

## Responses to "Horizontal Merger Guidelines: Questions for Public Comment"

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### I. Introduction and Overview

#### A. Qualifications and Background

1. I am the Katherine Dusak Miller Professor of Economics at the Booth Graduate School of Business at the University of Chicago. I specialize in the economics of industrial organization, which is the study of individual markets and includes the study of antitrust and regulatory issues. I am also Senior Managing Director at Compass Lexecon, an economic consulting firm that specializes in the application of economic analysis to legal and regulatory issues.

2. I am co-author of the book Modern Industrial Organization, a leading textbook in the field of industrial organization and have published numerous articles in academic journals and books. I am also co-editor of the Journal of Law and Economics, a leading journal that publishes research applying economic analysis to industrial organization and legal matters. In addition, I am co-editor of Competition Policy International and serve on the editorial board of the Journal of Competition Law and Economics, two academic journals that focus on antitrust issues.

3. I served as the Deputy Assistant Attorney General for Economic Analysis at the U.S. Department of Justice between 2006 and 2008. Between 2005 and 2007, I served as a member of the Antitrust Modernization Commission, a 12-member bipartisan commission with members appointed by the President and Congress to review the adequacy of the nation's antitrust laws. I was the only economist to serve as a member of the Commission, which included leading antitrust lawyers, many of whom had extensive experience at enforcement agencies. I also have served as an outside consultant

during the DOJ and FTC's 1992 revision of the Merger Guidelines and also have consulted for both the DOJ and FTC on a variety of antitrust issues.

**B. Overview**

4. I have been retained by counsel for several organizations<sup>1</sup> to share my views relating to the possible revisions to the Horizontal Merger Guidelines being contemplated by the DOJ and FTC.<sup>2</sup> All the views expressed are my own.

5. The Guidelines have proven to be a valuable and durable guide to antitrust practitioners and courts. Accordingly, radical change is not needed. Nonetheless, to the extent a revision does occur, it is desirable to update and improve the Guidelines to reflect developments in merger analysis over recent years as well as changes in the types of issues that the agencies face in reviewing mergers. This statement summarizes some of my views on (i) the appropriate focus and scope of issues that should be addressed in the Guidelines, and (ii) specific areas where revisions to the Guidelines would help practitioners and courts evaluate whether a proposed transaction will adversely affect competition.

6. With respect to the appropriate focus of the Guidelines, my major conclusions are as follows:

- The Guidelines should focus on the first steps taken by agencies in analyzing mergers and should not try to provide a detailed explanation of the analytical techniques that may be used in the merger review process. Merger reviews often require sophisticated analyses of competitive effects that are specific to the facts of a given transaction and the scope of available data. Since it is not possible to provide an exhaustive list of possible modes of analysis, the guidelines should not incorrectly suggest that some

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<sup>1</sup> Sponsoring organizations include: AT&T, the Financial Services Roundtable, Microsoft Corporation, the National Association of Manufacturers, and Verizon Communications Inc.

<sup>2</sup> Federal Trade Commission and U.S. Department of Justice, "Horizontal Merger Guidelines: Questions for Public Comment," Sept. 22, 2009.

types of analyses are preferable to others. More detailed explanations of specific techniques can be better provided through statements that accompany the closing of investigations, as well as through commentaries.

- It would be inappropriate at present to incorporate an alternative to the Guidelines' current analytical starting point based on market definition and market concentration by replacing this starting point with one that is based on a competitive effects framework such as "upward pricing pressure" (UPP). While UPP is a promising tool for merger analysis, it is a sophisticated partial merger simulation analysis and exhibits the same strengths and limitations as other forms of merger simulation. There has also been very little empirical analysis performed to date that validates the predictive value of UPP in assessing the competitive effects of mergers. As a result, UPP does not today provide a simple or proven mechanism for identifying potential mergers that may or may not raise competitive concerns. Perhaps experience will prove it to be useful, but until that happens it should remain as one of many techniques designed to analyze competitive effects.

7. With respect to more specific revisions to the Guidelines, my major conclusions are as follows:

- There should be a well-established basis for any numerical thresholds for safe harbors in the Guidelines. Many approved transactions involve HHI changes in excess of the thresholds identified in the Guidelines, reflecting in part the weak empirical basis for the thresholds originally set forth. The agencies and the academic community should place greater emphasis on research that would help to establish thresholds that provide better guidance to courts and practitioners. Nonetheless, the Guidelines should stress

that no set of thresholds can be strictly applied and that a variety of other factors also need to be considered in the merger review process.

- The distinction between "unilateral" and "coordinated" effects in the Guidelines is artificial and should be deemphasized. Both types of effects are properly understood as variants of non-cooperative game theory with "unilateral" effects models typically reflecting a static oligopoly model with differentiated products and "coordinated" effects reflecting more dynamic considerations often involving homogeneous products. In practice the unilateral effects approach is often used when standard "coordinated effects" analysis based on market definition implies a very narrow market that might make agencies or courts uncomfortable for advocacy purposes. The revised Guidelines can make a valuable contribution by stressing that it is not illogical to identify competitive harm in narrowly but properly defined markets that include products subject to merger-related price increases.
- The Guidelines should place greater emphasis on the benefits to consumers that can result from merger-related savings in fixed costs. Current agency practice takes a skeptical view of fixed costs efficiencies and, as a result, agencies often fail to account fully for the nature of competition in industries in which fixed costs are substantial. Such industries, including computers, telecommunications, pharmaceuticals and others, are often characterized by intense dynamic competition and reductions in fixed costs in these sectors can increase incentives to invest in R&D and innovation. Failure to account fully for the effect of mergers on such incentives can cause agencies to stop mergers that would benefit consumers by fostering such innovation..
- The Guidelines should stress the difficulty of anticipating future changes in competitive conditions and should acknowledge that merger enforcement should not be based on

speculative assessments of future conditions. For example, attempts to assess the impact of a proposed merger based on hypothesized "innovation markets" frequently are highly speculative and should not be incorporated into the revised Guidelines. Similarly, claims that a proposed transaction will reduce "potential competition" are often based on speculative assessments of whether one of the participants in a proposed merger would have entered the market in the absence of the merger.

- The Guidelines should emphasize the importance of empirical evidence in overcoming enforcement agencies' skepticism about the role of entry, buyer response, and fixed cost savings in constraining post-merger price increases. More specifically, the Guidelines should give significant weight to empirical evidence about firms' past success in achieving fixed cost savings and the effect of past mergers on innovative activity. Similarly, the Guidelines should recognize that historical evidence about the impact of entry and/or large buyers on preserving post-merger competition should be given significant weight in merger analysis.
- The Guidelines should revise its approach to geographic market determination, shifting the focus of the analysis from one using supplier locations as a starting point to one based on the competitive alternatives faced by consumers at different geographic locations. This modification would eliminate what appear to be potential inconsistencies in the approach taken to define geographic markets and price discrimination markets in the Guidelines..
- Finally, the Guidelines' distinction between "committed" and "uncommitted" entry is artificial and should be deemphasized. The distinction between "committed" entrants, which incur significant sunk entry-related costs, and "uncommitted" entrants that do not fails to adequately recognize that there is a continuum between committed and

uncommitted entry. This analytical distinction has not been useful in practice and should be replaced by a discussion that is not based on arbitrary “bright line” rules.

## **II. The appropriate focus and scope of the Guidelines**

8. The Merger Guidelines have provided a durable and valuable guide to practitioners and the courts and have succeeded in making merger analysis more sensible and consistent. The Guidelines’ analytical framework is basically sound and identifies the economically appropriate set of questions that enforcement agencies and courts need to address in analyzing the competitive effects of a merger. The Guidelines focus on the right question – will a proposed merger adversely affect competition – and have provided stable and reliable guidance to practitioners and courts.

9. While the Guidelines have generally held up well over time, there is still room for improvements. Nearly 20 years have passed since the Guidelines last underwent a significant revision and there have been significant developments in merger analysis as well as significant changes in the types of transactions before the agencies. The review process now underway provides the agencies an opportunity to clarify certain conceptual shortcomings of the current Guidelines and to improve their usefulness to practitioners and courts.

10. The Antitrust Modernization Commission, the bipartisan Commission created by Congress with members appointed both by Congress and the President, came to a very similar conclusion in 2008. After hearing testimony from a wide range of antitrust scholars and practitioners, the Commission concluded that its “review and study of current merger enforcement standard revealed a general consensus that the framework for analyzing mergers used by the antitrust agencies and the courts is basically sound. [...] Nonetheless, room for improvement exists.”<sup>3</sup>

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<sup>3</sup> Antitrust Modernization Commission, Report and Recommendations (April 2007), p. 48.

**A. The Guidelines should attempt to outline the first steps in merger analysis but should not attempt to provide all the details of the merger review process.**

11. A basic issue is defining the appropriate scope of the Guidelines. The current Guidelines "describe the analytical framework and specific standards normally used by the Agency in analyzing mergers."<sup>4</sup> The Guidelines also explicitly recognize that "mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws. [...] Therefore, the Agency will apply the standards of the Guidelines reasonably and flexibly to the particular facts and circumstances of each proposed merger."<sup>5</sup>

12. In my view, the Guidelines' focus on the analytical framework instead of the specific details of the review process is appropriate. The Guidelines should not attempt to provide a detailed or precise roadmap of the types of studies agencies will or should perform in analyzing a proposed transaction. Instead, the Guidelines should continue to stress that merger analysis often involves diverse and sophisticated analyses that are often highly specific to the transaction at issue.

13. Methodologies such as merger simulation or evaluation of natural experiments may be appropriate and feasible in analyzing some, but not all, transactions and the precise nature of these analyses will differ from transaction to transaction. There is a substantial risk that attempts to use the Guidelines to provide a detailed list of specific methodologies will provide a misleading impression of the merger review process. That is, attempts to provide more detailed information on specific analytic approaches may provide *less* reliable guidance to practitioners by incorrectly suggesting that certain techniques are favored over others. The fact that the Guidelines are used by multiple audiences – including federal agencies other than DOJ and FTC, state Attorneys General, practitioners and courts – reinforces the importance of using the Guidelines to highlight the general economic framework and the

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<sup>4</sup> Guidelines, Section 0.

<sup>5</sup> Guidelines, Section 0.

central issues for merger analysis, as well as the first steps typically taken by the agencies in the review process.

14. Commentaries and agency closing statements are preferable mechanisms for providing details about the nature of past agency investigations and to provide transparency into the review process. For example, the DOJ and FTC's 2006 commentary on the review process<sup>6</sup> as well as the FTC's 2008 review of the market concentration in its merger investigations have provided valuable information to practitioners and insight into the review process.<sup>7</sup> Similarly, statements that accompany the closing of investigations can be used to provide detailed information about the nature of the analyses undertaken in the course of merger reviews.

15. Practitioners and courts need to understand that the Guidelines are just that – guidelines. This view extends to the Guidelines' use of numerical screens based on HHIs or market shares in defining safe harbors. Such screens are not ends in themselves but provide only a first step in more detailed analysis. This flexibility is essential because industries that appear to be concentrated based on any empirical thresholds may, in fact, be competitive, and vice-versa.

**B. The Guidelines should not endorse analysis of competitive effects as an alternative to the use of market concentration/market definition as the starting point for merger analysis.**

16. It would be inappropriate at this time for the Guidelines to adopt a competitive effects methodology such as "upward pricing pressure" (UPP) or others as a starting point for merger analysis, either in addition to or as a substitute for the Guidelines' current reliance on market definition/market concentration. While competitive effects analyses, including UPP, can be valuable in analyzing certain mergers, such approaches are relatively complex. Moreover, an approach such as UPP, though promising, is, at present, untested and thus is not a suitable starting point for merger analysis.

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<sup>6</sup> U.S. Department of Justice and Federal Trade Commission, "Commentary on the Horizontal Merger Guidelines," March 2006.

<sup>7</sup> Federal Trade Commission, "Horizontal Merger Investigation Data, Fiscal Years 1996-2007," December 2008.

17. UPP is a form of competitive effects analysis that provides a methodology for asking whether price will likely rise as the result of a merger. UPP is, in effect, a sophisticated partial merger simulation analysis and exhibits many of the limitations, as well as the strengths, that apply to other forms of merger simulation analysis. Application of UPP requires information on diversion ratios between products, margins (price less marginal cost) and potential merger-related cost savings. Measurement of each of these elements can be complex and raises a variety of issues that may generate disagreement among practitioners. Measurement issues that arise in UPP analysis can be more complicated than those that typically arise in market definition/market concentration analysis.

18. The theoretical limitations of standard merger simulation analysis also apply to UPP. These include: (i) the static nature of the oligopoly model that provides the theoretical underpinnings of the analysis; (ii) potential inconsistencies between available data on margins and diversion ratios (which, in turn, depend on the own-price and cross-price elasticities of demand); and (iii) the inability of UPP (and other competitive effects models) to account for product repositioning post-merger. Perhaps most important, UPP is new and little empirical analysis has been performed to validate its predictive value in assessing the competitive effects of mergers.

19. In my view, UPP does not now provide a simple or readily-applied alternative to analysis based on market definition/market concentration for use as a first step in identifying mergers that may raise competitive concerns and should not be incorporated into the Guidelines at this time. This is not to say that UPP or other competitive effects models should not have a role in merger analysis. To the contrary, they can play an important role in the review process and may over time prove to be sufficiently valuable to play a more important future role.

20. As I have stressed in prior work, the development of new empirical forms of merger analysis is a high priority for antitrust analysis. However, application of any new framework requires

testing and validation before it can be provide a reliable basis for antitrust policy.<sup>8</sup> Institutionalizing UPP or any other particular technique estimating competitive effects in the Guidelines today would raise the risk that antitrust practitioners and courts would place an undue amount of attention on a new and untested technique. If UPP proves valuable and reliable, such information can be conveyed in closing statements or in commentaries on the Guidelines published by the agencies.

21. While imperfect and necessarily crude, the market definition/market concentration framework has provided a useful starting point for merger analysis and has served practitioners, courts, federal agencies, and state Attorneys General well. Analyses of competitive effects and market definition/market concentration are complementary and should not be viewed as substitutes. Indeed, a finding that a merger will have an anticompetitive effect implies that competition in a particular economic market has been harmed. Viewed in this way, an analysis that identifies an anticompetitive effect should be viewed as defining a market in which a merger harms consumers. If a court is skeptical of a market definition, then evidence of an anticompetitive effect from a merger should allay some of the court's skepticism. Although it is conceivable that there are instances where market definition is impossible to apply but competitive effects analysis can be done, I suspect these cases are rare. The discipline of forcing decision makers to have a reasonable market definition in mind before finding a harmful competitive effect is likely to be valuable in constraining agencies and especially courts from making decisions based on arbitrary criteria.

22. Incorporating into the Guidelines a discussion of the role of critical loss analysis in defining markets raises similar concerns about the risks about providing misleading guidance to practitioners and courts that can result from endorsing a particular technique. Various forms of critical

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<sup>8</sup> Dennis Carlton, "Why We Need to Measure the Effect of Merger Policy and How to Do It," Competition Policy International (Spring 2009).

loss analysis have been used for many years but there remains controversy over its use.<sup>9</sup> At one level, critical loss is simply a different way of asking the identical question that the Guidelines ask in defining a market: how likely is it that a hypothetical monopolist of some group of products can raise price by, say, 5 or 10 percent? Critical loss analysis by itself introduces no new economic concepts, yet there may be some who think it does. Indeed, in my experience at the DOJ and as a consultant, I have seen many attempts to apply critical loss analysis that have generated significant confusion. As such, critical loss analysis should not at this time be incorporated into the Guidelines as a necessary or standard framework for evaluating market definition. Again, to the extent critical loss turns out to be a useful way to phrase the question of market definition, its use could be described in closing statements or in commentary.

### **III. Specific areas for revisions to the Guidelines**

23. As noted above, while the approach to merger enforcement outlined in the Guidelines is basically sound, there are a number of areas in which the Guidelines could be refined to better reflect advances in merger analysis. This section briefly identifies several areas where the economic logic in the Guidelines could be clarified or revised, as well as areas where gaps in the Guidelines' economic logic could be filled.

#### **A. There should be a well-established basis for any numerical thresholds used in the Guidelines.**

24. As mentioned above, many transactions approved by the enforcement agencies involve levels and changes in concentration in excess of the HHI thresholds now identified in the Guidelines. This reflects the fact that the thresholds incorporated into the Guidelines do not have a solid basis in economic analysis and are currently set at levels that are too low to provide proper guidance to

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<sup>9</sup>J. Farrell and C. Shapiro, "Improving Critical Loss Analysis," *The Antitrust Source*, February 2008 and D. Scheffman and J. Simons, "The State of Critical Loss Analysis," *Antitrust Source*, November 2003.

practitioners, courts and others. The DOJ, FTC and academic community should place greater emphasis on analysis that would help to establish thresholds that better reflect the risk of harm to competition that results from a proposed merger. However, the Guidelines need to note and enforcement agencies need to recognize that numerical thresholds can never hope to provide absolute guidance to enforcement activities. Thresholds can at best provide rough guidance and agencies enforcement decisions must also account for the large number of other factors that arise in a more detailed review.

**B. The distinction between "unilateral" and "coordinated" effects currently incorporated into the Guidelines is artificial and should be deemphasized.**

25. The Guidelines suggest that there is one economic theory that underlies the analysis of unilateral effects of a merger on competition and another that provides the basis for coordinated effects. As described in the Guidelines, mergers can reduce competition through unilateral effects because "merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output."<sup>10</sup> Alternatively, the Guidelines suggest that mergers can reduce competition through coordinated interaction by creating market conditions that "are conducive to reaching terms of coordination, detecting deviations from those terms, and punishing such deviations."<sup>11</sup>

26. However, the Guidelines' distinction between "unilateral" and "coordinated" effects is artificial and provides a misleading view to practitioners, courts and others of the economic theory that provides the foundation for merger enforcement. Instead, both "unilateral" and "coordinated" effects analyses are properly understood as variations of non-cooperative game theory, which provides the general theoretical basis for all types of concerns about the potential adverse effects of mergers on consumers.

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<sup>10</sup> Guidelines, Section 2.2.

<sup>11</sup> Guidelines, Section 2.1.

27. Empirical unilateral effects models are often based on models of Bertrand competition, which reflects the (highly stylized) view that firms compete by making non-cooperative decisions when determining prices for differentiated products. The Bertrand model is static in the sense that firms are assumed to make simultaneous decisions about price while recognizing the interdependence of their decisions. Analysis of coordinated effects is typically less formal than that for unilateral effects, and often involves identifying and evaluating a variety of factors that affect the way that firms respond to each others' actions over time.

28. Thus, a principle distinction between the Guidelines' analysis of "unilateral" and "coordinated" effects is the extent to which the analysis focuses on static or dynamic factors. This seems like a peculiar use of terminology over substance and both types of analyses are properly considered as variants of non-cooperative game theory. There is no reason that a static differentiated product model based on Bertrand competition cannot be extended to account for dynamic competition in which case it would look like what the Guidelines would call a coordinated effects model.

29. Further, one cannot distinguish between unilateral effects analysis and coordinated analysis by suggesting that unilateral effects analysis of differentiated products can be considered independently of market definition. The Guidelines suggest that unilateral and coordinated effects analysis may be distinguished based on whether the merging firms are each other's next best substitute and whether rivals hold price constant in response to price changes by the merged firm. If there is in fact an adverse competitive effect of the merger holding constant rivals' prices, then according to the Guidelines the two merging firms by themselves constitute a relevant market. That is, the logic of the Guidelines implies that the market is very narrow. But there is no need for an anticompetitive merger to be limited to firms that are each other's next best substitutes — all the competitive constraints on the merged firm should matter and there certainly is no reason to expect that rivals in the same market will not respond to a merged firm's price increase.

30. As a practical matter, unilateral effects analysis is often used in circumstances in which the standard "coordinated effects" analysis based on market definition/market concentration framework would imply a very narrow market definition that might make agencies and courts uncomfortable. That is, litigators may find it easier from an advocacy perspective to argue that the market is broad while relying on a unilateral effects analysis to demonstrate competitive impact. A revision to the Guidelines can make a valuable and basic contribution by stressing that it is not illogical to define markets that consist of the set of products subject to a modest post-merger price increase. That is, the agencies should not be reluctant to advocate a narrow market properly defined.

31. It is possible to draw a distinction between a situation in which a merger harms competition by reducing the number of firms competing in the same competitive game as existed pre-merger and a situation in which there are not only fewer firms post merger but the competitive game has changed. For example, the competitive game could have changed because certain information may become more transparent allowing for better monitoring of rivals' prices. But the Guidelines contain no such distinction as presently written.

32. The suggestion to deemphasize the distinction between "unilateral" and "coordinated" effects in the Guidelines today should not be misunderstood to allow the agencies to investigate or challenge mergers on vague or unstated grounds. The agencies should, of course, clearly delineate any theory of competitive harm being explored and, if appropriate, provide guidance to the merging parties as to how those concerns can be addressed.

**C. The Guidelines should place greater emphasis on fixed cost savings.**

33. The Guidelines currently recognize that mergers may result in substantial savings in fixed costs, but also note that it may be difficult to establish that these savings are merger-specific or to verify them. Agencies are also skeptical that consumers benefit from merger-related savings in fixed costs because, in many oligopoly models, price depends on marginal costs, not fixed costs.

34. However, such oligopoly models fail to fully capture the nature of dynamic competition in industries that are characterized by high fixed costs and low marginal costs.<sup>12</sup> Many industries that are the focus of current antitrust attention – including computers, telecommunications, pharmaceuticals, and others – fit these criteria, and are characterized by high levels of R&D and intense competition to innovate. In such industries, reductions in fixed costs are likely to increase incentives to invest in R&D by lowering the "hurdle" that firms must overcome to realize a profitable opportunity. Failure to account adequately for the effect of mergers on such incentives can cause agencies to stop mergers that would benefit consumers by fostering such innovation.

35. The Guidelines could provide an improved understanding of fixed cost efficiencies by explicitly recognizing the importance of merger-related reductions in fixed costs on a firm's incentive to invest in R&D and introduce new products and services that can improve consumer welfare. The economic literature recognizes that much of the gains in consumer welfare over time can be directly attributed to technological innovations and new products including, among others, new drugs and medical treatments, mobile phones, and the Internet.<sup>13</sup>

36. The Antitrust Modernization Commission also recommended that the enforcement agencies "should ensure that they give sufficient credit to certain fixed cost efficiencies."<sup>14</sup> The Commission recognized that fixed cost efficiencies benefit consumers by providing increased incentives to innovate and lower prices in the long run. The Commission also correctly stressed that merger-

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<sup>12</sup> Fixed cost reductions result in real resource savings which benefit society. However, there is no need to debate whether merger review should be based on consumer surplus or total surplus (including both producer and consumer surplus) as long as the role of fixed cost savings in fostering dynamic competition is properly recognized.

<sup>13</sup> To cite one example, Murphy and Topel find that advances in medical technology and health care have resulted in very large benefits to consumers. They conclude that "[c]umulative gains in life expectancy after 1900 were worth over \$1.2 million to the representative American in 2000, whereas post-1970 gains added about \$3.2 trillion per year to national wealth, equal to about half of GDP." K. Murphy and R. Topel, "The Value of Health and Longevity," 114 *Journal of Political Economy* 871 (2006).

<sup>14</sup> Antitrust Modernization Commission Report, p. 58.

related savings in fixed costs benefits consumers as well as producers, resulting in resource savings to the economy.

**D. The Guidelines should stress that merger enforcement should not rely on speculative theories of competitive harm.**

37. The economic literature stresses the difficulty of anticipating discrete future events such as the source and timing of new innovations due in part to the fact that innovations can come both from industry outsiders as well as current market participants. As noted above, the economic literature also recognizes the enormous contribution of new products and services to consumer welfare. Under these circumstances, errors by agencies in understanding the nature of innovation competition can result in significant consumer harm by slowing innovation.

38. In recent years, enforcement agencies have challenged proposed mergers based on concerns that the transactions would result in a reduction in competition in “innovation markets.”<sup>15</sup> However, the economic literature provides little guidance with respect to how participants in such markets should be identified or how many competitors are needed to preserve the appropriate competition in developing innovations.<sup>16</sup> As a result, enforcement actions based on claims of reduction in competition in innovation markets are inherently speculative.

39. Agencies may be able to use a careful fact-based analysis to identify circumstances in which a merger would harm innovation competition. For example, certain pharmaceutical markets have a well-defined product pipelines which identify new products that may be introduced over various time horizons and such information may be of value in assessing the impact of pharmaceutical mergers on innovation competition. However, I am not aware of any reliable basis that the Guidelines can use to

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<sup>15</sup> See M. Katz and H. Shelanski, “Mergers and Innovation,” 74 *Antitrust Law Journal* 1 (2007) for a discussion of cases involving innovation markets.

<sup>16</sup> See D. Carlton and R. Gertner, “Intellectual Property, Antitrust and Strategic Behavior,” in *Innovation Policy and the Economy*, vol. 3, (Adam Jaffe, Josh Lerner and Scott Stern, eds.), National Bureau of Economic Research (2003).

provide general guidance in identifying transactions that may harm innovation competition. As a result, attempts to use the Guidelines to institutionalize the concept of innovation markets are likely to result in misleading guidance to practitioners and courts.

40. Similarly, claims that a proposed transaction will reduce "potential competition" often require highly speculative assessments of whether one of the participants in a proposed merger would have entered the market in the absence of the merger. As with innovation, a detailed fact-based analysis may sometimes be able to establish that a merger involves a firm that would have entered in the absence of the proposed transactions. But attempts to describe such conditions in the Guidelines are likely to provide misleading guidance to practitioners and courts.

41. Enforcement agencies currently make significant efforts to avoid speculation in various parts of a merger review. For example, the agencies do not speculate about whether the parties to a proposed transaction might pursue an alternative transaction in identifying the benchmark against which a proposed transaction is considered. The Guidelines should also refrain from attempting to address other circumstances in which merger analysis is inherently speculative.

**E. The Guidelines should recognize that empirical evidence can be used to overcome the agencies' skepticism about the competitive importance of entry, buyer response, and fixed cost savings.**

42. Historically, enforcement agencies have been skeptical about the ability of entrants and large buyers to offset potential anticompetitive effects of mergers. Some of this skepticism is understandable since, for example, a wholesale endorsement of the proposition that entry is easy would imply no need for merger enforcement. Similarly, as discussed above, agencies have been skeptical that consumers can benefit from merger-related savings in fixed costs. While such skepticism may sometimes be appropriate in analyzing mergers, it is also important that agencies remain open to consideration of empirical evidence that demonstrates the historical importance of these factors in

preserving post-merger competition. For example, a company or industry with a track record of fixed cost savings and increased R&D from prior mergers may be able to show more clearly that such benefits are likely to result from the next transaction. The Guidelines should explicitly recognize that empirical analysis can be persuasive in the evaluation of these factors.

**F. The Guidelines should revise its approach to geographic market determination.**

43. The starting point for the geographic market definition analysis presented in the Guidelines focuses on the competitive conditions faced by suppliers in different geographic areas.<sup>17</sup> The Guidelines define the geographic market by, in effect, drawing a circle around a group of suppliers in a geographic area, and then asking whether a hypothetical monopolist of the identified locations would be able to sustain a price increase. The scope of the geographic market is defined by expanding the geographic area to the point at which outside suppliers would no longer be able to defeat an attempt by the hypothetical monopolist to raise price.

44. This approach, however, can provide a perhaps confusing view of the competitive impact of a merger between geographically distinct suppliers. Instead, geographic markets are more naturally defined using customers in a geographic location (not suppliers) as the starting point of the analysis. The scope of the geographic market would then be defined by expanding the geographical scope of this customer-centric area to the point that outside suppliers could no longer defeat an attempt by a hypothetical monopolist to raise price to particular buyers.

45. Shifting the focus of geographic market analysis in this way would be consistent with how the Guidelines identify price discrimination markets. More specifically, the Guidelines define price discrimination markets by first identifying a set of “targeted buyers” and then determining what other

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<sup>17</sup> Guidelines, Section 1.21, which states that “... the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a ‘small but significant and nontransitory’ increase in price ...”

products such buyers may switch to in response to an increase in the price of the relevant product. Although under certain conditions, a market with no price discrimination can be equally well defined either by starting with supplier locations or starting with buyer locations,<sup>18</sup> many cases involving geographic market definition involve some ability to price discriminate and, as a result, the consumer-based approach is generally preferable.

**G. The distinction between "committed" and "uncommitted" entry currently incorporated into the Guidelines is somewhat artificial and should be deemphasized.**

46. The Guidelines attempt to distinguish between "committed" entry, which requires that the supplier face significant sunk costs, and "uncommitted" entrants that can rapidly enter and exit without significant sunk costs. According to the Guidelines, uncommitted entrants include firms that do not currently sell in the relevant market but could do so within one year without the expenditure of significant sunk costs.<sup>19</sup> Committed entrants include firms that could achieve a significant impact on price within two years from the time of initial planning.<sup>20</sup>

47. This distinction, however, is artificial and confusing; it would be more appropriate for the Guidelines to recognize that there is a continuum between committed and uncommitted entry. For example, even firms that make closely related products often need to make irreversible investments in marketing and distribution when extending their product line. While the Guidelines ask the right question – whether competition be reduced over some relevant time period – the distinction between committed and uncommitted entrants has not proven to be of practical help in answering that question. Instead, empirical evidence based on entry by both "committed" and "uncommitted" entrants should be given full consideration by the enforcement agencies in both identifying market participants and evaluating the likelihood of entry.

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<sup>18</sup> D. Carlton, "Market Definition: Use and Abuse," Competition Policy International, (Spring 2007).

<sup>19</sup> Guidelines, Section 1.32.

<sup>20</sup> Guidelines, Section 3.0.