

>> Richard Feinsein: Why don't we get started with the next session? For those of you who don't know me, I'm Rich Feinsein. I'm privileged to serve as the director of the Bureau of Competition. One thing that I've already learned, just from coming up to this table, is that the Bureau of Competition has these very cool pens, which I didn't know about until this morning. So I'm happy to -- I will have gotten something out of today. In any event, the first two panels this morning, I think, set the bar pretty high. But we have a very distinguished group, which we hope will not disappoint the afternoon audience. I don't think we will. We've got an interesting topic, which is market definition. The way we're going to organize this is pretty much the same as it was done this morning, which is to say that I've asked each of the participants in the panel to make an opening statement of five to ten minutes, and I will enforce that. And after that, we will be kicking around some questions. If any members of the audience have questions, the same rules apply. Please write them down on a card and get them up to me and then we'll -- we will see if we can get into those. I also want to mention that Larry White has brought a handout. There are copies of it, I believe, on the table in the back of the room, as well as on the table in the hallway outside the room. It's a one page outline. So let me just very briefly introduce our four speakers, and then we'll get started. To my immediate left is Eduardo Perez Motta. And we're very, very pleased to have him with us today. He, since 2004, has served as the chairman of Mexico's Federal Commission on Competition. We're honored to have him participating in today's workshop. Eduardo has a long and distinguished career in public service in Mexico, and also has a background in economics. We're looking forward to hearing his remarks today. To Eduardo's left is Jonathan Baker, who is well-known to many people in this room, I'm sure. He is currently a professor at American University's Washington College of Law, and was formerly a director of the Bureau of Economics at the FTC. To Jonathan's left is Larry White, who is currently a professor of economics at the Stern School of Business at NYU, and where he is also the Deputy Chair of the economics department. And Larry served as the director of what was then known as the Economic Policy Office in the antitrust division in the early '80s, when I was actually working there as a staff attorney and assistant section chief. And we're delighted to have Larry here. Then, I'm not sure Joe has ever been to the left of anyone. But at the far end of this table is Joe Simons, who is well known to many people here. Joe, of course, served as the director of the Bureau of Competition from 2001 to 2003 as a very accomplished antitrust counselor and litigator, and is currently the co-

chair of the antitrust group at Paul, Weiss. So with that, let's begin the presentations, and we'll with Eduardo.

>> Eduardo Perez Motta: Well, thank you very much. It is a privilege to be here with you in this discussion. Let me start saying that I find this -- the idea to organize these hearings as something that are quite positive. And that is something that we should do, frankly speaking, we should do in Mexico as soon as possible. The law -- Mexican law specifies -- and the rulings specify how we have to do this. But it's always quite useful to give -- to put an outline, an outline or guidelines publically, so that all the operators and the economic operators or economic agents and lawyers and economists can understand what the methodology. The methodology that is used by the authority to take this issues. So I, first of all, I think it's a very good idea to have these guidelines. I know that your guidelines come from 1992. That's something that they have reviewed more recent comments from the guidelines, but I think it's always a good idea to have a check and to have -- to have this review publicly. This kind of hearings, I think it's a good idea. So let me thank you for inviting me, and also recognize that this is a very important exercise. And this is an exercise that we're going to actually follow very soon in Mexico. This topic, the topic that we are discussing in this panel, market definition, from the years that I have been the -- in the competition authority in Mexico, I frankly find that this might be one of the most contentious and maybe one of the most difficult issues always. What's a relevant market? How do you define the relevant market? This is a major issue, and it goes not only for mergers, but also for investigations. Well, actually for the investigations on the use of dominance. So this is, I think, this is a major problem and it's always important give discussion on this concept. Let me -- and I'm going to use my ten minutes. Let me explain to you, very briefly, how we work on merger analysis, and what's the basic element that we use in Mexico according to our law and our rulings. Our law is -- let's put it this way, the Competition Commission, the Mexican Competition Commission, the Competition Commission, is basically powered by the federal law of economic competition. And also has its regulations that the ones that allow us to challenge and to impose sanctions on any measure whose aim or effect -- this is the important point, the aim or effect is to reduce, lessen, or prevent competition and free market access to products and services are similar or substantially related. This is exactly, I mean, what the law says. So the competition is going to sanction those mergers that lessen, or harm, or impede competition. Basically, when they touch one of these three elements, we consider that they lessen,

or harm, or impede competition when they first comfort the ability, the ability to the companies that is going to come out from the merger to unilaterally set prices. That's the first point. The first element. The second is to unduly displace or restrict access to competitors. Or the third element, which is to facilitate anti-competitive conduct. Anti-competitive conduct could be either a collusion or unilateral competition conduct. So those are the sanctions -- I mean, those are the elements that could allow us to sanction a merger. Now, the elements that we consider for a merger analysis are basically five elements. The first is the definition of the relevant market, that's the main issue. The second is a market concentration and the market power, which is basically the market share or the ability to set prices, to restrict input by position, conduct, access to imports. So in this case, what we basically use is the Herfindahl-Hirschman Index, and another index that we have that we call the Dominance Index. We have published in the official gazette, basically how we handle those indexes. And this is information that is probable. The third element is the merger effect on competitors, clients, related markets, or agents. The fourth element is basically a cross ownership. And the fifth and last -- and this is something that was introduced recently in the reform of the law three years ago, is an efficiency. So the companies that are notifying a merge basically have to -- or they can justify on efficiency grounds, the impact that this merger is going to -- is going to have. So this is basically our legal framework. That's how we make this analysis. And I would like to stop here just to start this discussion. Thank you very much, Rich.

>> Richard Feinsein: Jonathan?

>> Jonathan B. Baker: Thank you. I want to thank rich and Carl for inviting me. And I'm delighted to be back to the FTC. And I think I probably ought to add that -- you didn't put it in your introduction, but I'm actually right now at the Federal Communications Commission, but I'm not speaking for them. Just for me. I have two points I'd like to make about market definition. The first is that market definition is more important for analyzing coordinated effects than for unilateral effects. So let me explain that first and then I'll go on to my second point. In a coordinated effects case, the key question is whether the merger changes the nature of the rivalry among the firms. Now, we need to define the market in order to figure out what firms to think about. Who are the market participants? And we also need to define the market to compute market shares, which we might want to use to determine how market concentration changes, or if we're not going to use that

route for identifying coordinated effects. We still might want to know market shares, perhaps to identify who the maverick is. So, the reasons in the nature of the coordinated effects analysis, that would lead us to want to define the market. In a unilateral effects case, and here, I'm going to talk about unilateral effects involving localized competition among sellers of differentiated products, which is the most common setting. The key question is different. The key question is whether a substantial fraction of the customers of one of the merging firms views a product of the other firm as their second choice. And unilateral effects cases, in other words, turn, most importantly, on the nature of the buyer substitution between the products of the merging firms, not on the way sellers interact. Now, you know, it's not that you wouldn't get into how sellers interact. But the key, initial, core question has to do with buyer substitution. Now, and in particular, about buyer's second choices from the buyers of one product -- what their second choice is, and whether it's the product of the merging firm -- the partner, the merge firm's partner. Market shares and market concentration often contain very little information about buyers' second choices. So, they don't help much in identifying unilateral effects. There's other kinds of evidence that might be more probative. You know, for example, how price varies with market structure, like we did in Staples, or diversion ratios, or other things that one would want to look at -- that would be more probative than market shares. And also, it may be hard to determine market shares reliably in differentiated product industries, where market boundaries can be difficult to draw -- in the densely packed space, that kind of thing. So, that's my first point. Market definition's more important for analyzing coordinated effects than unilateral effects. My second is that market definition needs to focus on one economic force only, namely buyer substitution. If you ask market definition to do too much, it's easy to get confused. So this is not quite an economic proposition. This is a how to make it work in practice proposition. And that's why the guidelines don't ask this analytical step to account for supply substitution, as well as demand substitution. Or at least, why it makes sense for them not to. In contrast, some courts will account for supply substitution in defining markets in -- at least in monopolization and other exclusionary conduct cases. And it's also why it's a bad idea to try to account for the significance of demand complementarities, including those associated with two-sided platforms, which is, you know, a topical issue in the market definition step of the analytical process. By all means, we have to think about that. And think about the significance of complementarities in order to evaluate the competitive effects of the merger. But let's do it in the step of analyzing competitive effects, not market definition. In fact, if you think about the structure

of the merger guidelines, that's -- they sensibly allocate the economic forces to different steps of the analysis. So, buyer substitutions analyze -- is what we're talking about. But supply substitution is mainly handled in the entry step, although there's also some aspects of it that are taken into account and then figured out who the market participants are. That would be the uncommitted entrants, and in the context of unilateral effects and repositioning. And the rivalry among sellers is addressed in the competitive effects analysis and some other things are addressed there, as well. Now, this allocation breaks down in unilateral effects cases, though. Because the guidelines ask us to analyze buyer substitution twice in a unilateral effects case. First, in defining the market. And then, once again later in determining diversion ratios, or whatever we're going to do, and to do the competitive effects analysis. Now, there are technical differences between the two analyses. You know, so, for example, if we thought that the merge firm would raise price, but not by as much as the snip, you know, say only by 4%. We might catch the problem in the competitive effects step, but not catch it when defining the market. But in general, it may well make sense, more sense, to analyze buyer substitution only once in unilateral effects cases. And if we are only going to do that, I would do it in the competitive effects analysis, rather than in the market definition step. Thanks.

>> Richard Feinsein: Thank you. And my apologies for leaving out your current duties at the FCC in the introduction.

>> Jonathan B. Baker: Oh, that's fine.

>> Richard Feinsein: Larry?

>> Lawrence J. White: Okay, again, my thanks to Rich and Carl for inviting me and shepherding this whole operation. I think it's a very, very valuable effort. I do want to talk about the hypothetical, monopolist market definition paradigm. It has stood the test of time. It's now been 27 years since 1982, when it was first enunciated. And I think there are good reasons why it has stood the test of time. First, it's a conservative approach. It basically asks, you know, as a general matter, although there are exceptions, what is the smallest group of producers if they colluded, i.e. acted as a hypothetical monopolist, what is the smallest group that can succeed in exercising or enhancing market power? Or equivalently, and this really goes to the heart of the matter, a relevant market is,

in essence, one that can be monopolized. And I think that's a very useful framework, a useful just world view of thinking, you know, what are we trying to find here? And then, of course, the remainder of the guidelines, as Jon just indicated, provide the means for determining the likelihood that either market power will arise initially, or any existing market power could be enhanced because of the structural and/or behavioral characteristics of the market. There is another very important aspect of the paradigm. It's flexible. First, whether the participants in the market are already exercising market power is irrelevant. That hung up a lot of people for a while. But it's irrelevant because the paradigm is basically asking could this merger make things worse? That's really the relevant question. Could this merger make things worse? Further, though the paradigm focuses on producers and properly so, because it's producers that are likely to collude -- or you have to worry -- sorry, not likely -- but it's they who might collude post merger. So, you want to be focusing your attention on them. But in the case of price discrimination markets, you've also got to identify relevant consumers, and so there's that flexibility there. Further aspect of flexibility -- the paradigm was developed in the context of a world view that was basically all about coordinated effects. That's the way -- in 1982, that's the way the men and women of the antitrust division, the U.S. Department of Justice, thought about, you know, what were the problems for mergers? It was a coordinated effects view. However, the paradigm is applicable for unilateral effects, has been used in these kinds of cases. But I want to ask the question -- Jon has addressed it to some extent, and I will address it in just a minute -- is it really necessary for unilateral effects cases? So those are the -- as I think about the strengths of the paradigm, why it has stood test of time -- it's a relatively conservative approach, and I think that's a healthy approach. And it's got these nice aspects of flexibility. All right, what are the limitations? Well, now I'm going to come back to the unilateral effects analysis, and as Joe Farrell's sharp eye noticed in my one-page handout that's available -- I screwed it up and mistakenly wrote "coordinated effects" where I really meant "unilateral effects," in this part of my outline. It's -- the market definition, I'm going to go more strongly than Jon on this point -- I think it's potentially confusing. A confusing afterthought in a unilateral effects analysis. And if you want a good example of that, I urge you to read Vaughn Walker's decision in the Oracle case. I have increasingly come around to the view that basically says if you have found significant unilateral effects, you've got a market. That's got to be a market, because you've found something where there are going to be post merger significant price increases. That's what we're concerned about. That's got to be a market. Now how that gets

phrased, I don't really care. But you don't want the market definition confusing the issue. You want it in unilateral cases, unilateral effects cases basically saying, you know, "hey, we found the effects that must mean there is a market here." The other thing I want to point out, and this is not strictly a merger guidelines issue, but I'm going to be using the inspiration of Rahm Emanuel, as you know, his maxim is "never let a good crisis go to waste." Well, never let a good opportunity go to waste. And the other thing I want to mention about the hypothetical monopolist market definition paradigm is that its application to monopolization cases is severely limited. It can only be used for prospective monopolization actions. Every once in a while, that may come up, but that's not the typical monopolization case. The typical monopolization case is where the defendant is being accused of bad acts and an essential feature is to argue that the defendant already has market power. And if that's so, you cannot use the hypothetical market, hypothetical monopolization market definition paradigm. Because trying to use it in that context really is committing the cellophane fallacy. So let me stop there.

>> Richard Feinsein: Thanks Larry. Go ahead, Joe.

>> Joseph J. Simons: All right. Thanks, Rich. Good afternoon, everyone. I want to thank Rich for inviting me, and I guess Joe and Carl, as well. You and your colleagues are to be highly commended, I think, for initiating this enterprise. I think no matter how it comes out, it's going to be extremely beneficial to the antitrust community. So let me start out by echoing some of the things that Larry said, and what some of the folks this morning said, as well, which is that the existing guidelines are very, very good, have very deep bipartisan support and have clearly withstood the test of time. As a result of that, my own view would be that I would be very cautious in making major changes, and I think if it were up to me, I'm not sure that I would change very much at all. But having said that, I'd like to cover four points today. Three -- I'm sorry, one, a kind of general comment on the guidelines, and then three points about the market definition. On the overall point, as currently drafted, the guidelines are very general in nature. They don't go into a huge amount of detail trying to anticipate every factual situation that might come up in a merger. And I think that's the right approach. I think it would be a mistake to inject a lot of detail into the guidelines rather than having them focus on broad principles, which Larry did a terrific job of laying out in terms of the market definition. So my sense would be, let's focus on the broader

principles and let's have the applications to the specific facts fleshed out over time to experience. That fleshing out process has been and can continue to be made transparent to those outside the agencies through speeches, closing statements, commentaries and the like. I think the method of applying the guidelines has developed very substantially over time, in different ways, with respect to different parts of it. And I just think it's really -- I think it's not possible to account for every factual situation. So my sense would be to kind of stick with the broad principles along the lines of the current form. All right, so since our panel is discussing market definition, let me try to make three points on that score. First, something very basic, which is that I think market definition needs to remain as a key part of the analytic framework for the merger guidelines. The statute and the case law require it. And I think that the -- at least my sense is that certainly when the lawyers getting rid of the market definition and the guidelines would not be -- would not have a lot of support. I understand, you know, just from talking to economists and certainly from what Jon and Larry have said just moments ago, you know, that type of approach is much more popular with the antitrust economists. And, you know, I think you can understand why. A lot of that is based on, you know, unilateral effects analysis. It is based on economic modeling and the simulations. That's much more, you know, easy for the economists to get their arms around, much less so for the lawyers. I think the lawyers are going to have some concern as to if you can really rely on that and how it's going to play out in court. I think there is one circumstance in particular, I think it's pretty rare where you're going to be able to prove direct effects. You're going to be able to prove an effect directly in a merger. And in that case, the market definition pretty much falls out of your proof of direct effects. This is consistent with what Larry was just saying. So if you prove that the merger caused the prices to go up. An example of that is the FTC's case involving Evanston hospital. Then pretty much there has to be a market there someplace. And in fact kind of an interesting side light I was at the Bureau once when that case was being developed. And the economics, the econometrics actually drove that investigation, because that showed that there was a price effect. The intuition of the lawyers was, "gee, it's kind of hard to define a market here." You had geographic issues, you had issues about one hospital was a community hospital, one hospital was a teaching hospital. And so there was a little bit of confusion about how should they approach the market definition? And what really drove that for the staff, I think, and for me, was the econometrics showing that there was an effect. So if we knew there was an effect, then there should be a market there. But I think that's a pretty rare case, and to kind of take the market

definition out the guidelines based on that, I think, would be a mistake. Second, I'd like to address a couple points relating to critical loss and diversion analysis. I would not recommend putting the details of how to do critical loss into the merger guidelines. I think critical loss or something like it is going to oftentimes be necessary when you're defining a market under the merger guidelines. But so unless the market is really obvious, and you know, it doesn't take brain surgery or any kind of serious analysis to figure out what the market is, you're going to have to get some sense of how much volume is necessary to make the price increase unprofitable. You do that through critical loss, and maybe there's other ways to do that, too, but one way or another, you got to get some sense of what that number is, what the range is. Is it 10% or 20%? Is it 70% or 80%? I think if you ask most folks today, they will tell you it is kind of toward the lower end. But if you went back 20 years before critical loss was done in any kind of serious way, you look at the NAG merger guidelines, for example, who say the numbers should be 75%. So one way or another, you're going to have to do that. The details are going to vary, depending on the factual circumstances. I think if you try to put that into the guidelines, you're going to create more problems than you're solving. Similarly, I wouldn't want to put anything in the guidelines that discussed estimating what I refer to the actual loss from the margin data, via the learning condition investigation or the inverse elasticity rule. However you want to characterize it. At least among lawyers and, I think, some economists as well, this would be highly controversial. And as far as I'm aware, it hasn't been done successfully in court. I think it's been tried a couple times and not done very well. And then the other thing is the necessary implication of using the learner condition underlie your analysis is at least from what I know, that virtually all horizontal mergers raise price and that is something that I think the lawyers will have an issue with. And then just on the diversion analysis, I think, at least my view of that is that that's something that is much more relevant for unilateral effects, and if you're going to discuss it, it should be in the unilateral effects section. And I don't really think that's really useful for the guidelines, in the market definition. And the third point I wanted to make relates to what type of snip we should talk about or use in the guidelines. Based on my own experiences talking to folks at the FTC and talking to folks at the DOJ, I have seen never and the folks can only think of once or twice where the -- a merger was investigated using something other than an across-the-board snip. The guidelines, as they're written currently, would allow a market to be defined on a snip relating to just one firm. So you have five firms in the market, one firm raises the price, and can you define a snip on that basis. I think that's -- you know, it's not done in

practice. I think it's misleading to do it that way. And my recommendation would be to take it out. And then the final thought I have is just to recommend adherence to the Hippocratic Oath -- Rich, it's particularly appropriate for him, since he was head of the health care shop -- you've got a very well-respected set of guidelines here, with a huge bipartisan consensus behind them. And so in that circumstance, I think it becomes really important, you know, above all else. "Do no harm."

Thanks.

>> Richard Feinberg: Well, I think I can probably speak for all six of us who are working diligently on this effort that that is our goal, to do no harm. Thank you very much, Joe. What I'd like to do first, I guess, for those of you who were here this morning, there was a very lively debate, particularly, I guess, on the second panel, relating to the use of direct evidence of the anti-competitive effects, or competitive effects -- not necessarily anti-competitive effects. The direct evidence of competitive effects. They touched to some degree on how that -- the availability of direct effects might bear on market definition. What I'd like to do is approach it from -- you know, sort of the same question from a little bit different perspective. And Joe, you alluded to a circumstance where you had a consummated merger, and it appeared, based on the econometrics, that the direct effects were fairly clear. That may not always be the case. Even in a consummated merger, that may not always be the case. And it's probably even less likely to be the case directly, as opposed to by analogy or by example, in an unconsummated merger where you're trying to make a prediction. So the first question I'd like to solicit the group's thinking on is, you know, given the fact that purpose of market definition is to identify the context in which likely or actual competitive effects are to be assessed, how -- are there circumstances where the existence of direct evidence of competitive effects reduces the need for a precise market definition? And if so, what are they? And should they be specifically addressed in the guidelines?

>> Lawrence J. White: All right, I'll leap out. Yes. Yes. Yes. And I'll say it again. If you found direct effects in a unilateral effects case, you have a rocket. And you don't need to go any farther. And, you know, anything more risks confusing Vaughn Walker. I guess that's -- I don't know how to say it more directly. And so I would just stop there.

>> Richard Feinstein: All right. Jon, why don't you go? Since Joe's had the floor more recently, let's give Jon a chance. Then Joe.

>> Jonathan B. Baker: That's fine, although I'm going to agree with Larry. So Joe might come out the other way. So -- let's -- there are two different kinds of direct evidence that are worth talking about. One is direct evidence of the ultimate question of anticompetitive effect, or the least of which -- I think of and relief of which I think of as let's say a price market structure kind of study like they did with Staples. But there's also direct evidence of something from them, for which you then infer that there's harm to competition, like, for example, direct evidence about demand elasticities and diversion ratios and things like that. And then if you are using market shares as your basis for proving harm to competition, you are making an inference, also. It's just based on market shares. So all kinds of evidence might be proven in different settings. And there will be cases where the direct evidence that the merger's gonna raise price is totally convincing, and other evidence won't help you much. Even if it came out the other way, you wouldn't believe it. And there will be cases where you'll have some the other kinds of evidence and the market shares, market concentration will help you. And so it -- it's more a -- in the first setting, you don't need to worry about market definition as much. And I guess I talked earlier about how that's more likely to be so in the unilateral context than in the coordinated effects context. I do want to say something since Larry brought up Vaughn Walker twice. I don't view that as a confused judge. I think that Judge Walker knew exactly what he was doing, he just didn't want to find unilateral text in that case. And that to be honest, I think it would be a mistake to rewrite the merger guidelines purely in response to what Judge Walker had to say, because he's very different from most judges. He was an antitrust expert who had a strong point of view, is my take. And most federal judges are not antitrust experts who aren't trying to sell us on their perspective on unilateral effects and merger analysis, but so wouldn't respond in the same way as him.

>> Richard Feinstein: Joe?

>> Joseph J. Simons: Right. So following up on that point from Jonathan, I couldn't agree more on the Vaughn Walker point, which leads right into the point I was going to make, which is I think for most, at least for me, a good case is one in which all the evidence points in the same direction. All

right? And if it really is a good case, the odds are good that the evidence is all going to flow in that one way. So even though you might have evidence of a direct effect, I would want to look at other evidence, as well. And I think in terms of a judge that -- the judge you're most likely to get in front of is not going to be the Vaughn Walker type of judge. The judge you're most likely to get in front of doesn't know anything about antitrust. And, you know, the way to convince that judge is, you know, the more stuff you've got going in the same direction, the more likely you are to convince him.

>> Lawrence J. White: I'd like to leap back in, because I've been really chewing on something that Joe said in his earlier remarks and I think is relevant here. He talked, at the very end, what type of snip, and he said suppose you have a market with five firms, but only one firm raises its price? All right. Okay? I assume you're talking post merger.

>> Joseph J. Simons: Yes, so a hypothetical monopolist controls the five firms. And the hypothetical monopolist only raises the price of firm one.

>> Lawrence J. White: And I would say you've been led astray by market definition that really -- if you've got the one firm that's going to be able to raise its price, you know, there's a market right there. And stop. Don't go any further. You're going to confuse somebody. And so -- think in terms of what's the goal here? It's to be preventing -- the raising a price, either in a coordinated manner, in which case market definition is terrifically important, echoing what Jon said earlier. Or unilaterally, in which case, stop, don't go any further. You're going to confuse somebody.

>> Joseph J. Simons: Can I follow up on that point?

>> Lawrence J. White: Of course.

>> Joseph J. Simons: So -- I probably was not clear in the example I was trying to, or at least I had in my mind. So here's what I had in my mind. If you think of a situation where there is ten equally situated firms, and you have a merger of firms one and two, and we assume for the example that they can't raise the price either of both their products, or either one of them. Now, we further

assume that firms one through five, if they're monopolized they can't profitably impose an across-the-board snip, either. But let's suppose we then assume that if the hypothetical monopolist of firms one through five could impose a profitable snip by just raising the price of product -- you know, firm one's product. All right? And under the guidelines, as currently written, you could define a market that way. Except for that wouldn't tell you that much. Because by hypothetical, we've assumed you can't have a unilateral effect. And the only way you can have a coordinated effect, the only way that firm -- the combined firm raises price is to get a side payment from three, four and five. So if that's the only way can you have a problem, then why are we looking at that? That's what I had in my mind.

>> Jonathan B. Baker: And that's sort of an answer to that -- well, you sort of say "side payment," what you're trying to do when you say that, is you want to rule out task to collision two.

>> Joseph J. Simons: No, no, no.

>> Jonathan B. Baker: But in the market you describe, in principle, there could be a coordinated effects problem. Maybe in this particular merger, you know, change the market structure in a way that made it possible for the post merger, you know, firms to raise price and the other firms would kind of go along and permit it in a way they wouldn't before. I mean, it's all kind of hypothetical. I'm not sure it's the real world thing. But in principle, it's exactly right. And the guidelines, you know, are conceptually correct in, I believe, in saying what you're referring to, that, you know, the hypothetical monopolist could raise the price of any or all of the additional products under its control. And if you insist on what you want to insist on, the way it was in the '84 guidelines, before this got changed in the '92 guidelines -- if you insist on coming back the way it was in the '84 guidelines at this point, you run a different risk that you're going to -- there's going to be a situation -- think about your example where there really is a unilateral effects problem. You want to prove the market and, you know, in your view of how to do the, write the guidelines, and the -- you could get at the unilateral effects problem, you know, and sell it to the court, let's say, in a market that has five firms in it. But if you had to do it across-the-board snip, you'd add an additional 20 firms. There's no way you can convince anybody that there's a problem. So I think it's correct to keep this in and sensible besides. It'll rarely be used, but it's appropriate.

>> Joseph J. Simons: See, my view is, and I think -- I think Whole Foods had this problem -- you start to look like you're gerrymandering a market so you don't have to prove a competitive effect. And you're going to rely on a presumption. So I would rather, let's define the market the way it's traditionally been done. And when you want to prove a competitive unilateral effects, you prove that. And if you do that sufficiently, you win. Otherwise, you're going to be defining very narrow markets.

>> Jonathan B. Baker: Okay. But you're running against the usual litigation dilemma in unilateral effects cases, the way you say that. Which is that maybe the, you know, if the market shares are not particularly meaningful and the two merging firms have products that are fairly close substitutes, but they are sort of in a little corner of a bigger market, but you don't want to define the narrow market. Well, then, you have low shares and it's hard to convince anybody that there's a problem. But then if you want to go the other route and define the narrow market and say it's a merger or a monopoly or a near-monopoly, then you run into the people who say well, narrow markets are gerrymandered, and there are those evil submarkets, they got too many adjectives. And you end up missing the problem because of this problem.

>> Joseph J. Simons: Well, no. You're trying to get a structural presumption. You're trying to fit your case into a structural presumption when you really have a different case. I think the guidelines would be benefitted if they would actually say something about this circumstance where can you have a unilateral effect in a broad market. So that way -- what tends to happen is, I think it has something to do with the way it is litigated, usually, is you go in and you try to say the market is narrow. And then you run into a problem when you lose on the market definition. Whereas, if you were kind of just said okay, here the market. You know, define the normal way it's defined. And we have a unilateral effect and here's the evidence we have for that. I think you might have a different situation. If you clarify it in the guidelines that that's what you're doing and that's appropriate to do, you know, maybe you do better.

>> Jonathan B. Baker: I kind of agree with that, because the real problem in the story is that you're trying to create a presumption of harm to competition in this unilateral case based on market shares,

when they're not particularly good indicators of anything in most unilateral effects cases. And it would be very useful to have an alternative basis for creating a presumption of competition that a court could, you know, get its arms around that would be based on something else that would be more probative. Then that would take the pressure off the market definition in quite interest the way you describe. And also have the benefit of having a framework for describing the harm to competition, then you can explain to the court that it connects up to the source of the evidence you're using to try and get that presumption.

>> Lawrence J. White: So, Jon, you just -- I thought you were an ally. You've just given into the devil. You know, come back to the basic idea of relevant market is something that can be monopolized. Something where the price can go up under -- if some structural things change. And, you know, narrow? Small? Doesn't bother me in saying that's the market. You know, at some point it's de minimus. I understand that, so you don't, you know -- but beyond de minimus, small, narrow, hey, if there's an effect, there's an effect. Why confuse it by saying there's this bigger market, but oh, there is something going on here, but we're not going to call this a market. Again, a relevant market is something that can be monopolized.

>> Jonathan B. Baker: That's not what I was arguing. I mean, I agree with you. That's perfectly fine to have a narrow market. Well, both of you are the devil. Neither one of you is the devil. There are devils over there. My boss is really, you know, an angel here. If we're forced into the market definition paradigm for analyzing unilateral effects, and are going to have to argue over it that way in court, there are advantages to both approaches. I have no problem with narrow markets. I have trouble with some markets, when I can define them. But what we were talking about before is what is the best way of creating a presumption and the anti-competitive effect? Maybe you even want to do it without markets entirely in unilateral effects cases, or at least downplay it. And the less you care about market definition unilateral effects cases, the more you want to look for something else than market shares to base your presumption on, the more important it is to have some alternative. And, you know, frankly, the more sensible it is, because market shares are often not very good predictors of harm in unilateral effects cases. So what I was saying before about the presumptions was essentially independent of market definition. Not buying into either the large market or the small market.

>> Richard Feinsein: So just to follow up real quickly -- if you don't have -- if you don't define the market in a way that allows you to estimate shares, if you sort of back into a -- if you focus on competitive effects and don't get to the point where there are presumptions, I suppose, what implication does that have for the safe harbor analysis that currently exists given certain HHI levels? What happens to it? Yeah, anybody.

>> Jonathan B. Baker: It's not clear to me that there is really a safe harbor. I mean, 'cause in real life, everything depends on the market definition. So, if the market is defined one way, okay, you're safe. If the market is defined another way, you're not.

>> Male Speaker: So if the market is defined as -- you should be safe. You said even if the market had been all sales of office consumables, so that Office Depot and Staples were then 5% of the market, you are perfectly comfortable saying that that merger's anti-competitive and you think that's the way it should be litigated.

>> Jonathan B. Baker: Here's what I'm trying to say. What I'm trying to say is that the market definition under the way it's currently structured comes with a presumption if you get the shares high enough. Right?

>> Richard Feinsein: Yeah, we're always focusing more and more on shares if we're low enough. But go ahead.

>> Joseph J. Simons: Usually, people rely on presumption to prove a case. And you lose on the shares. All right? And you're story about competitive effect.

>> Richard Feinsein: Let's -- Jon wants to say one more thing, and then I want to move on to a different issue.

>> Jonathan B. Baker: This little conversation is related to a point that I think Joe made before about -Joe did it in the context of talking with the Lerner Index. But the unilateral effects analysis,

you know, involving differentiated products -- if you're just looking at the substitution across the firms, and you're not thinking about other aspects of the analysis, it will look like all mergers have at least, initially, have a tendency to raise price. You know, we needed this in 1992 when we put that section in the guidelines. And the answer is just it's not true, I mean, in the sense that there's more to merger analysis than just the full competitive effects analysis goes beyond the buyer substitution and the first and second choice products. And when you get to the -- beyond the presumption, you have to -- you can rebut it. You can think about repositioning and you can think about efficiencies. Now, when Carl and Joe wrote their recent paper about to use diversion ratios and margins to create something that could be sort of like the basis of a presumption, they built in efficiencies assumption in there. So the -- essentially, the price would have to rise more than a certain amount or after a standard deduction, was the phrase that -- maybe? I don't know. That's one way to handle it. So going down this route of proving unilateral effects without a market definition, or at least building in a presumption through a route that doesn't require market shares and market concentration, isn't the same thing in saying all mergers are going to lead to higher prices. Because you can set it up in a way that incorporates some assumption about efficiencies or repositioning that would limit the cases to the ones where the concern is the greatest about a price raise.

>> Joseph J. Simons: But that strikes me as kind of artificial, because you then recognize that the underlying process produces a price increase for every horizontal merger, and you realize that's not right. So you're kind of using the efficiencies as a standard deduction to calibrate it down. But how do we know that that's even close to being properly calibrated?

>> Jonathan B. Baker: Well, we have to be doing better than the 35% safe harbor in the current guidelines. Or even the low HHI safe harbor and the current guidelines when it comes to unilateral effects, because the market shares aren't very helpful in analyzing the unilateral effects in a lot of cases. So this has got to be a better route.

>> Joseph J. Simons: Well, the problem is if you use this, though, you're going to end up challenging mergers at much lower concentration levels than you're -- you're going to be challenging lots of mergers you never would have challenged before.

>> Jonathan B. Baker: Would you view the Staples/Office Depot merger as a merger at a lower concentration level, or do you do it as a merger at a high concentration level? The concentration level is, you know, that you get depends on the market definition. And that may or may not be helpful here.

>> Joseph J. Simons: Well, I guess it depends on, you know, which market definition you have in mind, whether you're going to do a variable snip or you're going to do an across-the-board snip?

>> Richard Feinstein: Let me shift slightly, although we're going to stay on the topic of snip for a minute. You know, I think there's a fairly broad consensus that that's a useful tool in the market definition process. But in connection with the possibility of revising the guidelines, I'd be interested in hearing the panel's views on the question of whether the level of the snip should either be revised to the general proposition, or should be made more variable, depending upon particular circumstances. How, if at all, would you address that issue? That is the possibility of what level of snip ought to be used and when. Yes.

>> Eduardo Perez Motta: Thank you. Actually, my impression is that this need should have some flexibility. In our case, our commission does not apply this need formally. But we normally consider a range between 5% to 10% that follow, basically the U.S. and the other parameters. But you could have some cases, for instance, where the size may be substantially smaller in markets with low price cost margins, for instance. So I think flexibility should be considered.

>> Richard Feinstein: Anyone else want to comment on that?

>> Joseph J. Simons: I want to go back to Larry's kind of first principle on market definition. Certainly for the unilateral cases. And that is you're worried about -- you want to identify a market that could be being cartelized, right? And so you may have a situation, probably on average, 5% to 10% is probably good. But there might be cases in which, you know, a 5% to 10% price increase won't work, but a 20% price increase might. And if you come across that, well, then, you should use it. On the lower end, that might be a little bit more ambiguous, I guess, 'cause I'm not really

sure once you start to get down to 1% or 2%, whether that's really something you really apply with any kind of confidence, just because there's so much noise at that level.

>> Richard Feinsein: Yes, Jon?

>> Jonathan B. Baker: Well, I have no objection to the variable snip, and that makes sense. But there's a sort of -- I want to take a step back also, in through the way Joe and Larry were doing. I think there are all sorts of markets in which transactions can be analyzed. The market -- there are markets that are overlapping with each other. There's that -- that is to say if there's any market in the sense that Larry was emphasizing, that would be one that is profitable at monopolizing, which this particular merger presents a problem. They just ought to challenge it. And if it doesn't look like you get one with a small snip, but you get a different market with a larger one, that's one that looks like there is a problem, or vice versa. You ought to challenge it in either one of those that you see. But the real problem is not with -- that's really only an imperfect substitute for getting rid of the smallest market principle, which is the real underlying problem. Because there's no reason to tie yourself to some smallest market when, you know, if there's a competitive problem in a larger one, why not analyze it in that? The goal is to figure out where there is a problem and challenge bad mergers, not to have fidelity to an arbitrary smallest market that can get in the way of doing that.

>> Richard Feinsein: You anticipated what I was coming to next, which is the smallest market principle and the methodology which adds products in the order of next best substitutes. Are those areas that the panel would agree with Jon are good candidates for modification, or are they as they should be now?

>> Lawrence J. White: The way I read the guidelines is, you know, there is enough generality there, so it's sort of generally the smallest, but it encompasses the kinds of possibilities that Jon just described. So I don't see any need for big change. Unless there's just so much confusion and so there needs to be a little bit of clarifying language.

>> Richard Feinsein: Joe?

>> Joseph J. Simons: Yeah, just to me, it's not really clear why that was ever put in there. So if it could get clarified, maybe that would be helpful and keep it in, or if it can't, maybe take it out.

>> Richard Feinsein: So far, our entire discussion has been, at least implicitly, focused on product market issues. I'd like to solicit the thoughts of this panel on the general topic of geographic market. I mean, the notion of irrelevant market obviously includes both components. But we've really been, at least implicitly, focusing on identifying the products. Does the current treatment of geographic market in the guidelines call for modification in your opinion, or in your opinions?

>> Lawrence J. White: I don't think so. You're right, especially in unilateral effects, we tend to be thinking in terms of the phrase I use, you know, customers trapped between two diverse first and second choice products. But you can think of customers trapped geographically just as well. So I tend to think, generally, in both dimensions, both product space and geographic space. I don't see any need for greater clarification there.

>> Richard Feinsein: Joe? Jon? Eduardo?

>> Joseph J. Simons: The only thing that occurred to me is if the product is being sold on a deliberate basis, then you might have a kind of geographic price discrimination, then you might want to define it by customers.

>> Jonathan B. Baker: Look, I actually -- again in the context of the question is the way that the geographic market definition section talks about the hypothetical -- the only present or future of the relevant product at locations. And that the issue is -- when you think about buyer substitution, the buyers aren't substituting to the location where the producer produces, it's the location where the producer sells. And, you know, I think that would be the right thing to do. I think that must be what's meant -- and to change it from producer to seller. But I think everyone does it that way.

>> Richard Feinsein: We've got three economists and two lawyers on this panel, the second lawyer being the moderator. But I want to ask a question that a question about the use of noneconomic

evidence. It ties in a little bit, I think with the point that was made earlier in dealing -- judges are typically generalists and, you know, may not be as conversant in some of the topics that we've been talking about. I'd be interested in listening to each of you on your views on the role of noneconomic evidence, in particular, things like customer statements or internal documents which reflect business people's assessment of the competitive landscape. What role should that kind of evidence play in the market definition exercise that we've been discussing? Eduardo?

>> Eduardo Perez Motta: I think you should use it. Not only to use the noneconomic evidence, but also when -- I'm just looking at this problem on the authority's side. You have to understand that in the end, the person that's going to judge your resolution is a noneconomist. So the problem, I think, is a little bit more general. It's not only the use of the possibility to be open to use noneconomic elements. In this case, we're, in Mexico, we are pragmatic in that sense. Especially when you find a merge that would be direct evidence. This goes to your first question, as well. With the direct evidence, you don't see the problem. If it's clear that there is not a problem with that case, you have to stop there. You don't have to go further. And there you include noneconomic or direct evidence on markets, which is important. Now if you have to go to the economic analysis and define the relevant market and then to follow all the five steps that I was describing in the beginning, I think the challenge that you have as an agency, a competition agency, is something that is fairly obvious. Sometimes, it's not easy to do. It's how you can explain all the sophisticated analyses that you are using. In very simple terms, strong and very well articulated, but simple so that judges can understand easily, your analyses. They can just not only your procedures, but the substance of what you are doing.

>> Richard Feinstein: Jon?

>> Jonathan B. Baker: Well, so I pose the question this way. The -- we're interested in the economic force of buyer substitution in defining markets. And more precisely the way the question is has been refined in the context of the guidelines, how buyers would substitute in response to a price increase. And I think of the evidence that one might bring to bear in answering that question as falling into five different categories. The first is how have buyers responded to changes in the relative prices in the past? It is something one could think about. The second is what do buyers

say, you know, if you surveyed them or whatever, about what they would likely respond today if prices were changed? The third is inferring something about likely buyer responses to changes in prices. From characteristics of the products and locations that are known to matter to buyers. So what I have in mind there, for example, might be you work out the engineering study of the switching cost in geographic market definition, and it be profitable to go a little bit farther to get your price rise in your product or not? We can do this on the product side, as well. The fourth category inference about buyer substitution from the conduct of sellers. Sellers are experts on their buyers. So if the sellers are monitoring price changes at certain rival firms, certain rival products and responding to them, then you're learning actually about buyer substitution from that, because you're learning what these experts think about buyer substitution. And then the fifth category is the views of other industry experts. More broadly than the sellers. So consultants, or former executives, or trade association folks, or sellers of complimentary products who know about the market they sell into or buy from. So there are five categories of evidence. Each of those categories, you could have evidence that is systematic and quantitative, or that's anecdotal or qualitative. Even for the response of buyers' price changes in the past, well, you might think he's talking about measuring demand. Well, maybe I am. But you might be asking the firm's executives, who I remember a consulting thing I worked on once, the company said, "well, yeah, we tried raising the price in Milwaukee on our product, and we got hammered." Well, that's evidence of response of buyers to changes in prices in the past. And all these types of evidence can, in different, cases be probative. And so what you're really looking for is the type of evidence and the style, the form. You know, the qualitative, quantitative, whatever, that happens to be most probative in the particular facts in the case. And you rely on that or you put it all together. So I don't think there is any general preference evidence or any form of which it comes.

>> Lawrence J. White: I'm really intrigued with what Jon just said. I was going to stop with just his categories one and two, which I would paraphrase -- what did consumers do in the past in response to price changes in which a sophisticated version is working out the demand elasticities and diversion ratios, et cetera. Versus a consumer survey -- what would they do in the future in response? Now, empirical economists' bias is to trust more the category one rather than category two, because, gee, you know, can they really imagine all the full circumstances and the would feels much weaker than the did, so long as can you do the appropriate controlling for other things, et

cetera, et cetera, et cetera. I started thinking about, though, his third category. All right, you get engineering studies inferring switching costs. But where did those data come from? Either they came from what did or what would. You know, where else have the engineers come up with the parameters for that estimate? Now category four, gee, that's pretty strong. I absolutely endorse Jon's insight here that, you know, the sellers revealed behavior here, telling you something about what did. I mean of sort of strong, strong information about what did. And then category five, use of other industry experts. Well, again, you're back to where did they get their information? It's either from what did or what would. So I think it's really useful to focus on the two categories. What did, what would. As an economist, I like what did better. And I like Jon's extra insight, look at whenever you can past seller's behavior. But it's gonna be based on what did.

>> Richard Feinstein: Joe?

>> Joseph J. Simons: So the funny thing about the discussion so far, at least from my lawyers' perspective, if you look at the guidelines, those things are listed in the guidelines already. But the things that not listed in the guidelines is the econometrics. So, I don't know, maybe you want to put that in there. Maybe not. But the only point I would make is that it's -- this noneconomic evidence is the most important, because you can win a case, you can have a case without the econometric evidence. If you just have the econometric evidence, I don't think you'll win a case if that's all you have. And like I said before, the best case is everything points in the same direction.

>> Richard Feinstein: We are right at our end point. But I'm going to ask the audience's indulgence to give us two more minutes. There are four of us. If any of you would like in 30 seconds to offer a final observation, now's your have opportunity. Let's start with Joe and work our way back.

>> Joseph J. Simons: I think I said everything I need to say, so I don't need to take up your time.

>> Richard Feinstein: Not required.

>> Lawrence J. White: Okay, I want to make two points. One, I didn't add --

>> Richard Feinstein: You can take Joe's time.

>> Lawrence J. White: Which was, you know, there may be times when you don't have any "what did" evidence. And so the best you can do is use the survey "what would" and you just do the best you can with it. So I don't want to rule out "what would." But you have to understand its limitations. The other thing, I'm glad you mentioned econometrics, Joe. Econometrics gets a bad rap. You know, it's just statistics, guys. You know? And you understand means, okay? And can you understand the idea that, you know, means might be different. Well, econometrics is a slightly more complicated version of that, where you've gotta start controlling other things. The fact that you may not have a lot of training in econometrics, you know, if you're dealing with a traffic accident case, you might have, you know, engineers coming in to try to tell you about whether, you know, what the brakes failed or didn't fail, or the skid properties of asphalt when it's wet to this degree. And maybe you need to bring a meteorologist in. And there is going to be all kinds of expertise that you may not have. Sorry, econometrics is, again, it's just another set of expertise. It's like dealing with means and averages, only a little more complicated.

>> Richard Feinstein: Jon?

>> Jonathan B. Baker: I just thought I'd add that my engineer has another source of expertise, too.

>> Richard Feinstein: Eduardo?

>> Eduardo Perez Motta: Let me touch on the econometrics discussion. I think in the end, the challenge that we have is help to explain the econometrics results, in such a way that you can make something that is easy to understand. So I think both things go. You can make them work in the same direction. Sometimes you need sophisticated economic analysis to make your -- protect your decision. And you have to use it. And I think it's better to use it. But the challenge is how you can put that you in words that could be understandable for a person that is going to judge your decision, that is going to be a lawyer.

>> Richard Feinsein: I guess the final observation I would offer -- maybe the first observation I would offer is picking up on Larry's distinction between what did happen and what would happen. Unless you're talking about a consummated transaction, at the end of the day, we are always trying to figure out what will happen. And, therefore, I think both what did and what would are probative. Please join me in thanking this panel, and we'll reconvene at 3:30 for the final panel of the day, which will address unilateral effects. Thank you very much.