

>> Joe Farrell: Good morning. I'm Joe Farrell. You're going to be welcomed by the chairman and the Assistant Attorney General in just a moment. I'm doing a prewelcome, which consists of telling you about security. Those of you from outside the agency know all too much about security already this morning, I guess. But I'm asked to read you the following. First of all, if you go outside the building and you don't have an FTC badge and you want to get back in, you have to go through security again. Second, if there's a fire or evacuation, please leave the building in an orderly fashion. Outside the building, go across the street to the Georgetown law center. Look to the right front sidewalk. I'm not sure whether that's right as looked at from here or from there. That's our rallying point. So we rally there. And if it's perceived to be safer to remain inside, you will be told where to go inside the building. And if you spot suspicious activity, please alert security. Those are the security briefings. I have two other logistical comments. One is, there are cards for questions at the back of the room. If you have questions for panelists, please write them on the cards and pass them up to the moderator. And secondly, outside there are copies of the 1992/1997 horizontal merger guidelines. And you might be interested in those. And there's also a little flyer called where to eat near the FTC conference center. I noticed that the where to eat list is organized by price bands. And so, if you wondered whether it's legitimate to define a market by price bans, there's your answer. So without further ado, let me introduce the FTC chairman, Jon Liebowitz, to welcome you here.

>> Jon Leibowitz: I love it when economists makes jokes to start off meetings. On behalf of Christine Varney and I, let me welcome you to our scheduled workshop on updating the horizontal merger guidelines. When Christine and I started talking about this during the summer, we thought it was going to be a good time to think about updating the guidelines. But timing is everything. And given the announcement of Comcast, NBC Universal this morning, it's a truly propitious time to start updating the guidelines. Let me commend the FTC and DOJ team that's been working to put this together. On the FTC side, that would be Joe Farrell, who you're acquainted with, Rich Feinstein and Howard Sholansky, and for the Justice Department, that would be Molly Boast, Phil Wiser and Carl Shapiro. By all accounts, this group has worked together extremely well, which shouldn't be a great surprise. And I see Gene Kellman here, also an integral part of any policy-related matter. It shouldn't be a surprise they've worked really well together because several of them now have worked for both agencies and also because I think Phil lived in Howard's house for

a time. And of course, Carl and Joe are the virtual Chang and Ang of the antitrust community. We are really a far cry from the bad old days of the sheering brief, the Session 2 report and ugly clearance battles, I think, stretching on for months. It's really been the approach, I believe, since Christine and I started in our current jobs to work together collaboratively. I know it can be fun to talk about conflict between the FTC and the antitrust division rather than talking about our similarly held enforcement priorities and policies. But the reality is, we play really, really well together as this project demonstrates. Many of you know that I've been a critic of the extent to which the Chicago schools^-- by the way, I'm wearing my badge. We all have to wear our badges, particularly because the magnetometer is broken outside. As all of you know. Many of you know that I've been a critic of the extent to which the Chicago schools' optimism about efficiencies and indifference toward oligopoly conduct have affected merger reviews as well as antitrust law generally. But from my perspective, this effort isn't about giving any priority to one antitrust school or another. It's really about good government and making sure that the rules of the road are clear and well understood, especially by those who enforce them. From my perspective, the current guidelines have worked pretty well, actually, since the last update in 1992. And I know Jim Rill is right here and he deserves enormous credit of being the leader of that 1992^-- you do. Don't be so self-deprecating. You do. For being one of the leaders in the 1992 update. Yet they don't explain the process, I think, clearly enough to businesses. They don't explain it clearly enough to judges. Probably if I had to be honest, I would say that has helped us in some instances. It has hurt us in others. And they don't incorporate the latest economic thinking. So hopefully by giving everyone a better idea of how we look at mergers, and also how they ought to be examined by the courts, we can clear up some misconceptions and demystify the process. And if we can do that, I think everybody wins, especially consumers who benefit most from balanced, yet aggressive antitrust enforcement, and businesses which benefit, as you all know, enormously from certainty. And the reason why we need to update our guidelines is pretty clear. Over the past 17 years, since the last revision of the guidelines, merger analysis has developed in important ways. But as our joint commentary noted three years ago, and Tom Barnett is around here somewhere. Tom and Debbie Majoris were the leaders of that commentary. Guidelines tend to exaggerate the extent to which the agencies follow a single, rigid, step-by-step approach to merger analysis. And we don't always follow that approach when we evaluate mergers, instead we center our inquiry on one key question, whether mergers -- whether the merger under review is really likely to lessen or substantially lessen

competition. So the areas we'll be thinking about stem from that inquiry. And among them are the use of direct evidence of anticompetitive effects as an indication that a merger may harm consumers, whether to clarify how and why the agency has used the hypothetical monopolist test to define markets, whether to update the description of how the agencies use concentration statistics like HHIs to understand the impact of the merger on the market. You know, really, I think the question is really how much should we increase the HHI thresholds to the guidelines to better correspond to how we understand them. And whether to put remedies in the guidelines as other antitrust jurisdictions have done. And, of course, I'm going to keep an open mind. But I think all of these ideas make a lot of sense. Today we're going to have four panels and a veritable cavalcade of antitrust luminaries to help us eliminate these issues. Among those speaking today are Bob Pitofsky, Tim Muris, Doug Melamed. Doug is not here. We know why he's busy. That was an antitrust joke. I know it's early in the morning. And Deb Garza. And Tom Barnett who's back there, too. And most of those people are just on the first panel. After their review on the role of the guidelines, we'll have specific panels on direct evidence of competitive effects, market definition and unilateral effects. Of course, this is just the start of the project. We'll be taking our merger guidelines examination on the road. Holding workshops in New York and Chicago next week, and in Palo Alto next month. And the final workshop will be back here in Washington, D.C., at the end of January. And these workshops, of course, as you know, are about transparency. But just as importantly, they're about thinking through the merger review process with very smart folks in the antitrust community outside of our occasionally -- I wouldn't say often -- occasionally insular, inside of the beltway justice department, FTC antitrust access. So we really do look forward to hearing from all of you, from incorporating your ideas. You should feel free to challenge us as, of course, my staff does on a minute-by-minute basis to me. And with that, again, let me thank everyone for coming today. And let me turn it over to my very, very good friend and colleague, who has done just a spectacular job at the antitrust division, Christine Varney.

>> Christine Varney: Thanks, Jonathan. Jon did a terrific job laying out why here all here today and what we're doing in this undertaking and what we're going to be doing today. So before we turn to our first panel, let me add my thanks and my welcome. I know I've gotten a lot of questions as I'm sure Jon has this morning about the Comcast/NBC deal that was announced this morning. Let me share with you what I shared with my staff, and that is we are not commenting on that

today, but we're hopeful that this kind of undertaking can help us understand the emerging complex deals that we face, such as that one. So good morning, welcome and have a good day. Thank you.

>> Carl Shapiro: So if the people on the first panel would come up for five minutes because our leaders are so efficient -- as opposed to security. Okay. Thank you. Okay, that's good. Take your spot. We may just take a couple minutes to assemble here so we're not starting ahead of time. I think Bob. We're still waiting for Bob, it looks like. Okay, it's going to be a couple minutes, probably start at 9:30. Once our final two panels have cleared security.

>> Carl Shapiro: All right, let us get started. It's now actually 9:30, so we're on time. I thought I had all my panelists, but they're a slippery crew. I lost one again. Okay. Welcome. I'm Carl Shapiro. I am one of the members of the working group at the DOJ and the FTC for the review project here. Thank you all for coming. Those of you here physically and others who may be watching from elsewhere. As already indicated, we have a really distinguished panel. I'm very grateful for everybody here on the panel for joining me. Everybody on the panel has extensive, high-level experience in the antitrust agencies and considerable experience in the private practice and private sector as well. So those are dual perspectives that are extremely valuable. This panel is our first panel of the five workshops. The first of four panels today. And so particularly, given the distinguished group, this is an overview panel to really put the guidelines into historical perspective, talk about their role, their function and what types of things should be in the guidelines and what things shouldn't be in the guidelines as well as more specifically where updating and revisions might be most valuable and where they should not be done. So to frame some of that. We already indicated in our questions for public comments, we see two general reasons why we're undertaking this project at this time. One is to see if a gap has developed between the guidelines as written and actual practice and good government would call for closing that gap. And the other is learning as experiences develop that could be reflected in the intervening 17 or 18 years. Those are not disjoint concepts, but they're overlapping interests here. And we'll be addressing those on the panel. In getting ready for this morning, I went back and looked at the 1968 merger guidelines. I think we may hear a little bit about them from some of our panelists, we've got historical perspective. And just to -- I could not resist pointing out the guidelines themselves are 17 pages in total. And they cover horizontal, vertical and conglomerate mergers. Eight pages on -- eight pages

on the horizontal mergers. Very structuralist. So in the market that is highly concentrated with the top four firms having at least 75% of the market, if the acquiring firm has, say, 10% and the acquired firm has 2% or more of the market, this would be ordinarily challenged at the time. And it goes from there. So we've come a long way. And the question is what the next step might be and one of the backdrops for this, I think, is the decline of the structural presumption over the decades and how that affects merger enforcement and how it should be reflected in the guidelines. Okay. So each -- I've asked each of the panelists to give some introductory remarks of five to ten minutes. I will be tough and cut them off, they're distinguished nature notwithstanding. And I'd like to start with Bob Pitofsky as one of the Deans of the antitrust community. Bob, please start and please, all of have you been instructed to speak into the mike.

>> Robert Pitofsky: Thank you, Carl. Good morning, everybody, and welcome to Georgetown.

>> Carl Shapiro: If you don't mind.

>> Robert Pitofsky: How's that? Better? I'm going to two things. I am going to talk about the historical role of the guidelines with respect to American antitrust. And then I'm going to talk a bit about -- there is going to be another iteration, what some of the things ought to be included, excluded, clarified, amplified and so forth. Let me start with the guidelines. In my view, the guidelines process, is the most important influence on American antitrust policy in the last 50 years. I say wait, wait, wait. There's the Supreme Court, isn't there? There's scholarships, and there's speeches and statements by the enforcement people. Yeah, wait, wait, wait, there's the supreme court. What have they done? How many Supreme Court antitrust cases do they take? The last horizontal merger case, Supreme Court case, was 35 years ago. And it's not exactly an unimportant sector of the economy, but the court just isn't interested. Academics are very powerful influences, but they work their way into the guidelines. And, of course, the enforcement people make speeches and statements and bring cases. But it's a little hard to tell compared to the guidelines what it is they had in mind and which way they were going. The first guidelines were issued in 1968 by the Department of Justice. In those days, it was the style of the Federal Trade Commission to sit out projects like this, and they sat this one out and did not join these guidelines. Although later on, I think under Miles Kirkpatrick, they steadily joined the DOJ in later iterations

of the guidelines. The dominant influence, by far, was Donald Turner. Not only because he conceived the concept of guidelines, but he drew into those guidelines the beginnings of sophisticated and economic analysis, beginnings that progressed from there. And it wasn't exactly a noncontroversial process. Don's view was enforcement people had an obligation to tell the private sector what their enforcement intentions were. I think that's right. I thought it was right at the time. The problem is that a lot of lawyers at the DOJ said, what do you mean? You're going to give them a blueprint of what we think is okay and what we think isn't? How are we going to win any cases? All they'll do is waive the guidelines in front of the judges and say, "see, we followed the guidelines." It hasn't worked out that way. It hasn't worked out that way at all. The Department of Justice continues to win cases when it is forced to go to court. The FTC, during my 6 1/2 years, won 12 out of 14 cases when it was forced to go to court. And it was part of the guidelines. So Don stuck to his guns and, in fact, the guidelines have survived. Indeed, each iteration gets better and better. Although I will say two things about them. Each iteration makes it somewhat more difficult for the plaintiffs and the government to win. And more important, each iteration has far more sophisticated economic analysis incorporated. My dominant goal today. I hope I'll have more than one or two chances to talk about it. Is the following. That an aim of the people who are revising these guidelines should incorporate -- not exclusively -- but should incorporate the idea of making these guidelines simpler, clearer and in some particular areas amplified so as to give people a better idea of what is intended. Simpler. Can you hear it better now? Good. Simpler, my example would be barriers to entry, which run on about six or eight or nine pages in the guidelines. And introduce concepts like committed and uncommitted entrance, some costs, viable minimum scale. I mean, in a way it's a brilliant piece of analysis. And the lawyers in New York and the lawyers in Washington they get it, they're on board, but there are a lot of lawyers and businesspeople who find it very difficult to know what minimum viable scale would be in a year that hasn't happened yet. What do I think ought to be introduced into the guidelines that are not there now? Innovation markets. It seems to me that, as you look around the world, the action has to do with innovation. The guidelines from the very beginning have been preoccupied with price. But the price is not the only anticompetitive consequence of various kinds of transactions. And if two companies are both working on the same improvement in the pharmaceutical or widget or gadget or whatever they're working on. And they propose to merge, one could have a consumer welfare disadvantage. Now, the usual argument is you can't measure

market share in innovation markets. That's fairly common. And it is very difficult. But I think the answer is that you can. I want to know how many patents these two companies obtained in the last several years, how large is their staff? How qualified is their staff? What kind of machinery do they have? Judge Moore, among many others, has said "Look, it is extremely difficult, but it can be and it should be done." And market shares can be measured in those areas. A couple of final points, very briefly. I had been writing for a long time and very cranky about the failing company and the fence. I think it's too stringent. Congress didn't have in mind all those qualifications before you could assert a failing company. And I don't even think it's good economics. But we're going to talk about that on the panel later on so I'll hold my comments until a later point. A few other changes. HHI, 100, 1800 and so forth, is it really only a safe harbor if you're under 1,000? Nobody's brought a case -- actually, we brought two cases. I can't say nobody. But both oil companies. They were marketers. And they were around the 1500, 1600 range. But that's once in a blue moon. And if, in fact, the government's intention is not to bring cases unless the HHI is over 2,000 or 2,500, we ought to say so. Many people think the SNIP test is 5%. And maybe it is. Many other people would say it's 10%. And everybody in the know knows it. Maybe that's true. I don't know it one way or the other. But I do think it ought to be clearly stated in the guidelines as to what the SNIP test is. And if it's changed, it ought to be changed. As Don Turner would put it, to tell people what the enforcement intentions are of the enforcement agencies. And finally, this is just a pet peeve on my part. But I'm sure all of you recognize that even though trend to concentration was the principal concern of congress when they amended the Seller-Kiefer act in 1950. The principal concern, trend to concentration has never been regarded as a factor in deciding whether or not there have been or will be anticompetitive effects. All I ask is that the people who are working on revising the guidelines take a look at that and see if it belongs in the next version of the guidelines. Thank you.

>> Carl Shapiro: Thanks, Bob. Next I'd like to ask Jim Rill to speak to us. Jim was Assistant Attorney General when the current guidelines in chief were drafted in 1992. I think has great insights about that process and the results and how they've held up. Jim.

>> James F. Rill: Thanks very much, Carl. It's an honor to be here with such an august panel. It's rare that I'd be not the oldest person on the panel. I give that honor to Bob Pitofsky. Let's take a

look at what guidelines are supposed to do. And the '92 guidelines themselves, I think, set forth an explanation which makes a lot of sense. The guidelines, according now from the guidelines, the guidelines have the dual purpose of leading to appropriate enforcement decisions on horizontal mergers and providing the bar and the business community with reasonably clear guidance from which to assess the antitrust enforcement risks of proposed transactions. Good so far as it goes. There's another player, though, that's not mentioned in that statement and another player which I think is of importance in considering revision of the guidelines and, in fact, has played a major role in the revision of the guidelines that took place in 1982 and again in 1992, and again I think in 1997. And that is, of course, the courts. So the guidelines have an intellectual -- excuse me, an analytical path -- hopefully intellectual path, too, but an analytical path, but it's not a cookbook. Guidelines are not a cookbook. They're not a nice, articulate, well-defined recipe to follow in designing every aspect of merger enforcement but rather a broad but clear analytical path. I have a personal vendetta against anyone who talks to me about something called a guideline violation. I submit there is no such thing as a guideline violation. So how does one achieve those purposes? It seems to me there are three principles. And I owe this thought to an interesting paper that was prepared by Tim Muris and new institutional economics. That any principle, and I think applies to guidelines, need to be one based on sound law and economics, two, and of great importance, need to be readily understandable and tractable by counsel, by firms and by courts, and three, be sufficiently flexible to adapt to new learning in law and economics. Those three principles should, I submit, guide the process that's going on right now. I endorse the process that's going on right now. It's been 17 years since the 1992 guidelines. The 1992 guidelines were ten years after the 1982 guidelines which were 14 years after the 1968 guidelines. I have just given you my total knowledge of economic econometrics. I agree with Bob that the Turner guidelines were revolutionary in 1968 not only because of the infusion of some economic learning into the guidelines but the Assistant Attorney General had the fortitude to do that which I would never have done, they told the Supreme Court of the United States that it was full of baloney and that he certainly wouldn't bring cases that would fit under the rubric of the Cans case or the Patslast case. If you look at the Turner guidelines, the guideline levels are well above the learning of those two cases. But the Turner guidelines went so far as they went. And by 1982, economic learning in court decisions, particularly general dynamics, had begun to expose the error in reliance on rigid market tier tests. Thus, the Baxter guidelines undertook to raise the thresholds and identify factors

such as entry, in particular, that went beyond market shares. And although the 1982 guidelines were a massive step forward, I think a sea change, a seismic change in antitrust and for that reason I think Bill Baxter was one of the truly great assistant attorneys general to serve in that post, they remain largely structural and the flawed market share paradigm was put in terms of likelihood of challenge which I think went much too far. A second problem with the 1982 guidelines is that they were only, as were the '68 guidelines, only justice department guidelines. And when the 1992 guidelines came out, the Federal Trade Commission several days later put out a very general statement that they weren't necessarily following the '92 guidelines, but we were going to look at the '82 guidelines, law and facts of each case. During the next decade, the court decisions and economic literature put further doubt in the structural approach, even of the '82 guidelines. And we had cases like Baker Hughes which called into serious question the market share paradigm and to a great extent to entry. At the same time, the entry issue was being rather superficially handled. When you look at cases like waste management in the 2nd Circuit, where entry was sophisticatedly analyzed on the basis, well, it must be cheap to buy a trash truck. Entry, obviously, was not properly being defined either in the guidelines or certainly by the courts. And the Calder decision a year later was to the same effect, not with trash trucks but hose nozzles. Advanced economic theories -- advanced economic thinking, moreover, my particular favorite is Bobby Willig's article in Brookings produced a reliance on unilateral effects which had not been incorporated in the '82 guidelines, particularly in the area of differentiated products. The '92 guidelines in that area were somewhat actually anticipated in enforcement decisions such as the Procter & Gamble rohrer case, finding within a broad stomach remedy market unilateral effects by the acquisition of Maalox by Pepto-Bismol. Thus there was a need to accommodate new learning and replace some of the gaps, to use Carl's term, that existed in the guidelines versus the courts and economic learning. The '92 guidelines, the notion of a presumption on the market share paradigm replaced the notion of the likelihood of challenge. The competitive effects provisions of the guideline were greatly expanded into a separate and rather long section. There was a much more comprehensive approach to entry. And Bob indicated a somewhat intricate approach to entry. There was, I think, most important the infusion of the notion of unilateral effects, particularly in differentiated markets, but also in commodity markets apart from the analysis of coordinated effects. And, yes, they were the first ever joint guidelines issued by the Federal Trade Commission as well as the Department of Justice. And there's stories there I could tell you but won't on this panel. So let's go back to the desirability

of revision now. Is there new learning to be reflected? Yes. Certainly with respect to the market share paradigm and presumptions. Do we accurately explain in the guidelines what the agencies are doing now? No. If one looks at the FTC's reports on when challenges are made and in what particular industries at what market share levels, at what level the customer complaints and other factors, they bear little relationship to the 1800-100 formula set forth in the guidelines even as a presumption. Is a presumption right or is simply the market share paradigm a trigger to further analysis, which it seems to be in many of the court decisions? And we need to wonder whether the guidelines currently provide an explanation of what the agencies are doing and what the courts are doing in a concise and understandable matter, and there I go to the issue of unilateral effects. Which I think does cry out for further explanation, but not necessarily radical change. I think that we want to keep the -- and I would urge the drafters to keep the market definition and hypothetical monopolist test, these are tests that have withstood the weather-beating winds of time. They have widely been adopted by the courts, and I could cite all the cases from Swedish Match through Oracle as a starting paradigm. The question is, does it have to be a starting paradigm, or can there be a holistic approach? I think the holistic approach is fine, but doesn't become mush. But Oracle, Country Lakes Food, Sunguard, Swedish Match, all of these cases adopt the market definition paradigm, and it seems to me that's appropriate. The courts raised questions of the HHI levels in fact in the Arch Coal decision, the district court not only looked at the guidelines but then looked at the FTC report which indicated the FTC itself doesn't follow the rigid principles of the guidelines. I think one reads Oracle and would have to say that the arguments of the positions taken by Judge Von Walker in that case illuminates some of the areas where unilateral effects can be addressed in guideline form, but I would urge not to, even in the unilateral effects differentiate product area to abandon the market definition principle. Bob mentioned the SNIP test. I agree with him. I think there needs to be an explanation of when the snip test -- 5% snip test is deviated from and what reasons and why because it's not spelled out in the guidelines, but it happens. And if you look at the paper we submitted, it happens a lot in the energy and in the retail food industry. Finally, I think the power buyer point needs to be looked at, if there is such a principle to be considered. It came up not only in Country Lake Foods but also in the ADM synthetic sweetener business. So after 17 years, this adolescent, I think, is ready to grow into somewhat more maturity. I would say radical change is not appropriate. Some commentary is quite probably appropriate, but I don't think a treatise is appropriate, because you start writing a treatise, you get into formulas, you lose both

comprehensibility and flexibility. Overall I think the project is timely, excellent and certainly led by the competent people who should be leading a project of this sort. Again, I'm honored to be able to participate. Thanks Carl and Joe.

>> Carl Shapiro: Thank you so much, Jim. That's very gracious. We'll turn to some of these questions you've posed in the discussion for sure. Next I'd like to ask Doug Melamed to speak. Doug was deputy assistant Attorney General and acting Attorney General -- excuse me, acting assistant Attorney General in the antitrust division in the late '90s. And I'm sure we'll put that hat on and not his new hat as Intel's general counsel as he speaks.

>> A. Douglas Melamed: I'm always thinking of the public interest, Carl. And the happy news is the interest of the intel and interest of the public are aligned. There's no tension there. I'm going to just -- okay. Let me just say at the outset, I think guidelines in the merger area are especially important because unlike the Sherman act where, you know, 99% of the law and the guidance given to the business community arises out of the case law, this is a common law process, in the merger context is largely a regulatory process. Obviously, one constrained by the law and one the law is influenced by the regulatory actions. But is largely a regulatory process in terms of its most immediate and significant impact on the business community. So it's critical that the regulators -- I don't like that word, but it's not a bad shorthand, articulate with as much clarity as possible the way that they think and they think private parties and courts ought to think about mergers. So I think guidelines are important. And that being the case, I think after 17 years, it is very desirable to bring them up to date to reflect contemporary learning. Let me -- introductory comments, I want to make two points. One a broad one and one a narrow one. The broad one is this. I actually haven't read the guidelines for a long time or hadn't until a couple days ago when I read them in anticipation of this panel. I guess maybe I had gone back to look for little passages to cite in briefs or something but not really looked at them in any comprehensive way. And while reading them, I was struck by how formalistic they are. They have all sorts of definitions and categories of abstractions, committed verses uncommitted entry. The definition of a market, notion of HHIs, and most importantly, the five-step analysis which, although there's some lip service paid to, well, this is only an aid in answering the ultimate question of competitive effects, is really presented almost as a decision tree kind of process. Now, the various analytical tools that are described in the

guidelines, whether they're the SNIP test or version ratios and so forth are important analytical tools. And I think it would be very valuable for the agencies to update the description of those tools and how they are used to reflect current practice and current economic thinking. But they're not ends in themselves. This isn't kind of an exercise. Merger review is not an exercise, applying these various analytical tools. They are simply tools, means of shedding light on the ultimate question whether the contemplated merger is enter competition and disadvantage some segment of the community that we want to protect. So I think while the analytical tools that are described in the guidelines are very valuable, I don't think the guidelines actually describe, taken as a whole, describe the process that practitioners of the agencies actually go through when they're doing a merger. And I think in that respect, they are somewhat -- I don't want to say misleading because I think at least regular practitioners know that -- but they ought to be updated, I think, starting from, perhaps, that premise. Roughly speaking, here's what I do. And I think a lot of people do something like this in analyzing a horizontal merger. You have companies A and B. You represent A in practice or if you're an agency, you're looking at the contemplated merger. And so you say, okay. Do A and B compete? And if so, where? Who are the consumers or the suppliers if you're concerned about by side markets for whose patronage do they compete? And then you ask, who else do they compete with? Who else constrains their behavior, those trading partners? And then you ask, okay, now, if we eliminate rivalry between A and B, what's going to happen? Are there going to be other extent competitors to constrain it? Is it likely that people on the fringes will enter or readjust their competitive behavior? Are these rivals close as substitutes for one another or are they not so close? You know, are we dealing with homogeneous products? Do we have concerns about coordinated effects? Are we dealing with unilateral effects? But the analysis starts, at least in my opinion, by asking who are the merging parties? Where do they compete? What's the affected area of commerce? And now how do I analyze the question or answer the question, what happens if we eliminate rivalry between these two merging parties? And in the course of thinking of it building up from the facts that way, at various times one might think, "gee, there are certain analytical tools that might be helpful here." It might be helpful to know what is the market. It might be helpful to know, are there likely entrants. And I don't know, committed, noncommitted. I don't think that's part of most people's active vocabulary. But you do ask how likely is it that they're going to enter? And you look at the factors that go in, you know, to that dichotomy and the guidelines and so forth. The problem, I think, with starting with sort of from the abstractions and

working down is not only doesn't describe what, in fact, happens, which reflects that it's a problem. But that it can lead to -- it can lead to some erroneous conclusions. For example, firms outside the market can be important constraints on behavior of firms in the market. If you imagine, for example, a monopolist merging with the closest, albeit distant, substitute who's outside the market, you might be very concerned about the competitive impact of losing the constraint of that outside the market and closest substitute. If you focus just on the market and the HHIs, you know, you're obviously going to lose sight of that. Committed, uncommitted is really a matter of degree. I think the dichotomy doesn't make a lot of sense. Market shares matter sometimes and sometimes more than others. Of course, the problem with market shares is that we don't really care about historic market shares. We only care about future market shares. And so we might want to make a prediction, what will the market shares be in some relative time? We might start with historic market shares as a past is prologue question, but always asking the question, is it a good prologue or do we have a general dynamics kind of situation here? So I guess the big one suggestion is, I'd like to see the guidelines focus more on how one actually builds up a competitive analysis starting from the facts, how one uses the analytical tools that are presently in the guidelines, and I assume will be enriched by this revision rather than by coming up with a nice conceptual framework of how one might employ all these tools in some stylized merger analysis. The second and narrower suggestion I would have has to do with efficiencies. Efficiencies are really important. Obviously. Innovation is really important. All the studies, we all know, show innovation contributes a great deal more to economic welfare than avoiding dead weight loss. So we really have to keep an eye on efficiencies. Now, I understand probably a fraction as others in this room but to some extent at least that mergers are commonly overpredicted. I'm sorry, efficiencies are common overpredicted in mergers not just for agency consumption but probably for board of director consumption. All the studies about mergers failing and so forth. But it is still very important, it seems to me, that the agencies and the practitioners and ultimately the courts have a clear idea of how to think about efficiencies. How to assess them, recognizing the uncertainty of prediction, and then how to evaluate them. How to compare them against what might look like gains of market power by the merging firms. And I'm particularly interested in an issue that was treated in the '97 update as a footnote item. And I think is really a very important question that I don't know the answer to. That is to say, I don't know what the agencies or the courts would say in response to this question. What do you do if you have significant efficiencies in market? I'll use that term, market A and what

apparently looks like a moderate and a competitive concern in market B, there's a lot of people I think would say, "well, the courts are clear. You can't weigh the benefits of market A against the harms market B. That's an anticompetitive transaction." I don't think that would be the right policy result. And I would hope the new guidelines would explicitly grapple with that issue and give us guidance as to how that comparison and tradeoff could be handled.

>> Carl Shapiro: Thank you, Doug. Again, lots of food for thought later. A number of people brought up innovation. I think it's something we really want to return to. There's not much in the guidelines on that. So everybody, put your thinking caps on. Next, I'd like to ask Tim Muris to speak. Tim, you know, has experience going back to the '80s, the '82 guidelines and more recently, of course, chairman of the Federal Trade Commission. So Tim, tell us.

>> Tim Muris: Thank you, Carl. It's a pleasure to be here. I'm sorry. It's a pleasure to be here at old-timers day. Except for Carl who's a recidivist, I guess. As others of us are. Let me try to discuss three principles for revising the guidelines and to begin, the guidelines have succeeded in significant part because they do not try to do too much. Rather than complex, lengthy regulations, they provide a flexible and durable framework that reflects the antitrust community's consensus. This focus on consensus should underlay any potential changes to the guidelines. The lack of such consensus doomed the recent attempt to provide a one-size-fits-all test for unilateralizing conduct under Section 2. The consensus regarding the relative incision of simple concentration tests, which we've heard about already justifies reflection of that view in any revisions to the current guidelines. Major changes that lack such consensus, however, risk the fate of last year's Section 2 report. My second point is that the guidelines should reflect agency practice. And when I was chairman, I pushed this in two ways. The data release which I'll discuss momentarily in the merger commentary which we began as well. In terms of practice, the agency should adjust the HHI thresholds and no longer characterize certain mergers as presumptively anticompetitive. Jim Rill's 1992 revision stated that the numbers are only the starting point. And I agree with that. Nevertheless, the numbers can provide useful screens, and let me suggest three. First, when there's a post-merger HHI below 1800, there's unlikely to be competitive concerns. It sounds like Bob had an idea of 2,000. I'll talk about the data release in more detail in a second. Second, post-merger HHIs between 1800 and 2400 are unlikely to have adverse competitive effects when the delta is

below 300. Mergers in this tier with the delta of 300 or more are likely to require detailed investigation into their likely competitive effects. And third, post-merger HHIs of 2400 or greater are unlikely to have adverse competitive effects when the delta is below 150. Mergers in this tier with deltas above 150 or more require detailed investigation into their likely competitive effects. Now, these numbers don't come from any theory. These numbers, I believe, come from the agency's data releases. Now, because the data releases were in ranges, it's possible, and the agencies have the actual numbers in hand, it's possible that these numbers aren't precisely correct, and there should be some adjustments. But I do believe that the experience would provide a very useful screen. And the numbers reflect, you know, hundreds of merger investigations involving, indeed because the merger wave occurred in the late '90s, most of the numbers are still from the Clinton Administration. Another topic on which the guidelines of practice diverge involves fixed costs. I think the commentary makes it clear that fixed costs account under certain circumstances and any revisions should reflect that. Moreover, the guidelines should confirm that the burden on the parties to demonstrate efficiencies is no greater than the agency's burden to show anticompetitive effects. Now, my experience is that agency leaders accept the statement that I just made, although there are some on the staff that I don't think agree, if agency practices to apply different burdens, then I think any revisions should justify such an extraordinary position. My third and final point is that evaluations of individual mergers is heavily fact specific. And that therefore any changes to the guidelines should highlight those facts that are particularly probative. And let me suggest five examples. The first is that the best evidence for determining efficiencies involve actual experience. Just as the agencies rightly dismiss unsubstantiated claims, they should accept as presumptively valid those claims based on the best possible evidence, which is the resulting efficiencies or lack thereof in recent mergers involving one of the merging companies or others in the relevant industry. And, of course, such evidence can include improvements in product quality, not just reductions in cost. Second, the guidelines should not assume the form of competition among firms offering differentiated products. Any revision to the guidelines that assumes a certain form of competition. For example, that firms compete by simply setting price would make it more difficult for the guidelines to characterize existing competition accurately and to predict any loss of competition following a merger. The guidelines framework searches for ways in which market power may be exercised successfully. And that analysis depends heavily on the particular setting -- industry setting in the form that competition makes. Specifying the form of competition

independent of the industry particulars risks serious error. And I associate here myself with an article by Werden, Frobe and Sheffman who noted that after 15 years of using various models, we all have a greater appreciation in the complexity and variety of competitive processes and clearer understanding that different modeling assumptions can amplify or attenuate merger price increases. As the guidelines move away from structural presumptions, they should not incorporate models that do not reflect real world competition. The third highly probative fact any revisions should recognize that merging firms have an incentive to pass on marginal cost savings regardless of the number of remaining competitors which is a proposition that simply follows from the fact that almost everyone faces a downward sloping demand curve. Fourth, the guidelines should reflect the importance of customer views in determining the likelihood of anticompetitive effects. The data release showed that strong, consistent complaints almost always lead to a challenge. In my experience, I think most people's experience is that when you've got strong, consistent support, the agencies will not challenge. Unfortunately, in Hines and Oracle, courts were dismissive of customer opinions. In assessing customer testimony, the courts and the agencies should recognize the policy judgment that underlies the business judgment rule so prominent in corporate law. This rule essentially requires judicial abstention from second guessing corporate decisions based in part of the relative experience of business versus judges and courts. The business judgment rule creates the presumption that corporate directors and officers act on an informed basis in good faith and in the best interest of the corporation. This rationale applies to customer testimony. Once the agencies or courts have screened customers to ensure their testimony is reasonably informed, in good faith and not based on conflicting or anticompetitive incentives, the decision-maker should give great weight to customers' views on mergers' likely effects. Customers will most directly experience the effects of a merger. Their self-interests combined with their knowledge of the industry ensures that their views will provide crucial evidence. Most antitrust lawyers, on both sides of the table, agree that customers remain the most objective marketplace participants. The decisions they make frequently provide a better window on how the merger actually functions than an economist model or the court's intuition. Finally, my final probative fact involves the importance of post-merger evidence and consummated mergers. Here the agencies have something fundamentally different than typically in the normal HSR process. And they can't have it anyway. Evidence of the mergers actual competitive impact. When reliable evidence of that impact is available, it should trump the predictive analysis used in the standard HSR process. The relevant

analogy is to judicial decisions regarding the superiority of direct evidence of competitive impact in Section 1 decisions. Now, of course, the post-merger evidence has to be reliable, and the agencies have to be confident that their measurements are accurate and merger specific. In at least two instances decisions will likely be impossible. The first involved cases in which too little time had passed post-merger to measure the effect. I think Chicago Bridge was a good example of that. And the second occurs when the merging parties have manipulated the post-acquisition evidence. Thank you, and I look forward to our discussion.

>> Carl Shapiro: Okay. Thank you very much, Tim. Our last speaker, Deb Garza, like Doug, was a deputy assistant Attorney General then acting assistant Attorney General in the antitrust division, but a bit more recently. Deb, please go.

>> Deborah Garza: Thank you. And it really is an honor to join this panel of colleagues, each of whom has contributed significantly to antitrust scholarship and the development of competition policy, both within and outside the United States, in particular with respect to the ICN, which you're responsible for. My comments today will draw largely on the work of the antitrust modernization commission as well as on my experience in both private practice and in government using the merger guidelines, explaining them to clients, merging parties and persons affected by mergers. I've also had a bit of experience working on guidelines, including the 1984 revisions to the 1982 justice department merger guidelines. So I'm very sympathetic to the challenges that the agencies are facing. But I'm also very sympathetic to the notion of why it's an important thing to be engaged in review and potential revision of the guidelines. Guidelines serve several important purposes. Educating the public about the goals and substance of competition policy is one. Ensuring the transparency and fairness of enforcement is another. Providing certainty that is needed for the free flow of capital in well functions markets, facilitating voluntary compliance with the law and sometimes advancing development along with the courts. And I think the '68 guidelines, '82, '84, all the subsequent guideline revisions have actually done a remarkable job of helping to forge the development of merger law in the United States and abroad. On the other hand, we may discuss this later, I don't think it should be the primary purpose of the guidelines to try to advance the law. I also think that even the process of developing, reviewing and updating guidelines serves a very important purpose in fostering dialogue and understanding, forcing the

agencies to examine the efficacy of current policy and the articulation of that policy and ensuring that enforcement policy remains valid. Even if no significant changes are made to the guidelines, there is a real value, I think, to confirming the consensus support for them. Of course, it's important to ensure that the guidelines remain current, that they accurately reflect both the agency's actual enforcement policy in practices and recent developments in the law. A material gap between what the guidelines say and what the agencies do actually could undermine public confidence and legitimacy of government enforcement. I want to quickly go to the AMC commendations. And I note, too, going last, it gives me the opportunity to see that just as the AMC, there was a substantial amount of bipartisan consensus about a number of things that I think that I've seen developing up here already while there are some differences, some substantial consensus on a number of matters. Let me go quickly through the AMC recommendations that I think are relevant to the current exercise. For those of you who don't carry the AMC report around with you.

>> Carl Shapiro: It's big.

>> Deborah Garza: It is big. I know. I should get a nice little abridged version of it. First, the AMC concluded that there was a general consensus, that the basic framework for analyzing mergers, followed by the US enforcement agencies and courts is sound. And I think that's an important starting point. Second, the AMC concluded that no major changes to merger enforcement policy are needed to address issues and industries characterized by technological change and innovation because current law, including the merger guidelines, are sufficiently flexible to address those aspects of competition. At the same time, the AMC did make several recommendations specifically related to the review of innovation-related aspects of mergers. The AMC recommended that the merger guidelines should be updated to explain more extensively how the agencies evaluate the potential impact of a merger on innovation. The ability to innovate is a significant reason for some mergers and innovation is extremely important to economic welfare. Yet the current guidelines, mention innovation only in passing in footnote six which states that market power also may lessen competition on dimensions other than price such as product, quality, service and innovation. The commission recognized that there remains a need for additional learning regarding innovation competition but concluded that the agencies have sufficiently consider the issues involved to provide more useful guidance than what we see in that footnote.

Next, the AMC recommended that the merger guidelines should be updated to include an explanation of how the agencies evaluate nonhorizontal mergers. Now I realize that this exercise is specifically designed to think about the horizontal merger guidelines, but let me tilt at some windmills here and represent the AMC by suggesting that it would be very worthwhile for the agencies to revisit the -- their treatment and articulation of their treatment of vertical guidelines. The '82 and '84 merger guidelines which were only the DOJ contained a section addressing nonhorizontal mergers including vertical mergers and mergers raising potential competition concerns. Although that section of the '82 and '84 guidelines addressing nonhorizontal mergers was never formally abandoned, the '92 merger guidelines and the '97 revisions did not include that section. And as the FTC has never, to my knowledge, issued any sort of guidelines or statements about their treatment of vertical mergers. Although significant thinking has occurred regarding vertical mergers since 1984, the guidelines haven't been updated, we think that the AMC concluded that the horizontal merger guidelines have brought significant transparency on how the agencies evaluate horizontal mergers. The business community has benefited, practitioners have benefited and we think they would benefit greatly from some updated articulation of the competitive effects of vertical mergers. And I note that the commissioner Liebowitz mentioned today that the Comcast/NBC Universal merger which I don't know but I suspect may have some vertical aspects to it. Just another illustration, agencies do look at vertical aspects of transactions in important transactions, and it seems to me a real miss not to do something to address that the last time they spoke to this issue was in 1982. The AMC recommended that the agency should increase the weight given to fixed-cost efficiencies such as research and development expenses on dynamic innovation driven industries, where marginal costs were relatively low to typical prices. The current merger guidelines appear to weigh most heavily, efficiencies that will reduce price to consumers in the short run. Reductions in total costs including fixed costs such as improving upon the rate and quality and innovation have less effect on pricing in the short run, obviously, in the longer run, however, some if not all such efficiencies could also likely benefit consumers in the form of lower prices, increased choice, improved quality. Although the current merger guidelines do recognize that R&D efficiency should be considered, they appear to treat them with particular skepticism. While the AMC recognized the difficulty of measuring efficiencies and balancing the value of future benefits that may result from innovation against the current costs to consumers, given the importance of innovation and the centrality of innovation-based industries to our current

economy, the commission urged agencies to, in effect, give the highest priority to the appropriate treatment and articulation of how it looks at innovation issues and merger analysis. The AMC recommended that the agency should give substantial weight to demonstrating that a merger will enhance consumer welfare by enabling companies to increase innovation. Recommended that the agency should be flexible in adjusting the two-year time horizon for entry where appropriate to account for innovation that may change competitive conditions. The commission expressed concern that the current merger guidelines do not clearly acknowledge the possibility of dynamic change over a longer period of time than two years. Innovation may result in entry beyond a two-year time horizon, while we recognize that the guidelines do not purport to present a hard and fast rule, the commission recommended that the agencies increase their flexibility with regard to ensure that innovation that will change competitive conditions more than two years out receives the proper consideration. And finally, the AMC recommended further study of merger policies, specifically the agency recommended that the commission recommended that the agencies seek to heighten understanding of the basis for U.S. merger enforcement policy, including through a study of the relationship between concentration and other market characteristics and market performance to provide a better basis for assessing the efficacy of current merger policy. Thank you.

>> Carl Shapiro: Thank you very much, Deb. Before we turn to discussion, I wanted to have a brief advertisement for our next panel. The word from our sponsor. We're particularly fortunate to have Judge Doug Ginsburg here on the next panel. We're very honored that he's chosen to accept our invitation to come and speak. So stay tuned for that. Now, back to our regularly scheduled programming. Well, let me just pick right up -- I have a number of questions and want to move it along. And I'll look for each of you to indicate when you want to weigh in here. The innovation topics, almost every one of you has mentioned it, okay? So let's stipulate that innovation's really important. Let's even stipulate it's more important than small price changes, okay? How should we -- and the AMC says we should factor that more in. There's virtually nothing in the guidelines on innovation effects. How might we do that? While maintaining flexibility and while recognizing it may be very hard for the agencies to peer into the future far enough to really discern innovation effects. What kind of markers could we look to if we want to add some material on that in the guidelines? Tim, I know you're interested in this topic.

>> Tim Muris: Sure. I think you should give more guidance, I'm not sure you're ready to do guidelines. There are three particular issues that make this particularly difficult. One is the economics doesn't point in any uniform way. We know, I think, with great confidence, and the statistics show this, that mergers to monopoly and mergers to duopoly and normally are bad and should be challenged. The economic models and limited evidence on the innovation point and some of the best summary is still in a report Bob did in that first set of hearings that he had, about the best that you can say is that in so-called mergers to monopoly situations, sometimes it's anticompetitive, but not always. So you've got a fundamentally different meaning of numbers than you have in product market cases. That's the first problem. The second problem is the benefits from successful innovation in many cases are just overwhelming and take the drug situation. We did the Genzi case, one of the few cases, when I was chairman, that was controversial, and we allowed what was a 2-1 merger to go through, and they succeeded in a drug deal with horrible disease called poppy's disease. Those kind of benefits, you know, dwarf the benefits and the typical product merger of 5%, 7% lower costs. And that's more true generally with innovation. I think people believe. The third problem is our experience are being -- I still say are, I guess I can't get over that -- experience, you know, being the government with all this is mostly at the FTC and mostly with drug mergers. There's nothing wrong with that, but there's a particular regulatory process that makes the whole innovation issue more tractable. So what I would suggest is rather than do guidelines is that you offer more guidance beginning with someone writing, you know, a nice paper about just exactly what the FTC has done in all those drug cases. You know, why they've done it, how they've done it, the arguments that have occurred, try to make it relatively neutral, at least in part. So again, more guidance for sure. I'm not sure we're ready for guidelines.

>> Carl Shapiro: Bob.

>> Robert Pitofsky: I agree entirely that defining an innovation market and measuring market share is much more difficult than other efforts that we've engaged in because so many innovation markets are just ideas. And after spending \$100 million, it turns out the idea isn't going to go anywhere. So I agree that as a preliminary -- the people who are going to revise the next set of guidelines should take a look at what happened over the last 20 years in terms of innovation and get some statistics together. But then to opt out and not give as much -- as much direction as we can to the public

sector about market definition and market share. I talked about market share in my initial remarks. I know how difficult it is. But people have been working on it. There are articles on it. Wrap has an article on it. Judge Bork wrote a little bit on it. It's not easily done the way price analysis is done. But that doesn't mean that it can't be done. Or you do as much as you can, give as much hint to the public sector as you can. And move on from there.

>> Carl Shapiro: Deb?

>> Deborah Garza: The AMC thing appreciated that in it's -- directly in its recommendation and report that there is an issue about whether or not the agency's thinking has matured sufficiently to get guidelines, as Tim suggested, and it is important, I think, that the guidelines represent a consensus document and aren't sort of -- represent the flavor of the month club in terms of, you know, economic thinking. But what we saw with the AMC was that the public, the nonexperts that looked at the policymakers that looked at the guidelines saw guidelines that seemed to be looking at a static world and seemed to be really focused more highly on price effects and didn't seem to, frankly, give enough weight to -- and consideration to innovation issues. I don't think that's a true assessment of what actually happens at the agencies. I think when the agencies do their analysis, they are thinking of competition in a dynamic sense. It's just that the nature of the guidelines were such that they were, because of the way they are written, are more focused on the sort of static competition world and more of the price effects. And so, if they were written, I think the concern is that they don't adequately leave room for consideration of the effects on innovation, which as Tim has said, can really swamp any other effects or concerns. Even while you may not be able to specify much in the guidelines about how you're going to look at innovation issues which the AMC thought it was important to make sure and clear that they are an issue. And then Frankly urged that through this process of looking at the guidelines and potentially revising them that there should be a lot more work and thinking and articulation whether or not it's in the guidelines, but a lot more articulation of the issues that are relevant to innovation and merger analysis so that whether it's in the guidelines or outside the guidelines, you are pushing forward the thinking in that area and articulating the issues clearly even if it's not in the structural guidelines sense.

>> Carl Shapiro: Doug and then Jim.

>> A. Douglas Melamed: Just a couple of modest thoughts. I don't claim great expertise here, but here are my thoughts. One, I think, first of all, innovation has two potential roles here. One is, are we worried about harm to some innovation in what some people would call the innovation market. And the other is a perspective future innovation the kind of efficiency benefit that one might imagine from the merger. I think the analysis might be different. As to the former, my sense is to have great skepticism about the value of defining innovation markets, trying to figure out how to measure shares in them and so forth. I think the whole premise of that doesn't really apply. The whole premise of defining shares is to figure out, you know, sort of whether there's a likelihood of anybody being able to price off a marginal revenue curve rather than the demand curve and create dead weight loss. Innovation, the issue is, how are you likely to shift the demand curve? So I'm not sure that even if we could define innovation market and measure shares would tell us an awful lot about the likelihood that incentives for innovation would be affected. That's one thought. The second thought is, maybe the way to look at innovation on either of these questions, the plus and the minus, is to go directly to the question of do we think the transaction affects incentives to innovate? Often two big potential innovators might get together precisely because they see potential synergies. Whether they're spreading their fixed costs of R&D or putting together two nutty geniuses in the same room or whatever it is. But if they have incentives to innovate, one ought not to be worried about that. On the other hand, obviously there are situations, I suppose, where an incumbent monopolist might buy up a potentially disruptive innovator in order to shut it down. But it seems to me that rather than focus on the formality of market definition and shares, we ought to be asking simply the question of what do we think this transaction does to incentives? Maybe that ought to be a prime driver of the analysis.

>> James F. Rill: Doug picked upon a point also that I was concerned about and thinking about innovation as inclusion in the guidelines. And I think agree with Tim that it's probably not quite ready for primetime if the guidelines are indeed considered to be primetime because the learning is still on the way. One has to look not only at the quality from the parties' standpoint, the plus side of including innovation analysis and the calculation of efficiencies, but also the minus side of looking at the possible anticompetitive effect analysis or the result of overinclusion of innovation, innovation output functions, innovation firms in a merger case. There's literature that's been

pointed out -- excuse me -- a good bit of literature out there, but some of the literature is, I think, a little bit terrifying in the sense of looking at the very broad-based possible inclusion in the, quote, market, unquote, of R&D functions that maybe only functions very distant but nonetheless theoretically related in product categories with products being, for example, treatment of a particular condition. Or even a related condition. And some of the literature would include that in looking at the possible anticompetitive effect of a transaction between firms whose R&D capacity seem to be at least first analysis going on quite different tracks would put them in the same market and look to a possible challenge to the merger on that basis. So I think great care has to be taken to distil some of the literature and see how fundamentally sound it is, how it would play and quit and go back to the principle, is this an understandable standard that would be tractable and flexible enough to make sense in the guidelines. I think more has to be done with the literature and possibly with the cases certainly on the competitive effects side, possibly not so much so on the efficiency side.

>> Carl Shapiro: We have two panelists who want a second bite here. Bob.

>> Robert Pitofsky: Very brief. The implication seems to be if you had an innovation market, the result would be findings of anticompetitive fact and therefore a decline in innovation. The guidelines should also incorporate the notion quite often mergers between firms that are engaged in innovation are going to be very efficient, that they're going to be able to combine technologies. That's the history that we had with related areas, R&D joint ventures. Not one was found illegal for the first 100 years. It seems to me that the guidelines ought to set out the pros and the cons. Of consumer effects of innovation markets.

>> Deborah Garza: Very briefly. The AMC had not actually recommended that there be focus on innovation markets in the guidelines. But notwithstanding what Jim and Tim have said, it seems to me that there is a -- about the state of the learning. It seems to me that there is a sufficient consensus and, in fact, the agencies do look at things like the effect of a transaction on incentives to innovate. And our proposal would be that in the competitive effects discussion, one should at least articulate that when you have a merger that is being driven by or involve significant issues of innovation, here's the way we're going to look at it. Here's the kinds of things we're going to be

concerned about like how it's going to affect incentive to innovate. And on the flip side, indicating that the agencies will recognize, innovation-related efficiencies and how so and to make clear that two years is not a hard and fast rule. And that fixed-cost efficiencies relate to our research and development may have a real role to play.

>> Carl Shapiro: Well, let me push this a little bit further before we move to another topic. It strikes me as if we focus on incentive and ability to engage in innovation, there's a pretty clear tradeoff such as we get in unilateral effects which is if the merging firms are -- if one firm's success would take a lot of business away from the other, we have some rivalry there that might be diminished by the merger that could retard innovation. On the other hand, they might be able to get synergies or efficiencies. That could be articulated without invoking any notion of innovation markets and simply explains the same type of analysis who would do perhaps with a longer time frame that we do to some degree for innovation and do routinely for other dimensions of competition. Reactions to that. Doug?

>> A. Douglas Melamed: Very Briefly, I think that makes sense, but I just want to -- it does seem to me -- and, you know, those know the literature better than I, correct me if I'm wrong -- that the tradeoff between diminished rivalry and diminished incentive to innovate is a lot less direct than is the tradeoff between diminished rivalry and higher prices. If I'm right about that, it seems to me that the agencies -- they ought to note that rather than just lead people to believe that, well gee, a 3-2, it must be anticompetitive.

>> Carl Shapiro: Okay, so your homework assignment is submit supplemental comments on why it's so less direct. He's pulling the microphone away from you to agree.

>> male speaker: It's not just a lot less direct. It's that when you look at the literature, there are lots of models that say it's better to have fewer firms because you can capture, you know, the benefits innovation. Now, I think there's a very good paper which I think does a good job, you know, there are people who have taken the insight that I've just said and said therefore, all mergers ought to be approved and innovation, you know, innovation is king, and I think the paper does a good job of debunking that view. But it doesn't mean that we're dealing with the same kind of insights that we

have in product markets. And what it means, if you are going to write anything that reflects a consensus, it's going to be awfully short. And -- but -- but as opposed to and, there would be great value, to just -- just as we did that data released, I was surprised, I think everybody was surprised a little bit where the numbers came out. You know, let's look -- the FTC's got enough experience now in this area with the drug mergers that I think it would be useful to collect it and publish it.

>> Carl Shapiro: So if we noted the importance of appropriability which is underlined, I think, your point as part of incentives, would that assuage your concerns or you still think it's too murky?

>> male speaker: Well, like I find, you add that you've got a few sentences, I don't mind saying that. But I don't think it tells us a lot. And it's not on a par with what Jim said, you know, in terms of the primetime. And you still haven't addressed this issue -- I mean, outside of the drug mergers, it's a real murky issue, unbelievably murky, about trying to identify who the relevant parties are.

>> Carl Shapiro: Okay. Let me move to a different topic that's also been brought up by a number of you which is I would say the decline of the structural presumption, Jim, you referred to the floored market share paradigm. Tim, you mentioned adjusting HHI thresholds which, you know, is still using the paradigm, of course, and we've already signaled that we're not departing -- planning to depart if we do update the guidelines from the use of market division in HHIs, but given that it's not a consensus, a lot of voices saying structural measures should get less weight, how -- and we should do more holistic approach, if we move in that direction, which downplays the role of market concentration as an indicator of competitive effects and focus more on other ways of assessing the facts, how can this be done without weakening merger enforcement? To the extent that the structural presumption is an important tool that the agencies use in court. How do we do that?

>> male speaker: I don't think we can do it. I agree some structural presumption is not everything. I've described it as a launching pad that gets you started. And then you look at a lot of other factors. But to say that 20% market share and 80% market share are pretty much the same thing is going to diminish the ability to enforce the antitrust laws.

>> A. Douglas Melamed: I think there's a lesson to be learned from Europe here. Perhaps not many but certainly one. The European 2004 guidelines and dealing with market structure levels indicate that they're a starting point for further analysis. I think as it has developed in the United States, that's probably what they are now. A starting point for further analysis. I think the notion of presumption in the '92 guidelines is at most a weak presumption at this stage. And I think the court decision's are very obviously bear that out. Certainly at levels other than 2-1. But does that weaken antitrust enforcement that one needs to go on and look at competitive effects, other measures of competitive effects, other empirical evidence that would indicate that a merger might have adverse competitive effects? Once the certain threshold for further analysis has been cleared, I don't think the evidence will bear that out. I think that commensurate with the decline of the power of the structural presumption, if you will, there has not been a decline in merger analysis or merger review. And certain levels the presumption remains in effect. I think there were flaws in the H.J. Heinz decision. But it seems to me that if one accepts the analysis of the decision, one can't argue with the notion that if the facts were as stated, there would have been a very high level of proof shown to overcome the fact that it's a 3-2 merger. I could argue with that finding, but nonetheless, I think that shows there was not particularly a weakening of merger enforcement and a whole range of decisions such as Swedish match and others show that I don't think there's been a weakening of either the enforcement of vitality of the agencies or of the court's decisions properly designed. I don't think the presumption's there to necessarily to add vitality to antitrust enforcement in the merger area.

>> Carl Shapiro: Tim?

>> Tim Muris: Well, two points. The success or failure of the government in court I don't think has turned one way or the other on the structural presumption. And indeed, the courts are -- parties are so reluctant to take the agencies to court, it happens very infrequently. Second, and this is a point, when I was chairman, I thought, do we want to redo the merger guidelines? And I said no because I believe in consensus. But I believe we ought to lay the groundwork for future revisions by doing two things. Any revisions have to address the numbers, but what are the numbers? So we did the data release. And then the commentary on actual agency practice. Obviously, you're going to need to confront the data and either accept it or explain it away in revising the numbers.

>> James F. Rill: An additional thought. The guidelines are not a statute. And you write all the guidelines you want describing how the agencies go about merger analysis. They could be reconciled with a world in which the law says that there's a structural presumption, now we, the prosecutors, are going to tell you how we're going to exercise our prosecutorial discretion. And you could have a world in which you either you don't undermine the structural presumption except by the force of an analysis that suggests that maybe courts shouldn't give too much weight to the presumption. But I think they are two separate questions. But the law isn't what the agency's practice ought to be.

>> A. Douglas Melamed: Let me just respond to that point. Two of the guidelines are not statutory, but -- and, in fact, there's, I think, Judge Thomas Pinfield Jackson once described them as an admission against interests by the government. But the courts increasingly, and you can cite cases, myriad cases where the courts have treated the guidelines noting that they're not law, but nonetheless enormously persuasive by the expert agencies and follow the guidelines as though they were almost starred as precedent.

>> Carl Shapiro: So, it seems to me that the reality is that did the extent the guidelines continue to downplay the importance of market share or Herfindahls and say it's a starting point but you don't get much from that, it's very hard, isn't it, for the agencies if they go to court than to put a lot more weight on that measure? Doug, were you saying otherwise?

>> A. Douglas Melamed: I'm saying you could write around this problem if you were worried about it. I actually think, in the spirit of what Jim was saying, if you articulate attractable and sensible ways to analyze mergers for the agency, you shouldn't be worried about the fact it will weaken your litigation end, you ought to assume courts can apply, too. But if you wanted to draft around that, you could try to do it.

>> Carl Shapiro: This is full rule of reason analysis, especially in court. And I think that might not -- that might be a damning emission in some ways. After all these years of doing mergers and studying mergers, you would think maybe we could come up with some better shortcuts. That's the

reason I mentioned the facts is I think there are occasional factual shortcuts. But the reality is, you know, in Section 1, they're always talking about nobody does full rule of reason analysis. Well, mergers are full rule of reason analysis. And that's reality. I'm happy with that myself.

>> Carl Shapiro: Well, the guidelines right now, they have a disclaimer saying this is how we do things but it's not necessarily how we'll conduct litigation. Should we drop that disclaimer and encourage the courts explicitly to rely on the guidelines or just keep it the way it is?

>> A. Douglas Melamed: I don't think it adds a lot.

>> Carl Shapiro: Drop it?

>> male speaker: Yeah, option A.

>> Robert Pitofsky: I'm sorry, what is the consequence on dropping it? The courts are told not to pay any attention to it?

>> A. Douglas Melamed: No, it's a gratuitous footnote that was trying to get away from actually trying to align burdens of proof and other technical litigation strategies in the guideline. I don't think it pulls any useful purpose now. I don't think the effect is to weaken or strengthen the force of the guidelines.

>> Robert Pitofsky: Vis-a-vis the courts.

>> A. Douglas Melamed: Right.

>> Robert Pitofsky: I go back to the original here. I think the guidelines tell you what the enforcement intentions of the enforcement agencies are. I don't believe the courts should be bound by them. Maybe a little interest, but very little interest. Much more bound by precedent, although there isn't an awful lot of precedent.

>> A. Douglas Melamed: But the fact of the matter is the courts are feeling influenced by the guidelines. Read the cases.

>> Robert Pitofsky: A few of them have. Not that many.

>> A. Douglas Melamed: There aren't that many cases.

>> Robert Pitofsky: I stick by what I said. There's still not that many. You're right, that's the reason. I think the judges should do their job. The guidelines are for the purpose originally intended. Give people an idea of what the enforcement agencies are likely to do.

>> Deborah Garza: And I don't know why dropping the footnote, but the fact of the matter is that, what the agencies will look at and how they assess a merger is one thing and how courts try merger cases is another. And I don't think the guidelines should worry about things like the allocation of burdens and various tools that the courts will use to help them assess the evidence. And Frankly, I know that there is always a concern and has been a concern by the agencies about how the guidelines might affect their litigation success. But to be Frank, I think it's incumbent on the government to make its case in court on the rule of reason. And Frankly, if the judge is reaching for the merger guidelines to rule against you, chances are you've already lost him or her on the merits of the case.

>> Carl Shapiro: Tim, you mentioned in the commentary that was released in 2006, and there's a lot of good stuff in there. We asked in our public questions whether there were parts of it that might be incorporated into the guidelines themselves. I guess I want to ask you not so much to mention specific parts of the commentary, any of you, but what is the role these adjunct documents -- and should we take parts where there is a consensus, for example, and move it into the guidelines? How should we view that commentary, which is the latest sort of systematic statement as we undertake this project?

>> Tim Muris: Sure. Well, when we, at least for myself, I envisioned the commentary as, you know, the purpose of it was to reflect actual practice and multiply purposes when somebody sat

down to revise the guidelines. Also, I think the commentary does something that's quite useful and probably wouldn't work in the guidelines. All the case examples. And I think, you know, occasionally doing that in whatever form is helpful. And although the people who worked on it won't agree with this, the commentary is -- you know, doing -- cooperation between the two agencies can sometimes be strenuous. I'm looking for a delicate word here. I guess that wasn't one. And I think -- I think that something like the commentary can be done more frequently with relative ease than revising the guidelines. So I think they're complements, as opposed to substitutes. Although partly, again, I think any revisions should reflect some of the consensus that's in there.

>> Carl Shapiro: Doug?

>> A. Douglas Melamed: I'm not sure I disagree with Tim, but just a note of concern about the last point he made. It's precisely because the commentary can be published with less angst, that one has to wonder whether we get too accustomed to commentary. We don't simply have the whim of the current, you know, senior staff in the agency, rather than something that is more considered and more than doing reflection of, hopefully, both agencies.

>> Carl Shapiro: Okay. Tim, again, you mentioned there were a lot of examples in the commentary. We posed the question whether or not -- let's say not real, but hypothetical examples, might be valuable in the guidelines. They're in the I.P. licensing guidelines, about ten of them, there's about ten in the collaboration guidelines. As a professor, I find them rather helpful as a pedagogical tool. That would be a change for the merger guidelines. A good change, or perhaps not? Comments?

>> James F. Rill: There are, to be sure, one or two examples in the 1992 guidelines. I don't think they're very happy examples. I will only say that there's some merit to what Tim suggested, and that is that joint effort is very strenuous. You can read into that what you'd like. In the merger area -- and I read the I.P. guidelines and the international guidelines carefully, and I think the examples are quite fitting. I think the merger area and its companion rule of reasoned analysis makes it much less amenable to examples that are particularly useful, because the rule of reasoned analysis is so

fact-specific that a slight change in some of the underlying factual basis, empirical basis for the analysis, could change the outcome of the answer to the question that might be posed in the examples. And I think examples are much more -- much more appropriate for speeches and possibly commentary than they are in the guidelines, because there are too many variables that could go into the production of the example that could make a slight change in the variables to come out with a different answer.

>> Carl Shapiro: You want to comment?

>> Tim Muris: Well, you know, as an academic, I generally like examples. But examples here seem odd, given the hundreds of actual examples of cases you've got. You know, if you want to pull -- that's point one. If you want to pull an example, you do what the commentary did. But that has -- people don't want to do that to protect the innocent or whatever. And second, it would fundamentally change the nature of the guidelines, in the sense that I don't think you could just sprinkle -- given so many different points in the guidelines, I don't think you could just sprinkle, you know, ten through. You'd have to have a lot. It would change the documents significantly. Maybe that's a good thing. I think inertia and precedent probably say it's not. But I suppose I could be persuaded otherwise.

>> A. Douglas Melamed: Let me try to start persuading you otherwise, or at least suggest this. I thought Tim's comment about there's so many mergers and how can you have examples is odd, because there are examples in the nonmerger guidelines where there are vastly more actual transactions in litigated cases, and nevertheless, examples were workable there. That's thought one. Thought two, yes, if the agencies can't agree on a set of examples, you shouldn't scuttle the whole project. Just get rid of the examples. But I'm not sure it would be a bad idea -- or particularly, I think it might be a good idea, even if you only had a handful of examples rather than example illustrating every important analytical point -- to put into the guidelines examples thrown upon some very illuminating things the agencies have done in years, such as the explanations in the GENZI and cruise line cases, which were extremely valuable. And perhaps could be brought in, you know, at a key point when you're talking about certain use of certain kinds of data or incentives

and innovation or whatever. Even if you didn't have 40 examples. You only had a half dozen, I think it might be a little --

>> Carl Shapiro: Okay. Let me just give each of you a chance for a minute or two, if there's some last remark you want to make, having heard this discussion. I'm surprising you with this, perhaps, but reactions overall?

>> James F. Rill: Well, I'll simply start and say that the entire process that you're undergoing right now is an enormously beneficial -- is an enormously beneficial perspective, and it seems to me that panels such as this and perhaps even more so, the panels which will be following on, are going to themselves, I think, add significantly to the learning that's going to be evolving around the discussions that are taking place. Regardless of whether there's a revision or not. And I think that, as I've indicated and the other panelists have indicated, there are areas that are ripe for revision, look particularly towards the unilateral effects panel at the close of the day. So I applaud the process. It's worthwhile in and of itself, even if nothing more comes out of it than the learning that can be extracted from the panels.

>> Carl Shapiro: Thank you, Jim. Tim?

>> Tim Muris: Well, maybe you've already done this or have a sense of doing it, but the questions that you've asked are very open-ended and could lead to, you know, a fairly wholesale revision. At some stage, I think you should communicate publicly, you know, before you actually write whatever you're going to write that you've decided for X, Y, Z reasons to focus on A, B and C. And you have embarked on an effort that, you know, is praiseworthy, but immense, and to use the word again, potentially strenuous.

>> Deborah Garza: Just to echo what everybody else has said, the other thing I think as we go forward, I think it's going to be important to -- not to try to make the guidelines carry too big a load. You can't make them do more than they should do. And I think what they should do is to -- is mainly to communicate to those who are subject to government enforcement, what the rules of the road are to the extent possible. Provide certainty, provide transparency. Don't worry so much

about trying to move the courts and so, therefore, don't load too much into the guidelines and remember, as others have said here, this is not regulation, it's really just an articulation of the general way in which the agency will look at certain factors and what factors it will look at.

>> Carl Shapiro: Well, thank you all. Let me just set up a little bit what's to come the rest of the day in the context of what we just heard. I sort of consciously steered clear of some of the more specific issues, you know, how are we going to deal with unilateral effects or the market definition, algorithm and the sniff test, because those are going to be treated later today. And some of the other topics we didn't have time for much, efficiencies, will be addressed in other workshops. The very next panel's on direct evidence. And I think that fits very nicely with one of the themes, I attempted to say consensus here, that as we put less weight on market shares alone and do the more full analysis, perhaps starting with the way Doug described it, that there are a variety of different types of evidence we look to and the guidelines, while sound in structure, don't say much about how we do that. So please stick around to hear that and other panels. We're going to take a 15-minute break. Please join me in thanking this panel.

>> Male Speaker: Thank you all.