way to take into account these deviations in the mix of transactions in the data itself. There has always been "healthy competition" between the FTC and the DOJ to be the agency to investigate and, where appropriate, challenge transactions. Accordingly, both agencies may try to protect their turf by seeking clearance to investigate transactions that even potentially raise competition issues. Thus, comparison of the actions taken with respect to "investigated" transactions would deal with eliminating some of the uninteresting transactions from the outset.

But, as suggested above, even using the "investigated" base to measure enforcement would tend to leave uncorrected the mix-of-transactions factor. Therefore, a better benchmark may be based on the transactions receiving second requests, since presumably most of the non-horizontal and financial/minority transactions would be dealt with either from the outset or during the preliminary investigation. To our knowledge, none of the critics is suggesting that "politics" may be resulting in under-enforcement at these decision points. Indeed, the criticism voiced by Baker/Shapiro and others appears to be that the top officials at the agencies "kill" challenges that the staff would otherwise bring. If such activity were to be occurring, then presumably it would occur, not at the time of the decision to investigate the transaction, or even at the decision to issue a second request, but instead at the conclusion of the review process.

Thus, a comparison of the percentage of second requests resulting in challenges would appear to be a way to adjust to the hypothesis that the underlying deals have changed. This approach, however, still would not totally correct for possibly lower enforcement statistics that may be due to staff overload (thereby not eliminating pre-second-request transactions that ultimately do not get challenged) or the possibility that, in some administrations, officials push for "cheap consents" to bolster statistics, as suggested by the Muris Article. Rather than choosing the correct barometer, provided below is a comparison of the data contained in the Annual Reports to Congress for the Clinton and Bush Administrations (underlying data is

provided in Appendix B), which suggest that on the basis of raw numbers enforcement activity has not lagged on a combined agency basis:

	1994-2000	2002-2008	2002-1/06/09 ¹⁵¹
% of Adjusted Transactions Investigated	11.9%	16.8%	
% of Adjusted Transactions with Second Requests	2.96%	2.99%	
% of Investigated Transactions with Second Requests¹⁵²	24.8%	17.8%	
% of Second Requests Resulting in Challenges	61.8%	67.6%	71.7%
% of Adjusted Transactions Challenged	1.8%	2.03%	2.15%

The results of the survey add little probative value to the determination of the entire track record of the administrations. The perceptions of events that occurred 10 to 20 years ago become vague. The sampling size is very small and consists of less than two dozen “inside the Beltway” antitrust practitioners. It does not, for instance, include members of the antitrust bar in New York, where arguably much of the M&A activity originates. It includes practitioners who do little or no merger work, concentrating instead on cartels, litigation, and unilateral conduct.

Moreover, the perceptions of the decisions of a few high-profile cases, such as Whirlpool/Maytag,¹⁵³ Monsanto/Delta and Pine Land,¹⁵⁴ and (the then pending but subsequently decided) XM/Sirius¹⁵⁵ transactions can greatly impact the “perceptions” of the public. All three of these transactions were thoroughly investigated by the staff and the parties raised persuasive explanations as to why the mergers would not result in market power or higher prices/lower innovation. Surely it is a disservice to the staffs of both agencies to pin the conclusions of enforcement activity overall on a handful of the hundreds of mergers investigated in the last eight years—much less the dozens of transactions the agencies challenged. Nor, we submit, is there any probative value to the survey, which appears so problematic from a survey design perspective.

If there was truly under-enforcement by the agencies, it is difficult to discern why the agencies have lost so many of the cases they have brought. The evidentiary record upon which the agencies relied to make their enforcement decisions for some reason has not resonated with the courts charged with deciding whether to order, at the agencies’ behest, a PI blocking the merger. As a result, the common edict expressed by Justice Stewart that “the government

always wins”¹⁵⁶ seemed to have been reversed (particularly in 2004-2007), perhaps explaining the reticence of some officials to bring challenges in close cases.

It is also too simplistic and potentially inaccurate to conclude from the perceived litigation track record that the agencies (particularly the DOJ) do not bring challenges in court, or always lose, and therefore are ineffective enforcers. As mentioned above, the agencies have been successful in obtaining consents and restructured transactions to resolve concerns. Also, in a number of cases, the transaction parties abandoned their transactions¹⁵⁷—either before or after a complaint was filed—due to agency concerns.¹⁵⁸ Also, in a number of court challenges, the parties settled with the agency before trial.¹⁵⁹ These outcomes should also be considered agency “wins,” since presumably in these matters the agency had good chances of prevailing.

Finally, state attorneys general have jurisdiction to challenge mergers, and have for the last two decades have been active participants in the HSR review process. In prior administrations, states even brought challenges in matters in which they were not satisfied with the decision of the reviewing federal enforcement agency¹⁶⁰ Indeed, in 1993 the National Association of Attorneys General promulgated horizontal merger guidelines that differed to a degree from the federal 1992 guidelines.¹⁶¹ Although there were a few examples during the Bush Administration years of such state attorney general intervention,¹⁶² we note that this handful of instances in which the states acted were statistically insignificant (except perhaps in FY 2005, in which about half of these interventions occur and which appears to be an outlier year in federal enforcement). We believe that the lack of significant separate state attorney general intervention overall further supports our belief that there has not been systematic under-enforcement during the Bush Administration years.

C. Do the Agencies Differ in Their Level of Merger Enforcement and Why?

The above discussion, however, does not entirely answer allegations voiced by Baker/Shapiro that the “Pitofsky FTC brought enforcement the actions at the rate of 0.75 percent of HSR filings—similar to the Muris FTC’s 0.8 percent rate, close to the historical average of 0.9 percent, and roughly double the rate of the current DOJ. AAG Klein’s DOJ was slightly above the historical average of 1.0 percent.”¹⁶³ In a subsequent *The New Republic* article, Baker further expounds that

“If Bush’s Justice Department is the most hands-off since Reagan’s (and it may be worse), Bush’s Federal Trade Commission makes for a startling contrast. Perhaps because its five staggered-term commissioners must vary in party affiliation, making it inherently less ideal logical, the FTC’s antitrust wing over the last eight years has actually worked the way it’s supposed to . . . while the Bush Justice Department avoided merger challenges . . . the FTC has brought them at about the usual rate.”¹⁶⁴

Similarly, Harkrider’s econometric analysis suggests that, all else being equal, transactions in the sample were nearly 24 percent less likely to be challenged by the DOJ during the Bush Administration than in the Clinton Administration and remained about the same

during both administrations at the FTC. Harkrider acknowledges that the types of mergers may have been qualitatively different in these time periods, as well as the possibility that merger commitments in the merger agreements could have impacted these results, but concludes that “[d]espite all of these caveats, it seems clear that the merger enforcement behavior was different in 2001 to 2006 as compared to 1996 to 2000, a result that is hardly surprising given the change from a Democratic to a Republican administration.”¹⁶⁵ Based on the data in Appendix B, however, the results of each of the FTC and DOJ from FY 2002 through January 20, 2009 are as follows:

	FTC	DOJ
Percentage of Preliminary Investigations to Second Request	14.3%	21.4%
Percentage of Preliminary Investigations to Enforcement Action	11.4%	14.0%
Percentage of Second Requests to Enforcement Action	80.8%	67.7%

Although a bit lower than the FTC’s rate, the percentage of second requests in which the DOJ took action was substantial and well within the historic range of prior administrations.

First, there is no doubt that the differences in attitudes regarding the appropriate threshold for settling cases can impact “close cases” and therefore skew the enforcement action results. As the data indicate, these differences exist even within each institution and administration. Baker/Shapiro reflect these differences when comparing the Steiger FTC statistics to the Pitofsky statistics. So, too, can these differences exist between the two agencies at any given time. Reflect upon the differences in the rhetoric between the FTC and DOJ officials in the last few years. As then-FTC Chairman Deborah Platt Majoras responded in a July 15, 2007 interview to the question regarding “are you more friendly to mergers than previous administrations?”:

I read that all the time. It’s simply not borne out at the FTC. You look at the number of mergers we’ve challenged or if you look at it as a percentage of the merger filings, it’s pretty even since about the first Bush administration. I can’t think there was a merger that people have point to and said, “Why didn’t you guys take a closer look or why didn’t you challenge it?” To me it’s not some political thing that shifts a whole heck of a lot.¹⁶⁶

The FTC has repeatedly said that, in close or novel cases, it will bring a challenge, preferring to develop case law by bringing close cases and losing than not bringing an action at all. Indeed, as reported in one article, FTC Chairman Deborah Platt Majoras has said she wants to bring a case, and she said, “You can’t win if you don’t play.”¹⁶⁷ Similarly, Chairman Majoras has indicated:

I would love to see the Court take a merger case. I think, by my calculation, the Supreme Court hasn’t decided a substantive merger issue since the 1970s. We’ve been working under the

1992 Merger Guidelines, including a unilateral effects regime, for a number of years. While a lot of us talk about how we think it's fairly settled the way we review mergers, some people, I think, disagree. I think it would be terrific.

I may be a little more optimistic about the possibility of the Court taking on a merger case because, perhaps, if we had an FTC merger case in Part 3, especially if the AMC doesn't have its way and Part 3 is still a meaningful part of our enforcement regime, then I think it is possible that we could get one up, and I think that would be a good thing.

More recently, FTC Commissioner J. Thomas Rosch said. "Litigious? Emphatically no. . . We're willing to lose. . . That doesn't mean we want to lose, and we certainly don't vote out cases that we think we're going to lose. But we are willing to vote out cases when we think there's a violation."¹⁶⁸

In contrast, at the DOJ, the agency will bring cases if it believes that it will win, based on the evidentiary record before it. As Deputy AAG for Civil Enforcement David L. Meyer indicated in November 2007:

When staff does reach [the conclusion that a transaction will likely cause substantial harm] . . . we are cognizant of the fact that we do not possess any authority to command that parties abandon or restructure their transaction. We are law enforcers, not sector regulators. If we believe that a transaction would violate Section 7, we must persuade a district court that we are correct and invoke the equitable power of the court to enjoin the transaction or require an appropriate remedy. Pleading and proving a Section 7 violation in court poses challenges, as some recent outcomes in litigated merger cases underscore . . . do we take into account whether we could prevail in court if we were put to that test? Absolutely. It would be irresponsible to bring cases that we had no reasonable expectation of winning.¹⁶⁹

AAG Thomas O. Barnett explained at the 2008 ABA Section of Antitrust Law Spring Meeting:

. . . Are we, or the FTC, afraid to litigate a merger case? We like to litigate merger cases—it's professionally rewarding—but you have to pick the right cases. We are ready to do it.

There have been times when I have signed a complaint, on the expectation that we would be filing it within days. The parties then elected to come to the settlement table and we resolved it through a consent decree. That's a win/win. It's a very positive outcome. But I mention it to underscore that at the time we actually thought we were going to litigate.¹⁷⁰

In June 2008 remarks, AAG Barnett defended the DOJ's record by noting:

Since FY2001, the Division has identified problems with 112 transactions . . . [with] a . . . 98 percent success rate since FY2001, and since 2004, our win record is—so far—unblemished; we have obtained relief in 100 percent of the transactions in which a problem was identified during that period.

What is more, in the vast majority of cases we have achieved this record without having to undergo the delay, expense, and uncertainty of contested litigation. . . .¹⁷¹

This difference in enforcement philosophy may have had an impact on a case-by-case basis, but the impact is very subtle and has been vastly overstated by the critics.

The enforcement actions may also be impacted by some other institutional factors, which also can impact a particular official's enforcement philosophy. First, there are structural differences between the agencies that can affect the outcome (as well as the timing of the investigation) in some small percentage of mergers. At the DOJ, the true ultimate decision-maker is the AAG.¹⁷² Having one decision-maker streamlines the decision-making process. In contrast, the ultimate decision-making at the FTC occurs at the Commissioner level—consisting of five Commissioners of different political parties and perspectives. Thus, the process at the FTC is one of consensus and discussion, which can take additional time and, at times, compromise among the Commissioners in order to satisfy the various constituencies. Again, not a lot of weight should be given to these structural differences at the reviewing agency for the vast majority of transactions that are cleared (either early in the process or following a full investigation) or resolved amicably through a straightforward divestiture, but they could make a difference in a close case.

Today, there are also clear differences between the FTC and the DOJ regarding certain aspects of relief. These differences can impact how the enforcement statistics look to the casual observer. The DOJ has consistently been willing to permit parties to “fix” transactions absent a consent if it has assurances that the relief will be implemented.¹⁷³ The DOJ also has been willing to enter into “pocket consents” that provide parties with the flexibility to close time-sensitive hostile transactions prior to the conclusion of the investigation or when certain regulatory approvals are likely to resolve the competitive concerns. The DOJ has used pocket decrees in a variety of settings in the last few years. For example, as in *Mital/Arcelor*,¹⁷⁴ the DOJ previously entered into a pocket decree in the *Connor Brothers*¹⁷⁵ transaction, recognizing that to hold up the transaction for the completion of the full investigation would have killed the transaction due to idiosyncrasies existing under the operative foreign law. In *Raycom*¹⁷⁶ and *GE/Media General*,¹⁷⁷ the DOJ similarly entered into pocket decrees in the event that the FCC orders addressing the concerns were not followed. Pocket decrees have also been obtained as an insurance policy in situations in which the parties have offered a “fix-it-first.” Again, the focus of the DOJ has been on whether there are adequate safeguards in place to ensure that any concerns will be addressed. The DOJ has very rarely included “crown jewels” provisions in its consent decrees,¹⁷⁸ and typically provides a three-to-six month period for divestitures. As illustrated in the *SBC/ATT* and *Verizon/MCI* transactions, the DOJ has accepted relief other than the divestiture of one of the transaction parties' assets in order to preserve the efficiencies of the main transaction.¹⁷⁹ In contrast, the FTC has not permitted parties to “fix” transactions absent consent orders and will not enter into “pocket decrees.”¹⁸⁰

Another exogenous factor is that the level of activity at the two agencies can differ as a result of which sectors of the economy have been consolidating and which agency historically reviews those sectors. For example, take the volume of transactions in two sectors that have been traditionally allocated to DOJ: communications and paper. As Appendix D shows, the average number of communications transactions for the five-year period of 1996 to 2000 and the seven-year period 2001 to 2007 decreased by about a third. In the paper section, the decrease is even more dramatic; from 1996-2000 there were, on average, almost 80 transactions per year, compared with 48 for 2001-2007, i.e., about 60 percent less.¹⁸¹ In the banking industry, also under the jurisdiction of the DOJ, the number dropped a whopping 46 percent. Accordingly, even if the transactions raised the same issues, there were less opportunities for the DOJ to review these transactions.

Moreover, markets do not remain the same over time. One DOJ official suggests that many of the transactions the DOJ reviews involve companies operating in the services and technology sectors where, on average, transportation costs are lower and change is more rapid than in some of the more traditional “industrial” sectors of the economy.¹⁸² Perhaps the most “changed” industry in the entire economy is the telecommunications sector when one considers the advent of the internet (and the introduction of internet telephony), the entry of the Baby Bells into long distance, and the ubiquity of mobile phone service, not to mention the coinciding changes in regulatory frameworks, including the auctioning of additional spectrum.¹⁸³

Also, many of the transactions reviewed by the DOJ during this time frame were subject to review (and imposition of conditions and relief) and/or ongoing regulation by regulatory bodies, such as the FCC or the Federal Reserve, thereby obviating the need for intervention by the DOJ. Without doubt, these exogenous factors had bearing on the enforcement statistics of the DOJ, as compared with the FTC.

Even factoring in these differences, however, there still seems to be a difference in the ultimate decision and the perceived role of the agency in close cases. But, the difference is not so significant that one can conclude that the Bush Administration DOJ has on the whole been lax on merger enforcement, as some critics clearly suggest. As Deborah Feinstein concludes in her article, “[m]any mergers continue to be resolved only after concessions by the parties, and investigative levels remain high. Whatever one’s views about the relative enforcement policies of the Clinton or Bush Administration’s, reports of the complete demise of federal merger enforcement have been exaggerated.¹⁸⁴

V. LOOKING FORWARD: WILL THE ELECTION MAKE A MATERIAL DIFFERENCE IN THE REVIEW OF A PARTICULAR MERGER?

Given the extensive antitrust expertise that will remain at the agencies, as well as that of the officials that President Obama nominated for leadership positions, it seems unlikely that changes in merger enforcement will occur in any but the closest of decisions and, even then, to the extent that an individual official decides a matter in one direction or another, will most likely be decided not on the existence of any fundamental difference in principles or objectives

but on a difference in how they view the facts and the likely effects of the conduct in the particular matter. But, as pointed out above, the institutional differences between the two agencies, as well as personal enforcement philosophies, may impact decision-making in some specific merger reviews.

Although most of the staff and some of the officials (particularly at the FTC, where Commissioners may serve seven-year terms) will remain, two other developments may—depending on how they evolve—have a greater impact on enforcement postures than even who has been appointed to the leadership roles. The courts' role in merger settlements and challenges is currently evolving. First, depending on the outcome in the two areas discussed below, material differences may exist between the agencies in the process undertaken by each. Second, the court's role could impact the outcome of the cases reviewed and the willingness of both the agencies and the parties to settle.

One of the areas that is currently evolving concerns the judiciary's role in DOJ consents. Any proposed consent with the DOJ must be filed and approved by a federal district court under the Antitrust Procedures and Penalties Act of 1974, commonly known as the "Tunney Act."¹⁸⁵ As originally adopted, the Tunney Act listed factors that "the court may consider;" the Act granted the court the discretion to determine which cases require its examination. Congress amended the Tunney Act in 2004 to mandate that the court consider certain factors, thereby potentially expanding the judicial mandate. Nonetheless, the amendments explicitly indicate that "nothing in this section shall be construed to require the court to conduct an evidentiary hearing or to require the court to permit anyone to intervene."¹⁸⁶

An intense debate commenced regarding the meaning of the 2004 amendments when the DOJ sought approval of its proposed final judgments in the SBC/AT&T and Verizon/MCI transactions.¹⁸⁷ When ultimately approving the proposed consent (17 months after the DOJ filed the case), the court found that, in amending the Tunney Act, Congress sought to foreclose "judicial rubber-stamping" but did not intend for the court to reject proposed remedies merely because the court believed other remedies were preferable. The court framed the relevant question as not whether a proposed remedy is the "best one" but whether it is "within the reaches of the public interest."¹⁸⁸ The court also saw its role as ensuring that the consent is written unambiguously, including whether the proposed judgment makes implementation of the judgment manageable and the compliance mechanisms work.¹⁸⁹ We hope that the delay in the approval by the court of these particular settlements will be *sui generis*, due to their being the first major settlements reviewed under the revised Tunney Act in which multiple third parties raised concerns. Otherwise, the willingness of both the DOJ and the transaction parties to settle concerns with a consent may be adversely affected, particularly when compared with the autonomy of the FTC in entering into—and accepting—consents.

A more systemic concern arises in connection with the diverging role of the courts in providing a meaningful role in a merger challenge initiated by the FTC versus the DOJ. When the DOJ challenges a transaction by filing a case in federal district court, the judge decides

whether to grant a preliminary injunction to the merger and ultimately whether the merger is anticompetitive. In contrast, the FTC itself can ultimately decide as part of an administrative proceeding whether the merger is anticompetitive, subject theoretically to appellate court review and, when it brings an action in district court, it is merely seeking a preliminary injunction of the merger pending its review.

In a July 3, 2008 speech, FTC Commissioner J. Thomas Rosch suggests that the FTC “arguably abdicated” its responsibility to judge unfair competition cases—which, he implies, includes merger challenges—and allowed that responsibility to fall onto federal district courts. Commissioner Rosch believes Congress did not originally intend that outcome:

Congress concluded that it was in the public interest to grant this judicial authority to the Commission instead of to the federal district courts. That too is apparent from the language of Section 5(b). Nowhere in that provision is concurrent judicial authority—or any authority to review Commission decisions—given to the federal district courts. To the contrary, the power to review Commission decisions is given exclusively to the federal appellate courts. Again, this was no accident. In proposing the new agency to the House of Representatives, President Wilson expressed skepticism that federal district courts were equipped “to adjust the remedy to the wrong in the way that will meet all other circumstances of the case” and confidence that the Commission could and would do so.¹⁹⁰

Commissioner Rosch posits that

...for the last five years, the Congressional intent has arguably been turned on its head. First, in Arch Coal, and more recently in the challenges to the Western/Giant and Whole Foods/Wild Oats mergers, federal district courts in Section 13(b) proceedings made the Commission’s likelihood of success on the merits at a plenary trial, instead of the public interest, the ultimate issues. Indeed, in Arch Coal and Whole Foods, the courts essentially turned proceedings on the Commission’s application for a preliminary injunction into plenary trials on the merits.

Yet, the resulting different standards and procedure for FTC-initiated and DOJ-initiated challenges to mergers could well be outcome-determinative in close cases and would no doubt significantly impact the actions of the respective agencies and transaction parties in a material number of transactions. AMC repeatedly noted that any differences—real or perceived—between the FTC and the DOJ in their merger challenges can undermine public confidence:

Parties to a proposed merger should receive comparable treatment and face similar burdens regardless of whether the FTC or the DOJ reviews their merger. A divergence undermines the public’s trust that the antitrust agencies will review transactions efficiently and fairly. More important, it creates the impression that the ultimate decision as to whether a merger may proceed depends in substantial part on which agency reviews the transaction. In particular, the divergence may permit the FTC to exert greater leverage in obtaining the parties’ assent to a consent decree... [T]he commission makes three interrelated recommendations for

administrative action and legislative change that, together, will ensure that parties before either agency face comparable procedural approaches and burdens when an injunction is sought, regardless of which agency reviews the merger.

[1] The Federal Trade Commission should adopt a policy that when it seeks injunctive relief in Hart-Scott-Rodino Act merger cases in federal court, it will seek both preliminary and permanent injunctive relief, and will seek to consolidate those proceedings so long as it is able to reach agreement on an appropriate scheduling order with the merging parties. . . .

[2] Congress should amend Section 13(b) of the Federal Trade Commission Act to prohibit the Federal Trade Commission from pursuing administrative litigation in Hart-Scott-Rodino act merger cases. . . .

[3] Congress should ensure that the same standard for the grant of a preliminary injunction applies to both the Federal Trade Commission and . . . the [DOJ] by amending Section 13(b) of the Federal Trade Commission to specify that, when the Federal Trade Commission seeks a preliminary injunction in a Hart-Scott-Rodino merger case, the Federal Trade Commission is subject to the same standard for the grant of a preliminary injunction as the [DOJ]. . .¹⁹¹

Thus, how much deference district courts must give the FTC in merger cases is a critical question, particularly in light of the string of district court losses the FTC has otherwise suffered. Any differences—real or perceived—between the FTC and the DOJ in their merger challenges could undermine public confidence.

VI. RECOMMENDATIONS FOR THE NEXT ADMINISTRATION

A. *Procedural Changes*

To build upon the progress of the Bush Administration years, the Obama Administration should consider four procedural changes.

First, the two agencies should be encouraged to enter into a clearance allocation arrangement, thereby eliminating potential uncertainty as to timing and outcome as well as differences in outcome according to which agency ultimately is cleared to investigate the transaction.¹⁹² A clearance agreement would also increase the number of “working days” in the initial waiting period, thereby potentially decreasing the number of second requests even further.

Second, the agencies should offer transaction parties the opportunity to trade off an abbreviated second request in favor of allowing the agencies another opportunity for discovery from the transaction parties in any transaction that is challenged by the agency in court, without coupling it with a prolonged second request waiting period. This step might reduce the incentive for the agencies to issue all-encompassing second requests as well as to permit quicker staff review. Given that almost all transactions are either cleared or resolved through consent,

this alternative path would eliminate the added expense and time built into the process that is the result of treating all transactions as if they were going to be litigated.

Third, a federal magistrate could be designated, instead of a person within each respective agency, to determine appeals concerning second requests, thereby preventing “gaming” of the system by either the transaction parties or agency staff. It is far from clear, however, that including this approach would work in practice.

Fourth, the scope and burden of electronic production should be addressed, particularly at the DOJ, where the technical requirements are more expensive to implement than at the FTC. The ABA recommends the creation of a joint working group to engage in a dialogue regarding these issues.

B. Continuation of Transparency Objectives

Transparency is a key element to an effective enforcement regime. It is not only important to ensure that the business community and agency staff engage in the most up-to-date methodology in merger analysis, but serves an important role outside the United States in supporting the U.S. leadership role in international policymaking. Accordingly, the next administration should consider periodically issuing brief summaries or digests as to their reasons for not proceeding on significant matters so that the business community could gauge better what arguments are worth developing.

In addition, it has been almost 15 years since the agencies issued their latest Horizontal Merger Guidelines (and 10 years since the efficiencies section was added). The vertical and conglomerate merger discussion in the Guidelines, which were not addressed in 1992, are particularly out-of-date. The ABA and some other well-respected antitrust experts have suggested that the agencies consider whether new, updated merger guidelines would be appropriate at this time.¹⁹³ On the other hand, the existing guidelines have achieved widespread acceptance by the courts and foreign authorities and have contributed very substantially to clarifying the analytical path of the agencies in reviewing mergers

As a first step, we recommend that the agencies form a working group that includes members of the bar and possibly workshops to compare prior agency commentary and releases with more recently issued guidelines of other jurisdictions (e.g., the EU and United Kingdom) and economic and business literature to ensure that the views publicly communicated by the agencies reflect current best practices. To the extent that there is a disparity between what has been communicated and current practices or state-of-the-art practice, the agencies could then ensure that these views are publicly communicated.

We do not need to decide at this time whether ultimately new merger guidelines will be advisable to achieve the transparency objectives and leadership role of the United States in lieu of other communications that elaborate on aspects of the current merger guidelines. First, given the process of drafting new guidelines that reflect a consensus view of both agencies, it is by no means clear that such guidelines would provide as complete and accurate of a discussion as

might be achieved through the papers published in connection with a workshop, speeches, press releases, or other working papers of the staff. Moreover, given the considerable time that is likely to lapse before the new guidelines issued, such interpretive communications can fill any perceived gap existing from reference to the existing guidelines. Topics that could be readily addressed through reports and commentaries would be a more comprehensive discussion of the factors suggesting or negating the existence of unilateral and coordinated effects; the appropriate application of the guidelines framework in delineating markets for industries undergoing significant and permanent changes due to convergence of technologies or product/service developments; the application of the guidelines analysis to high-technology markets, including the role and timing of actual and potential entry by the transaction parties and third-parties and the assertion of innovation markets; the role and recognition of buyer power; the significance and measurement of low-sunk-cost entry; the application of the guidelines analysis to bid-markets; and the recognition and role of mavericks.

Also, as discussed *supra*, the focus of the agencies has been primarily on unilateral-effects cases. Part of this reliance has arisen from the use of economics to develop “evidence” based on data and merger simulations in support of such theories. In contrast, the agencies have not developed tools to identify and prove coordinated-effects cases. The agencies may find that focusing on such effects, potentially through the use of merger retrospectives to understand better what market structures and dynamics foster coordinated effects, would provide for a more balanced approach to merger analysis. Indeed, well-designed merger retrospectives could be generally useful to understand what creates and maintains market power, market dynamics, and competitive effects. As former Deputy AAG for Economics Dennis Carlton recently stated,

Imagine that the Federal Reserve Board was trying to control the rate of inflation but did not have access to price statistics. Instead, it relied on opinions of a few non-randomly chosen shoppers about how fast they thought prices were rising. I suspect that the Fed would do a much poorer job of controlling inflation than it now does. Moreover, it is possible that in the absence of reliable quantitative information, monetary policy could be heavily influenced by the ideological views of the people running the Federal Reserve Board. . . . Without quantitative measures of the effectiveness of merger policy and of the accuracy of the government’s analyses underlying merger policy, judgments about the appropriate antitrust policy will be based on qualitative information that can be subject to alternative interpretations. . . . There is a need to gather post-merger industry data and a need to gather the predictions of DOJ merger analysis in order to evaluate whether U.S. policy and analysis can be improved. Strong opinions are not substitutes for quantitative analysis.¹⁹⁴

FTC Chairman William Kovacic also strongly advocated such retrospective studies in a September 2008 speech.¹⁹⁵ Studies of consummated mergers that were questioned but not challenged, or challenged unsuccessfully, would be useful to determine whether the predicted effects occurred when the predictions were based on certain types of evidence. The ABA Transition Report recommends that the agencies select a sample of prior merger decisions—including both decisions to intervene and decisions to decline enforcement—to assess whether

subsequent developments in the mandates involved justified the decisions. The ABA also suggests that the costs and benefits of consummated merger challenges be assessed separately.¹⁹⁶

C. International Advocacy Is Important

This section outlines some of the potential measures through which multijurisdictional merger review could be improved and the potential for unnecessary regulatory costs minimized.

Although convergence may not be the silver bullet to achieve successful international merger enforcement, initiatives that help to “mind the gap” among reviewing agencies are a worthwhile endeavor. To a large extent, many of the measures necessary to foster procedural convergence—which would help to reduce burden and inconsistencies—would be met if individual states adopted the thirteen ICN Recommended Practices for merger notification procedures detailed above. The ideal level of substantive convergence is somewhat more difficult to achieve, although the ICN working group on mergers is making progress in this regard. Perhaps the best way to achieve the optimal level of substantive convergence is through the exchange of ideas and the practical experience gained from cooperating with other competition agencies on actual cases.

Convergence need not mean moving towards the most widespread system or the lowest common denominator likely to achieve consensus. Instead, genuine efforts should be made to adopt the very best possible system—even if that means creating a new system. As pointed out by former AAG R. Hewitt Pate, convergence should not follow a “mixing bowl” approach that “blends together a hodgepodge of different standards and processes without any regard for whether some might be more effective or appropriate than others.”¹⁹⁷

Substantive convergence will not guarantee that agencies will reach the same conclusions. First, there may be differences in factual situations in different markets. Second, there will always remain some scope for justified differences of opinion. Reasonable people applying the same law and the same analysis may reach different conclusions on similar facts.¹⁹⁸ Nor would it be appropriate to use convergence to codify principles that could not evolve over time or that may not be appropriate for all jurisdictions.

The close cooperation existing among antitrust agencies in a number of jurisdictions needs to be encouraged and become even more widespread. When regulators are sufficiently familiar and comfortable with each other simply to pick up the phone and discuss a pending investigation, the risk of divergent decisions is reduced. In particular, when ideas are exchanged at an early stage before opinions have become entrenched, discussions are likely to reduce the risk of conflicting decisions.

Such a relationship of trust and respect will also foster substantive convergence. The use of work-sharing arrangements should be expanded to include an allocation of investigation topics exclusively to the competition authority that has the greatest interest and nexus to the

issue. Waivers could be granted by the parties so that the competition authorities could engage in a dialogue regarding the results of the investigation. In large, complex transactions in which the parties waive confidentiality, it may also be possible for the authority not taking primary responsibility for the investigation to lend a staff member to the investigating authority to work on the particular transaction. During the remedies stage, it could be more efficient and effective to have one competition authority take the lead in seeking a remedy that can take care of all competitive concerns raised in a specific transaction. This should help avoid situations in which remedies imposed in one jurisdiction frustrate those imposed in another jurisdiction or frustrate the achievement of the pro-competitive benefits of the transaction (e.g., synergies, new product innovations) in another jurisdiction. Such an approach is consistent with recommendations in the ICPAC Report.¹⁹⁹ Yet, even some of the major jurisdictions (e.g., EU) currently may lack the discretion to forego exercise of jurisdiction in merger cases. Such restrictions on discretion, however, would not prevent those jurisdictions from accepting commitments that are the same as, or similar to, those offered by the transaction parties in another jurisdiction.

The use of joint studies and roundtable discussions to develop policy is an important way for competition authorities to reach consensus and to develop better tools for analyzing transactions on particular issues. The ICN's Merger Subgroups should continue their initiatives to promote convergence through expansion of such projects as the Merger Guidelines Report. Continued analysis in areas in which there is no widespread consensus is needed. Joint ex post and empirical merger studies to explore such topics as efficiencies, treatment of distressed industries and firms, vertical and conglomerate merger analysis, and remedies may be useful—although they may also be costly to agencies and to businesses if they are required to participate in such studies. Some competition authorities have undertaken ex post studies of mergers, including those in which the transaction parties were required to provide remedies and others are currently in the process of doing so.

Ex post studies are important to the evolution of effective competition enforcement and striking the right balance between private and public interests. The results of such studies should be shared publicly to the extent consistent with confidentiality provisions, so that the business community can make informed decisions regarding mergers and acquisitions activity. The methodology and results of such studies should also be discussed among competition authorities and refined in subsequent studies.

Principles of international law, such as territorial sovereignty and proportionality, also can provide useful guiding considerations for competition authorities in order to ensure that one jurisdiction does not unintentionally thwart the enforcement scope of other jurisdictions. Such principles form the underpinnings for comity. The U.S.-EU Best Practices recognize the role of the enforcement agencies in avoiding the potential for harm as a result of conflicting remedies. In most instances, the exercise of comity principles is an exercise of prosecutorial discretion. The United States indicates, “[t]he agencies will listen to the views of foreign agencies regarding particular remedies and, provided that competition concerns in the U.S. market are addressed, will make efforts to accommodate the interests of foreign governments.

The FTC has in at least one nonpublic matter benefited from a remedy obtained by a foreign agency that addressed completely the competition concerns in the United States so that the FTC did not have to bring its own enforcement action.²⁰⁰ The U.S. agencies should consider adopting guidelines for determining when to apply comity principles to avoid inconsistent enforcement action and to achieve greater convergence in competition laws at both the bilateral and multilateral levels. Thresholds should be adopted so mergers that lack sufficient nexus to a particular jurisdiction are not subject to notification.

The development of best practices should continue to be undertaken, including by some of the multinational organizations, such as ICN, European Competition Network (“ECN”) and OECD to foster the convergence discussion where the regulatory burdens are felt most acutely by transaction parties and perhaps can be most practically addressed; focusing particularly on remaining issues of procedural divergence such as market share tests, timing, rights of parties to information and the opportunity to be heard, meaningful oversight of the investigating agency, and rights of appeal. Greater transparency, including more information published on analysis in individual cases, helps to foster substantive convergence. The focus should continue to be on implementation by jurisdictions of the best practices adopted by the ICN, OECD, and ECN, and through bilateral and multilateral cooperation agreements. In addition, peer-review proceedings of organizations such as OECD could include as part of their investigation and review such topics as the authorities’ willingness and ability to work cooperatively with other jurisdictions, as well as their consideration of comity principles.

In addition, the U.S. should consider the potential of expanding its existing bilateral arrangements to include some of the more important emerging economies, such as China and India. Other soft convergence can be achieved through staff exchanges and training assistance between agencies. The private sector can encourage such convergence through waivers that facilitate the exchange of information and analysis among the reviewing agencies.

Finally, it is critical that the U.S. agencies devote resources to capacity-building among the various jurisdictions that belong to the ICN and OECD, including by remaining active in the ICN’s work on unilateral conduct, merger review procedure and analysis, and cartels, and in various training workshops, as well as the OECD Competition Committee’s substantive roundtables and peer reviews.²⁰¹ The technical assistance provided by the agencies to staff attorneys internationally should be continued, and assistance should be expanded to include more training on economic theory and practice in antitrust enforcement.

D. Investment in Agency Staff Is Important

As noted by both the ABA Transition report and the AAI Report, the trial capabilities of the agency staff are important to the effectiveness of federal antitrust enforcement.²⁰² The ABA recommends that the agencies should consider: (1) implementing a “best practices” standard to prepare lawyers to try cases and to remain trial-ready through the sharing of information and programs; (2) designating as “senior trial counsel” a limited number of experienced staff lawyers who would actively supervise trial preparation; and (3) in exceptional circumstances

and on a case-by-case basis, retain outside antitrust counsel to prepare or try cases. We endorse all three recommendations and also urge the ABA and other organizations to offer litigation training programs that will be accessible to government lawyers, in order to assist the agencies in the development of their staffs' capabilities.

VII. CONCLUSION

From a competition policy standpoint, the Bush Administration antitrust agencies continued many of the initiatives of the prior administrations and achieved significant improvements in both their merger review process and transparency, as well as their leadership role in international competition fora. The agencies were busy for most of the Bush Administration years in reviewing specific transactions and, as indicated above, challenging those transactions in which a second request was warranted. The agencies also continued to develop and test economic theories and tools. Staff were expected to engage in a robust review of the entire body of evidence and to engage in a meaningful dialogue with the parties regarding the merits as well as possible remedies. Nevertheless, the perception of some observers was that the Bush Administration (particularly the DOJ) was lax in its merger enforcement. The hype surrounding the likely increase in merger enforcement under the Obama Administration should eliminate from the discussion any perceptions—right or wrong—that mergers will not be reviewed and, where concerns arise, challenged, either in court or by requiring that the parties remedy the concerns. The Obama Administration would be well served by continuing and building upon the internal and external procedures developed by the Bush Administration rather than in any way drastically changing the course.

Appendix A: Summary of Transactions by Fiscal Year (FY)²⁰³

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u> <u>204</u>
Reported Transactions	2,305	2,816	3,087	3,702	4,728	4,642	4,926	2,376	1,187	1,014	1,454	1,695	1,768	2,201	1,761
Adjusted Transactions₂₀₄	2,128	2,612	2,864	3,438	4,575	4,340	4,749	2,237	1,142	968	1,377	1,610	1,746	2,108	1,659
Number of Preliminary Investigations	362	378	510	516	452	391	339	262	209	231	236	203	304	296	305
Number of Second Requests	73	101	99	122	125	113	98	70	49	35	35	50	45	63	41
% of Adjusted Transactions Investigated	17%	14%	18%	15%	10%	11%	7%	12%	18%	24%	17%	13%	17%	13%	18%
% of Adjusted Transactions with Second Requests	3.5%	3.8%	3.5%	3.5%	2.7%	2.6%	2.1%	3.1%	4.3%	3.6%	2.5%	3.1%	2.6%	2.9%	2.5%
% of Investigated Transactions with Second Requests	20%	27%	19%	24%	28%	29%	29%	27%	23%	15%	15%	25%	15%	21%	13%

Appendix B: Agency Enforcement Record

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ccv
Second Requests (Total)	73	101	99	122	125	113	98	70	49	35	35	50	45	63	41
Number resulting in challenges, consents, restructurings, etc.	44	51	57	59	84	77	80	55	34	35	24	18	32	38	34
% resulting in challenges, etc.	60%	50%	58%	48%	67%	68%	82%	79%	69%	100%	69%	36%	71%	60%	83%
% of adjusted transactions challenged	2.06 %	1.95 %	1.99 %	1.72 %	1.84 %	1.77 %	1.68 %	2.46 %	2.97 %	3.62 %	1.74 %	1.11 %	1.83 %	1.80 %	2.04 %
DOJ (Second Request)	27	43	63	77	79	68	55	43	22	15	15	25	17	32	20
Number of Preliminary Investigations	126	108	210	263	174	173	150	123	85	83	94	120	101	95	103
% of Investigations to second requests	21%	40%	30%	29%	45%	39%	37%	35%	26%	18%	16%	21%	17%	33%	10%
Number resulting in challenges, consents, restructurings, etc.	22	18	30	31	51	47	48	32	10	15	9	4	16	21	15
% second requests resulting in challenges, etc.	81%	42%	48%	40%	64%	69%	87%	74%	45%	100%	60%	16%	17%	66%	75%
% of investigated transactions challenged	17.5 %	16.7 %	14.3 %	11.8 %	29.39 %	27.2 %	32%	26%	11.8 %	18.1 %	9.6%	3.3%	15.8 %	22.1 %	14.6 %
FTC (Second Requests)	46	58	36	45	46	45	43	27	27	20	20	25	28	31	21
Number of Preliminary Investigations	236	270	300	253	278	218	189	131	124	148	142	183	203	201	202
% of Investigations to second requests	19%	21%	12%	18%	17%	21%	23%	21%	22%	14%	14%	14%	14%	15%	10%
Number resulting in challenges, consents, restructurings, etc.	20	33	27	28	33	30	32	23	24	20	15	14	16	22	19
% second requests resulting in challenges, etc.	43%	57%	75%	62%	72%	66%	74%	85%	88%	100%	75%	56%	57%	71%	90%
% of investigated transactions challenged	8.5%	12.2%	9%	11.07 %	11.9%	13.8%	16.9%	17.6%	19.4%	13.5%	10.6%	7.7%	7.9%	10.9%	9.4%

Appendix C: Transactions Below \$50 Million Threshold

	1994	1995	1996	1997	1998	1999	2000	TOTAL
HSR Adjusted Transactions	906	1,420	1,550	1,761	2,398	2,163	2,247	12,445
% total adjusted transactions	43%	54%	54%	48%	52%	56%	47%	N/A
Number investigated	98	126	260	172	144	124	89	953
% of investigated transactions	27%	23%	39%	33%	32%	32%	26%	N/A
Number of second requests	19	24	31	27	27	17	22	167
Percentage of second requests	27%	24%	31%	22%	22%	15%	22%	

Appendix D: Type of Transactions

Year	LBOs	PE	Communications	Paper	Grocery	Petro	Pharma	Banks	Chemical
1996	223	389	394	108	245	472	106	694	247
1997	232	480	416	95	227	540	108	554	235
1998	210	524	441	76	226	472	97	540	221
1999	240	597	539	67	173	329	94	408	196
2000	377	732	644	53	151	270	102	328	224
2001	198	475	424	38	125	232	95	298	149
2002	216	528	329	35	94	288	91	224	127
2003	188	716	309	42	137	357	148	306	194
2004	346	991	321	44	138	406	130	312	152
2005	497	1,248	288	55	130	448	119	217	174
2006	688	1,565	283	57	169	597	132	290	206
2007	693	1,734	324	66	211	590	125	272	212
2008	349	897	151	31	117	371	92	121	140

Source: Thomson Financial SDC Platinum

¹See Jonathan B. Baker and Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, prepared for the Kirkpatrick Conference on Conservative Economic Influence on U.S. Antitrust Policy, Georgetown University Law Center (April 2007) (revised October 2007) (“Baker/Shapiro Study”), available at <http://faculty.haas.berkeley.edu/shapiro/mergerpolicy.pdf>; Dennis Berman, *The Game: Handicapping Deal Hype and Hubris*, WALL ST. J. (Jan. 16, 2007) at C1; Jonathan B. Baker and Carl Shapiro, *Detecting and Revising the Decline in Horizontal Merger Enforcement*, 22 ANTITRUST 29 (Summer 2008) (“Baker/Shapiro Antitrust Article”); George Cary, *Current Merger Enforcement: A House Divided Cannot Stand on a One Legged Stool* (Nov. 15, 2007) (“Cary Article”) at 3; American Antitrust Institute, *The Next Antitrust Agenda: The American Antitrust Institute’s Transition Report on Competition Policy to the 44th President*, Vandepas Publishing (Sept. 2008) (“AAI Report”) at 155; James Langerfeld & Daniel R. Shulman, *The Future of U.S. Federal Antitrust Enforcement – Learning from Past and Current Influences*, 8 SEDONA CONF. J. 1, 5 (2007) (concludes that the DOJ opened fewer merger investigations during the GW Bush Administration; although the decline in the issuance of second requests could reflect either a decline in enforcement or improved Bush efficiency in enforcement agency operations, other statistics show that

enforcement has declined). *But see* Malcolm B. Coate & Shawn W. Ulrick, *Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996-2003*, available at <http://www.ftc.gov/os/2005/02/0502economicissues.pdf> (a study that reviewed internal FTC staff merger memoranda concluded that the FTC's review standards did not vary between administrations).

²See Timothy J. Muris, *Facts Trump Politics: The Complexities of Comparing Merger Enforcement over Time and Between Agencies*, 22 ANTITRUST 37 (Summer 2008) ("Muris Article").

³Many of our suggestions are substantially the same as the recommendations expressed by the ABA Section of Antitrust Law in its recently released 2008 Transition Report see ABA, American Bar Association Section of Antitrust Law 2008 Transition Report (Nov. 2008) ("ABA Transition Report"), available at <http://www.abanet.org/antitrust/at-comments/2008/11-08/comments-obamabiden.pdf> and the final report of the Antitrust Modernization Commission, Antitrust Modernization Commissions Report of Recommendations (April 2007) ("AMC Report"), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

⁴See DOJ, Merger Review Process Initiative (Oct. 12, 2001; revised Aug. 4, 2004), available at <http://www.usdoj.gov/atr/public/204895.htm>; FTC, Guidance for Voluntary Submission of Documents During the Initial Waiting Period ("FTC Voluntary Submission Guide"), available at <http://www.ftc.gov/bc/hsr/hsrguidance.shtm>. These initiatives were subsequently revised, most notably by the DOJ in 2006, to offer additional limitations on searches if the transaction parties agree to an investigation schedule and to a set time period for the DOJ to conduct post-complaint discovery should the investigation result in contested litigation. *See* DOJ, Merger Review Process Initiative (revised Dec. 14, 2006) ("DOJ Merger Initiative"), available at <http://www.usdoj.gov/atr/public/220237.htm>. Unfortunately, only one company has utilized this option to date. *See* Thomas O. Barnett, Current Issues in Merger Enforcement: Thoughts on Theory Litigation Practice, and Retrospective (June 26, 2008) ("Barnett June 26, 2008 Remarks"), available at <http://www.usdoj.gov/atr/public/speeches/234537.htm>.

⁵See, e.g., FTC & DOJ, ANNUAL REPORT TO CONGRESS, FISCAL YEAR 2006 (2007), available at <http://www.ftc.gov/reports/hsr06/>.

⁶See, e.g., In the Matter of Agrium Inc., Docket No. C-4219 (May 5, 2008), available at <http://www.ftc.gov/os/caselist/0810073/index.shtm>.

⁷See J. Robert Kramer, II, Director of Operations, Antitrust Div., DOJ, Merger Review Process Retrospective (Nov. 14, 2008) ("Kramer Speech").

⁸See Cecile Kohrs Lindell, *Merger filings plummet*, THE DEAL (Nov. 14, 2008).

⁹See FTC, Federal Trade Commission Strategic Plan, Fiscal Years 2006-2011 (Sept. 30, 2006), available at <http://www.ftc.gov/opp/gpra/spfy06fy11.pdf>.

¹⁰See FTC, Introductory Guide III to the Premerger Notification Program (July 2006), available at <http://www.ftc.gov/bc/hsr/introguides/guide3.pdf>.

¹¹See FTC, Reforms to the Merger Review Process (Feb. 16, 2006) at 5, available at <http://www.ftc.gov/os/2006/02/mergerreviewprocess.pdf>. *See* DOJ, Press Release, Antitrust Division Announces Amendments to Its 2001 Merger Review Process Initiative (Dec. 15, 2006), available at http://www.usdoj.gov/atr/public/press_releases/2006/220302.htm.

¹²See David L. Meyer, Deputy Assistant Attorney Gen., Antitrust Div., DOJ, Merger Enforcement Is Alive and Well at the Department of Justice (Nov. 15, 2007) ("Meyer Speech"), available at <http://www.usdoj.gov/atr/public/speeches/227713.htm>.

¹³See Kramer Speech at 13.

¹⁴See Public Law 106 – 553.

¹⁵See DOJ, Second Request Internal Procedure (Revised Jun. 2001), available at <http://www.usdoj.gov/atr/public/8430.htm>; 16 C.F.R. § 2.20 (2008).

¹⁶There is only one reported case in which one of the enforcement agencies challenged a transaction party's failure to comply with a second request, and the ultimate decision does not include any substantive discussion. *See* FTC v. McCormick & Co., 1988-1 Trade Cas. (CCH) ¶ 67,976 (D.D.C. 1988).

¹⁷See In re Omnicare, Inc./NeighborCare, Inc., File No. 041-0146 (FTC June 16, 2005) (statement of the Commission), available at <http://www.ftc.gov/os/caselist/0410146/050616stmtcomm0410146.pdf>; DOJ, Press Release, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of Chicago Mercantile Exchange Holdings Inc.'s Acquisition of CBOT Holdings Inc. (June 11, 2007), available at http://www.usdoj.gov/opa/pr/2007/June/07_at_422.html (the merger parties were not uniquely situated to enter into each other's markets; NYSE/Euronext announced intention to offer futures products, and IntercontinentalExchangeCbot intends to offer interest rate futures). Moreover, entry may have played an important mitigating role in the DOJ's clearance of the Blackboard/WebCT transaction in late 2005 without a second request and the FTC's clearance of the Seagate/Maxtor transaction. No statements, however, were issued in either of these transactions confirming the basis for the clearance.

¹⁸See DOJ, Press Release, Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Merger of Delta Airlines Inc. and Northwest Airlines Corporation (Oct. 29, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/238849.htm; DOJ, Press Release, Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc. (Mar. 24, 2008) ("XM Press Release"), available at http://www.usdoj.gov/opa/pr/2008/March/08_at_226.html; DOJ, Press Release,

Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Joint Venture Between SABMiller plc and Molson Coors Brewing Company (Jun. 5, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/233845.htm; DOJ, Press Release, Department of Justice Antitrust Division Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag (Mar. 29, 2006), available at http://www.usdoj.gov/atr/public/press_releases/2006/215326.htm; DOJ, Press Release, Statement by Assistant Attorney General R. Hewitt Pate Regarding the Closing of the America West / US Airways Investigation (June 23, 2005), available at <http://www.usdoj.gov/opa/pr/2005/June/05at338.htm>. Efficiencies also constituted one of the reasons cited by DOJ for clearing the NewsMedia acquisition of certain Knight Ridder newspapers from McClatchy and for not requiring additional relief in the SBC/AT&T and Verizon/MCI transactions. See *United States v. SBC Commc'ns, Inc.*, No. 05-2102 (D.D.C. Oct. 27, 2006) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f212400/212424.pdf>; *United States v. Verizon Commc'ns, Inc.*, No. 05-2103 (D.D.C. Oct. 27, 2006) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f212400/212433.pdf>.

¹⁹See XM Press Release; *United States v. SBC Commc'ns, Inc.*, Civil Action No. 1:05CV02102 (D.D.C. Nov. 16, 2005) (competitive impact statement) ("SBC Competitive Impact Statement"), available at <http://www.usdoj.gov/atr/cases/f213000/213026.htm>; *United States v. Verizon Commc'ns, Inc.*, Civil Action No. 1:05CV02103 (D.D.C. Nov. 16, 2005) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f213000/213028.htm>; In re Federated Department Stores, Inc./The May Department Stores Company, File No. 051-0111 (FTC Aug. 30, 2005) (statement of the Commission), available at <http://www.ftc.gov/os/caselist/0510001/050830stmt0510001.pdf>.

²⁰See DOJ, Press Release, Department of Justice Antitrust Division Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag (Mar. 29, 2006), available at http://www.usdoj.gov/atr/public/press_releases/2006/215326.htm; *United States v. SBC Commc'ns, Inc.*, Civil Action No. 1:05CV02102 (D.D.C. Nov. 16, 2005) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f213000/213026.htm>. Although the DOJ did not issue a statement when it cleared Blackboard Inc.'s purchase of WebCT, Inc. or the FTC when it cleared Seagate Technology's purchase of Maxtor Corporation, it appears that in both cases the reviewing agency concluded that final equipment manufacturers had sufficient market power to defeat any attempts by manufacturers following those two transactions to exercise market power. Press Release, Blackboard Inc., Blackboard and WebCT Announce Agreement to Merge (Oct. 12, 2005), available at <http://www.blackboard.com/company/press/release.aspx?id=767025>; Press Release, Seagate Technology, Seagate Technology to Acquire Maxtor Corporation (Dec. 21, 2005), available at http://www.seagate.com/www/v/index.jsp?locale=en-US&name=Seagate_Technology_To_Acquire_Maxtor_Corporation&vgnnextoid=1e8a814fef83e010VgnVCM100000dd04090aRCRD.

²¹See, e.g., In re Google Inc., File No. 071-0101, (FTC Dec. 20, 2007) (statement), available at <http://www.ftc.gov/os/caselist/0710170/071220statement.pdf> (staff reportedly conducted over 100 interviews, and obtained more than two million pages of documents from the parties, as well as the records of documents from third parties).

²²See Royal Caribbean, Press Release, P&O Princess Cruises plc and Royal Caribbean Cruises Ltd. Combine to Create the World's Largest Cruise Vacation Group (Nov. 20, 2001), available at <http://www.royalcaribbean.com/ourCompany/pressCenter/pressReleases/info.do?sessionId=0000SF3DMZwI43xtvwDmLdO75FL:13hldil87?prDate=11-20-2001&prCode=B>, <http://www.royalcaribbean.com/ourCompany/pressCenter/pressReleases/info.do?sessionId=0000SF3DMZwI43xtvwDmLdO75FL:13hldil87?prDate=11-20-2001&prCode=C> and <http://www.royalcaribbean.com/ourCompany/pressCenter/pressReleases/info.do?sessionId=0000SF3DMZwI43xtvwDmLdO75FL:13hldil87?prDate=11-20-2001&prCode=D>.

²³See Adrian Sainz, *Carnival in Hostile Bid for Princess*, JUNEAU EMPIRE ONLINE NEWS (Dec. 18, 2001), available at http://www.juneauempire.com/stories/121801/sta_carnivalcruise.shtml.

²⁴See FTC, Press Release, Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc (Oct. 4, 2002) ("FTC Carnival Statement"), available at www.ftc.gov/os/2002/10/cruisestatement.htm.

²⁵See James Kanter, DJ EU Clearance Leaves Cruise Rivals Looking to US Regulators (July 24, 2002).

²⁶Confidentiality waivers by the parties facilitated the information-sharing that allowed the agencies to conduct parallel analyses and arrive at compatible solutions to the competition issues.

²⁷See FTC Carnival Statement.

²⁸*Id.*; See also David Scheffman, Director, Bureau of Economics, FTC, Cruise Investigation: Empirical Economics, Financial Analyses (Nov. 2002), available at www.ftc.gov/be/hilites/ftcabrownbag.pdf.

²⁹*Id.*

³⁰See FTC Carnival Statement; Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, Royal Caribbean/Princess and Carnival/Princess (Oct. 4, 2002), available at www.ftc.gov/os/2002/10/cruisedissent.htm.

³¹*Id.*

³²*Id.*

³³See Simons Carnival Speech at 11.

³⁴In July 2006, the FCC also approved this transaction, with conditions, Federal Communications Commission, In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and

subsidiaries, debtors-in-possession), to Time Warner Cable Inc. et al. (memorandum opinion and order) (July 21, 2006), available at http://fjallfoss.fcc.gov/edocs_public/attachmatch/FCC-06-105A1.pdf.

³⁵See, e.g., *The Bon-Ton Stores, Inc. v. The May Dep't Stores Co.*, 881 F. Supp. 860 (W.D.N.Y. 1994).

³⁶See FTC, Press Release, FTC Issues Statement on Closure of Federation/May Investigation (Aug. 30, 2005), available at www.ftc.gov/opa/2005/08/federatedmay.htm.

³⁷*Id.*

³⁸Several states disagreed with this analysis, however, and entered into consents with the transactions parties requiring the divestiture of select stores consistent with a narrow market definition.

³⁹See *In re Google Inc.*, File No. 071-0101 (Dec. 20, 2007) (statement), available at <http://www.ftc.gov/os/caselist/0710170/071220statement.pdf>.

⁴⁰On March 11, 2008, the EU approved the transaction without any conditions. See Press Release, European Union, Mergers: Commission clears proposed acquisition of DoubleClick by Google (Mar. 11, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/426>.

⁴¹See DOJ, Press Release, Statement of the Department of Justice's Antitrust Division Regarding its Investigation of Hearst Corporation's Proposed Acquisition of Tracking Stock in MediaNews Group Inc. (Oct. 25, 2007), available at http://www.usdoj.gov/opa/pr/2007/October/07_at_853.html.

⁴²See DOJ, Press Release, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc. (Mar. 24, 2008) ("XM Press Release"), available at http://www.usdoj.gov/opa/pr/2008/March/08_at_226.html.

⁴³See XM Press Release.

⁴⁴See DOJ, Press Release, Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Joint Venture Between SABMiller plc and Molson Coors Brewing Company (Jun. 5, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/233845.htm.

⁴⁵See FTC, Transcript, Unilateral Effects Analysis and Litigation Workshop (Feb. 12, 2007), available at http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/transcripts/021208_sess1.pdf.

⁴⁶See FTC, Press Release, FTC and DOJ Plan Analysis of Past Merger Enforcement Cases (Nov. 18, 2003), available at <http://www.ftc.gov/opa/2003/11/mergercases.shtm>. The AAI Report indicates that, since 1996, 72 percent of the FTC's merger enforcement actions came only when the post-merger HHI reached 2400 or more, and when there were deltas of over 500. AAI Report at 157. The AAI Report further states that, at the FTC, mergers generally become close calls only when they reduce the number of significant firms from four to three; with more firms, enforcement is less frequent. Industry-specific patterns that align with this general pattern exist at both agencies. See AAI Report at 157.

⁴⁷On October 21, 2004, the DOJ issued a merger remedies guide to provide the public "with an understanding of the Division's analytical framework for and implementing relief in merger cases." See DOJ, Press Release, Antitrust Division Issues Merger Remedies Guide (Oct. 21, 2004), available at http://www.usdoj.gov/atr/public/press_releases/2004/205912.htm.

⁴⁸See FTC, Horizontal Merger Investigation Data, Fiscal Years 1996-2007 (2008), available at <http://www.ftc.gov/opa/2008/12/horizmerger.shtm>. In 2007, the FTC had issued additional data through FY 2005, available at <http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf>. In late 2003, the FTC and the DOJ published a report summarizing data on market structure for the horizontal mergers they opposed during FY 1999-2003. See FTC, DOJ, Merger Challenges Data, FY 1999-2003 (Dec. 18, 2003), available at <http://www.ftc.gov/os/2003/12/mdp.pdf>. During 2004, the FTC published a similar report on nearly all mergers it had investigated through the issuance of a second request in FY 1996-2003. See FTC, Horizontal Mergers Investigation Data, FY 1996-2003 (Aug. 31, 2004), available at <http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf>. The data show that, during the relevant time period, the FTC has rarely challenged a merger unless the post-merger HHI exceeded 2,400 and the HHI increase was greater than 500 points. The judge in the Arch Coal decision took note of the publicly released statistics.

⁴⁹See FTC, DOJ, Commentary on the Horizontal Merger Guidelines, available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf>; FTC, Press Release, FTC, DOJ Issue Joint Commentary on the Horizontal Merger Guidelines (March 27, 2006) ("Commentary"), available at <http://www.ftc.gov/opa/2006/03/mergercom.htm>. The Commentary is the latest elaboration on current enforcement standards.

⁵⁰See FTC, FAQs on Merger Remedies (March 2002), available at <http://www.ftc.gov/bc/mergerfaq.shtm>.

⁵¹See FTC, Bureau of Economics, Best Practices for Data, and Economic and Financial Analyses in Antitrust Investigations (Nov. 7, 2002), available at <http://www.ftc.gov/be/ftcbebp.pdf>.

⁵²See FTC, Bureau of Competition, Statement of the Federal Trade Commission's Bureau of Competition on Guidelines for Merger Investigations (Dec. 11, 2002), available at www.ftc.gov/os/2002/12/bcguidelines0212_11.htm.

⁵³See FTC, Bureau of Competition, Guidelines for Negotiating Merger Remedies (Apr. 2, 2003), available at www.ftc.gov/opa/2003/04/mergerremedies.htm.

⁵⁴See William E. Kovacic, *Extraterritoriality, Institutions, and Convergence in International Competition Policy*, 97 AM. SOC'Y INT'L L. PROC. 309 (2003).

⁵⁵Case No. COMP/M2220, Gen. Elec./Honeywell, Commission Decision of 3 July 2001, *aff'd*, Cases T-209 and 210/01, *Honeywell Int'l v. Comm'n and Gen. Elec. v. Comm'n*, 2005 E.C.R. II-5575 (2005). See, e.g., William J. Kolasky, Deputy Ass't Att'y Gen., DOJ, Antitrust Div., *Conglomerate Mergers and Range Effects: It's a long way from Chicago to Brussels*, Address before George Mason University Symposium (Nov. 9, 2001), available at <http://www.usdoj.gov/atr/public/speeches/9536.htm>; See also Alec Burnside, *GE, Honey, I Sunk the Merger*, 2002 EUR. COMPETITION L. REV. 107.

⁵⁶See FTC, Press Release, E.U. Meet to Discuss Continuing Antitrust Cooperation (Sept. 24, 2001), available at <http://www.ftc.gov/opa/2001/09/muris.shtm>; See Press Release IP/01/1795, *supra* note 11.

⁵⁷See FTC, Press Release, United States and European Union Antitrust Agencies Issue "Best Practices" for Coordinating Member Reviews (Oct. 30, 2002), available at <http://www.ftc.gov/opa/2002/10/euguidelines.shtm>.

⁵⁸See US-EU Merger Working Group, *Best Practices on Cooperation in Merger Investigations* (2002), available at <http://www.ftc.gov/opa/2002/10/mergerbestpractices.shtm>.

⁵⁹*Id.*

⁶⁰See DOJ, Antitrust Cooperation Agreements, available at http://www.usdoj.gov/atr/public/international/int_arrangements.htm.

⁶¹See Sheridan Scott, "C" for Competition: How We Get Things Done in a Globalized Business World (June 17, 2005), [http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/vwapj/insight%20speech_eng.pdf/\\$file/insight%20speech_eng.pdf](http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/vwapj/insight%20speech_eng.pdf/$file/insight%20speech_eng.pdf).

⁶²See Fox, *International Antitrust and the Doha Dome*, 43 VA. J. INT'L L. 911, 917 (2002-03).

⁶³Examples of mergers where close coordination and cooperation between the reviewing agencies took place include Case No. COMP/M.1378, Hoechst/Rhône Poulenc, Commission Decision of 30 Jan. 2004; Case No. COMP/M.2922, Pfizer/Pharmacia, Commission Decision of 27 Feb. 2003; Case No. COMP/M.2972, DSM/Roche Vitamins, 2004 O.J. (L 82) 73; Case No. COMP/M.3354, Sanofi-Synthelabo/Aventis, Commission Decision of 26 Apr. 2004; Case No. COMP/M.3280, Air France/KLM, Commission Decision of 11 Feb. 2004; Case No. COMP/M.3225, Alcan/Pechiney (II), Commission Decision of 29 Sept. 2003; Case No. COMP/M./3083, GE/Instrumentarium, 2004 O.J. (L 109) 1; Case No. COMP/M.3333, Sony/BMG, 2005 O.J. (L 62) 30; Case No. COMP/M.3216, Oracle/PeopleSoft, 2005 O.J. (L 218) 6; Case No. COMP/M.4242, Thermo Electron/Fisher Scientific, Commission Decision of 9 Nov. 2006; and Case No. COMP/M.4141, Linde/BOC, Commission Decision of 6 June 2006. See FTC, Press Release, *FTC Challenges Owens Corning's Acquisition of Saint Gobain Assets* (Oct. 26, 2007) (FTC investigated cooperatively with the EU and Mexican competition authorities), available at <http://www.ftc.gov/opa/2007/10/corning.shtm>. See also DOJ, Press Release, *Justice Department Requires Thomson to Sell Financial Data and Related Assets in Order to Acquire Reuters* (Feb. 19, 2008) ("This resolution by the Antitrust Division, the European Commission, and the Canadian Competition Bureau is an example of effective cooperation in global competition enforcement[.]"), available at http://www.usdoj.gov/atr/public/press_releases/2008/230250.pdf; Eur. Comm'n, Press Release IP/08/260, *Mergers: Commission Clears Acquisition of Reuters by Thomson Subject to Conditions* (Feb. 19, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/260>; Canadian Competition Bureau, Press Release, *Competition Bureau Clears Thomson Acquisition of Reuters* (Feb. 19, 2008), available at <http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/en/02574e.html>. In contrast, as also noted in ICN's Merger Remedies Review Project, in the EC's review of the Shell/BASF joint venture (Case No. COMP/M.1751, Commission Decision of 29 Mar. 2000), which entailed all of their worldwide polypropylene and polyethylene interests, the EU "could have usefully coordinated much earlier with the U.S. authorities, i.e., during the investigation phase when assessing the remedy. . . ." ICN Mergers Working Group, Analytical Framework Subgroup, *Merger Remedies Review Project 29* (2005) ("Merger Remedies Review Project").

⁶⁴See, e.g., Thomson/Reuters disclosed *supra*; FTC, Press Release, *FTC Settlement Would Preserve Competition in U.S. Market for Fluoropolymer Resins* (May 2, 2002) (Solvay/Montedison-Ausimont) (coordination between EU and FTC to design a uniform remedy), available at <http://www.ftc.gov/opa/2002/05/solvayausimont.shtm>.

⁶⁵The OECD has provided for cooperation between member countries in the enforcement of their national competition laws since 1967. See ICN, *Implementation of the ICN Recommended Practices for Merger Notification and Review Procedures 4* (2005) ("ICN Implementation Report") See also J. William Rowley & A. Neil Campbell, *Implementation of the International Competition Network's Recommended Practices for Merger Notification Procedures: Final Report*, 5 BUS. L. INT'L 110 (2004).

⁶⁶See OECD, Recommendation of the Council on Merger Review, C (2005) 34 (Mar. 23, 2005).

⁶⁷See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., *Dynamic Efficiencies in Merger Analysis*, OECD Doc. No. DAF/COMP(2007)41, 2008, available at <http://www.oecd.org/dataoecd/53/22/40623561.pdf>.

⁶⁸See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., *Vertical Mergers*, OECD Doc. No. DAF/COMP(2007)41, 2008, available at <http://www.oecd.org/dataoecd/24/49/39891031.pdf>.

⁶⁹See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., *Competition in Bidding Markets*, OECD Doc. No. DAF/COMP(2006)31, 2006, available at <http://www.oecd.org/dataoecd/44/1/38773965.pdf>.

⁷⁰See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., *Barriers to Entry*, OECD Doc. No. DAF/COMP(2005)42, 2005, available at <http://www.oecd.org/dataoecd/43/49/36344429.pdf>.

⁷¹See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., Competition on the Merits, OECD Doc. No. DAF/COMP(2005)27, 2005, available at <http://www.oecd.org/dataoecd/7/13/35911017.pdf>.

⁷²See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., Merger Remedies, OECD Doc. No. DAF/COMP(2004)21, 2004, available at <http://www.oecd.org/dataoecd/61/45/34305995.pdf>.

⁷³See OECD, Directorate for Financial and Enterprise Affairs, Competition Comm., Media Mergers, OECD Doc. No. DAF/COMP(2003)16, 2003, available at <http://www.oecd.org/dataoecd/15/3/17372985.pdf>.

⁷⁴See ICN, Memorandum from the ICN on the Establishment and Operation of the International Competition Network, available at <http://www.internationalcompetitionnetwork.org/media/library/mou.pdf>.

⁷⁵See ICN, Merger Working Group, 2007-2008 Work Plan, available at http://www.internationalcompetitionnetwork.org/media/library/mergers/Merger_Working_Group_2007-2008wp.pdf.

⁷⁶The Analytical Framework for Merger Review and Investigative Techniques Subgroups were recently combined into one subgroup: the Merger Investigation and Analysis Subgroup. See ICN, Mergers Working Group, 2005-2006 Subgroup Draft Work Plans (2005), available at http://www.internationalcompetitionnetwork.org/media/library/conference_4thbonn_2005/Mergers2005-06_Work_Plan.pdf.

⁷⁷See ICN, Merger Working Group, Guiding Principles for Merger Notification and Review (2002) (hereinafter, Principles for Merger Notification and Review), available at <http://www.internationalcompetitionnetwork.org/media/archive0611/icnnpguidingprin.htm>.

⁷⁸See ICN, Merger Working Group, Recommended Practices for Merger Notification Procedures (2003) (hereinafter, Recommended Practices for Merger Notification Procedures), available at <http://www.internationalcompetitionnetwork.org/media/archive0611/mnprepractices.pdf>.

⁷⁹See ICN, Merger Working Group, Notification and Procedure Subgroup, Report on the Costs and Burdens of Multijurisdictional Merger Review (2004), available at <http://www.internationalcompetitionnetwork.org/media/archive0611/costburd.pdf>.

⁸⁰The first three Recommended Practices were adopted at the ICN's Annual Conference in Naples in September 2002. See Konrad von Finckenstein, *International Antitrust Policy and the International Competition Framework*, INTERNATIONAL ANTITRUST LAW AND POLICY 37 (2002 Fordham Corp. L. Inst., Barry E. Hawk ed., 2003). The next four were adopted at the Annual Conference in Merida in June 2003. See Fernando Sanchez Ugarte, Chairman, ICN Steering Group, Presentation at the 2004 Antitrust Conference, New York (Mar. 4, 2004). The last four were adopted at the Annual Conference in Seoul in April 2004. See ICN, Press Release, New Merger Review Standards Issued by International Competition Network (Apr. 22, 2004), available at <http://www.internationalcompetitionnetwork.org/index.php/en/newsroom/2004/04/22/7>. The ICN adopted the last two recommended practices at its Annual Conference in Bonn, Germany, in June 2005. See ICN, Recommended Practices for Merger Notification Procedures, *supra* note 72.

⁸¹*Id.*

⁸²See ICN, Implementation Handbook, *supra* note 24.

⁸³See ICN, Mergers Working Group, 2006-2007 Work Plan (2006), available at http://www.internationalcompetitionnetwork.org/media/library/mergers/Merger_Working_Group_2007-2008wp.pdf.

⁸⁴See ICN, Mergers Working Group, Analytical Framework Subgroup, Project on Merger Guidelines (2004), available at http://www.internationalcompetitionnetwork.org/media/library/conference_3rd_seoul_2004/amg_chapl_overview.pdf.

⁸⁵See ICN, Merger Guidelines Workbook, *supra* note 25.

⁸⁶*Id.*

⁸⁷See ICN, Merger Remedies Review Project, *supra* note 28.

⁸⁸See ICN, Merger Working Group, Investigative Techniques Subgroup, ICN Investigative Technique Handbook for Merger Review (2005), available at http://www.internationalcompetitionnetwork.org/media/library/conference_4th_bonn_2005/Investigative_Techniques_Handbook.pdf.

⁸⁹See ICN, Merger Working Group, Recommended Practices for Merger Analysis (2008), available at http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf.

⁹⁰*Id.*

⁹¹See ICN, Merger Working Group, 2008-2009 Work Plan (2008), available at http://www.internationalcompetitionnetwork.org/media/library/mergers/Merger_WG_3.pdf.

⁹²The distinction between coordinated interaction and unilateral effects is complicated. In unilateral theories, the merged entity has the ability to increase its prices profitably and unilaterally, as established in a differentiated Bertrand oligopoly, or auction models with a merger of the two lowest cost bidders. In coordinated interaction theories, the merger results in an increased likelihood that the remaining firms can coordinate their actions to reduce competition or in a decreased likelihood that any existing coordination would break down. This reduction in competition may come from the firms now being able to collude explicitly, or, more likely, a change in the incentives and the ability of the competitors to engage in tacit coordination. In August 2002, then Assistant Attorney General Charles A. James noted that "reaching too quickly for unilateral effects theories to the exclusion of

meaningful coordinated effects analysis could result in the Division missing cases that should be brought or crafting its relief too narrowly." See Charles A. James, Assistant Attorney General, DOJ, Rediscovering Coordinated Effects, Remarks at the Annual Meeting of ABA Section of Antitrust Law (Aug. 13, 2002), available at <http://www.usdoj.gov/atr/public/speeches/200124.htm>. Accord R. Hewitt Pate, Assistant Attorney General, Antitrust Division, DOJ, Antitrust Enforcement at the DOJ—Issues in Merger Investigations and Litigation, ABCNY Speech (Dec. 10, 2002), available at www.usdoj.gov/atr/public/speeches/200868.htm (noting the DOJ's interest in coordinated effects theory; Timothy J. Muris, Chairman, FTC, Improving the Economic Foundations of Competition Policy (Jan. 15, 2003), available at http://www.ftc.gov/speeches/muris/improve_confoundatio.shtm (indicating the FTC's renewed interest in coordinated effects theory).

⁹³At the DOJ, for instance, See *United States v. Mittal Steel Company N.V.*, Case No. 1:06-CV-01360 (D.D.C. Aug. 1, 2006) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f217400/217491.htm> (the transaction would result in two firms—the merged firm and a third party—accounting for more than 80 percent of all sales of tin mill products in the eastern United States, thereby facilitating coordination, and the merger eliminated Acelor's Dofasco mill as a maverick); *United States v. CEMEX, S.A.B. de C.V.*, No. 1:07-CV-00640 (D.D.C. May 23, 2007) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f223500/223543.htm> (in one of the markets, the primary concern was coordinated); *United States v. Vulcan Materials Company*, Case No. 1:07-CV-02044 (D.D.C. Nov. 13, 2007) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f227600/227646.htm> (merger would reduce the number of firms in Western Atlanta from 4 to 3, making tacit or explicit coordination more likely); *United States v. SGL Carbon AG*, Civil Action No. 03-521 (W.D. Pa. Apr. 15, 2003) (verified complaint), available at <http://www.usdoj.gov/atr/cases/f200900/200935.htm>; *United States v. UPM-Kymmene Oyj*, Civil No. 03C2528 (N.D. Ill. July 25, 2003) (memorandum opinion and order), available at <http://www.usdoj.gov/atr/cases/f201100/201196.htm>; and *United States v. Waste Management, Inc. and Allied Waste Industries, Inc.*, Case No. 1:03CV01409 (D.D.C. July 22, 2003) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f201100/201187.htm>.

⁹⁴See, e.g., *United States v. UPM-Kymmene Oyj*, Civil No. 03C2528 (N.D. Ill. Apr. 15, 2003) (verified complaint), available at <http://www.usdoj.gov/atr/cases/f200900/200942.htm> (labelstock producers); *FTC v. Arch Coal, Inc.*, Civ. No. 1:04CV534 (D.D.C. Apr. 1, 2004) (complaint), available at <http://www.ftc.gov/os/2004/04/archcoalcmp.pdf> (coordinated interaction among coal producers in SPRB region).

⁹⁵See Barnett June 26, 2008 Remarks.

⁹⁶As reported by the agencies, from FY1996-2007, only 6.5 percent of second requests contained a vertical theory for potential harm.

⁹⁷See, e.g., *United States v. Monsanto Co.*, No. 1:07-cv-00992 (D.D.C. May 31, 2007) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f223600/223679.pdf> (divestiture of germplasm); In the Matter of Lockheed Martin Corporation, File No. 051 0165 (FTC Oct. 3, 2006) (agreement containing consent order), available at <http://www.ftc.gov/os/caselist/0510165/0510165agreement.pdf> (launch vehicles; no discrimination provisions; firewalls).

⁹⁸See, e.g., *United States v. Premdor Inc.*, Civil No. 1:01CV01696 (D.D.C. Aug. 3, 2001) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f9000/9017.htm>.

⁹⁹See, e.g., *United States v. Northrop Grumman Corporation and TRW Inc.*, Civil No. 1:02CV02432 (D.D.C. June 11, 2003) (final judgment), available at <http://www.usdoj.gov/atr/cases/f201000/201076.htm> (nondiscrimination provisions); FTC, Press Release, *FTC Orders Significant Divestitures in Clearing Valero's Acquisition of Kaneb Services and Pipe Line Partners* (June 15, 2005), available at <http://www.ftc.gov/opa/2005/06/valerokaneb.shtm> (The order requires Valero, the largest petroleum terminal operator and second-largest operator of liquid petroleum pipelines in the United States, to develop an information firewall and maintain open, non-discriminatory access to two retained Northern California terminals, in order to ensure access to ethanol terminaling in Northern California following its acquisition of Kaneb); FTC, Press Release, *FTC Challenges Vertical Agreement Between Fresenius and Daiichi Sankyo* (Sept. 15, 2008), available at <http://www.ftc.gov/opa/2008/09/fresenius.shtm> (prevents Fresenius from reporting an intra-company transfer price to CMS for Venofer that is higher than the level set forth in the order); FTC, Press Release, *FTC Intervenes in Hexion's Proposed Acquisition of Huntsman Corp.* (Oct. 2, 2008), available at <http://www.ftc.gov/opa/2008/10/hexion.shtm>.

¹⁰⁰See, e.g., *United States v. Monsanto Co.*, No. 1:07-cv-00992 (D.D.C. May 31, 2007) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f223600/223679.pdf> (divestiture of germplasm) ("Monsanto"); *United States v. Premdor Inc.*, Civil No. 1:01CV01696 (D.D.C. Apr. 8, 2002) (final judgment), available at <http://www.usdoj.gov/atr/cases/f8900/8909.htm> (divestiture of molded doorskin production). Also note that in 2004, in the Cytec/Digene transaction the parties abandoned a transaction with both horizontal and vertical concerns raised by the FTC. See FTC, Press Release, *Federal Trade Commission Seeks to Block Cytec Corporation's acquisition of Digene Corporation*, FTC File No. 021-0098 (June 24, 2002), available at http://www.ftc.gov/opa/2002/06/cytec_digene.htm.

¹⁰¹See *In re TC Group, L.L.C.*, File No. 061-0197 (FTC Jan. 25, 2007) (decision and order), available at <http://www.ftc.gov/os/caselist/0610197/decisionorder.pdf> (relinquish daily involvement, convert interest into passive investment, firewall).

¹⁰²See *United States v. AT&T Inc. and Dobson Communications Corporation*, Case 1:07-CV-01952 (D.D.C. Oct. 30, 2007) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f227300/227309.htm>; *United States v. CommScope, Inc.*

and Andrew Corporation, Case 1:07-cv-02200 (D.D.C. Dec. 6, 2007) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f228300/228364.htm> (30 percent interest in Andes); United States v. Bain Capital, Thomas H. Lee Partners, L.P. and Clear Channel Communications, Inc., Case 1:08-cv-00245 (D.D.C. Feb. 13, 2008), available at <http://www.usdoj.gov/atr/cases/f230100/230166.htm> (divestiture in markets overlapping with Cumulus and Univision); United States v. Univision Comms. Inc. and Hispanic Broadcasting Corp., No. 1:03-CV-01952 (D.D.C. May 7, 2003) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f201000/201006.htm>.

¹⁰³From FY 1996-2007, potential competition and buyer power theories were included as a basis for a second request in 2.6 percent and 2.3 percent of second requests respectively. Many of the pharmaceutical transactions concerned the elimination of a potential competitor in the market as a result of the merger. For instance, in the last 100 days of the Bush Administration, the FTC asserted in its Inverness Medical Innovation challenge that “but for” the transaction, ACON would have developed new consumer protection tests; and in Ovation, that the acquisition of NeoProfen was to thwart the competitive threat that its imminent entry would have on the monopoly position of Indocin. See FTC, Press Release, Inverness Medical Innovation Settles FTC Charge That it Stifled Future Competition in U.S. Market for Consumer Pregnancy Tests (Dec. 23, 2008), available at <http://www.ftc.gov/opa/2008/12/inverness.shtm>; FTC, Press Release, FTC Sues Ovation Pharmaceuticals for Illegally Acquiring Drug Used to Treat Premature Babies with Life-Threatening Heart Condition (Dec. 16, 2008), available at <http://www.ftc.gov/opa/2008/12/ovation.shtm>. Outside the pharmaceuticals area, the FTC recently challenged on potential competition grounds the CCS/Newpark transaction and the DOJ challenged Microsemi’s consummated acquisition of Semicco on potential competition theories. See FTC, Press Release, FTC Moves to Block CCS’s Proposed Acquisition of Rival Newpark Environmental Services (Oct. 23, 2008), available at <http://www.ftc.gov/opa/2008/10/redsky.shtm>; DOJ, Press Release, Justice Department Files Antitrust Lawsuit Against Microsemi Corporation (Dec. 18, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/240549.htm. On October 20, 2008 the DOJ and ten states filed a preliminary injunction action to block the combination of the third and fourth largest beef packers, partially on the basis that the combination would leave feed lots in the market with only one major buyer of fed cattle. See United States v. JBS S.A., Case No. 08-CV-5992, (N.D.II. Dec. 20, 2008) (complaint) available at <http://www.usdoj.gov/atr/cases/f238300/238388.htm>.

¹⁰⁴See, e.g., United States v. Amsted Indus., Inc., No. 1:07-CV-00710, (D.D.C. Apr. 18, 2007) (final judgment), available at <http://www.usdoj.gov/atr/cases/f224900/224931.htm> (rights to “market specific intellectual assets” for casting patterns); United States v. Reuters (add cite) (license remedy); United States v. CommScope, Inc. and Andrew Corporation, Case 1:07-cv-02200 (D.D.C. Dec. 6, 2007) (competitive impact statement), available at <http://www.usdoj.gov/atr/cases/f228300/228364.htm> (required divestiture of underlying IP to third party subject to the license with Andes); In the Matter of Johnson & Johnson, Docket No. C-4154 (Dec. 27, 2005) (agreement containing consent order), available at <http://www.ftc.gov/os/caselist/0510050/051102agree0510050.pdf> (license to Abbott).

¹⁰⁵See, e.g., In re Chevron Corporation and Unocal Corporation, Docket No. C-4144 (FTC July 27, 2005) (decision and order), available at <http://www.ftc.gov/os/caselist/0510125/050802do0510125.pdf> (parties to cease from enforcing Unocal’s relevant patents, undertaking any new enforcement efforts to patents, collecting damages, royalties, or other payments, and to dismiss all pending infringement actions); In re Kyphon Inc., Docket No. C-4201 (FTC Dec. 7, 2007) (decision and order), available at <http://www.ftc.gov/os/caselist/0710101/071207decision.pdf>.

¹⁰⁶See generally Ilene Knable Gotts & Philip A. Proger, *Closed but Not Safe? FTC Challenges Consummated Transactions*, 5 M&A LAWYER 17 (May 2002) for an article discussing the law underlying such challenges.

¹⁰⁷See In re Evanston Northwestern Healthcare Corp., No. 9315 (FTC Aug. 6, 2007) (opinion), available at <http://www.ftc.gov/os/adipro/d9315/070806opinion.pdf>.

¹⁰⁸See Amiee E. DeFilippo, *Summary of APA Brown Bag Program on Implications for Merger Analysis from the Evanston Decision*, THE THRESHOLD (Fall 2007) at 38, 40.

¹⁰⁹See FTC, Press Release, Commission Rules That Evanston Northwestern Healthcare Corp.’s Acquisition of Highland Park Hospital Was Anticompetitive (Aug. 6, 2007), available at <http://www.ftc.gov/opa/2007/108/evanston.shtm>.

¹¹⁰See FTC, Press Release, FTC Sues Ovation Pharmaceuticals for Illegally Acquiring Drug Used to Treat Premature Babies with Life-Threatening Heart Condition (Dec. 16, 2008), available at <http://www.ftc.gov/opa/2008/12/ovation.shtm>.

¹¹¹See AAI Report at 167.

¹¹²See FTC v. Libbey, Inc. 2002-1 Trade Cas. (CCH) ¶ 73,650 (D.D.C. 2002) (largest producers of soda-line glassware to the U.S. food industry; court rejected that proffered fixes worked because of outsourcing arrangement).

¹¹³See FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 121 (D.D.C. 2004); FTC v. Equitable Res., Inc., No. 07-0490, 2007 U.S. Dist. LEXIS 35061 (W.D. Pa. May 14, 2007); FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1 (D.D.C. 2007); FTC v. Western Ref., Inc., No. 07-352, 2007 U.S. Dist. LEXIS 47606 (D.N.M. May 29, 2007)

¹¹⁴See In the Matter of Whole Foods Mkt, Inc, 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008).

¹¹⁵See FTC v. Equitable Res., Inc., No. 07-2499 (3d Cir. June 1, 2007) (order of the court of appeals), available at <http://www.ftc.gov/os/caselist/0610140/070601order.pdf>.

¹¹⁶See FTC, Press Release, FTC and Virginia Attorney General Seek to Block Inova Health System Foundation's Acquisition of Prince William Health System (May 9, 2008) ("Inova Press Release"), available at <http://www.ftc.gov/opa/2008/05/inova.shtm>.

¹¹⁷See Cecile Kohrs Lindell, *Hospitals Cancel Merger Plans*, THE DAILY DEAL (Jun. 6, 2008) ("Inova Article"), available at <http://www.thedeal.com/servlet/ContentServer?pagename=TheDeal/TDDArticle/TDStandardArticle&bn=NULL&c=TDDArticle&cid=1212755504285>.

¹¹⁸See FTC, Press Release, FTC Moves to Block CCS's Proposed Acquisition of Rival Newpark Environmental Services (Oct. 23, 2008), available at <http://www.ftc.gov/opa/2008/10/redsky.shtm>

¹¹⁹See FTC, Press Release, FTC Launches Suit to Block Merger of CCC and Mitchell (Nov. 25, 2008), available at <http://www.ftc.gov/opa/2008/11/cccmitchell.shtm>.

¹²⁰See FTC, Press Release, FTC Sues to Block Oldcastle Architectural's Proposed Acquisition of the Pavestone Companies (Jan. 14, 2009), available at <http://www.ftc.gov/opa/2009/01/crh.shtm>.

¹²¹See *United States v. UPM-Kymmene Oyj*, Civil No. 03C2528 (N.D. Ill. July 25, 2003) (memorandum opinion and order), available at <http://www.usdoj.gov/atr/cases/f201100/201196.htm> (merger between labelstock producers blocked on coordinated effects grounds).

¹²²See *United States v. SunGard Data Systems, Inc.*, 172 F. Supp. 2d 172 (D.D.C. 2001); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

¹²³See *United States v. Darby Gazette Co.*, No. 2: 07-0329 (S.D. W. Va. filed May 22, 2007).

¹²⁴See DOJ, Press Release, Justice Department Files Lawsuit to Stop JBS S.A. from Acquiring National Beef Packing Co. (Oct. 20, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/238382.htm.

¹²⁵See DOJ, Press Release, Justice Department Files Antitrust Lawsuit Against Microsemi Corporation (Dec. 18, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/240549.htm.

¹²⁶See, e.g., *United States v. SunGard Data Sys.*, *supra* (DOJ failed to establish that a substantial number of customers lacked alternative solutions).

¹²⁷See generally Ken Heyer, *Predicting the Competitive Effects of Mergers by Listening to Customers*, 74 ANTITR. L. J. 87 (2007); Ilene Knable Gotts & Daniel Hemli, *Just the Facts: the Role of Customer and Economic Evidence in M&A Analysis*, 13 GEO. MASON L. REV. 1217 (2006); See, e.g., *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 121 (D.D.C. 2004) ("customers do not, of course, have the expertise to state what will happen in the market"); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1131 (N.D. Cal. 2004) ("the most persuasive testimony . . . is not what they say in court, but what they do in the market").

¹²⁸See AAI Report at 168-69.

¹²⁹See *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007), *revs'd* 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008)

¹³⁰In contrast to *FTC v. Staples*, 970 F. Supp. 1066 (D.D.C. 1997), where the court found the pricing data and company documents consistent in establishing a separate market and unilateral effect from the merger, in *Whole Foods* the court used the company's documents to support the economic data (particularly the defendant's critical loss analysis) to show why the market was not sustainable.

¹³¹In *FTC v. Foster*, 2007-1 Trade Cases ¶ 75,735, 2007 WL 1793441 (D.N.M. 2007), the FTC's economic expert unsuccessfully relied on a preliminary draft of an incremental products marketing document created in 2005 to argue that increasing Giant's production would result in lower prices in Albuquerque. The court pointed out that the company would not have relied upon the document and a later presentation to the Board did not use the data or assumptions of the draft document. The court buttressed its conclusions with the testimony of the defendant's economic expert.

¹³²See, e.g., *Oracle, supra*; *FTC v. Foster, supra*.

¹³³See, e.g., Cary Article at 3.

¹³⁴See 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008) at 5.

¹³⁵*Id.*

¹³⁶See 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008) at 20.

¹³⁷See 128 S. Ct. 2007, 2219 (2008), as cited at 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008) at 28, 29.

¹³⁸See 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008) at 29.

¹³⁹See Cecile Kohrs Lindell, *Hospital feud in two courtrooms*, DAILY DEAL (May 27, 2008), available at <http://www.thedeal.com/servlet/ContentServer?pagename=TheDeal/TDDArticle/TDStandardArticle&bn=NULL&c=TDDArticle&cid=1211840628371>.

¹⁴⁰See *Inova Article*.

¹⁴¹As discussed in Comments filed by the American Bar Association Section of Antitrust Law in response to the Commission's notice of proposed revisions to the Part III rules, the proposed changes will not sufficiently alter the timing of a final decision to permit most transactions to remain alive and all time limitations imposed seem to be, at least for the initial phases, at the expense of defendants—not the FTC. See ABA, Comment of the ABA Section of Antitrust Law in Response to the Federal Trade Commission's Request for Public Comment Regarding Parts 3 and 4 Rules of Practice Rulemaking—P072104 (Nov. 6, 2008), available at <http://www.abanet.org/antitrust/at-comments/2008/11-08/comments-3and4.pdf>. The FTC proceeded despite concerns raised by the

bar with issuing final interim rules on December 23, 2008. Press Release, FTC Issues Final Rules Amending Parts 3 and 4 of its Rules of Practice; Rules are Designed to Expedite and Streamline the Entire Part 3 Proceeding (Dec. 23, 2008), available at <http://www.ftc.gov/opa/2008/12/part3.shtm>. Interestingly, a review of the FTC's records in administrative hearings over the last twenty-five years disclosed that in almost every single contested Sherman Act case with disputed facts, the FTC ruled in favor of complaint counsel, even where the Administrative Law Judge had ruled for the parties. See A. Douglas Melamed, Comments Submitted to the Federal Trade Commission, Workshop Concerning Section 5 of the FTC Act (Oct. 17, 2008). In many of those cases, the courts of appeals or the Supreme Court subsequently reversed the FTC. Although these cases did not involve merger challenges, it nevertheless suggests that there may be a bias against defendants and, unlike a Sherman Act case, it is unlikely that a merger will remain intact long enough to prevail in a Court of Appeals.

¹⁴²See Dennis Berman, *The Game: Handicapping Deal Hype and Hubris*, WALL ST. J. (January 16, 2006) at c1.

¹⁴³See Stephen Labaton, *Sirius Chief Talks of Ways to Get MX Deal Approved*, N.Y. TIMES (March 1, 2007), available at http://www.nytimes.com/2007/03/01/technology/01radio.html?_r=1&scp=1&sq=Sirius%20Chief%20Talks%20of%20Ways%20&st=cse&oref=slogin.

¹⁴⁴See Baker/Shapiro Study.

¹⁴⁵See Baker/Shapiro Antitrust Article at 30.

¹⁴⁶*Id.*

¹⁴⁷*Id.* at 30-31.

¹⁴⁸See Muris Article.

¹⁴⁹See Kathryn M. Fenton, A. Douglas Melamed, Mario Monti, Timothy J. Muris, R. Hewitt Pate and Robert Pitofsky, *Round Table Discussion: Advice for the New Administration*, 22 ANTITRUST 8, 10-1 (Summer 2008).

¹⁵⁰The FY2004-2005 statistics truly are outliers and have the potential of distorting the results. In a recent article, Deborah Feinstein endeavors to attribute the subsequent uptick in FY2007 to a reaction by the business community in trying increasingly problematic transactions in response to a perception of lax enforcement environment at the agencies, subsequently resulting in a higher percentage of transactions being challenged by the agencies. See Deborah L. Feinstein, *Recent Trends in U.S. Merger Enforcement: Down But Not Out*, 21 ANTITRUST 74 (Summer 2007) ("Feinstein Article"). Feinstein concludes that, "if true, the observed decline in Bush era merger challenges tends to understate the degree to which enforcement postures have become more conservative." See Feinstein Article at 75. We respectfully submit that such prognoses overstate the importance of competition enforcement in the decision-making of businesses regarding whether to proceed with transactions in any but the close cases—and there are simply not that many close transactions to explain the fluctuations, nor the continued higher level of enforcement. Another explanation could be the uptick in the number of transactions in FY2004-2006 taxed agency resources.

¹⁵¹The results for the complete Bush Administration fiscal years, if anything, understate the enforcement activities, particularly for the latter years, since they do not include enforcement activity from the beginning of FY 2009: for the FTC 3 consents, 3 litigation challenges, and one abandoned transaction (as well as a consent and litigation in two consummated mergers); and at the DOJ, 5 consents and one court challenge (as well as one challenge of a consummated merger).

¹⁵²John Harkrider similarly analyzes the statistics for 1996 to 2006 and finds that the ratio of clearances to challenges and second requests to clearances have fallen in the latter period, perhaps reflecting greater efficiency in the review process by only issuing second requests when the agency is likely to challenge the transaction and sparing other transactions the significant direct and indirect costs of a second request. Harkrider further determines that the agencies challenged a higher percentage of second requests between 2001 and 2006 than they did from 1996 to 2000, which he attributes entirely to the FTC, which raised its ratio from 70 percent to 82 percent during the two time periods, respectively. See John D. Harkrider, *Antitrust Enforcement During the Bush Administration—An Economic Estimation*, 22 ANTITRUST 43, 45 (Summer 2008) ("Harkrider Article"). Harkrider also endeavors to present a probit econometric estimation looking at 212 transactions during this time frame. Harkrider finds that the FTC statistics between the two administrations remain the same, but the DOJ enforcement statistics were significantly lower in the Bush Administration. Harkrider has two noteworthy caveats for his results: (1) the model only examines merger challenges once a second request has been issued, leaving open the possibility that the agencies may now be using a different standard for the issuance of the second request; (2) the scope of remedies may be different. Harkrider also seems to find a difference based on what the risk allocation provisions of the underlying purchase agreement might provide.

¹⁵³In *Maytag/Whirlpool*, despite combined market shares for residential washing machines of over 70 percent by one contested measure, the DOJ permitted the transaction to proceed on the basis of strong rivalry, fringe growth from established domestic brands and imports, buyer power, and efficiencies. Also, recognition of changed market conditions that mitigated the potential for the exercise of market power (a/k/a the General Dynamics defense) appears to have featured prominently in agency decisions to clear several, other high-profile transactions without requiring any relief (albeit typically after the agency conducted a protracted investigation).

¹⁵⁴For a discussion of the Monsanto/Delta and Pine Land merger See Ilene Knable Gotts, *U.S. Agencies Flex Muscle in FY 2007 Merger Review But FTC Unanimously Loses in Court*, Issue 1, 2008 ANTITRUST REPORT 2, 37-39 (2008).

¹⁵⁵See *infra* Section I.B.

¹⁵⁶See *United States v. Von's Grocery Co.*, 384 U.S. at 301.

¹⁵⁷See, e.g., Inova Article; Press Release, U.S. Dep't of Justice, DOJ and Several States will Sue to Stop United Airlines from Acquiring US Airways (July 27, 2001), available at http://www.usdoj.atr/public/press_releases/2001/8701.htm; *United States v. General Dynamics and Newport News*, 01-CV-02200 (D.D.C. Oct 23, 2001) (complaint), available at <http://www.usdoj.gov/atr/cases/f9300/9373.htm>; *United States v. Echostar, Hughes Electronic, GM, and Direct TV*, 1:02-CV-02138 (Oct. 31, 2002) (complaint), available at <http://www.usdoj.gov/atr/cases/f200400/200409.htm>.

¹⁵⁸This is particularly the case at the DOJ where the agency accepts "fix-it-firsts" and pocket decrees that are never "counted" once the regulatory agency acts.

¹⁵⁹First Data, *supra*; *United States v. Dairy Farmers of America, Inc.*, *supra*.

¹⁶⁰See, e.g., *California v. American Stores Co.*, 495, U.S. 271 (1990); *New York v. Kraft General Foods*, 926 F.Supp. 321 (S.D.N.Y. 1995); *California v. Sutter Health Sys.*, 84 F.Supp.2d 1957 (N.D.Cal 2000).

¹⁶¹NAAG, *Horizontal Merger Guidelines*(1993), reprinted in 4 trade Reg. Rep. (CCH) ¶ 13,406.

¹⁶²See *Wal-Mart Stores Inc. v. Rodriguez*, Civ. No. 02-2778PG, 2002 WL 31931657 (D. P.R Dec. 26, 2002) (Puerto Rico Attorney General unsuccessfully tried to have court enjoin merger); *State of California v. Marquee Holdings, Inc. and LCE Holdings Inc., Compliant for Equitable Relief for Violation of Clayton Act* (Dec. 22, 2005), available at http://ag.ca.gov/newsalters/cms05/05-109_0a.pdf (California required divestiture of two San Francisco movie theatres in the AMC/Loews merger); *District of Columbia v. Marquee Holdings Inc.*, Complaint (Dec. 22, 2005), available at <http://occ.dc.gov/occ/frames.asp?doc+occ/lib/occ/amcloewscomplaint.pdf> (DC required AMC/Loew's to sell two theaters); Five states—California, Massachusetts, Maryland, Pennsylvania, and New York—disagreed with the FTC in the Federated/May transaction and required Federated to sell 26 California, 7 Massachusetts, 4 Maryland, 3 New York, and 7 Pennsylvania stores, with priority given to certain specified potential buyers (which are each traditional department store competitors). See PA Attn'y Gen., Press Release, AG Corbett resolves antitrust concerns following merger of Federated Department Stores and the May Company (Aug. 30, 2005), available at <http://www.attorneygeneral.gov/press/release.cfm?p=093757EC-AFC3-E88-91754088B02FBC02>; (in 2 locations in Pennsylvania, the companies may sell the properties to buyers for any purpose); N.Y. Att'y Gen., Press Release, Department Store Chain to Divest Three NY Stores as Part of Acquisition (Aug. 30, 2005), available at http://www.oag.state.ny.us/press/2005/aug/aug30b_05.html; FTC, Press Release, FTC Challenges Rite Aid's Proposed \$3.5 Billion Acquisition of Brooks and Eckerd Pharmacies from Canada's Jean Coutu Group, Inc. (June 4, 2007), available at <http://www.ftc.gov/opa/2007/06/riteaid.shtm> (3 more stores divested to satisfy state attorneys general concerns); Press Release, Commonwealth of Mass. Office of the Attorney Gen., Attorney General Martha Coakley and Ten Other States Reach Settlement in School Bus Merger Case (Sept. 26, 2007), available at http://www.mass.gov/?pageID=pressreleases&agId=Cago&prModName=cagopressrelease&prFile=2007_09_26_bus_settlement.xml (Massachusetts Attorney General required First Group/Laidlow to sell nine school bus transportation contracts in areas of Massachusetts to another school bus operator; and All American Patriots, New Mexico Attorney General King Joins 12 State Effort to Protect Farmers (Aug. 30, 2007) available at http://www.allamericanpatriots.com/48730641_new_mexico_new_mexico_attorney_general_king_joins_12_state_effort_protect_farmers (13 State attorneys called for the court to reject the proposed consent decree in the Monsanto/Delta and Pine Land transaction).

¹⁶³See Baker/Shapiro Antitrust Article at 31.

¹⁶⁴Jonathan B. Baker, *Turning on Itself, How Dueling Agencies in the Bush Administration Made Mincemeat of Antitrust Regulation Policy*, THE NEW REPUBLIC (Sept. 15, 2008).

¹⁶⁵See Harkrider Article at 48.

¹⁶⁶See On the Record: Deborah Platt Majoras, Chairwoman, FTC, SFGate.com (July 15, 2007), available at <http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2007/07/15/BUGC2QVKBO1.DTL&type=printable>.

¹⁶⁷See Cecile Kohrs Lindell, *McData forces FTC Juggling*, THE DAILY DEAL (January 11, 2007), available at <http://www.thedeal.com/servlet/ContentServer?pagename=TheDeal/TDDArticle/TDStandardArticle&bn=NULL&c=TDDArticle&cid=1168374848220>.

¹⁶⁸See ABA, ABA Antitrust Fall Forum: random notes, 731 FTC: Watch 4 (Nov. 24, 2008).

¹⁶⁹See Meyer Speech.

¹⁷⁰See Kathryn M. Fenton, Christopher B. Hockett, Thomas O. Barnett, Robert L. Hubbard, Neelie Kroes and Deborah Platt Majoras, Roundtable Conference with Enforcement Officials, theantitrustsource.com (April 2008), available at <http://www.abanet.org/antitrust/at-source/08/04/Apr08-EnforceRT4=25f.pdf>, at 5.

¹⁷¹See Barnett June 26, 2008 Remarks.

¹⁷²The Assistant Attorney General reports to the Attorney General, but intervention by the Attorney General, while not unprecedented, is very rare.

¹⁷³See DOJ, Press Release, Justice Department Requires Restructuring of Acquisition by Aggregate Industries plc of Wakefield Materials Co. (Sept. 6, 2002), available at http://www.usdoj.gov/atr/public/press_release/2002/200194.htm; DOJ, Press Release, Justice Department Requires Suiza Foods and Dean Foods to Divest 11 Dairy Processing Plants (Dec. 18, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/9721.htm; DOJ, Press Release, Justice Department Requires SunTrust Bank and

Huntington National Bank to Make Divestitures in Florida (Dec. 3, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/9645.htm; and DOJ, Press Release, Justice Department Requires Wells Fargo and Company to Make Divestitures in Two States (Nov. 29, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/9623.htm. In addition, on February 6, 2002, American General Media – Rocky Mountain and Salisbury Broadcasting were permitted to acquire two radio stations in Colorado after agreeing to divest stations in Aspen and Vail, Colorado and to terminate a joint sales agreement.

¹⁷⁴See DOJ, Press Release, Justice Department Requires Divestiture in Mittal Steel's Acquisition of Arcelor (Aug. 1, 2006), available at http://www.usdoj.gov/opa/pr/2006/August/06_at_483.html.

¹⁷⁵See DOJ, Press Release, Justice Department Requires Sardines Divestiture in Connors Bros. Acquisition of Bumble Bee (Aug. 31, 2004), available at http://www.usdoj.gov/atr/public/press_releases/2004/205267.htm.

¹⁷⁶See Frannie Wellings, Free Press successfully petitions FCC over Raycom ownership, Free Press (Jan. 18, 2006), available at <http://freepress.net/fcc/update.php?id=115/>.

¹⁷⁷See Media General Inc., Press Release, Media General Completes Purchase of Four NBC Television Stations (June 26, 2006), available at <http://www.sec.gov/Archives/edgar/data/216539/000119312506136662/dex991.htm>.

¹⁷⁸But see Monsanto.

¹⁷⁹See DOJ, Press Release, Justice Department Announces Agreement to Modify SBC/BellSouth Consent Decree (Aug. 11, 2004), available at http://www.usdoj.gov/opa/pr/2004/August/04_at_555.htm.

¹⁸⁰The one noted exception was when the FTC entered into hold separate order on June 26, 2005 to permit Hoechst AG's acquisition of Marion Merrell Dow pending the conclusion of the FTC investigation. See Marion Merrell Dow Inc. Form 8-K, filed on June 28, 1995, available at <http://www.secinfo.com/d1sTx.a8.htm>.

¹⁸¹By comparison, compare the results for grocery and petroleum transaction volume in Appendix D. Deal volume in these two sectors (which historically accounts for about 55 percent of the markets challenged by the FTC) dropped just about 10 percent between these two periods, due to a drop in grocery transactions, with petroleum deal volume remaining the same. The third area in which the FTC tends to be active is chemicals, which also remained about the same in volume during these two periods. A fourth area—Pharma—actually increased almost 20 percent in deal volume during the second period.

¹⁸²See Meyer Speech.

¹⁸³For a general discussion on the transformation of the telecommunications industry See Ilene Knable Gotts, *Telecommunications Without Borders? The Impact of US Pre-Merger Regimes*, COMPETITION L. INT'L (Oct. 2006); Ilene Knable Gotts, *Back to the Future? Will Telecommunications and Entertainment Service Providers Be Permitted to Converge Globally?*, 7 BUS. L. INT'L 308 (Sept. 2006); Ilene Knable Gotts and Damian G. Didden, *The Goldilocks Standard: Getting the Antitrust Review Standard "Just Right" for the Telecommunications Industry*, ANTITRUST REPORT 3 (Summer 2004).

¹⁸⁴See Feinstein Article at 80.

¹⁸⁵See 15 U.S.C. § 16(b) (2000).

¹⁸⁶See 15 U.S.C. § 16(e)(2) (Supp. 2005).

¹⁸⁷See *United States v. SBC Commc'ns, Inc.*, No. 05-2102 (D.D.C. Oct. 27, 2006) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f212400/212424.pdf>; *United States v. Verizon Commc'ns, Inc.*, No. 05-2103 (D.D.C. Oct. 27, 2006) (proposed final judgment), available at <http://www.usdoj.gov/atr/cases/f212400/212433.pdf>. On July 25, 2006, Judge Sullivan refused to enter the proposed consents but instead required resubmission of more information. On March 29, 2007—17 months after the DOJ filed complaints in both of these matters—Judge Sullivan granted the DOJ's motion for entry of the final judgments in both cases, finding that entry is in the public interest. The court determined that under the Tunney Act it was not the court's task to decide whether: (1) the mergers under review as a whole run afoul of the antitrust laws; (2) they are altogether in the public interest; or (3) they should be approved by other branches of the federal government. Rather, the court's role is limited to whether the divestitures agreed upon by the merging parties and the DOJ are "in the public interest." For a more extensive discussion of the Tunney Act process and these matters, See Ilene Knable Gotts, *U.S. Agencies Flex Muscle in FY2007 Merger Review BA FTC Unanimously Loses in Court*, Issue 1, 2008 ANTITRUST REPORT 2, 9-12 (2008).

¹⁸⁸*Id.* at 15.

¹⁸⁹*Id.*

¹⁹⁰See J. Thomas Rosch, Comm'r, FTC, A Peek Inside: One Commissioner's Perspective on the Commissioner's Roles as Prosecutor and Judge, Remarks Presented at the NERA 2008 Antitrust & Trade Regulation Seminar (July 3, 2008), available at <http://ftc.gov/speeches/rosch/080703nera.pdf> at 12.

¹⁹¹See AMC Report at 138, 139.

¹⁹²The ABA 2008 Transition Report and AMC recommended changes to the clearance process to eliminate unnecessary delay and uncertainty. See ABA Transition Report at 6 and AMC Report (beginning at 130).

¹⁹³The AMC Report (recommendation #11d) at 51; ABA Transition Report; and AAI Report at 171 (all recommend as well that the Merger Guidelines be updated to incorporate modern economic learning, particularly concerning vertical and conglomerate mergers.)

¹⁹⁴See Dennis W. Carlton, *The Need to Measure the Effect of Merger Policy and How to Do It*, 22 ANTITRUST 39, 42 (Summer 2008) (“Carlton Article”).

¹⁹⁵William E. Kovacic, Chairman, Federal Trade Commission, *The United States and the Future Development of Global Competition Policy*, Georgetown Global Antitrust Enforcement Symposium, Washington, D.C. (Sept. 23, 2008) available at <http://www.ftc.gov/speeches/kovacic/080923compolicygwkovacic.pdf>.

¹⁹⁶The AAI Report at 172 also urges the agencies to conduct more retrospective studies of merger enforcement, particularly to analyze the effects of mergers in close cases that were not challenged or mergers that the agencies challenged but the courts declined to enjoin.

¹⁹⁷Accord R. Hewitt Pate, *Current Issues in International Antitrust Enforcement*, 2004 FORDHAM CORP. L. INST. 17, 21.

¹⁹⁸See Sally Southey, Assistant Commissioner of Competition, Canadian Competition Bureau, *Canadian Perspectives on International Cooperation*, Address before the 2003 International Conference on Competition Policies/Laws, Taiwan.

¹⁹⁹See International Competition Policy Advisory Committee to the Attorney General and Assistant Attorney General for Antitrust, *Final Report* (Feb. 2000) at 76, 78.

²⁰⁰See United States submission to the February 15, 2005 OECD Roundtable Discussion on Cross-Border Remedies in Merger Review.

²⁰¹Accord Kovacic Georgetown Speech.

²⁰²See ABA Transition Report at 13; AAI Report at 172.

²⁰³Throughout this article, data are reported by FY, commencing October 1 and ending September 30 of each year.

²⁰⁴Adjusted to include only those filings in which a party could have received a second request.

^{ccv}These data do not include transactions reported in FY 2008 but for which the agencies took enforcement action or caused the parties to abandon the transaction during the first 100 days of FY 2009 (i.e., pre-Inauguration).