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When Economists Are Kings

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Introduction

The 1982 Merger Guidelines: When Economists Are Kings?*

Eleanor M. Fox†

I INTRODUCTION

The Justice Department's 1982 Merger Guidelines¹ signal the second wave in the merger of antitrust law and economics. The first wave was marked by Derek Bok in 1960 with the publication of his article, *Section 7 of the Clayton Act and the Merging of Law and Economics*.² The driving force behind the first wave of this movement was law and legal policy. Scholarship of economists was integrated into the law, and economics was used as a tool to implement a policy declared by Congress. The body of economic scholarship upon which Bok drew held that market structure influences conduct, which in turn determines performance, and that concentrated market structures tend to foster noncompetitive performance.³ The first merger movement may be seen as vertical—the then available economic learning was an input into the law.

Four significant developments catalyzed the second wave of the merger of antitrust law and economics: first, developments in the anti-trust case law; second, advances in economic learning; third, changes in the spatial dimensions of competition, with many markets developing transnational characteristics; and fourth, setbacks in the American economy, which helped change the political mood of the country and

* "Until philosophers are kings . . . then only will this our State have a possibility of life and behold the light of day." 3 DIALOGUES OF PLATO: THE REPUBLIC 170-71 (B. Jowett trans. 3d ed. 1892).

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1. U.S. Dep't of Justice, Merger Guidelines, 47 Fed. Reg. 28,493 (1982), reprinted in 71 CALIF. L. REV. 649 (1983) [hereinafter cited without cross-reference as Guidelines].

2. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

3. *Id.* at 238-49.

provoked a call for less government intervention as a cure.⁴

By the end of the 1960's, the case law reflected what many came to regard as the excesses of antitrust. Reflecting a bias against big mergers for social and political reasons, decisions of the Supreme Court invalidated the merger of any significant competitors or pairs of supplier and buyer, even in fragmented markets into which entry was easy, and without regard to any efficiencies that the merger might have promised.⁵

During the same period, several developments in economic thinking occurred. The most dramatic development was the wider acceptance of the view that performance cannot be predicted from market structure. Some economists concluded that, even in highly concentrated markets, firms are as likely as not to perform competitively, and that high profits are more likely to indicate returns from efficiency than exercises of power.⁶ Furthermore, some of these economists believe that tacit collusion virtually never exists, while explicit collusion is usually detectable, and therefore a sound merger policy would not be concerned with cartels.⁷ The work of most economists, however, continues to confirm a relationship between market power and high concentration in high barrier markets,⁸ but many contemporary economists are skeptical of the once accepted wisdom that high concentration necessarily means poor performance.⁹ Moreover, economists have devoted

4. See Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1140-46 (1981).

5. See, e.g., *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

6. E.g., D. ARMENTANO, *ANTITRUST AND MONOPOLY* ch. 2 (1982); Y. BROZEN, *CONCENTRATION, MERGERS, AND PUBLIC POLICY* (1982) (especially chs. 3 and 6); R. BORK, *THE ANTI-TRUST PARADOX* chs. 8, 10 (1978); Demsetz, *Two Systems of Belief About Monopoly*, in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (H. Goldschmid, H. Mann & J. Weston eds. 1974); Peltzman, *The Gains and Losses From Industrial Concentration*, 20 J.L. & ECON. 229 (1977). See Edwards, Joffe, Kolasky, McGowan, Mendez-Penate, Ordovery, Proger, Soloman & Toepke, *Proposed Revisions of the Justice Department's Merger Guidelines*, 81 COLUM. L. REV. 1543, 1550-51, 1560-64 (1981) [hereinafter cited as Edwards Task Force].

7. Although this latter proposition goes much further than that documented *supra* at note 6, it is supported by all of the authorities cited there except the Edwards Task Force. However, many economists who believe that "the linkage between concentration and collusion is so complicated and so poorly understood" nevertheless conclude that the dangers of tacit collusion or undetectable express collusion are so significant that the merger law should be designed to deal with them. See, e.g., R. POSNER, *ANTITRUST LAW* 96-97, 111-13 (1976).

8. E.g., R. POSNER, *supra* note 7; F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* (2d ed. 1980).

Some economists have focused upon strategies that may be used by leading firms to discipline or destroy rivals, leading to lower output and higher price. See STRATEGY, PREDATION, AND ANTI-TRUST ANALYSIS (S. Salop ed. 1981) (proceedings of staff seminar, FTC Bureau of Economics and Competition, June 5-6, 1980), and Williamson, whose work includes *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977).

9. See Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

continuing attention to firm efficiencies, even those beyond plant scale, that may be realized by merger.¹⁰ In the late 1960's and 1970's their research demonstrated that resource savings from efficiencies can swamp resource losses from price enhancing mergers.¹¹

Meanwhile, economic conditions changed. Fiercely efficient foreign competitors eroded the market positions of American producers and contributed to already high levels of unemployment.¹² With inflation and unemployment undermining hopes for a higher standard of living, antitrust law was regarded with suspicion. It was blamed for standing in the way of efficient transactions and preventing American businesses from competing more successfully in domestic and transnational marketplaces.

The election of Ronald Reagan as President in 1980 reflected the changed political mood of the country. Mr. Reagan had promised to restore the economy to its former vigor by getting government out of the business of business.¹³ A vision of antitrust as conservative microeconomic policy, which would sanction suit only when it could create a more efficient allocation of resources and thus greater aggregate wealth, fit nicely with the political philosophy and campaign commitment of the Administration.¹⁴

The second wave of the merger of antitrust law and economics arises in this context. This merger movement has a different character from the first. Its proponents suggest that law and economics are to merge, and that economics is to be the surviving partner. The 1982 Merger Guidelines are symbolic of this second wave. They represent a new positivism; a reduction of legal principles to a simple, unitary, quasi-scientific, outcome-oriented economic model that, in a generalized sense, has been offered as the model for solving all antitrust problems. By embodying only one substantive goal—allocative efficiency—the model offers the appearance of clarity, predictability, and reduced government intervention.

This Symposium explores the 1982 Merger Guidelines from many points of view, and does so on both policy and technical levels. In this Introduction, I first give a brief description of the articles in the Sym-

10. Work regarding efficiencies beyond plant scale relates principally to vertical mergers. See, e.g., Williamson, *Vertical Merger Guidelines: Interpreting the 1982 Reforms*, 71 CALIF. L. REV. 604, 614-15 (1983).

11. See, e.g., Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699 (1977) [hereinafter cited as Williamson, *Economies Defense Revisited*]; Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968) [hereinafter cited as Williamson, *Economies Defense*].

12. See I. MAGAZINER & R. REICH, *MINDING AMERICA'S BUSINESS* pt. 1 (1982).

13. Sheils, Thomas, Abraham & Lubenow, *An Economic Dream in Peril*, NEWSWEEK, Sept. 8, 1980, at 50, 51.

14. See Fox, *supra* note 4, at 1155-57.

sium, and then offer some observations about major issues raised by the authors' views and my views of the future of the Guidelines. For purposes of my task, I divide the articles into two categories relating to the central question asked by the Guidelines: whether a particular merger is likely to give the merging parties power to raise price, or whether it is likely to facilitate price coordination (generally referred to in the Guidelines as "collusion") among the merged firm and its immediate competitors.¹⁵ The theory of the Guidelines is that, first, under certain structural conditions, including high concentration and significant barriers to entry, a single dominant firm will probably have power to elevate price above a competitive price; and second, that if there are no more than a few significant competitors, those firms will tend to cooperate rather than compete on price in ways that cannot be easily checked by the law against price fixing.¹⁶

In my first category, I treat articles basically in sympathy with the Guidelines' central question or methodology. Despite this sympathy, many of these papers make trenchant criticisms and give constructive suggestions for working within the Guidelines' general framework. In the second category I treat papers that are basically critical of the Guidelines, or suggest that sound policy or analysis might indicate a different path.¹⁷

II

THE SYMPOSIUM ARTICLES

A. *Working Within the Framework of the Guidelines*

The Symposium articles open with Professor Areeda's reflections on the theory and potential influence of the Guidelines.¹⁸ The Guidelines were ostensibly issued to describe government case selection, to guide the Antitrust Division staff, and to inform the business community. As Areeda observes, however, the potential influence of the Guidelines is far greater, and the drafters apparently intended for it to be so. The Justice Department's views command the respect of other agencies of the government faced with questions of merger policy. Moreover, especially in view of the lack of incentives for private suit except by takeover targets, the Department's case selection can pro-

15. The central question that governs merger analysis may be stated in different ways. Possible variations are set forth *infra* in the Appendix to this Introduction.

16. See Guidelines § I, 47 Fed. Reg. at 28,494, 71 CALIF. L. REV. at 649.

17. Although the editors of this Symposium have not organized the articles along these lines, I have for organizational purposes tried to make the assignments on the basis of whether the article suggests working within the framework of the Guidelines or whether its central suggestion is along a different route.

18. Areeda, *Justice's Merger Guidelines: The General Theory*, 71 CALIF. L. REV. 303 (1983).

foundly influence private conduct and the law. Rather than merely providing certainty to business or instructing the staff, "the Division's officials have given every indication of a mission to improve and rectify antitrust law."¹⁹

While Areeda believes that the "analytical road mapped out [by the Guidelines] is generally sound,"²⁰ he observes the "curious" precision of the numbers selected as benchmarks.²¹ He worries about the unavailability of the data required by the Guidelines' methodology, and about the vagueness of the factors that are represented to be crucial in guiding judgments on mergers within a large gray area.²²

One of the important substantive issues raised by Areeda is whether the law should prevent a merger that, if replicated, would lessen competition. The Guidelines do not attempt to check such mergers. Areeda observes that the Guidelines' election to disregard this dynamic effect may create incentives to merge early, and may be inconsistent with the spirit of the law.²³

Professor—and former Assistant Attorney General—Thomas Kauper echoes Areeda's concern that the Guidelines do not guide.²⁴ He sees the Guidelines as guidelines at the high and low ends, "with an essay in the middle."²⁵ He expresses the additional concern that the Guidelines invite extensive government regulation. The broad discretion retained by the Department may inspire Congressional staffs and outside parties to intervene; and it may induce the proponents of mergers to negotiate agreements that, while acceptable to the government, cannibalize the acquired company.²⁶

Kauper regards judicial precedent as an important element in merger policy, while the Guidelines do not. As he notes, the Guidelines choose to err on the side of nonintervention rather than on the side of precedent. Thus, he raises the question: What is the duty of the government to enforce the law?²⁷

Kauper points out that thresholds for violation are necessarily arbitrary and that there is no economic consensus on the level at which tacit or undetectable express collusion will occur. He would choose lower threshold levels, if indeed there should be guidelines at all; and

19. *Id.* at 307.

20. *Id.* at 310.

21. *Id.* at 308.

22. *Id.* at 309.

23. *Id.* at 310.

24. Kauper, *The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency and Failure*, 71 CALIF. L. REV. 497, 508 (1983).

25. *Id.* at 513.

26. *Id.* at 509.

27. *Id.* at 502.

he would offer a broader efficiencies defense in order not to deter salutary mergers that the broader sweep might catch.²⁸ Kauper's article is particularly insightful in articulating the tradeoffs and choices that a drafter of guidelines must confront. He identifies the problems and alternatives faced in developing generalized standards for rephrasing mergers that have anticompetitive properties,²⁹ for facilitating mergers that increase efficiency³⁰ or save seriously failing companies,³¹ and for doing so in a manner that is clear, predictable, and faithful to precedent.³²

The article contributed by former Assistant Attorney General Donald Baker and William Blumenthal³³ is largely complementary to Kauper's except in one respect. Baker and Blumenthal believe that the Guidelines do guide. They do so, the authors argue, by concentrating solely on one of the many economic theories, albeit "one of comparatively narrow . . . focus"—the tendency of increasing concentration to enhance the risk of tacit collusion.³⁴ This conspiracy theory of merger enforcement is not a trivial shift in perspective, Baker and Blumenthal observe, but they welcome the model as providing the framework for a unitary, intellectually consistent approach.³⁵

Baker and Blumenthal identify market definition as the most important contribution of the Guidelines. Product market definition is not a radical departure. Geographic market definition "stray[s] much farther," but in ways the authors welcome. The old impermeable magic circle of market definition can now be pierced, and the market definition process no longer ignores the fact that behavior of sellers within a magic circle may be constrained by rivals outside.³⁶ They also observe that certain vertical and potential competition Guidelines expand areas of probable suit beyond developed principles of the case law, and they predict that the expansive theories may face difficulties in the courts.³⁷

The Baker-Blumenthal and Kauper articles provide unusual insight into practical problems that confront enforcers in crisis situations. They report that the Department may be, of necessity, more tolerant towards claims of efficiencies and failure than the Guidelines are or

28. *Id.* at 521-24.

29. *See, e.g., id.* at 518.

30. *See, e.g., id.*

31. *See, e.g., id.* at 527-28.

32. *See, e.g., id.* at 504.

33. Baker & Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 CALIF. L. REV. 311 (1982).

34. *Id.* at 315.

35. *Id.* at 313.

36. *Id.* at 325.

37. *Id.* at 337-39.

could reasonably reveal.³⁸

While Baker and Blumenthal express skepticism about the Guidelines' approach to mergers that eliminate potential competition, on grounds that the case law has not sanctioned a structural test, Professor Joseph Brodley embraces the Guidelines' approach to potential competition and offers a proposal that is consistent with, and could enhance the effectiveness of, this portion of the Guidelines.³⁹ Brodley notes that the Supreme Court decisions articulating the theories of potential competition could impose insurmountable burdens on antitrust plaintiffs unaided by presumptions. He then formulates presumptions based, as are the Guidelines, on "unitary, structural, and objective" criteria.⁴⁰

Brodley makes a particular contribution in analyzing the kind of proof that is appropriate and should be sufficient to show that the acquiring firm has an entry advantage possessed by not more than a few other firms. He proposes a rule for presumptively establishing entry advantage based on objective economic facts showing proximity of the acquiring firm to the target firm's market.⁴¹

The Symposium article most favorable to the Guidelines is the contribution of Federal Trade Commissioner David Clanton.⁴² Like Brodley and most of the lawyer-scholar contributors, Clanton would encourage a marriage of economics with principles of clarity, simplicity, and justiciability. The Guidelines organize the analytical inquiry and keep it within bounds, and they do so, Clanton observes, in three ways: first, they limit the range within which factors other than market share and concentration will be considered; second, they specify the economic model that underlies the analysis, thus clarifying the relevance of the other factors when they are used; and third, they limit admissible factors. Clanton invites application of a similar structure and focus to other areas of antitrust law.⁴³

The work of the contributing economists contrasts with and complements the work of the legal scholars who have contributed to this Symposium. While the latter tend to search for clear and administrable principles that make economic sense, the economist contributors play the valuable role of expanding the inquiry and testing whether the generalizations can and do capture the fine-tuned and frequently com-

38. *Id.* at 343-44 (efficiency defense); 345-46 (failing company defense); Kauper, *supra* note 24, at 530-31 (failing company defense).

39. Brodley, *Potential Competition Under the Merger Guidelines*, 71 CALIF. L. REV. 376, 391 (1983).

40. *Id.* at 389.

41. *Id.* at 389-95.

42. Clanton, *Focusing the Inquiry: Specificity in the Merger Guidelines and Elsewhere*, 71 CALIF. L. REV. 430 (1983).

43. *Id.* at 442-44.

plex lessons of economics. Professors of Economics Janusz Ordover and Robert Willig ask whether the Guidelines accurately identify mergers likely to have anticompetitive effects.⁴⁴ As to market definition, their answer is that the Guidelines create "a forensically useful framework that embodies much of the best available economic learning," within limits.⁴⁵ The limits are considerable. For example, the Guidelines require data that may be unavailable.⁴⁶ Also the outcome of the Guidelines' analysis is sensitive to behavioral assumptions about firms outside of the provisional market, and behavioral assumptions may be influenced by noneconomic policy preferences, e.g., the preference for a more—or less—interventionist antitrust law.⁴⁷ Furthermore, the Guidelines' methodology for defining markets, which starts from current price even in already cartelized markets,⁴⁸ may portend more lenient treatment for mergers in noncompetitive markets.⁴⁹ Ordover and Willig make many important technical points,⁵⁰ some of which may be useful to the analysis mapped out by the Guidelines;⁵¹ some of which may go beyond the scope of workable guidelines but could be usable in litigation;⁵² and some of which could influence adjustment of the Guidelines or the law to economic principles if the courts should mold the merger law to maximize welfare.⁵³

44. Ordover & Willig, *The 1982 Justice Department Merger Guidelines: An Economic Assessment*, 71 CALIF. L. REV. 535, 536 (1983).

45. *Id.* at 539.

46. *Id.* at 541.

47. *Id.*

48. The Guidelines' theory is that the law should intervene only if the merger creates power over price or augments existing power over price. Guidelines § I, 47 Fed. Reg. at 28,494, 71 CALIF. L. REV. at 650.

49. Ordover & Willig, *supra* note 44, at 543.

50. Observations of Professors Ordover and Willig include: (1) The same index number on the Herfindahl-Hirschman Index of concentration (HHI), and the same increase in the HHI, may signify different things in different markets depending on the price elasticity of industry demand, and it is unlikely that the market definition process will produce markets with about the same elasticity of demand. *Id.* at 558-59. (2) Divertability of product by a distant producer into a market wherein price is artificially high is a function of opportunity cost, which rises as the quantity diverted increases. *Id.* at 564. (3) The postmerger market share may not be the sum of the premerger shares; it is likely to be less if the merger does not produce efficiencies. *Id.* at 562. (4) Vertical mergers may evolve from mixed proefficiency and anticompetitive motives; the tension between loss of competition and gain in efficiencies from vertical mergers may be most pronounced at high concentration levels, and therefore high concentration has even less value as a predictor of net welfare loss for vertical than for horizontal mergers. *Id.* at 572.

51. *See id.* at 564.

52. *See id.* at 558-59.

53. "Welfare" or "social welfare" is a technical economic term that is the focus of "welfare economics." Many and perhaps most contemporary economists apply welfare economics in their analysis of antitrust problems to determine what is, in their view, the optimal economic solution. Welfare economics is applied by economists as diverse as Landes (associated with the Chicago School), Scherer, and Williamson. *See* Landes, *Appendix: An Introduction to the Economics of Antitrust*, in R. POSNER & F. EASTERBROOK, *ANTITRUST: CASES, ECONOMIC NOTES AND OTHER*

Professor of Economics Oliver Williamson applies economic learning to the Guidelines' treatment of vertical mergers.⁵⁴ Much of this learning originated from his own pioneering efforts in developing transaction-cost economics.⁵⁵ Williamson focuses on why firms choose a vertically integrated structure. He observes that bounded rationality⁵⁶ (which can be a serious impediment to contracting) and opportunism⁵⁷ (which tends to arise if asymmetry develops between buyer and seller) may make it more efficient for a firm to govern its transactions

MATERIALS 1068-69 (2d ed. 1981); F. SCHERER, *supra* note 8; Williamson, *Economies Defense*, *supra* note 11, at 21-32 (suggesting qualification of the neoclassical model).

Welfare economics is concerned with the allocation of resources. Social welfare is deemed maximized if resources are most efficiently allocated. Resources are deemed most efficiently allocated if, given the distribution of wealth and the accustomed ways and costs of production and distribution, resources are allocated to the uses that best satisfy consumers' desires to buy at or above the price that covers the cost of the good to society (i.e., cost to the producer-distributor, including sufficient profit to attract capital). If too few resources flow into a market to satisfy this standard, resources are misallocated. This condition may result from government restraints (such as the restraints imposed on entry into the public utility industry), or—although much more rarely—from private restraints. For example, if two of the leading competitors in a five-firm, high-barrier market merge, the remaining four firms might, under certain conditions, have power to reduce output by tacit agreement without attracting new entry. In such a case, too few resources will be used to produce the restrained product, in light of consumers' desires and willingness to buy that product at a price that at least covers cost.

Economists applying welfare economics reach different conclusions in analyzing the same problem not because of any disagreement with the above statements but because of different assumptions and observations regarding when, if ever, private firms, without government assistance, can reduce output without attracting new entry in the relatively near term. For example, in *Marathon Co. v. Mobil Corp.*, 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982), Professor Scherer testified that there was a regional market for oil, while Professor Stigler testified that there was no regional market. *See id.* (excerpts of testimony of Professors Scherer and Stigler on file at *California Law Review*).

There are distinguished dissenters from the view that welfare economics is the correct tool to determine the best way to optimize consumers' interests in competition. The dissenters or skeptics include economists as diverse as Walter Adams, Dominick Armentano, Betty Bock, and Eugene Singer. *See Adams, Economic Theory and Economic Policy*, 40 REV. SOC. ECON. 1 (1982); D. ARMENTANO, *supra* note 6, ch. 2 (containing a lucid and graphic description of the assumptions and limitations inherent in welfare economics); Bock, *Overview, Concentration: Issues, Convictions and Facts*, in *INDUSTRIAL CONCENTRATION AND THE MARKET SYSTEM* 167, 169-71 (E. Fox & J. Halverson eds. 1979); E. SINGER, *ANTITRUST ECONOMICS AND LEGAL ANALYSIS* (1981). *See also* Fox, *supra* note 4, at 1159-66.

I find compelling the inference that, while output restriction might be used as one proxy for estimating optimal consumers' interests in competition, an antitrust policy that prohibits only those transactions that decrease "social welfare" as calculated by use of welfare economics is not essentially descriptive of protecting consumers' interests in competition.

54. Williamson, *supra* note 10.

55. *See, e.g.*, O. WILLIAMSON, *MARKETS AND HIERARCHIES* (1975).

56. Bounded rationality refers to the limitations of human beings in dealing with complex problems. Given the limitations of the human mind as well as the unavailability of all relevant data in the time frame within which the business manager or other decisionmaker must decide, decisions are made without complete knowledge. *See* Williamson, *supra* note 10, at 612.

57. Opportunism refers to the Machiavellian strategy of taking advantage of opportunities to exploit, even when, for example, the exploitative conduct goes beyond the spirit of a contract. For example, after a buyer chooses a seller, and after the seller makes a significant investment in

through its own internal hierarchy rather than by dependence on the market.⁵⁸ Thus, integration may reduce transaction costs. While it may provide opportunities for extensive cost savings, vertical integration may also adversely affect price or entry conditions when the market is concentrated, entry is not easy, and at least one party has a nontrivial degree of monopoly power. Williamson explores the conditions that give rise to these anticompetitive effects.⁵⁹

Williamson commends certain portions of the Guidelines as sensitive to the teachings of transaction-cost economics. He suggests areas for further responsiveness of the law to economics, including broadening the efficiencies defense, and he expresses the hope and view that economic learning is "driving" the outcomes of antitrust enforcement policy.⁶⁰

B. *Questioning the Guidelines*

The articles in the second group are either basically critical of the Guidelines or else contain a central suggestion taking a different path from the one the Guidelines have chosen. In some, but not all, of these articles there are pointed intimations that the Guidelines do not reflect an economic consensus; that their appearance of certainty and predictability is illusory; that their choice of an economic model was neither inevitable nor compatible with the law; and that their promulgators may have ulterior motives. I have selected for this grouping the articles by Harris and Jorde, Calkins, Davidson, Bauer, and Schwartz.

Robert Harris, Professor of Business Administration, and Thomas Jorde, Professor of Law, take issue with the Guidelines' major premise that appropriate antitrust policy can or should be derived from neoclassical economic theory biased in favor of a liberty or property right to merge.⁶¹ The combination of the chosen economic approach with the chosen political economy perspective produces the principle that all mergers should be allowed if one cannot infer, from application of the economic model, that the merger will probably misallocate resources.⁶² Harris and Jorde contend that this principle ignores important values.

Moreover, Harris and Jorde argue, the bias in favor of mergers is increased cumulatively by the many assumptions that the Guidelines build into the economic model. These assumptions, they claim, are not

transaction-specific assets, the seller may have power, within a range, to take advantage of the buyer. *Id.* at 612-13.

58. *Id.* at 613.

59. *Id.* at 614-15 & n.42.

60. *Id.* at 617.

61. Harris & Jorde, *Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement*, 71 CALIF. L. REV. 464, 465 (1983).

62. *Id.*

necessary and may be incorrect. Two examples are: first, the assumption that buyers and sellers immediately recognize the hypothesized price increase;⁶³ and second, the assumption that markets behave like auctions and that sellers move their resources in response to marginally better profit opportunities regardless of accustomed business patterns and of relationships with long term customers.⁶⁴

Harris and Jorde argue that the proper use of models is to provide testable hypotheses, not to provide hypotheses that are automatically incorporated into law.⁶⁵ They argue further that public policy should be sensitive to values that are provided by the law but are not and cannot be incorporated into the neoclassical model. One such value is reflected by the goal of safeguarding a process that provides for procedural fairness in economic transactions.⁶⁶

Harris and Jorde focus their critique on market definition. They find that the new methodology for market definition produces excessively broad markets that greatly understate market power, and represents a dramatic break from tradition. That the bias is consistently in the same direction is, they believe, not accidental. "The Guidelines are, first and foremost, a statement of the political position of the present Justice Department."⁶⁷

The authors propose an alternative. They argue that the market definition process should begin with the private plaintiffs or other identifiable group (e.g., buyers) most likely to be injured if injury should occur. The plaintiff should be able to make its prima facie case by identifying the products and the geographic area to which the group could readily turn. Defendants should then have the burden of demonstrating potential sources of supply that would become available in the face of a rise in price. They would be obliged to satisfy their burden of proof by hard evidence, such as testimony from business experts who know the business, and not by resort to speculation and hypothetical argument.⁶⁸

After a market is defined, market concentration must be measured. Stephen Calkins devotes his article to the method of measuring concentration used in the Guidelines.⁶⁹ He asks whether it was wise to change

63. *Id.* at 481.

64. *Id.* at 477.

65. *Id.* at 468.

66. *Id.* at 466.

67. *Id.* at 486.

68. *Id.* at 493-96.

69. Calkins, *The New Merger Guidelines and the Herfindahl-Hirschman Index*, 71 CALIF. L. REV. 402 (1983). Calkins is not antagonistic to the Guidelines. He does not pass judgment on what the measure of concentration should be. I have included his article in this grouping merely because he concludes that the Guidelines' change in the measure of concentration is not indicated by objective criteria, such as generally accepted "advances" in economic learning.

from the traditional and familiar N-firm⁷⁰ concentration ratio to the relatively unfamiliar Herfindahl-Hirschman Index (HHI).⁷¹ Describing the HHI, Calkins notes the need for data that may be unavailable and the fact that small errors in estimating the market shares of leading firms may distort the index by hundreds of points.⁷² He explores the "checkered" history of judicial attempts to use the HHI, finding that the few courts that have attempted to apply it have done so with mixed success.⁷³ He examines the use of the HHI for identifying safe harbors—a use for which concentration ratios are by nature not well suited—but concludes that the Guidelines' creation of safe harbors could facilitate some anticompetitive mergers.⁷⁴

Calkins believes that, if the necessary data is available, the HHI is a slightly superior measure of concentration. He notes, however, that the basic premise that inferences can be drawn from high concentration has been challenged, and worries that the very specificity of the HHI may hold the danger of creating a false impression of scientific accuracy. He concludes that a shift from concentration ratios to the HHI will probably make little substantive difference except that the new vocabulary may prevent the reversion to an era of hostility to mergers and may thereby function as part of an endeavor to shift the merger law towards greater permissiveness.⁷⁵

Professor Kenneth Davidson focuses on one aspect of the Guidelines' effect on competition.⁷⁶ He challenges the correctness of the Guidelines' focus on price collusion, and in turn their particular attention to "homogeneity [as] a condition that facilitates reaching consensus and detecting deviation."⁷⁷ He argues that homogeneity itself is a factor that tends to undermine cartels because homogeneous products tend to be price sensitive, and cheating (price competition) tends to be profitable. Therefore, cartels involving homogeneous products are inherently unstable, and instability mitigates the need for antitrust con-

70. "N" refers to a chosen number, such as 4 or 8. A four-firm concentration ratio of 80% indicates that four firms account for 80% of the market. Most commonly the percentage of the market has been calculated in terms of sales. It may also be calculated in terms of capacity or other indicia of presence in the market. Under the Guidelines, market share might also be calculated in terms of potential sales or divertable capacity—that is, near-term potential presence if performance should deteriorate—as well as actual presence in the market. Guidelines § II(D), 47 Fed. Reg. at 28,496, 71 CALIF. L. REV. at 654-55.

71. The HHI is calculated by summing the squares of the market shares of all firms counted as within the market. *Id.* § III(A), 47 Fed. Reg. at 28,497, 71 CALIF. L. REV. at 655.

72. Calkins, *supra* note 69, at 404-05.

73. *Id.* at 410-15.

74. *Id.* at 419-22.

75. *Id.* at 428-29.

76. Davidson, *The Competitive Significance of Segmented Markets*, 71 CALIF. L. REV. 445 (1983).

77. *Id.* at 445 (footnote omitted).

cern. Also observing that overcapacity and lower than normal industry earnings have tended to be the incentive for collusion on the price of homogeneous products, Davidson states that cartels for homogeneous products are neither stable nor likely to produce high profits.⁷⁸

Professor Davidson suggests another tack. He believes that concentration within heterogeneous product markets may facilitate market segmentation even without express agreement, and lead to market power within segments.⁷⁹ He suggests that each seller in a segmented market of heterogeneous products faces less elastic demand than sellers in homogeneous product markets, other things being equal, because buyers are likely to be more sensitive to differentiated quality characteristics than to price. He argues that market segmentation tends to be conducive to mutually beneficial strategies—such as advertising, lobbying, and pricing within a spectrum—in good times and bad, leading to higher profits over longer periods.⁸⁰ Davidson suggests more research into aspects of segmented markets, including research that might reveal levels of concentration that should trigger concern for division of markets into noncompeting segments.⁸¹

While Professor Davidson would examine new frontiers, Professor Bauer's article on conglomerate mergers reveals, simply, profound dismay.⁸² The Guidelines' treatment of this subject, he writes, is somewhat predictable.⁸³ Nonetheless, the Department's enforcement intentions regarding conglomerate mergers "are inconsistent with the case law . . . and also represent unsound policy."⁸⁴ Bauer reviews the judicial precedents and the 1968 Guidelines, and observes that the 1982 Guidelines would discard what he regards as still viable principles in favor of a discrete, and not universally accepted, view of the law. He urges more private suits to enforce the law, and he advocates pressure on the Government to take stronger measures to curb conglomerate mergers.⁸⁵

Professor Louis Schwartz's article expands upon the discontents.⁸⁶ Schwartz details the complexity and ambiguity of the Guidelines, and fears that they will provide the Justice Department with a long rein for subjective decisionmaking. The endeavor to link market power to mar-

78. *Id.* at 449-51.

79. *Id.* at 454-57.

80. *Id.* at 457.

81. *Id.* at 463.

82. Bauer, *Government Enforcement Policy of Clayton Act Section 7: Carte Blanche for Conglomerate Mergers?*, 71 CALIF. L. REV. 348 (1983).

83. *Id.* at 351.

84. *Id.*

85. *Id.* at 374.

86. Schwartz, *New Merger Guidelines—Guide to Governmental Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws?*, 71 CALIF. L. REV. 575 (1983).

ket share may be undermined by the expansive market definitions that the Guidelines invite, Schwartz argues, and he observes further that market share is not necessarily the best proxy for market power. Schwartz proposes the use of administered pricing as an alternative benchmark. Price and market share stability may be observed over time. Inferences of administered pricing can be drawn from observed facts, not mere theory. For example, if stability is observed while costs or sales fluctuate, or if price is raised during a period when sales are declining, one can infer that price was administered by private firms rather than set by the market.⁸⁷

Schwartz's message is unmistakable. The Guidelines are an "elaborate and costly pretense of science masking an intuitional or philosophically biased discretionary judgment,"⁸⁸ and a device to facilitate the "smuggling" of Chicago School economic doctrine into the law.⁸⁹

One perspective is missing from those basically critical of the Guidelines. This viewpoint proceeds along the following lines.

Antitrust, including merger policy, can be justified only to the extent that enforcement prevents misallocation of resources, and thus tends to maximize the aggregate wealth of the nation (sometimes referred to as improving "social welfare").⁹⁰ This allocative efficiency or welfare goal is the premise of the Guidelines,⁹¹ and has been explicitly adopted as the working premise of the Assistant Attorney General in charge of the Antitrust Division⁹² and the Chairman of the Federal Trade Commission⁹³ in enforcing the antitrust law.⁹⁴

According to this viewpoint, no merger should be enjoined unless it probably will misallocate resources. Mergers—like all other business transactions—are one vehicle for a more efficient allocation. Firms know best how to move their own resources to the best profit opportunities. Assuming perfect information, only market power or efficiencies

87. *Id.* at 581-82.

88. *Id.* at 594.

89. *Id.* at 577.

90. *See supra* note 53.

91. *See* Guidelines § I n.5, 47 Fed. Reg. at 28,494 n.5, 71 CALIF. L. REV. at 650 n.5.

92. *See* Brief for the United States as Amicus Curiae in Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit, *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981), *cert. denied*, 102 S. Ct. 1708 (1982):

Experts may disagree about how large a market share is sufficient to justify the conclusion that a particular acquisition will be, on balance, anticompetitive, *i.e.*, that the decrease in consumer welfare resulting from restriction of output by the parties is likely to exceed any increase in consumer welfare resulting from increased efficiency.

Id. at 11.

93. *See Interview with James C. Miller*, 51 ANTITRUST L.J. 3, 5, 16-18 (1982).

94. The allocative efficiency goal is enhanced by the Attorney General's commitment to give freer rein to business. *See Attorney General William French Smith's Remarks to District of Columbia Bar*, ANTITRUST & TRADE REG. REP. (BNA) No. 1021, at H-1 (July 2, 1981).

(or both) can explain the prospect for greater return on investment. Therefore, mergers that do not create or enhance market power must be presumed efficient, and only mergers that create or enhance market power and that decrease aggregate wealth should be enjoined.⁹⁵

Economic analysis can indicate when a merger probably will misallocate resources and thus decrease wealth (although mergers rarely do so). A merger can misallocate resources only if two conditions are satisfied. First, the merger must create or augment power to cut back output and keep the output lower than normal in spite of responses by buyers and other suppliers.⁹⁶ Second, the merger itself must not produce significant cost savings.⁹⁷ If the merger produces any significant cost savings, the resource savings may swamp the resource loss.⁹⁸

While it was once widely accepted economic theory that performance could be predicted from market structure, and that market concentration would probably produce collusion and thus a welfare loss, this is no longer the case.⁹⁹ We can make meaningful generalizations as to when a merger cannot and does not threaten welfare loss, but we cannot predict from market structure whether a merger will probably cause a welfare loss.¹⁰⁰ Thus, we know that a merger is unlikely to misallocate resources and produce a welfare loss if the market is unconcentrated (e.g., more than six to eight firms),¹⁰¹ or the merger does not significantly increase concentration, or entry barriers are not significant, or (except in the case of single firm dominance) any particular market factor (such as different cost structures of the competitors) makes collusion unlikely to occur or cheating difficult to detect, or the

95. See R. BORK, *supra* note 6.

96. To achieve this power, the merger must either produce a dominant firm, or such high concentration that firms can (and probably will) tacitly agree to raise prices and lower output, and will be able to detect and prevent cheating from that tacit agreement.

97. See R. POSNER, *supra* note 7, chs. 2, 6 (the only possible antitrust problems are monopoly and collusion); Williamson, *Economics Defense Revisited*, *supra* note 11; Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381 (1980).

98. Williamson, *Economics Defense Revisited*, *supra* note 11; Muris, *supra* note 96.

99. See authorities cited *supra* note 6.

100. A merger will not lessen welfare when the elasticity of demand is significant. Facing such elasticity, a firm or group of firms has no power to raise price and lower output, and to hold that price rise in the face of buyer and supplier shifts. *E.g.*, Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 944-52 (1981).

101. Economists debate the point at which there are too many competitors to collude. By its choice of HHI numbers, the Justice Department has selected 10 as a number presumptively sufficient for effective competition. (There is a safe harbor for horizontal mergers where the HHI is below 1000. A market of 10 equal sized firms has an HHI of 1000.) It has chosen 5 or 6 competitors as a number presumptively sufficient for collusion. (Below 1800 is a safe harbor for non-horizontal mergers, and an index number above 1800 indicates probable illegality for a horizontal merger. 1800 translates into 5.5 equal sized firms.) See also Kirkwood, *Antitrust Implications of the Recent Experimental Literature on Collusion*, in STRATEGY, PREDATION AND ANTITRUST ANALYSIS, *supra* note 8, at 605.

merger has significant potential to produce cost savings, the merger is unlikely to misallocate resources and produce a welfare loss.¹⁰²

On the other hand, mergers in high-barrier markets above a certain level of high concentration should be examined on the basis of a variety of factors to determine whether the merger confers output limiting power. If it does confer such power, the merger should be examined for offsetting cost savings.

Accordingly, this theory holds that while guidelines can be devised to identify mergers not likely to misallocate resources, no guidelines (based on a few objective criteria, such as concentration and market share), can be devised to identify mergers likely to misallocate resources.¹⁰³ Those who believe that allocative efficiency is the only appropriate basis for merger policy can take one of two paths if called upon to issue guidelines. They can issue guidelines indicating areas of probable safety and stating a methodology for analyzing those mergers that cannot be screened out by simple objective criteria. Or, they can compromise economic principles and provide guidelines even for concentrated markets, perhaps hoping to move antitrust toward a less interventionist regime.

This laissez-faire theory completes the spectrum of viewpoints that are not congruent with the Guidelines.

CONCLUSION

Some areas of consensus and some contours of debate have emerged. There is consensus that antitrust should not be used in ways that interfere with efficiency, but there is wide debate on what efficiency is and how best to achieve it. There is consensus that economics should be used to inform antitrust, but there is no consensus that welfare economics should control antitrust outcomes.¹⁰⁴ There is no con-

102. *E.g.*, R. BORK, *supra* note 6, chs. 4-6; F. SCHERER, *supra* note 8, ch. 3 & at 544-46; Williamson, *Economies Defense Revisited*, *supra* note 11.

103. *See supra* notes 6, 98. *Cf.* FTC, Statement Concerning Horizontal Mergers § IV (June 14, 1982), reprinted in TRADE REG. REP. (CCH) No. 546, at 71, 80 (June 16, 1982) (special supplement to 2 TRADE REG. REP. (CCH) ¶ 4225 (Aug. 9, 1982)) (stating a methodology for analysis, but not stating numbers that would indicate probable illegality) [hereinafter cited as FTC Statement]. The FTC Statement was issued the same day as the 1982 Merger Guidelines.

104. *See supra* note 53. In this second wave of the merger of antitrust law and economics, it is fashionable to assert that Congress adopted antitrust as a tool to enhance allocative efficiency, and that the Supreme Court tried to apply the antitrust law to enhance efficiency, but simply got it wrong. Yet to any student of history and the law, it is obvious that the allocative efficiency model does not quite fit.

The Congresses that enacted and amended § 7 of the Clayton Act were not trying to enhance aggregate wealth. They were not indifferent, as is economics, to who gets the benefit of enforcement. While Congress expected all of the people to get the political benefits of a decentralized economic system, in the sense that decentralization would tend to stave off fascism, socialism, and communism, Congress preferred exploited consumers to exploiting producers, and it preferred

sensus as to what behavioral presumptions should underlie the welfare economics models (e.g., whether buyers and sellers are presumed to act as if they are in auction markets); and there is no consensus that potential competition is as good a spur to competitive behavior as is direct competition. As a result of debate on the appropriate uses and limits of theoretical models, on the behavioral assumptions that underlie the models, on whether output limitation captures all restraints on competition worth worrying about, and on political economy values that could bias the analysis either for or against government intervention when the effect on efficiency is indeterminate, there is no consensus on an appropriate methodology for market definition.

Given an acceptable definition of the market, however, a consensus may be developing on horizontal and potential competition merger standards. If this is so, it is, I believe, not because antitrust is being brought into line with what is now acknowledged to be economically correct merger policy. There is no acknowledged economically correct merger policy.¹⁰⁵

If a limited consensus is developing, it is for other reasons. Many who favor minimal government intervention recognize that they must make concessions to the existence of antitrust law and judicial interpretations of it. Many who favor government intervention to control the size and structure of American business are willing to concede that there is increased evidence, or at least a commonly held perception, that some big mergers tend to produce efficiencies. There is a consensus that greater efficiency is desirable because it enhances the performance of domestic producers and the position of the United States in world economics and politics. The movement from a stricter merger policy to a more permissive merger policy is not driven by new learning in economics and is not a triumph of economics. The new Merger Guidelines are a triumph of conservatism.¹⁰⁶

The attempt is not to find economic truth, which we cannot do, but to develop a consensus, which we must try to do. Once this is understood, it may be acknowledged that compromise in the direction of

profit opportunities for "new men, new energies, and a new spirit of initiative" to profit opportunities for entrenched persons or firms with power or leverage. See Fox, *supra* note 4, at 1148-49 (quoting an address by President Wilson to a joint session of Congress, H.R. Doc. No. 625, 63d Cong., 2d Sess. 5 (1914), regarding interlocking directorates); *id.* at 1149-51 (discussing the 1950 amendments to the Clayton Act).

105. Indeed, there is no consensus that a merger law saves society more resources than it costs society, especially when the costs and possible errors of the enforcement system are included in the calculation. See, e.g., authorities cited *supra* note 6. See also McChesney, *On the Economics of Antitrust Enforcement*, 68 GEO. L.J. 1103, 1104 (1980).

106. See G. KOLKO, *THE TRIUMPH OF CONSERVATISM* (1963), whose title I have borrowed. But see Williamson, *supra* note 10, at 617; R. POSNER & F. EASTERBROOK, *supra* note 53, at 33 (Supp. 1982-83), quoted in Harris & Jorde, *supra* note 61, at 491 n.69.

clarity, predictability, precedent, and Congressional values such as the protection of a process and the prevention of "undue" concentration, is not only acceptable but probably inevitable.¹⁰⁷

I would predict the following. The horizontal and potential competition portions of the Guidelines will survive as one way to analyze mergers. The "probably-illegal" Guideline categories¹⁰⁸ will have particularly lasting effect in influencing both successive enforcers and the case law; if a merger is probably illegal under the Guidelines, it will remain probably illegal to enforcers and the courts. Traditional modes of analysis and established principles of law will also continue to influence successive enforcers and the courts, unless those principles or modes are shown to produce perverse results (i.e., block competitive performance), or to enlist the enforcement machinery for trivial ends, as viewed from a Brodley-Harris-Jorde perspective.¹⁰⁹ Concentration ratios will continue to be used, sometimes side by side with the HHI. Markets will continue to be viewed as snapshots of existing patterns of trade, while imminent potential competition proved by experts who know the business realities will be taken seriously.¹¹⁰ Actual existing forces in the snapshot market will continue to be valued more highly than constraints from the edge of the market, because they provide existing, known alternatives to which buyers can turn and which buyers can play off against one another.¹¹¹

As for horizontal merger standards, future enforcers will reduce the high threshold levels and contract the safe harbors of the Guidelines. They may, in addition or alternatively, accept the clearer and sometimes lower market share criteria suggested by, for example, Areeda and Turner.¹¹² The generous hospitality toward vertical mergers is not likely to survive, even though it will continue to be the case that few vertical mergers will be challenged and few of those found illegal. Whatever the future holds, I have no doubt that the availability of the Justice Department Guidelines and the FTC Statement¹¹³ as the focus of debate has enormous value to the clarity of thinking and thus the formulation and adjustment of policy and law. Since 1981, the

107. Cf. Fox, *supra* note 4 (these congressional values may be given weight without impairing efficiency).

108. *E.g.*, Guidelines § III(A)(1)(b), 47 Fed. Reg. at 28,497, 71 CALIF. L. REV. at 656.

109. Brodley and Harris-Jorde express the view that Congress meant to protect a process that would tend to assure acceptable results and that Congress did not enact outcome-oriented goals. See Brodley, *supra* note 39, at 382; Harris & Jorde, *supra* note 61, at 467.

110. See Harris & Jorde, *supra* note 61, at 495.

111. *Id.*

112. See 4 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 907, at 25-26 (1980); Kauper, *supra* note 24, at 523-24.

113. The Federal Trade Commission issued a Statement on Horizontal Mergers on the same day that the Justice Department issued the 1982 Guidelines. See *supra* note 103.

Justice Department and the Chairman of the FTC have advocated "reform" of antitrust law by placing it on an allocative efficiency base.¹¹⁴ Many have wondered and speculated about the meaning of such statements, whether they can be generalized into workable principles and predictable outcomes, and whether those principles and outcomes would keep faith with the law. The Justice Department Guidelines and the FTC Statement allow us to formulate some answers. The FTC Statement is an expository guide for analysis of horizontal mergers based on allocative efficiency principles as modified by data and evidentiary problems, and they reflect the perceptions that economic learning is still evolving, and that economics does not permit line drawing on the basis of concentration or other numbers. The Guidelines are an example of where those lines may be drawn by a conservative Administration that feels it must draw some lines but nonetheless seeks to scale back government interference with private decisions to merge.

Both statements help to crystallize a unitary, outcome oriented view of competition policy. By so doing at a time when antitrust has come under fire as counterefficient, they serve the useful purpose of putting critics to their proof and thus setting into motion a process for a wise and acceptable readjustment of policy and law. The articles in this Symposium are, in my view, enormously valuable contributions to this process.

114. *See supra* notes 92-93.

APPENDIX
WHAT IS THE QUESTION?

Treatments of merger standards often bypass the basic question: What does it mean for a merger to be "anticompetitive"? There is no one correct answer. The basic question may be stated in several ways. I set forth below options for formulating the question. Each option will include (a); (c) or (d); and (e).

- (a) Whether this merger
- (b) together with mergers of like-sized firms¹¹⁵
- (c) (will probably)
- [or]
- (d) (is likely to create a significant risk or chance of)¹¹⁶
- (e) confer(ring) on remaining firms in the market power or greater power over output and price
- (f) without offsetting resource savings from efficiencies,¹¹⁷
- (g) or block(ing) the opportunity to dissipate existing power over output and price,¹¹⁸
- (h) or significantly reduc(ing) chances of innovation¹¹⁹ or alter-

115. That is, we might consider whether anticompetitive effects are likely if the merging parties merge and similarly situated firms merge. This approach is consistent with the potentiality language of § 7 and a principle of fairness; i.e., if two 7% companies can legally merge today, it may be unacceptable to prevent the next two 7% firms from merging tomorrow. The Supreme Court has adopted this perspective. *Brown Shoe Co. v. United States*, 370 U.S. 294, 343-44 (1962). Professor Areeda urges the principle as an appropriate policy in view of the fact that a contrary approach provides an incentive to merge early. Areeda, *supra* note 18, at 310.

116. Whether the anticompetitive effect must be a probable or merely a significant risk can make important differences. For example, if Ford and General Motors were to merge, given the current strength of foreign competition, there is a strong case for the proposition that the merger would not give them power over price. However, there may be a significant risk that the strength of foreign competition may weaken, for economic or political reasons, and that General Motors-Ford would then become the beneficiary of market power.

In a case in which the market was not yet concentrated, the Supreme Court suggested that the probability standard was appropriate. *Brown Shoe*, 370 U.S. at 343. Where concentration was already great, the Supreme Court said that "the importance of . . . preserving the possibility of eventual deconcentration is correspondingly great." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 365 n.42 (1963).

117. This clause could also qualify (g), (h), and (i).

118. See *Philadelphia Nat'l Bank*, 374 U.S. at 365 n.42.

119. Clause (h) would be relevant only when the market is highly concentrated. It could be significant when potential competition or next best buyer alternatives are a fairly good check on supracompetitive pricing.

As to innovation, see W. BAXTER, P. COOTNER & K. SCOTT, *RETAIL BANKING IN THE ELECTRONIC AGE* (1977). The authors observe that decreased competition can produce one of two types of social loss. The first type is the static loss associated with reduced output and higher price. "The second type of loss which should be taken into account relates to the pace, over time, at which . . . technology . . . is advanced." *Id.* at 85. Referring to this possible dynamic loss in the context of collaboration between electronic funds transfer systems, the authors state:

natives available to consumers,¹²⁰

(i) or unreasonably exclud(ing) competitors from access on the merits to a scarce or potentially scarce input or a significant share of a market outlet.¹²¹

"Whether technological advances occur rapidly or only relatively slowly will depend in significant part upon the intensity of rivalry that prevails among suppliers of EFTS services." *Id.*

See also United States v. Aluminum Co. of Am. (Rome Cable), 377 U.S. 271 (1964), in which the Supreme Court invalidated a merger to preserve the independence of a pioneer in the industry.

120. A purpose of the merger law is to preserve alternatives for consumers. *See Philadelphia Nat'l Bank*, 374 U.S. at 360 n.37, 369-70. This objective is likewise relevant only when the market is highly concentrated.

Actual competition among existing competitors, more than potential competition, may heighten the responsiveness of producers to consumers. Professor Shepherd states:

Actual competition in the market . . . is crucial. It exists and exerts force. In contrast, potential competition (the possibility that some firm not now in the market will enter at some future time) is usually a secondary and often a trivial matter compared to actual competition. Entry is a probabilistic thing, of unknown degree, both in its likelihood and in its size. . . .

On the whole, the recent preoccupation of some analysts with entry is a strange effort to replace the heart of the problem with a literally peripheral aspect.

Shepherd, *Concepts of Competition and Efficient Policy in the Telecommunications Sector* 99, 104 (presented at the Conference on Regulation and the New Telecommunications Networks (June 3, 1982)) (on file with the *California Law Review*) (forthcoming in TELECOMMUNICATIONS TODAY AND TOMORROW (E. Noam ed. 1983)) (emphasis in original) (taking issue with the view that, if a market is "contestable," consumers' interests in competition are exhausted). *Cf.* Baumol, *Contestable Markets: An Uprising in the Theory of Industry Structures*, 72 AM. ECON. REV. 1 (1982) (in some situations potential competition may be a good check against supracompetitive pricing).

Where the market is highly concentrated, the law can appropriately prevent unreasonable elimination of existing alternatives, even though potential competition may arguably constrain price elevation and output restrictions.

Clause (h), like clause (g), would indicate illegality of a General Motors-Ford merger even if such a merger does not produce greater power over output.

121. The Supreme Court has decided only four vertical and reciprocity merger cases. In all four it found violations, and in all four the finding was based, at least in principal part, on the right of competitors not to be fenced out of any substantial segment of a market, even at a margin, by considerations other than the merits of the product sold. *E.g.*, *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 594 (1965); *Brown Shoe Co. v. United States*, 370 U.S. 294, 323-24 (1962); *United States v. E.I. du Pont de Nemours & Co. (General Motors)*, 353 U.S. 586, 603-07 (1957); *United States v. Ford Motor Co.*, 286 F. Supp. 407, 442 (D. Mich. 1968), *aff'd*, 405 U.S. 562, 570-71 (1972).

Apparently, in none of the above cases did defendants gain firm efficiencies as a result of the merger. In *General Motors*, the Court found that duPont used its stock in General Motors to sell more fabrics and finishes to General Motors. 353 U.S. at 606. Consolidated Foods used and attempted to use its buying power to induce its suppliers of processed meat to buy their dehydrated onions and garlic from acquired Gentry. 380 U.S. at 596-97. Ford bought spark plug manufacturing assets of Electric Autolite despite the fact that it could buy spark plugs on the open market at one-third of cost (because sales of plugs to the auto manufacturers for incorporation into the original vehicle gave the plug manufacturers entry into the lucrative after market). 405 U.S. at 565.

A principle based on unreasonable exclusion need not invalidate vertical mergers that are undertaken to realize significant real economies and that do not threaten harm to consumers. Likewise, it should not bar mergers producing de minimis or trivial foreclosure. For an example

Option (a)(c)(e)(f) is the most permissive. It identifies the merger law with allocative efficiency. In addition, and quite separately, it reflects the judgment that the merger law should not be enforced unless it enhances allocative efficiency, as judged from the allocation at the time of the merger. This option is not the only option indicated by a commitment to allocative efficiency. Indeed, (g) would further increase allocative efficiency, and (b), (d), (h) and (i) need not lessen allocative efficiency.¹²²

Option (a)(c)(e)(f) is also the option adopted by the Guidelines. Choice of this option, particularly exclusion of (g) combined with the assumption, relevant to (e), that potential competition within a price and time range is as good as actual competition, can profoundly influence market definition and thus antitrust outcomes. To define the market, the Guidelines hypothesize a price increase above *current* price, no matter how concentrated and collusive the market is already.¹²³

Option (a)(b)(d)(e)(g)(h)(i) represents the strictest merger enforcement policy within the range presented. This option is supported by the case law.¹²⁴

of a trivial foreclosure (approximately 1%), see *Brown Shoe*, 370 U.S. at 323-24 (the Court, however, did not then view the foreclosure as trivial).

122. If it were the case that all mergers are efficient unless they produce output restriction, then a merger policy based on allocative efficiency would reject clauses (b), (d), (h) and (i). However, it is obviously not the case that all such mergers are efficient. Consider, for example, U.S. Steel's acquisition of Marathon Oil Company. See *Du Pont's Unconvincing Merger*, N.Y. Times, Nov. 14, 1982, § 3, at 1, col. 2 (Du Pont-Conoco). See also Testimony of F.M. Scherer before the Subcommittee on Monopolies and Commercial Law, Committee on the Judiciary, House of Representatives, Sept. 23, 1981 (on file at the *California Law Review*). That mergers are efficient is not an inference from the evidence; it is an assumption in spite of the evidence. *Id.*

123. Although the Guidelines do not have a broad efficiencies defense, they have high threshold levels for challenge, apparently so as not to restrict efficiency-creating horizontal mergers. See Kauper, *supra* note 24, at 520. As for vertical mergers, the Guidelines indicate great breadth for recognizing efficiencies. See Guidelines § IV(B)(1)(c) n.49, 47 Fed. Reg. at 28,501 n.49, 71 CALIF. L. REV. at 664 n.49.

124. See *supra* notes 1-7.