

**Summary of Antitrust Modernization Commission Hearing  
Economist's Roundtable on Merger Enforcement**

**January 19, 2006**

The Antitrust Modernization Commission (“AMC” or “Commission”) held a hearing on January 19, 2006 to obtain testimony from a roundtable of economists regarding the level of merger enforcement. The panel generally agreed that the current level of merger enforcement was appropriate, that the Federal Merger Guidelines had largely been successful, and that the framework was sound. The panel further agreed that the question of whether it would be profitable to raise prices by 5% without substitution was an appropriate tool for defining markets which had stood the test of time, but that the merger guidelines had only been partially successful in replacing argument with hard quantitative data. There was also agreement that the distinction between unilateral and coordinated effects was a useful one, and that each required a different methodology. The panel agreed that the available data on vertical mergers made an assessment of enforcement policy too hard to even research. There was, however, some disagreement between panel members as to how useful the Guidelines methodology was in dealing with Section 2 cases.

**I. Summary of Written Testimony:**

A. **Prof. Daniel Rubinfeld**, University of California at Berkeley, School of Law

Professor Rubinfeld opened his written statement by noting that in his experience as an enforcer, consultant, and expert witness, he found the Guidelines to be extremely helpful. However, he felt that there were occasions where the Guidelines should be given less weight. He notes, for example, that one such occasion was the use of market definition in unilateral effects cases. A second was the reliance on current measures of concentration where mergers involved dynamic markets. Professor Rubinfeld confined the remainder of his remarks to addressing specific questions.

*Should merger policy be more or less aggressive?* Professor Rubinfeld notes that it is difficult to answer this question, but that he rejects the argument that one can demonstrate over-enforcement by the number of agency losses. He points out that if the agencies only brought the cases they knew they could win, the risk of Type 2 errors would be too high, as detrimental cases lying on the margin would not be pursued.

*Can one identify and estimate market demand?* The Professor notes that identifying and estimating relevant demand elasticities can be a difficult exercise, but he rejects the assertion that it can only be accomplished in industries that generate substantial micro-level data. He points out that there are numerous ways to identify demand, some of which do not require extensive data.

*Is the Hypothetical Monopolist –SSNIP test – useful?* The Professor stated that the he has found the test to be useful, but there are situations where the test is in his view, not workable, such as where the market is highly differentiated or because of data limitations. He notes that while there is significant literature in this area, the Guidelines are largely silent. Nevertheless, he states that even when full implementation is not possible, the Guidelines are useful in that they require evaluating surveys or documentary evidence.

*Is the Guidelines Market Definition Useful in Section 2 Cases?* Professor Rubinfeld notes that the status of the market differs in the Section 2 situation, as the industry is allegedly already coordinating prices at a monopoly level. Thus, because of the difficulty in establishing the competitive level with specificity, full use of the Guidelines is precluded. Nevertheless, he feels the framework of the Guidelines is helpful, as it focuses the analysis of the shape of the demand curve. He also notes that an examination of barriers to entry is essential to evaluate market power, and believes the Guidelines foster sound policy, though more work needs to be done distinguishing sunk costs, the basis for distinguishing committed from uncommitted entry.

*Do profit margins provide useful indicators of antitrust market power?* Professor Rubinfeld notes that the use of profit margins can be valuable, but must be used with care. However, he states that the price-cost margin does not, standing alone offer a useful measure of market power for antitrust purposes, as many firms can have relatively high price-cost margins yet little market power. He points out that in his opinion, a price-average cost test would be more appropriate for measuring market power in high fixed cost industries.

*Are measures of concentration, such as HHI's, useful in merger analyses?* The Professor notes that in his opinion the Guidelines place the appropriate weight on measures of concentration. He rejects those criticisms that the cutoffs do not accurately predict when a merger might be challenged, pointing out that the purpose of the Guidelines is to give guidance, not to be predictive. He sees no reason to change the Guidelines at this point.

*Should concentration measures be used in dynamic industries?* Professor Rubinfeld points out that it is important to ask whether a merger will cause the new entity to have durable, lasting market power, but that in dynamic, innovative industries where entry is likely, current and historical market shares are likely to provide a poor indication of future competitive effects. The Professor points to the recent acquisition of MCI by Verizon as an example.

*Should competition be treated differently in network industries?* The Professor answers this question “yes,” pointing out that in network industries, a dominant firm can generate substantial benefits that flow from control over the network, yet these benefits may be short lived absent competition.

*How should buyer power be treated?* Professor Rubinfeld observes that in merger analysis buyer power is paid little or no attention. This is unfortunate, as the presence of buyer power could be a countervailing force against the market power of the merged seller.

*Is market definition a necessary prerequisite for a unilateral effects analysis?* Professor Rubinfeld states that as a matter of economics, he believes the answer to this question is “no.” He notes that the Guidelines appropriately distinguish between coordinated and unilateral effects and that a simulation for unilateral effects is subject to problems of choosing the appropriate products to include in the relevant market.

*If the relevant market contains a large number of products, can one necessarily conclude that there are likely to be no significant price effects?* Professor Rubinfeld also answers this question “no,” noting that even if the set of merger products in a market is large, the merger of two closely related products can generate substantial unilateral effects.

*Is merger simulation a reliable methodology?* Professor Rubinfeld appears to feel that it is, or at least can be if properly constructed. He points out that in recent years, the techniques have emerged as a promising framework for unilateral effects analysis, and that there is growing use of merger simulation by enforcement agencies around the world. He does note, however, that merger simulation is not a panacea for all of the economic issues that arise in difficult transactions and that it should not be the sole basis on which a merger should be evaluated.

B. **Prof. Lawrence J. White**, New York University, Leonard N. Stern School of Business

Professor White focuses on whether current measures of market power are effective in circumstances where the issue is “unilateral effects.” He points out that under the 1982 Guidelines, the theory of harm from a merger was that of “coordinated effects.” Coordinated effects are the enhanced ability of sellers of either homogeneous or differentiated products to generally and jointly sell at higher prices. It was not until the 1992 revisions that the Guidelines explicitly recognized a second theory of harm, that of “unilateral effects, whereby the merger of two sellers of differentiated products can yield a post-merger increase in the merged firm’s prices.

Professor White observes that the Guidelines “hypothetical monopolist,” or “SSNIP” test is a natural approach for the “coordinated effects” perspective, as it sought the smallest group of products over which the post-merger sellers might be able to exercise market power. He points out, however, that the “unilateral effects” theory of harm does not require a market specification, but rather requires information about the demand characteristics of the merging firms’ customers. Professor White concludes that while the current Guidelines remain a useful guide for structuring the inquiry where the theory of harm is “coordinated effects,” they are far less useful in dealing with “unilateral effects.” He recommends that this dichotomy be clearly acknowledged by the agencies,

and that when the Guidelines are revised, if not sooner, a alternative set of procedures for inquiry and enforcement be developed for addressing “unilateral effects.”

Professor White also notes that while empirical studies strongly support the conclusion that concentration matters, they do little to indicate what level of concentration should trigger antitrust enforcement. He suggests two lines of inquiry. First, he proposes post-merger pricing studies be conducted in the markets where mergers that were “close,” as evidenced by second requests, and suggests that the results would be suggestive of whether enforcement was too strict or too lenient. Second, he suggests a “meta analysis” of all of the existent price concentration studies.

Finally, Professor White observes that while the Guidelines work well for coordinated effects merger inquiries, he feels that they are inappropriate for most monopolization inquiries. He suggests that the agencies acknowledge this problem and focus attention on developing an appropriate remedy.

C. **Prof. Peter C. Reiss**, Stanford University, Graduate School of Business

Professor Reiss focuses his comments on problems associated with the analysis of likelihood of entry. He notes that Section 3 of the 1997 Guidelines state that entry analysis can obviate concerns about mergers in highly concentrated markets “if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above pre-merger levels.” In other words, parties can alleviate anticompetitive concerns by showing that entry would be likely, timely and significant in response to higher prices. Professor Reiss notes, however, that while there is agreement as to principles, there is little agreement as to how to determine whether entry will be likely.

Professor Reiss points to developments in game-theoretic models of entry and market concentration, most notably: concepts and theoretical assumptions dealing with the extent to which entrants’ fixed costs are sunk; the extent of future market uncertainties; entrants’ expectations about incumbent behavior; how quickly decisions can be implemented; and the costliness of changing decisions. Particularly important among these when considering the “uncommitted entrant” is developments in how economists now see sunk costs. While most economists tend to think of sunk costs as non-recoverable fixed costs, they have now noted that in uncertain environments there can be sunk opportunity costs, that is, implicit costs incurred when a firm forecloses future options. This development in thinking is important, because while economists believe that a rational firm will ignore sunk costs in their decision making once the costs are incurred, potential but “uncommitted” entrants who have yet to incur these costs will consider the possible future loss of sunk costs when deciding whether to enter. Thus, the level of demand necessary to keep a participant in the market is less than that necessary to attract a new entrant. Additionally, incumbents may be able to use the potential entrant’s different attitude toward sunk costs to strategically deter entry.

Professor Reiss observes that while Section 3 of the 1992 Guidelines discusses the concept of sunk costs, and that subsection 1.32 specifically directs that the agencies identify “uncommitted entrants,” it is unclear how sunk opportunity costs are to be recognized in practice. He notes that economic theory suggests that the magnitude of sunk opportunity costs depends on the volatilities of potential entrants’ uncertainties, the correlation of these uncertainties, and how the uncertainties impact entrants’ profits. He concludes that while economists are making progress trying to develop indirect estimates of sunk costs, these methods will not likely become part of Agency practice or courtroom assessments any time soon.

Professor Reiss points to the fact that Section 3 of the Guidelines focuses largely on “committed” entrants, and that while subsection 3.2 spells out the steps the Agency should take when considering whether entry is “likely,” it provides relatively little guidance on how these quantities should be estimated. He states that the quantitative demands of a complete Section 3 analysis makes him skeptical that such quantitative analysis will be undertaken. Furthermore, even if it were, he doubts a court would have much patience with wading through the likely econometric complexity. More likely, the complexity of a complete analysis may lead the Agencies and the court to base their decisions only on documents and factual testimony. Professor Reiss points to *FTC v. Staples* as an example.

D. **Prof. Steven N. Kaplan**, University of Chicago Graduate School of Business

Professor Kaplan addresses the findings of studies by financial economists in evaluating merger success. He concludes that while the literature does not address antitrust concerns directly, the financial economics literature take as a whole does not support a call for a more aggressive antitrust policy. Professor Kaplan surveys a number of different types of methodologies, including stock market based studies, accounting based studies, and productivity based studies.

Stock market based announced return studies measure the economic impact of an acquisition by measuring the combined change in value of the merging firms at the time of the announcement. The change in the value at the acquisition announcement is the sum of (1) the market’s estimate of the synergies in the acquisition and (2) the market’s revaluation of the acquirer and the target as standalone entities based on new information in the announcement. He notes that there is some indication that announcement returns are more negative in larger deals. Professor Kaplan concludes that the overall findings of these types of studies suggest that existing merger policy is successful on average in deterring antitrust-related problems, and, as these studies typically have found little adverse evidence, raise the question of whether a less aggressive antitrust policy would be desirable.

Next Professor Kaplan looked at accounting-based and clinical studies. Accounting-based studies use measures such as operating margins to evaluate acquisition success. Clinical studies follow a particular merger or small groups of mergers. He notes

that there appears to be no clear relation on average between acquisitions and subsequent accounting performance. However, Professor Kaplan observes that these studies do indicate that any efficiency gains such as those from cost cutting are more prevalent and more greatly valued by the stock market than gains from revenue growth.

Finally, Professor Kaplan looks at productivity-based studies, which look at such issues as changes in total factory productivity to evaluate acquisition success. He notes that there appears to be no clear relation on average between acquisitions and subsequent productivity performance. Professor Kaplan does find that these studies indicate that plant-level productivity improvements are greater in diversifying acquisitions.

Professor Kaplan concludes that, while the evidence from these various types of studies is not uniform, they support the conclusion that acquisitions do create value, and that taken as a whole, the financial economics literature provides little, if any, support for a more aggressive antitrust policy.

E. **Prof. Timothy Bresnahan**, Stanford University (no written statement yet available)

Professor Bresnahan stated several opinions during his opening remarks. First, he noted that there was nothing in the numbers to suggest that there was anything to complain about with regards to the current level of enforcement, and that the analysis of unilateral effects was appropriate as currently applied. He also observed that one difficulty with studies of merger enforcement was that the studies heavily over-sample concentrated industries, and therefore were not so informative with regard to the economy as a whole.

In Professor Bresnahan's opinion, enforcement should focus more on competitive effects and less on market definition. Additionally, he stated that he felt that there was too much focus on consent decrees requiring the spin-off of divisions in order to get mergers approved, noting that these probably do not do much for competition. Otherwise, he stated that he felt that merger enforcement was about where it should be.

## **II. Highlights from Questions and Answers (Paraphrased):**

Q: Do you believe that the current framework of the Guidelines is sound?

A: Yes, but work needs to be done to clarify how unilateral effects will be dealt with, as enforcement needs to be transparent and predictable.

Q: Do you believe that the currently assigned and defined role of market share is correct?

A: Yes

Q: Do you believe that the HHI thresholds are at the correct levels?

A: Yes, but agencies should conduct studies on approved mergers which had second requests to measure actual effects to be sure that levels are correct.

Prof. Bresnahan: Yes, but threshold levels are not an accurate reflection of current agency practice.

Q: Despite the fact that there is no hard evidence the HHI level is correct, you all still are comfortable with the current levels?

A: Yes. And the panel all agreed that they would feel comfortable defending the current levels to the editorial board of the Wall Street Journal.

Q: What specific changes should the Commission recommend to the Congress?

A: Prof. White: Clarify the policy and procedures for dealing with unilateral effects.

Prof. Rubinfeld: That courts be allowed to appoint more independent court appointed experts to help advise the courts on complex antitrust issues.

Prof. Reiss: Strongly in favor of court appointed experts to advise the court.

Prof. Bresnahan: Also in favor of court appointed experts, and also noted that pretrial procedure needed reform as certain aspects are ineffective as screens and produce more costs than benefits.

Q: Is the guidelines definition of market, which focuses on demand substitution, correct, and is this how the relevant market is actually determined in practice?

A: Prof. White: The Guidelines frame the question in the appropriate way, and the definition has survived the test of time. However, contrary to what many believe, the data need not be overwhelming. You don't need fancy econometric analysis to be able to show what is going on.

Prof. Rubinfeld: The substitution principle set forth in the Guidelines has use, and a simple consumer survey is not an acceptable substitute for market analysis. Nevertheless, the requirements of the Guidelines can be met through the use of other methods.

Q: Should the European Union, China, and Singapore follow the United States model in defining and dealing with unilateral and cooperative effects and HHI thresholds?

A: Prof. Kaplan: Mergers in the European Union are more difficult, and that is not to the European's benefit. It would be better for all concerned if the European Union's policy were more similar to that of the United States.

Prof. Rubinfeld: Yes, and the United States needs to be more active in this area, as more countries are copying the European Union's model than are copying the United States model, despite the advanced learning in economics.

Prof. White: Yes, and for similar reasons, we should also focus on reducing trade barriers, which is an excellent antitrust policy.

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