

1 FEDERAL TRADE COMMISSION

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3 A ROUNDTABLE SPONSORED BY THE BUREAU OF ECONOMICS
4 UNDERSTANDING MERGERS:
5 STRATEGY & PLANNING, IMPLEMENTATION AND OUTCOMES
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11 December 9 and 10, 2002
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26 FEDERAL TRADE COMMISSION
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32 **(INTRODUCTORY REMARKS EXCERPT)**
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1 **Monday, December 9, 2002**
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3 **Introductory Remarks**
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5 **Timothy J. Muris**, Chairman, Federal Trade Commission..... 5
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7 **David T. Scheffman**, Director, Bureau of Economics, Federal
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P R O C E E D I N G S

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3 MR. SCHEFFMAN: Thank you all very much for
4 coming. I'm David Scheffman, Director of the Bureau of
5 Economics. I'm pleased to introduce Chairman Tim Muris.

6 CHAIRMAN MURIS: Welcome to our Roundtable on
7 Understanding Mergers, which is sponsored by the Bureau of
8 Economics. Throughout my career as a Commission official
9 and a law professor, I have thought that efficiencies ought
10 to be an important part of the Commission's agenda, and
11 that's what we're going to talk about today and tomorrow.

12 A main point I'm going to raise today is the fact
13 that, although efficiencies are an important part of our
14 agenda, we rarely have serious efficiencies presented to us.

15 Today, we'll have three panels. These panels will
16 discuss the rationales behind mergers, including important
17 questions about assessing the value a merger will create,
18 the likelihood that it will achieve that value, and how to
19 achieve a merger's objectives.

20 Tomorrow we'll have two panels. The first panel
21 will discuss the relationship between various costs and
22 business decision-making. The next panel will discuss what
23 the private sector perceives about the business planning
24 that merging parties may do without becoming illegal gun-
25 jumping, and we'll discuss the implications of our concerns
26 with gun-jumping.

27 Before we get to all that, I want to focus briefly

1 on my personal views of how the Commission should treat
2 efficiency claims. The government once treated efficiencies
3 as a reason to block a merger. Indeed, that position was
4 taken at the Commission as recently as 1974. We've, of
5 course, come a long way since then.

6 Modern merger analysis is much more sensible about
7 efficiencies. The 1997 revisions to the U.S. Department of
8 Justice and Federal Trade Commission Horizontal Merger
9 Guidelines elaborated on the importance of efficiencies and
10 offered some guidance on how to evaluate efficiencies.

11 Efficiency claims, however, have not flourished.
12 At least, in part, I believe this is because of a
13 misunderstanding of their role. Many apparently believe
14 that, practically speaking, efficiencies count only when the
15 merger is otherwise determined not to be anti-competitive.
16 Although I have written that the government has remained too
17 hostile to efficiency claims, especially in court, it is not
18 that hostile.

19 Efficiencies can matter, even when there is a
20 basis for concern. Of course, the more likely and
21 substantial are the likelihood of the anti-competitive
22 effects, the more likely and substantial must be
23 efficiencies to overcome the concerns about anti-competitive
24 effects.

25 A related misreading of the guidelines is to over-
26 emphasize the structural presumptions. The guidelines do
27 not state, and enforcement policy has never been over the

1 last 20 years, that a high HHI plus a significant delta is
2 dispositive evidence of anti-competitive effects. Instead,
3 a high HHI and significant delta in a properly defined
4 market, and the presence of barriers to entry, provide a
5 prima facie case. The prima facie case can be rebutted by
6 the absence of a viable, factually-supported theory of anti-
7 competitive effects.

8 Again, the strength of the affirmative case
9 matters. Thus, two-to-one or three-to-two mergers in well-
10 defined markets protected from entry are likely to pass the
11 anti-competitive test simply because of the very low number
12 of competitors.

13 In other circumstances, however, efficiencies can
14 be a significant component of the rebuttal of the prima
15 facie case. For example, in a four-to-three merger for
16 which the viability of an anti-competitive theory is
17 questionable, likely and sufficient efficiencies should lead
18 to a decision not to challenge the merger.

19 Last year, the Commission voted to close its
20 investigation of the proposed merger of the third- and
21 fourth-ranked drug wholesaling companies. In a public
22 statement, we concluded there was insufficient evidence to
23 support a theory of competitive harm, including a lack of
24 evidence that either of the merged firms had contributed
25 significantly to the ongoing trend of decreases in drug
26 wholesaling prices or that the resulting industry structure
27 likely would lead to price increases or prevent further

1 price reductions.

2 We also noted that the proposed transaction would
3 likely give the merged firm sufficient scale to allow it to
4 become more cost competitive with the two leading firms and
5 to invest in the value-added services consumers desire.

6 Further, we believed that the combined firm could
7 initiate these improvements more rapidly than either could
8 do individually and that this timing advantage would be
9 significant enough to constitute a cognizable, merger-
10 specific efficiency.

11 One source of confusion about the role of
12 efficiencies comes from the litigated cases. Generally, the
13 courts have placed more weight on structural presumptions
14 than do the Horizontal Merger Guidelines or actual
15 enforcement policy. For example, in *Cardinal Health*, the
16 Court appeared to have relied principally on the presumption
17 that increases in concentration would lead to higher prices.
18 There were also significant customer complaints, although
19 the Court did not appear to weigh those heavily. Despite
20 both acknowledging substantial efficiencies and recognizing
21 the lack of strong proof of price effects, the Court granted
22 the injunction the Commission sought.

23 When the government does lose in court, the reason
24 generally has been deficiencies in the evidence supporting
25 the government's allegations of market definition or of
26 entry barriers, rather than the viability of the theory of
27 anti-competitive effects.

1 An important decision that may be misunderstood is
2 the so-called Baby Foods case. The crucial issue in that
3 case was whether the merger was a three-to-two merger of
4 head-to-head competitors or a two-to-one merger of
5 competitors competing vigorously for shelf space, or
6 instead, was a transaction that would actually enhance
7 competition by combining two weak firms into one that could
8 at last challenge the dominance of Gerber.

9 If the evidence supported the three-to-two head-
10 to-head competitor characterization or the two-to-one
11 competitor for shelf space characterization, then the
12 structural presumptions rightfully would have trumped at the
13 preliminary injunction stage what was a solid and
14 substantial efficiency claim.

15 The parties lost, in part, because the District
16 Court ignored both antitrust economics and relevant
17 precedent, and did not even allow the substantial customer
18 testimony supporting the merger, let alone give that
19 testimony proper weight. Lacking such evidence, the D.C.
20 Circuit found that the record did not sufficiently rebut the
21 three-to-two or two-to-one structural presumptions on
22 appeal.

23 The misunderstanding of the role of efficiencies
24 in the Horizontal Merger Guidelines, in prosecutorial
25 decisions, and in court decisions has led some to advise
26 their clients not to make the effort necessary to put
27 forward their best efficiencies case.

1 On the Commission side, the dearth of sound,
2 factually-supported efficiency presentations leads us
3 usually to reject the efficiencies that are claimed. When
4 the parties present back-of-the-envelope calculations or
5 advance claims of efficiencies with insufficient support,
6 the staff will not accept them, and understandably so.
7 Although this may give the staff a reputation for not
8 welcoming efficiency arguments, the only deserved reputation
9 is one for rejecting poorly developed arguments.

10 The dilemma is obvious. Parties don't bother
11 giving us good material, and without good material, we don't
12 believe in efficiency arguments. It's the classic chicken
13 and egg problem. The antitrust bar should know, however,
14 that we take substantial, well-documented efficiencies
15 seriously, and we recognize that mergers can lead to a
16 variety of efficiencies beyond reductions in variable costs.

17 Counsel should also bear in mind that efficiencies
18 can be important in cases that result in consent decrees.
19 Presentations of credible efficiency claims can lead to a
20 settlement that preserves competition while allowing the
21 parties to achieve most, if not all, of the efficiencies
22 they believe will flow from the merger.

23 I want to encourage the presentation of solid,
24 credible evidence. I also want to reassure antitrust
25 counsel that such evidence will be taken seriously. That
26 requires some leap of faith from counsel, but the Commission
27 cannot move first in this area. We necessarily take the

1 arguments as presented to us, although we evaluate them
2 independently. We do not make them up for the parties. As
3 Commissioner Leary recently detailed, when the arguments
4 presented to us are strong, we will give them detailed
5 attention.

6 In sum, efficiencies should sometimes be an
7 important and substantial component of the party's
8 presentation to the Commission. We take such efficiencies
9 seriously. In turn, we expect that the parties will present
10 these claims with enough evidence to allow us to evaluate
11 their validity. I do not expect that substantial efficiency
12 studies will be presented in very many cases. I do hope
13 that they occur with more frequency than current practice.

14 Indeed, in four years as a Commission official,
15 counting my experience from the 1980s in the Bureau of
16 Competition, I've seen serious efficiency claims made only a
17 few times. I encourage the bar to do better. Solid
18 efficiency presentations will better enable the Commission
19 to identify and forego challenging those mergers with bona
20 fide efficiencies that benefit consumers.

21 We'll now move to what should be very interesting
22 and informative discussions by experts on mergers. Thank
23 you for coming.

24 MR. SCHEFFMAN: Again, I want to thank you for
25 coming. When Chairman Muris asked me to return to the
26 Commission a year and a half ago, I asked him what he wanted
27 to accomplish. Efficiencies were one of the primary focuses

1 on his agenda, and one of the reasons why he came back.
2 We've been doing a lot of work in the Bureau of Economics on
3 this and other related topics for the last year and a half.
4 Part of this work you'll see in Paul Pautler's paper on
5 merger outcomes literature that's available out front.

6 Over the next day and a half, we're going to hear
7 from an extraordinary group of people, professors and
8 researchers, consultants, business people, financial experts
9 and lawyers, who will be talking to us about what they know
10 from their research and expertise and experience about
11 various aspects of M&A, mergers and acquisitions. This
12 undoubtedly will be one of the most interesting conferences
13 on M&A that has ever been put together.

14 We're greatly indebted to the panelists who have
15 agreed to participate in this roundtable. If you look at
16 your program, you can see the very high opportunity cost
17 that's involved with the caliber of the people that we have
18 here. But what's interesting is that when we called and
19 invited people to participate, their uniform response was,
20 when and where. I believe that's testament to the
21 importance of the antitrust mission of the FTC and DOJ and
22 the respect our agencies have in the academic, consulting,
23 and business communities.

24 The audience is also extraordinary. There are
25 people here from the FTC and DOJ, from Commerce, from the
26 Fed, from other U.S. Government agencies, and from
27 competition enforcement agencies in Canada and Europe.

1 Now, this is an unusual roundtable for those of
2 you antitrusters, as most of you in the audience are. Its
3 topic is related to merger enforcement under the antitrust
4 laws, but the panelists today are not antitrust economists
5 or lawyers, save Mike Scherer. This was a conscious
6 decision, to have a panel of this type.

7 For many years before returning to the Commission,
8 I was a business school strategy professor and a business
9 consultant. From that experience, I've come to believe that
10 antitrust enforcers and economists and many private lawyers
11 do not sufficiently understand the business side of M&A, and
12 other business decisions, to be able to adequately and
13 appropriately deal with the potential benefits of mergers.

14 Thus, today, we're going to hear from people with
15 acknowledged expertise and experience with the business and
16 economic side of M&A, not the antitrust side. They are not
17 going to specifically address how we should analyze
18 efficiencies in our merger reviews. Rather, what we learn
19 in the next day and a half, along with a lot of other work
20 that's going on at the FTC and at DOJ, will greatly expand
21 our understanding of the business motivation and effects of
22 mergers, and therefore, should improve our ability to assess
23 efficiency claims.

24 I want to thank the Chairman for making this
25 possible. I want to thank Paul Pautler who did all the work
26 in setting this up, along with his assistants, his
27 secretary, Crystal Meadows, and Research Analyst Stefano

1 Sciolli.

2 So, we look forward to a very interesting day
3 and a half of discussions on aspects of mergers and
4 acquisitions.

5 MR. PAUTLER: We'll move on to Panel 1 now,
6 please. For the members of Panel 1, please come on up.

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