Written Testimony of
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Chairman Kohl, Members of the Antitrust Subcommittee,

Thank you for this opportunity to present some views of the American Antitrust Institute ("AAI") as you conduct oversight hearings of the two federal antitrust agencies. The AAI is an independent non-profit education, research, and advocacy organization.[1]

As a "watchdog" in this field, we have observed the ebb and flow of antitrust activity at the federal level for over nine years. Were it not for our faith in the historic resilience of antitrust, we would be pessimistic, indeed.

Let us be clear that our pessimism does not lie with the capabilities or professionalism of our current antitrust enforcers. We believe them to be high quality individuals, worthy of individual respect. The problem is that they, along with much of our judiciary, have in varying degrees been captured – captured by a laissez faire world view that is disinclined to observe market failures, tends to assume benign motives of the largest corporations, and is congenitally prejudiced against government's ability to play an affirmative role to protect the public. In short, the neoclassical mindset has captured antitrust and reduced its potential vitality and significance to a hard core.

We should also be clear to say that within the hard core and very occasionally outside of the core, many of the activities of the agencies are being carried out with vigor and excellence. The DOJ continues to investigate horizontal collusion and to bring important anti-cartel cases whose positive impact on the economy is substantial. Its leniency program should be celebrated as one of the great success stories in antitrust history. Its current efforts to reform the real estate residential brokerage industry are particularly valuable.

The FTC, whose Commissioners are collectively among the most talented and experienced in history, often enforces the law with creativity and vigor, as exemplified in its handling of patent, standard-setting, and pharmaceutical cases. Its public hearings and reports on a variety of issues are valuable in providing illumination to educate courts, Congress, and public policy markers.. The FTC should be applauded for its revival of the administrative litigation process which gives it a unique forum to address the antitrust cases with the most complex economic and policy issues.

The two agencies are also to be commended for the ways in which they have worked cooperatively, e.g., on the real estate industry and in some of their joint hearings.

[1] Background is available at www.antitrustinstitute.org. The author is grateful to members of the AAI Advisory Board for their assistance in preparing this document.

Both agencies have given careful attention to administrative improvements. Both agencies have contributed importantly to the development of the International Competition Network as an effective means—and truly creative mechanism-- for bringing the world's antitrust authorities closer together.

But the painful reality is that the level of enforcement in some respects has diminished in a fashion harmful to both competition and consumers. In particular:

- Neither agency has challenged a merger in a federal court trial in over 3 years, an almost unprecedented period of non-litigation. The ability to litigate is essential to the ability to enforce, and this period of non-enforcement can only embolden parties to propose competitively dubious mergers;

- Merger enforcement standards generally are more permissive in many industries, frequently permitting consolidation to as few as 2 or 3 players in a market;

- The agencies are focusing not so much on enforcement as on procedural "innovations" to permit parties in mergers to resolve concerns without enforceable consents and on occasion without a seemingly warranted Second Request investigation;

- Civil enforcement at the Antitrust Division, since the elimination of the Civil Enforcement Task Force, has diminished if not been entirely eclipsed. After six years of the prior Administration (which had created the Civil Enforcement Section that no longer exists), significant cases had been brought against American Airlines, Visa, Mastercard, and Microsoft.

The results of the lack of enforcement are felt by all U.S. consumers in their daily lives. As markets for gasoline, food products, consumer goods, and health care products have consolidated, consumers are now paying more for essential products. Congress should think of diminished competition as an antitrust tax for consumers.

We strongly believe in the important mission of the federal antitrust enforcement agencies. The subcommittee plays a vital role in providing oversight on the enforcement priorities and direction. We unequivocally hope that the subcommittee will focus on antitrust enforcement and Congress will increase the funding of each of the agencies, so that they might do more than they are doing. At the same time, we believe that Congress should insist that the agencies play a larger role in the domestic economy.

The Agencies Should Be Opposing Concentration Of The Economy

Antitrust law was created by Congress and supported on a bipartisan basis for 116 years because it is supposed to protect the public from the abuse of centralized economic power. So focused are our antitrust agencies on what they call "competitive effects" and "efficiency," they no longer really seem to care about concentration of economic power. We believe that Congress wanted antitrust to maintain more than a small handful of rivals in any particular industry. It wanted consumers to have a wider range of choices. It

wanted a wider range of rivals kicking each other to come up with better ideas about how to keep ahead of the competition. It wanted to hold open the opportunity for smaller competitors and newcomers to succeed on a level playing field, so that the economy would be open and dynamic and so that the American dream could be satisfied by a larger portion of the population. And it wanted to prevent an increase of the political power that inevitably comes with concentrated economic power.

We do not call for a reactionary return to mindless condemnation of mergers resulting in slight increases in concentration that have little likelihood of affecting consumer choice, quality or prices. However, the pendulum has swing too far in the direction of concentration—not as a result of natural processes but as a result of federal non-enforcement.

Policy Has Encouraged Mergers To Higher Levels Of Concentration

What we have today are Federal Horizontal Merger Guidelines that essentially say that mergers from five major competitors to four will be considered dangerous, a generally reasonable position. In fact, however, only mergers from three major competitors to two are likely to be challenged (though this does not mean they necessarily will be challenged[2]), and even mergers to monopoly, as XM-Sirius would be if satellite radio is found to be a relevant antitrust market, are now put forward by knowledgeable counsel with hope that they will be permitted to slip through. We are well into another merger wave right now, and everyone knows that this is the right time to try to push forward a merger that could be antitrust-provocative, because a subsequent Administration would likely apply a tougher standard. But today's consolidation is a stiff price to pay, because a merger is forever and cannot be un-done in the future.

Why does concentration matter and what should its role be in antitrust analysis? The AAI has thought carefully about the role of concentration and three years ago, after extensive internal discussions, developed a detailed statement that is attached. We believe that it better reflects the intent of Congress and the current state of economic knowledge than the policies being followed today. To summarize the principal points that we made three years ago, which we contend are still relevant:

> Concentration. Recent pronouncements by the government may indicate a movement away from negative presumptions about the effects of exceptionally large mergers in highly concentrated markets. The AAI Statement says that the anti-mergers laws, relevant Supreme Court decisions, and sound public policy considerations all mandate that concentration should continue to play an important role in merger enforcement. Large increases in concentration to very high levels of market concentration should lead to a rebuttable presumption that a merger is likely to lead to anticompetitive conduct.

[2] See the AAI White Paper on the Whirlpool/Maytag merger, http://www.antitrustinstitute.org/Archives/477.ashx., which was permitted to be consummated and the Brocade/McData merger that the FTC recently allowed to go through without remedy or public comment, http://www.theregister.co.uk/2007/01/24/ftc_brocdata_approval/.

Incipiency. Mergers should be evaluated under the incipiency doctrine, a relatively strict legal standard established by the Clayton Act. Although the Sherman Act blocks only those mergers likely to lead to monopoly power or the dangerous probability of monopoly power, the Clayton Act is designed to block mergers the effect of which "may be substantially to lessen competition or to tend to create a monopoly." This means that increases in concentration should be prohibited even if they might not be quite large enough or assuredly anticompetitive to constitute a Sherman Act violation. Recent enforcement policy by the government virtually ignores Congress' incipiency doctrine. Nor have the agencies brought any actions relying on the incipiency doctrine.

Efficiency. National merger policy today rests upon the assumption that mergers usually produce important efficiencies. Yet, respected economic research has found that many, perhaps most, mergers do not lead to significant reductions in cost or to increased innovation. Many, perhaps most, of the predicted efficiencies from mergers have failed to materialize. The AAI Statement urges that in specific investigations, claims of efficiency benefits arising from a merger should be viewed more skeptically, and should be accompanied by empirical evidence demonstrating how these benefits will be achieved and how they will directly benefit consumers.

Potential Competition. Potential entrants can reduce the likelihood of anticompetitive effects from a merger, particularly where efficient small-scale entry by multiple firms is possible. On the other hand, mergers between an incumbent and a potential entrant can cause anticompetitive harm. Accordingly, competitive concerns may arise from mergers that remove significant potential entry, both perceived and likely actual potential entrants. This is a particular concern in high technology markets, where significant competition may occur well before products are sold to consumers. Potential entry should be a more important element in the analysis of the competitive effects of a merger than it has been in recent years.

Here is just one example. Because the agencies have taken a narrow view of the scope of Section 7, they have permitted massive consolidation in the gasoline industry through a series of mergers of most of the major oil companies.[3] The agencies proclaim that they have brought several enforcement actions. But when carefully reviewed they simply have required divestitures where there were clear competitive overlaps in a merger. A greater consideration of both the incipiency doctrine and potential competition effects may have led to far more significant enforcement which may have forestalled this massive consolidation of the gasoline industry. There should be little doubt that consumers pay a high price for this massive consolidation.

[3] Concerning competition in the petroleum industry, see two recent Working Papers by the AAI's Diana Moss at http://www.antitrustinstitute.org/Archives/oil_1.ashx and http://www.antitrustinstitute.org/Archives/oil_2.ashx.

We believe that the correct oversight response would be for Congress to reassert that it expects the agencies to play a more forceful role in evaluating and stopping mergers to high levels of concentration.

Merger Enforcement Has Diminished

Overall the level of merger enforcement has diminished significantly over the past six years. [4] Although this may be partially due to the change in HSR reporting levels and the number of reportable filings, there is a very discernable reduction in the number of Second Requests and enforcement actions.

Since 2004-- the year of DOJ's defeat in *Oracle/Peoplesoft* and the FTC defeat in *Arch Coal*-- neither agency has been to trial in a federal court merger case. This appears to be an unprecedented period of non-litigation by the agencies. The agencies might suggest that they never go to court because no one is willing to litigate with them, but the total lack of litigation and the modest number of consents might suggest that there is a problem of under-enforcement. Have the agencies been snake-bitten? Congress must tell the agencies that they are expected to lose some of their cases—and will not be punished-- if they are doing their job with the appropriate thoughtfulness, courage and energy.

We also have a concern over institutional expertise. One of the reasons the agencies in the past Administration were able to bring a greater number of enforcement actions was that they had the experience of litigating numerous merger cases, Thus, they were able to successfully challenge mergers in critical industries such as Northrup/Grumman, MCI/Worldcom, Microsoft/Intuit, Staples/Office Depot, Drug

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[4] To compare the level of merger enforcement at the FTC and DOJ we looked at the number of Second Requests issued and the number of enforcement actions brought from 1998-2005, as reported in the annual HSR Reports filed with Congress. This enabled us to look at a 4-year period in both the Clinton and Bush II Administrations. There are many reasons for variations in the level in enforcement, most importantly that the United States was in a merger wave toward the end of the 1990s, and HSR thresholds were amended to reduce filing obligations in 2000.

From 1998-2001 the DOJ issued 245 Second Requests, and brought enforcement actions in 177 matters of 72.2% of the investigations. From 2002-2005 they issued 82 Second Requests, approximately 33.5% of the number issued from 1998-2001. Of these 82 Second Requests, 38 or 46% resulted in enforcement actions, a significantly lower percentage than in the earlier period.

From 1998-2001, the FTC issued 161 Second Requests, and brought enforcement actions in 118 matters of 73.3% of the investigations. From 2002-2005 they issued 87 Second Requests, approximately 54.0% of the number issued from 1998-2001. Of these 87 Second Requests, 74 or 85.1% resulted in enforcement actions.

From 1998-2001, there were 15,901 HSR filings and 404 Second Requests or second requests were issued in 2.5% of the HSR filings. From 2002-2005, there were 5137 HSR filings (32.3% of the earlier period). There were 169 Second Requests or Second Requests were issued in 3.3% of the HSR filings. So even though filings have been reduced by over 2/3rds, reflecting fewer mergers and a much reduced portion of mergers having to be filed, the agencies issued Second Requests only in about 1/3rd more matters (as a percentage of HSR filings).

Wholesalers and Heinz/Beech-Nut. By willing to aggressively litigate cases, the agencies protected markets from unnecessary consolidation, built institutional litigation expertise and helped develop merger law. Experience teaches that the ability to litigate is crucial in demonstrating to companies that the law will be enforced.

The Agencies Engage In Procedural "Innovations" That Are Contrary To The Intent Of Congress And The Interests Of Consumers

The merger review process can be costly and time consuming. Merger reviews must be completed within a short period of time and making an assessment of the competitive impact of a merger can be a complex process with many demands for information. Moreover, given the boom of information secured in today's information-friendly, document-intensive economy, even simple document requests can result in massive productions.

Appropriately, both agencies have made efforts to reduce the burdens of the merger review process. The agencies continue to improve and refine the Second Request process as evidenced by the FTC and DOJ issuance of Second Request guidelines and the joint DOJ-FTC effort to conduct an internal review and implement reforms of the merger review process in order to eliminate unnecessary burden, remove costly duplication.

However, in three important respects we believe the Agencies have gone too far in streamlining the process and have ignored Congressional intent in both the HSR and Tunney Acts: (1) resolving matters without issuance of a Second Request, (2) resolving mergers without securing an enforceable consent order; and (3) failing to comply with the obligations of the Tunney Act.

Skipping The Second Request

We recognize that companies may often have important reasons for consummating a transaction within a certain period of time. Sometimes these concerns will put the companies in a position where they ask the agencies simply to enter a consent order based on a limited investigation or even without a Second Request. In these cases it may appear tempting from the agencies' perspective to resolve the case quickly.

Given the ever-increasing complexities of the parties, markets and transactions we believe these procedural shortcuts can be very risky and are contrary to the Congressional intent for the merger review process. The purpose of the Hart-Scott-Rodino Act is twofold: (1) to obtain information about potential anticompetitive effects, and (2) to maintain the status quo until a decision of whether to seek injunctive relief is made.[5] And while the initial pre-merger notice prepared by the parties contains a limited amount of

[5] American Bar Association, The Merger Review Process: A Step-by-Step Guide to Federal Merger Review 117 (2d ed. 2001).

information,[6] the Second Request allows the enforcement agencies to gather additional factual information to investigate any potentially anticompetitive effects.[7]

The Second Request benefits consumers by providing a powerful investigative tool to challenge mergers at their incipiency, and thereby reduce the need for lengthy post-acquisition litigation and divestiture periods. Congress enacted HSR in 1976 in response to the government's inability to conduct complete investigations and to obtain adequate relief because the transactions were so complex that they were "difficult at best, and frequently impossible to 'unscramble' after consummation."[8]

Whether an Agency decides not to issue a Second Request is not a public event. However, based on limited information, we believe both agencies have resolved matters in the past year without the issuance of a Second Request: the FTC's evaluation of the Boston Scientific/Guidant merger and the Antitrust Division's evaluation of the United Healthcare/Pacificare merger. Although both cases resulted in a consent order, we are concerned that by conducting an abbreviated investigation without the benefit of a Second Request the agencies may have missed competitively important issues. We note that after the United/Pacificare merger was consummated, a private antitrust suit was filed alleging the parties engaged in illegal gun-jumping during the merger investigation. With a full investigation this and other anticompetitive conduct may have been uncovered by the Division.

We are also concerned about the efforts of parties in some cases to avoid Second Requests by multiple refilings of the HSR filing. This may be an effort to convince the agency to avoid a Second Request by conducting a slightly longer "informal" investigation. Again, we think this can be a perilous approach, since it is only through the use of compulsory process that the Agencies can make a full assessment of the competitive issues posed by a merger. We have illustrated this point in our comments to the FTC in the Express Scripts/Caremark merger, a merger of two of the three largest Pharmacy Benefit Managers in the U.S.[9]

Finally, we anticipate there will be continued efforts, perhaps led by the upcoming report of the Antitrust Modernization Commission, to refine the Second Request process in ways that will make it more difficult for the agencies to do the work Congress intended. As the Committee evaluates any such proposals, it should keep in mind that only relatively large mergers are reported to the agencies and only approximately 2-3 percent of these result in full-scale investigations. Most mergers are competitively harmless, but the ones that are very large deserve closer scrutiny than many receive. We would urge Congress to press for the agencies to increase the ratio of Second Requests to HSR filings.

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[6] 16 C.F.R. § 803 append. (2005).
[7] *Id.* at §803.20.
[8] H.R. Rep. No. 94-1373, 94th Cong., 2d Sess. 8 (1976), as reprinted in 1976 U.S.C.C.A.N. 2572, 2640-41.
[9] See the AAI's White Paper on this merger at http://www.antitrustinstitute.org/Archives/express_scripts.ashx.

Resolving Mergers Without Consent Decrees

Merger enforcement is increasingly a regulatory process. Mergers are typically resolved by having the parties agree to restructure the transaction either by divesting a business, some assets, or agreeing to some type of behavioral relief. As mergers and markets have become more complex, the nature of the relief in these cases has become similarly complex. For example, enforcement decrees in the pharmaceutical industry often can be over 50 pages long and may involve the use of trustees to assure the success of the order.

One can readily see why an enforceable order is vital to assuring that a merger remedy will be effective. Yet in some cases the Antitrust Division resolves mergers without securing an enforceable consent order. Not only does this potentially hamper the Division's ability to successfully ensure that relief is effective, but it also permits escape from the transparency requirements of the Tunney Act. The Division's practice in this area can not benefit consumers.

The Division Must Abide By The Tunney Act

The 2004 Amendment of the Tunney Act (the "2004 Amendment") sought to reverse the impression of the Courts that their role was limited to "rubber stamping" consent decrees and provide for a meaningful role for public input in the review of proposed remedies. The Tunney Act (the "Act") was originally passed in 1974 to end the practice of courts "rubber stamping" antitrust consent decrees that destroyed competition and harmed consumers.[10] The legislative history of the original Act moreover reflects the sentiments of Senator Tunney, among others, that the trial courts must exercise their "independent judgment in antitrust consent decrees – and not merely act as a rubberstamp upon out-of-court settlements."[11] In direct response to recent cases, which had disregarded this statute and its legislative intent, and had showed signs of a return to judicial "rubber stamping," Congress amended the Act in 2004.[12] Congress specified the purpose of the amendment:

(a) to effectuate the legislative intent of the Tunney Act and
(b) to restore the ability of courts to give real scrutiny to antirust consent decrees.[13]

Under the plain language of the amended Tunney Act, Congress *requires*, rather than *permits*, the court to examine a number of enumerated factors bearing on the competitive impact of the settlement, and mandates a review of the impact of a proposed consent decree upon competition in the relevant market or markets.[14] Congress further acknowledged that the leading case law of the D.C. Circuit Court of Appeals (i.e. the

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[10] See *U.S. v. American Telephone and Telegraph*, 552 F. Supp. 131, 148 (D.D.C. 1982) (*citing* S. Rep. No. 93-298, 93d Cong., 1st Sess. 5 (1973)).
[11] Hearings on S. 782 and S. 1088, 93d Cong. 452 (1973) (Senator Tunney).
[12] 150 Cong. Rec. S3610, 108th Cong., 2d Sess. 3610 (April 2, 2004) (Senator Kohl).
[13] *See* 150 Cong. Rec., S3617 (April 2, 2004) (Statement of Sen. Kohl).
[14] *See id.* at § 16(e)(1) (*emphasis added*).

Microsoft case), which interpreted the Act in a manner which made meaningful review of consent decrees virtually impossible, misconstrued the legislative intent of the statute.[15]

Unfortunately, the Justice Department has taken a very narrow view of these amendments, in particular in the Court's review of Verizon's acquisition of MCI (Verizon-MCI) and SBC's acquisition of AT&T (SBC-ATT). DOJ suggested a very limited role for court review. And while the DOJ correctly set forth the *"requires"* language of the statute in the competitive impact statement, they later erroneously assert that the statute *"permits"* a court to consider specifically enumerated factors.[16] No reasonable interpretation of the amended Tunney Act or the legislative history should dissuade a court from actively and independently determining whether a consent decree is in the public interest – the only check on potential government abuses. To hold otherwise would create a new antitrust "fallacy," which would abrogate the power and obligation of independent court review and revert back to the days of rubber stamping any consent decree filed by the government.

We also note that the DOJ permits settled mergers (i.e., those that are permitted subject to conditions) to go forward without awaiting the completion of a Tunney Act review. We believe this position is inconsistent with the Act and is intended to put too great a burden on the court, which if it were to reject the settlement would be forced to "unscramble the eggs" – the very problem that the HSR Act was intended to avoid.

We are pleased to note that Judge Sullivan in the Federal District Court down the street from here appears to be reviewing the two telecommunications mergers with a serious intent to determine whether they are in the public interest. Whatever the outcome, the subcommittee should review his ultimate decision with care to see if this type of detailed review is what is intended.

Civil Enforcement Needs Considerably More Attention at the Antitrust Division

One of the benefits of two federal enforcement agencies is that the public can compare the efforts and achievements of the two agencies. Although in most respects the two agencies' accomplishments are comparable, there is one area in which there is a significant disparity: the lack of civil enforcement at the Antitrust Division. At the FTC there have been numerous civil enforcement actions involving patents, standard setting, health care providers, pharmaceutical manufacturers and high tech markets. Some of these cases have been litigated in FTC administrative proceedings, other cases have been brought in federal district court. Some cases, such as the enforcement action against Unocal, resulted in benefits to consumers worth hundreds of millions of dollars annually.

In the past Administration, the Antitrust Division's civil enforcement was much more active, bringing cases against Microsoft, Visa, MasterCard, American Airlines, Pilkington, Dentsply, NASDAQ, and others. These cases not only brought important

[15] 150 Cong. Rec. S3610, 108th Cong., 2d Sess. 3610 (April 2, 2004) (Senator Kohl)
[16] *See* Competitive Impact Statement, filed on November 16, 2005.

benefits to millions of consumers, they also clarified the law in numerous areas critical to today's high tech economy.

Near the beginning of this Administration, the Division eliminated its Civil Nonmerger Enforcement task force, assigning the tasks to the various other enforcement sections on an industry-by-industry basis.[17] Since then there has been minimal civil enforcement, compared to either the level at the FTC or the level during the prior Administration. We question whether the reorganization has harmed the Division's abilities to fulfill its responsibilities in civil enforcement.

Single-Firm Conduct Must Not Escape Close Scrutiny

Monopoly has always been one of the principal evils targeted by the antitrust laws. The FTC's standard-setting cases (*Rambus, Unocal*) are excellent, but they tend to stand out in their isolation. Today, particularly at the DOJ, there seems to be a question about whether it is more important to protect the public against abuses of dominance in the market or to protect the ability of a dominant firm to compete aggressively. It is not clear where the agencies come out on this, but the rhetoric often seems to have shifted in favor of the latter. While some degree of balance is required, we hope that the joint hearings on single-firm conduct will clarify that protection against abuse of dominance is the dominant enforcement value. Based on various statements from the DOJ, domestically and in the context of criticisms of the European Commission's somewhat more pro-enforcement positions (not to mention its efforts to bully the Europeans into adopting its own views on how to deal with Microsoft), we are not confident that this will be the outcome. We urge Congress to continue to press the agencies to take a vigorous stand against anticompetitive behavior by dominant firms.

One of the important developments in our economy has been the growth of retailers with enormous buying power, changing the traditional power relationship between suppliers and distributors upon which much of antitrust has been based. Wal-Mart is the leading example of a distributor who dominates an entire supply chain in an unprecedented way. In addition, there is continuing and growing concern within the agricultural community of the effects of Buyer Power on independent farmers and ranchers, as the commodity-buying sector has become more concentrated.

We believe that the agencies have essentially ignored these important developments and have mechanistically applied a perspective that monopsony is the exact mirror image of monopoly. Following the government's lead, the Supreme Court adopted this view in its recent *Weyerhaeuser* decision. We believe that this is shortsighted and ignores differences between the exercise of Buyer Power and the exercise of Seller Power, which should be the subject of agency investigation. If the agencies will not look seriously at this, then this subcommittee should take it upon itself

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[17] The FTC has a section dedicated to civil enforcement. The Civil Nonmerger Enforcement Section at the Division was created in 1994.

to develop the empirical information necessary to evaluate the significance of the shift of power from manufacturers to retailers.[18]

The Balance Between Intellectual Property Rights and Antitrust Needs to be Restored

Since the creation of the Federal Circuit as a specialized court for intellectual property, there has been a shift in the traditional balance between intellectual property rights (IPR) and antitrust, in favor of IPR. The DOJ seems to have taken the lead in promoting this shift, whereas the FTC appears to be the defender of the traditional balance. Following joint hearings in 2002, the FTC published an excellent report on shortcomings in the patent system. A second report, to be published jointly with DOJ, was supposed to follow, providing guidance for the interrelationship between patents and antitrust – but internal differences have delayed publication lo these many years.[19] We urge the subcommittee to assert the case for balance and to urge the agencies to file separate reports if they cannot agree.

An example of the importance of promoting competition even in the presence of IPR is the acquisition by Monsanto of Delta and Pine Land, now pending before the DOJ.[20]

Private Enforcement Must Be Supported As A Critical Complement to Public Enforcement

Private enforcement is critically important to the American system of antitrust.[21] Through their amicus brief program, the government enforcers seem to take a generally dim view of private enforcement of the antitrust laws; the Solicitor General, usually speaking for the agencies, seemingly inevitably comes down in favor of the defendants' positions. We do not object to the agencies providing guidance to the courts, but we find ourselves consistently in disagreement with the guidance the Solicitor General provides.

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[18] Appropriate questions to be answered are set forth in AAI Working Paper 06-07: Albert A. Foer, Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust. http://www.antitrustinstitute.org/Archives/559.ashx

[19] A manifestation of the differences between the two agencies on IPR was their disagreement on whether the Supreme Court should grant certiorari to the *Schering Plough* opinion.

[20] See the AAI White Paper on this pending merger at http://www.antitrustinstitute.org/Archives/553.ashx.

[21] It is often estimated that over 90% of antitrust enforcement is through private litigation. An Interim Report of the AAI Private Enforcement Project, encompassing 29 out of an intended 40 case studies and a report summarizing the interim findings, was presented to the Antitrust Modernization Commission. The report was written by Professors Robert H. Lande and Joshua P. Davis. Case studies were prepared by a variety of lawyers, academics, and law students. The study documents recoveries totalling $14.2 - 15.9 billion in cash and suggests that many of the criticisms of private antitrust enforcement may be overstated. http://www.antitrustinstitute.org/Archives/550.ashx.

A good example is the pending *Leegin* case, in which the government is arguing in favor of overturning the per se rule against resale price maintenance, a venerable rule of antitrust that has been repeatedly supported by Congress.[22]

On or about April 2, the subcommittee will be receiving the final report of the Antitrust Modernization Commission (AMC). Based on preliminary votes, it appears that the AMC will be recommending to Congress reform legislation involving indirect purchaser class actions, joint and several liability, and repeal of the Robinson-Patman Act. We have provided memoranda to the AMC pointing out the dangers inherent in the first two areas.[23] The proposed reform relating to the *Illinois Brick* case and its aftermath would gut private enforcement and leave defendants with the benefits of their illegal actions. The modifications to joint and several liability appear to be technical but they would undermine the incentives to settle a case and would have a major impact on the court system. Repeal of Robinson-Patman, which was advocated by Chairman Majoras, could leave important areas of anticompetitive behavior unpoliced. We do not say that Robinson-Patman is a perfect law, but we believe that parts of it should be preserved and that, in any event, it should not be repealed without a much more careful review than was given by the AMC. We call these matters to your attention now, because if the subcommittee still believes in private enforcement, which we strongly support, it will have to face these issues squarely.

We thank the subcommittee for receiving this written testimony. Attached you will find the AAI Statement on Concentration in Horizontal Mergers.

[22] The AAI's amicus brief supporting the per se rule and providing a history of Congressional support, is at http://www.antitrustinstitute.org/Archives/leeg07.ashx.

[23] AAI Working Group Calls on AMC to Withdraw Recommendation on Indirect Purchaser Class Actions, http://www.antitrustinstitute.org/Archives/AdvancedSearch.aspx; Joint and Several Liability: AAI Working Group Says AMC Proposal Would Have Radical Impact, http://www.antitrustinstitute.org/Archives/amc07.ashx.

STATEMENT OF THE AMERICAN ANTITRUST INSTITUTE

ON

HORIZONTAL MERGER ANALYSIS AND THE ROLE OF CONCENTRATION IN THE MERGER GUIDELINES

February 10, 2004
Albert A. Foer, President

Introduction

Market concentration has often played a controversial role in merger law and policy. In the past, some have argued that "big is bad" and the government must use its antitrust tools to stop all trends toward concentration. On the opposite extreme, others have argued that concentration is never a problem as long as government is not creating or supporting entry barriers, because new competitors are always waiting in the wings, forcing even an apparent monopolist to behave in a competitive manner. Although debates about antitrust have moved beyond these older views, merger enforcement today has been criticized for giving concentration either too little or too much weight. A "post-Chicago" position on the proper role of seller concentration[24] and related issues in horizontal merger analysis that relies heavily on recent advances in empirical economic analysis has not yet clearly crystallized. The American Antitrust Institute[25] offers this Statement, based on extensive conversations and debate within the AAI Advisory Board, as a contribution toward crystallization. While the document attempts to reflect a consensus, it cannot and should not be expected that every member of the Advisory Board necessarily agrees with every word or even with all of the general positions taken.

1. **Concerns with Mergers.**

[24] We have not focused in this statement on concentration at the buyer level, which will be the subject of an AAI conference on June 22, 2004, exploring ways in which buyer power may differ from seller power.

[25] The AAI is an independent education, research, and advocacy organization, described on the Internet at www.antitrustinstitute.org. The drafting of this document has been a nine-month iterative process featuring very heavy input by a drafting committee of seven and repeated circulations to the full Advisory Board for comment. The author and the Board of Directors bear responsibility for the final version.

(a.) Horizontal mergers can raise competitive concerns for a number of reasons. A merger may create opportunities and incentives for unilateral price increases, express collusion or tacit coordination and strategic behavior that artificially disadvantages rivals or suppliers. These effects may lead to higher prices, which are harmful because they transfer income away from consumers and undermine allocative efficiency. They may also lead to higher costs, including the possible creation of so-called x-inefficiency.

(b.) Mergers can also reduce competition along other dimensions, including quality, service, the development of new and better products and other areas that significantly affect consumer choice. In an industry with differentiated products, a horizontal merger may also lead to a reduction in the variety of products, which can also harm consumers.

(c.) Economic research indicates that monopoly slows the pace of innovation. Incumbents may ignore or discourage the development of new products and technologies, particularly radical innovations, and both market and technological uncertainties make it likely that innovations will be forthcoming more rapidly when there are multiple, independent sources of initiative. Enhanced opportunities for express or tacit collusion associated with higher levels of concentration can lead to a reduction in the incentives for innovation and may channel investment by fringe firms or prospective entrants away from projects that would compete against the leading firms.

2. **Concentration**.

(a.) Since the Supreme Court's decisions in cases like *Philadelphia National Bank*, the level of market concentration has played a central role in merger analysis. However, the economics literature of that era that related measures of concentration to profits has been criticized for its over-reliance on questionable measures of profits and its failure to account for factors other than anticompetitive behavior that could explain the correlation between profits and concentration across industries.

(b.) The consensus conclusion from more recent studies using more sophisticated research tools is that increased concentration, at high levels, is associated with higher prices, and is therefore a suitable proxy, at least in the first instance, for an expectation of market power. In particular, as an empirical matter, high seller concentration in a properly defined market with significant barriers to entry is associated with higher prices, all other things being equal, and increases in concentration, particularly substantial ones in markets that are already highly concentrated, may precipitate large price increases.

(c.) Even if one is not persuaded by the economic literature alone, where the literature is inconclusive (as is often the case) it is appropriate to take into account the underlying policies of the antitrust laws, as manifested in legislative history and more than a century of judicial explication, reflecting a preference for open markets and more than a handful of competitors, all other things being equal; and a trust in openness, diversity, and forces of competition.

3. **Presumptions Regarding Concentration**.

(a.) Neither economic theory nor empirical economic research supports a single "bright line" level of concentration that separates anticompetitive from benign mergers in all or even most industries. Nonetheless, empirical results are generally consistent with current merger law: namely, that in general a substantial increase in an already high level of seller concentration creates a *rebuttable* presumption that a merger transaction is likely to have anticompetitive effects. These empirical results also support the appropriateness of a flexible sliding scale approach. That is, the higher the degree of concentration and the larger the magnitude of increase in concentration, the stronger the rebuttal evidence that should be required to overcome the presumption of consumer harm.

(b.) As an empirical matter, small mergers producing a low level of concentration generally are unlikely to be associated with consumer harm. In this regard, cases like *Von's Grocery Company* obviously no longer reflect appropriate merger policy, despite the statute's incipiency mandate. Even though the Guidelines' statements that low-concentration mergers within their safe harbor are "unlikely" to have anticompetitive effects and "ordinarily" require no further analysis are correct, increased guidance could be provided by specifying those rare circumstances where a challenge might nevertheless be appropriate. These exceptions should be made explicit and transparent, and should be limited to situations involving an industry with a history of collusion, or mergers that involve the elimination of a maverick or a weakening of a maverick's behavioral incentives.

(c.) Another reason why presumptions drawn from high concentration should be rebuttable is the fact that market definition is an imperfect procedure and, as a related point, certain common market definition procedures create the potential for systematic errors in defining markets. Procedures deserving reconsideration include: the use of the prevailing price as the pricing benchmark for the *ssnip* test ["small but significant and nontransitory increase in price"] for measuring cross-elasticity of demand; the use of critical loss analysis; and the principle that the agencies will adopt the smallest market definition that satisfies the *ssnip* test. The smallest market principle should be deleted from the Guidelines entirely. The validity

of the use of the prevailing price in the *ssnip* test and critical loss analysis should not be assumed, but rather should be carefully evaluated in every merger investigation.[26]

(d.) Though empirical research admittedly does not support a single "bright line" level of concentration or market share for determining when mergers are anticompetitive, the public identification of rebuttable threshold presumptions has served as a useful policy guide, channeling enforcement discretion and yielding an important degree of predictability for business planning. Recognizing that predictability is limited by the inherent vagaries of market definition and the difficulties of forecasting such factors as future market entry and competitive effects, merger analysis should be not so much a scientific endeavor as an administrable process of applying educated judgment to careful fact-finding within a commonly accepted, albeit ultimately imprecise, methodological framework.

4. **Incipiency.**

(a.) Merger enforcement, while emphasizing microeconomic analysis, must be carried out in light of the intent behind the antimerger statutes, and it is clear that Congress intended this enforcement to embody an incipiency doctrine. While the Sherman Act blocks mergers likely to lead to monopoly power or the dangerous probability of monopoly power, the Clayton Act is designed to block mergers the effect of which "may be substantially to lessen competition or to tend to create a monopoly." This means that increases in concentration should be prohibited even if the anticompetitive effects might not be quite large enough or certain enough to constitute Sherman Act violations.

(b.) This statutory language and the intent behind the Clayton Act as well as Supreme Court precedent, also require a degree of careful, economically informed prediction on the part of enforcers and the courts. Under the circumstances, errors of both over-enforcement and under-enforcement are inevitable, and the underlying facts and economics will often be inconclusive. The incipiency doctrine means that in close cases decision makers should resolve doubts on the side of blocking mergers that might lead to a reasonable probability of market power.

(c.) Preserving multiple competitors is likely to be an efficient administrative rule in otherwise close cases because mergers, once

[26] The AAI will conduct a symposium on "Combining Horizontal and Vertical Analysis in Antitrust: Implications of the Work of Robert L. Steiner" on June 21, 2004. This will explore whether the role of retailers gross margin is given adequate consideration in market definition and other merger-related issues that arise in the consumer goods sector.

consummated, are rarely undone. Enforcement policy almost never gets a chance to undo a merger that should not have taken place, but there almost surely will be future opportunities to permit consolidation in the industry in question.

(d.) In the absence of an "incipiency" policy, firms in an industry that might be contemplating consolidation may be induced into merging prematurely. When other large firms in an industry are merging, the firm that waits runs the risk of its later merger becoming the proposed merger that finally triggers agency opposition --even though in principle it is no worse or different from those mergers that preceded and thus got in under the wire. Enforcement decisions ought to take into consideration the likely strategic responses to a consummated merger by rivals and potential rivals.

5. **Coordinated Effects.**

(a.) At one time, the analysis of coordinated effects in mergers relied too heavily on the level and change in concentration. Expanding the analysis to include other factors has refined the analysis and made it more reliable. Further refinement of this analysis, including analysis of the pre- and post-merger competitive role of mavericks and other merger-induced changes in the likelihood of coordination, would improve predictions of likely merger effects.

(b.) This is not to say that coordinated effects prediction in the merger context should be identical with analysis of cartel incentives in a price-fixing context. The purpose of merger intervention is to prevent a situation that *may* be conducive to coordination from occurring in the future, not to demonstrate that coordination will inevitably occur.

(c.) With respect to potential coordinated effects, heightened concern has historically arisen around the point at which there will no longer be at least five strong competitors or when a dominant firm may enhance its price leadership role through a merger. We see no reason to revise this general benchmark at this time.

6. **Unilateral Effects.**

(a.) With respect to unilateral effects, the market shares of the merging firms can sometimes be used as a rough proxy of the closeness of substitution between the brands of the merging firms. However, market shares are at best a rough indicator of substitution and generally are inferior to careful factual and empirical analysis, including estimates of cross-elasticities.

(b.) The apparent minimization of unilateral effects analysis by the current federal enforcement agencies represents a step backwards. Unilateral effects analysis has a substantial history in industrial organization economics and represents a rigorous analytic approach. While there may be some basis for concern about over-reliance on simulation models in their current state of development, as a particular method of demonstrating the magnitude of unilateral effects, there is no good basis for skepticism of unilateral effects analysis itself.

(c.) With respect to unilateral effects, heightened concern has historically arisen around the point at which the leading firm's market share is at least 35%. We see no reason to change this benchmark level at this time.

7. **Burden Shifting.**

(a.) When high market shares and concentration resulting from merger create a presumption of consumer harm, the burden should shift onto merger proponents to demonstrate one or more of the following factors[27]:

(1.) Other reasons exist that demonstrate the inadequacy of measured market shares as a predictor of future competition;

(2.) Sufficient new entry or fringe expansion is likely to occur within a reasonable time to reverse or deter the probable competitive consequences of the merger;

(3.) The premerger degree of rivalry in the market is likely to be sustained or increased and the incentives of the merged firm to compete with incumbents are unlikely to be reduced;

(4.) The merger will permit cognizable efficiencies yielding potential benefits that outweigh the harms threatened by the transaction and thereby eliminate the likelihood of consumer harm.

(b.) If one or more of the above is established, the burden should shift to the government or other plaintiff to show that the merger would likely generate a net anticompetitive effect, taking into account all relevant evidence.

8. **Contestable Markets.**

[27] Merger case law and the Horizontal Merger Guidelines also properly recognize a narrow failing firm defense.

There is reason to doubt the empirical significance of the strongest version of the 'contestable market' theory, which holds that potential entry can cause even a monopolist benefiting from significant economies of scale to price competitively. This theory wrongly assumes both that entry requires no significant sunk costs (i.e., the entrant's expenditures on inputs can be fully recovered if entry fails) and that the monopolist's price response to entry is delayed.

9. **Potential Entry**.

(a.) Despite the very limited applicability of the pure contestable market model to real world settings, the more general potential entry concept nonetheless is an important element in the analysis of the likely competitive effects of a merger. On the one hand, potential entrants can reduce the likelihood of anticompetitive effects from a merger, particularly where efficient small scale entry by multiple firms is possible and where entry can be secret or sponsored by large buyers. On the other hand, mergers between an incumbent and a potential entrant can cause anticompetitive harm. Accordingly, competitive concerns may arise from mergers that remove significant potential entry, both perceived and likely actual potential entrants. This is a particular concern in high technology markets, where significant competition may occur well before products are sold to consumers.

(b.) Because of the competitive importance of potential entry in many industries, merger policy should place more emphasis on preventing mergers that reduce potential competition. This is an area where the case law has moved too far in the direction of laissez-faire. Federal and state enforcement agencies should undertake greater efforts to bring appropriate enforcement actions, refine the analysis and educate the courts.

10. **Efficiency from Mergers.**

(a.) National merger policy since 1981 has rested on the assumption that most mergers generate important efficiencies and therefore significantly contribute to consumer welfare. This is reflected in the fact that, typically, only 2-3% of mergers large enough to require federal pre-notification are pursued to the second request level of investigation. Yet, respected economic research has found that many, perhaps most, mergers do not lead to significant reductions in cost, although a small proportion of horizontal mergers have led to very significant efficiencies. Many of the predicted efficiencies of mergers have failed to materialize.

(b.) The practical importance of this research is that it is time to re-examine the underlying assumption that allows such a high proportion of significant horizontal mergers to be consummated.

(c.) In the meantime, in specific investigations, claims of efficiency benefits arising from a merger should be viewed skeptically. This is particularly true of theoretical arguments for gains arising from consolidated management and marketing. Moreover, the empirical evidence supporting claims of efficiency gains should be based on the specific cost structure and technology of the firms, and should be accompanied by further evidence that demonstrates how these cost reductions will benefit consumers.

(d.) To be cognizable, efficiencies must be non-speculative, merger-specific, and provide substantial direct benefit to customers. Only efficiencies net of any higher costs caused by the merger represent potential consumer benefits. Claimed benefits that will only arise in the long run are often more uncertain and for that reason should be given less weight.

(e.) Because a high proportion of mergers fail to provide the benefits that were predicted by their proponents and because there are large costs for society when anticompetitive mergers occur, Congress should provide federal antitrust enforcers additional resources to permit more detailed scrutiny of more proposed mergers than is possible today. Enforcers should be encouraged to scrutinize more mergers that might currently be deemed marginal.

11. **Research Topics.**

Recognition of the failure of so many mergers to produce their predicted benefits suggests that more research be devoted to examination of:

(a.) consummated mergers to evaluate whether or not they led to significant savings and/or price increases;

(b.) proposed mergers that were stopped or restructured as a result of antitrust intervention in order to evaluate the effectiveness of the government's intervention, including the sufficiency of remedies utilized;

(c.) the effects of merger enforcement on innovation, including both the extent to which innovation concerns played a role in past enforcement decisions, and the extent to which merger enforcement and non-enforcement has affected various types of innovation; and

(d.) merger dynamics in network industries, where predictions of merger-enhanced tipping effects may deter entry by potential competitors.

12. **Transparency and Evolution.**

Greater transparency on the part of the government is a necessary foundation for the beneficial evolution of antitrust policy. Although the government has recently made positive strides toward increased transparency, there remains a need for more detailed explanations of the agencies' reasoning with respect to actions taken (and, in certain instances, not taken); for projects like the joint FTC/DOJ compilation of data on completed investigations; and for other initiatives that will facilitate research by the government and by academics. The history of antitrust should not be characterized as pendulum-like, but rather as an on-going dialogue, continually evolving toward a better understanding of markets and competition within the context of a politically-determined legal framework.